

**Presentation to the Audit Committee
on July 13, 2018
Agenda Item AU13.9**

Enhance Focus on Lease Administration of City-owned Properties

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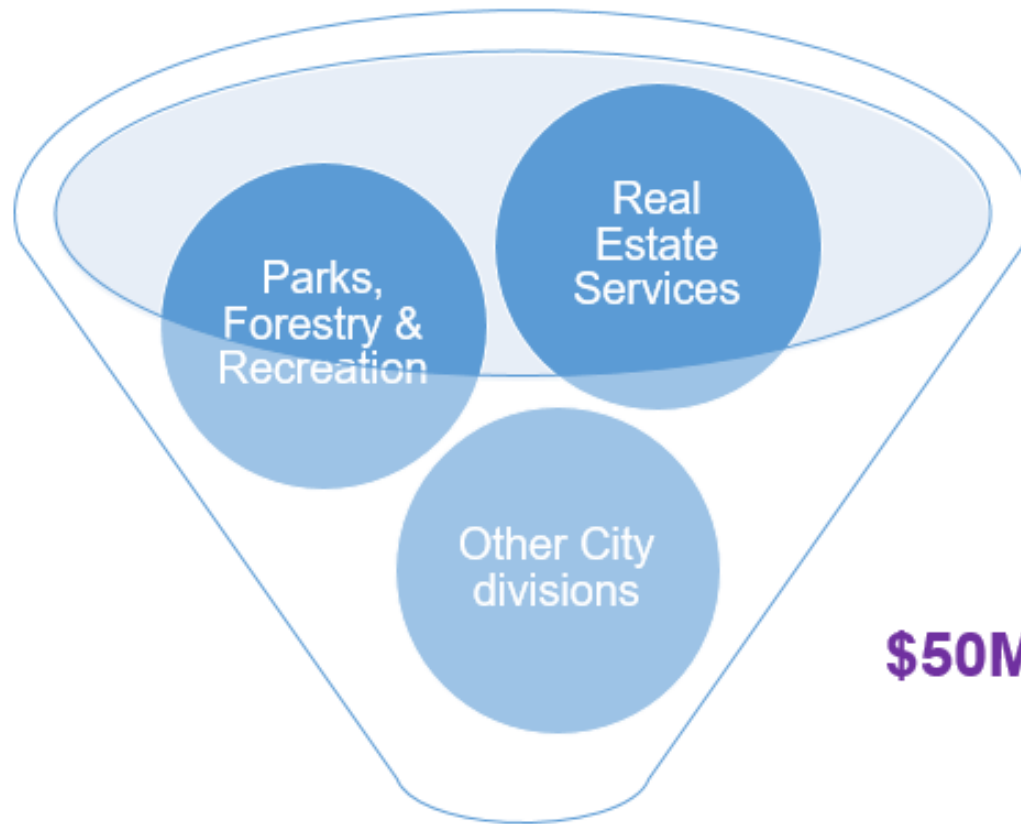


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Integrity, Excellence and Innovation

Presentation Outline

- ▶ Background
- ▶ Audit Objectives and Scope
- ▶ Key Audit Findings and Recommendations
- ▶ Conclusion

Background – Why this Audit is Important



1000+ leases
\$50M annual revenues

**Centralized Service
Delivery Model**

Background – Previous Audits Relevant to Lease Administration

Union Station Leasing (2017)

- City not billing or collecting certain rents and operating costs from tenants at Union Station

Water Billing and Collections (2017)

- Properties do not have a water meter installed
- Properties not billed for water consumption

Property Tax Billing (2016)

- Incorrect property tax classifications

Concession Agreements (2011)

- Need for processes to ensure City collects all snack bar and concession revenues and property taxes

Audit Objective & Scope

- ▶ **Audit Objective:** Assess the efficiency and effectiveness of lease administration activities
 1. Are leasing revenues being maximized?
 2. Are rents and recoveries being billed and collected on a timely basis?
 3. Is there compliance with agreements?

- ▶ **Scope:** Leases managed by the Real Estate Services and Parks, Forestry and Recreation Divisions.
Excludes Union Station leases

- ▶ **Limitations**

What We Found – Issues are not New

- ▶ In 2006, the Auditor General conducted a
“Review of the Administration of Leases on City-owned Property”
- ▶ That audit identified need for the City to:
 - Independently determine market rents
 - Improve execution and timely renewal of leases
 - Address provisions contained in lease agreements
 - Maintain an accurate and complete inventory of lease agreements
 - Establish a formal plan to identify and lease vacant property
 - Establish leasing policies and procedures

Summary of Key Findings

A.

Ensuring Lease Revenues are Maximized

B.

Billing and Collecting Rents and Recoveries

C.

Roadmap for Moving City-wide Leasing Forward

Summary of Key Findings



A. Ensure Lease Revenues are Maximized

1. Negotiated rents may not always be based on market rates

- Unable to verify that negotiated rents reflect market rates – documentation not retained in nearly half of files reviewed
- Better record retention for recent agreements

2. City not ensuring occupants fulfill obligations to make capital improvements

- \$14.8 million in capital commitments in agreements we reviewed:
 - \$2.5 million – Improvements not received by City
 - \$11.6 million – Documentation not available to demonstrate commitments were received in full

A. Ensure Lease Revenues are Maximized

3. Incremental rent revenues are lost when rent escalations, market reviews, and lease renewals are not performed

- Agreements did not require periodic rent adjustments or market reviews
- Required rent escalations were not billed / collected
- Required market reviews not performed
- 40% of RES leasing revenues generated from expired leases
 - **\$931,000** additional basic rents could have been generated had expired leases we reviewed been promptly renewed
 - Overhold rates (up to 200% of basic rent) rarely being charged

A. Ensure Lease Revenues are Maximized

Recommendations:

Retain documentation (research, appraisals, and financial analysis) to substantiate that rents reflect market rates

Track commitments by occupants to make capital improvements

Monitor to ensure they are received

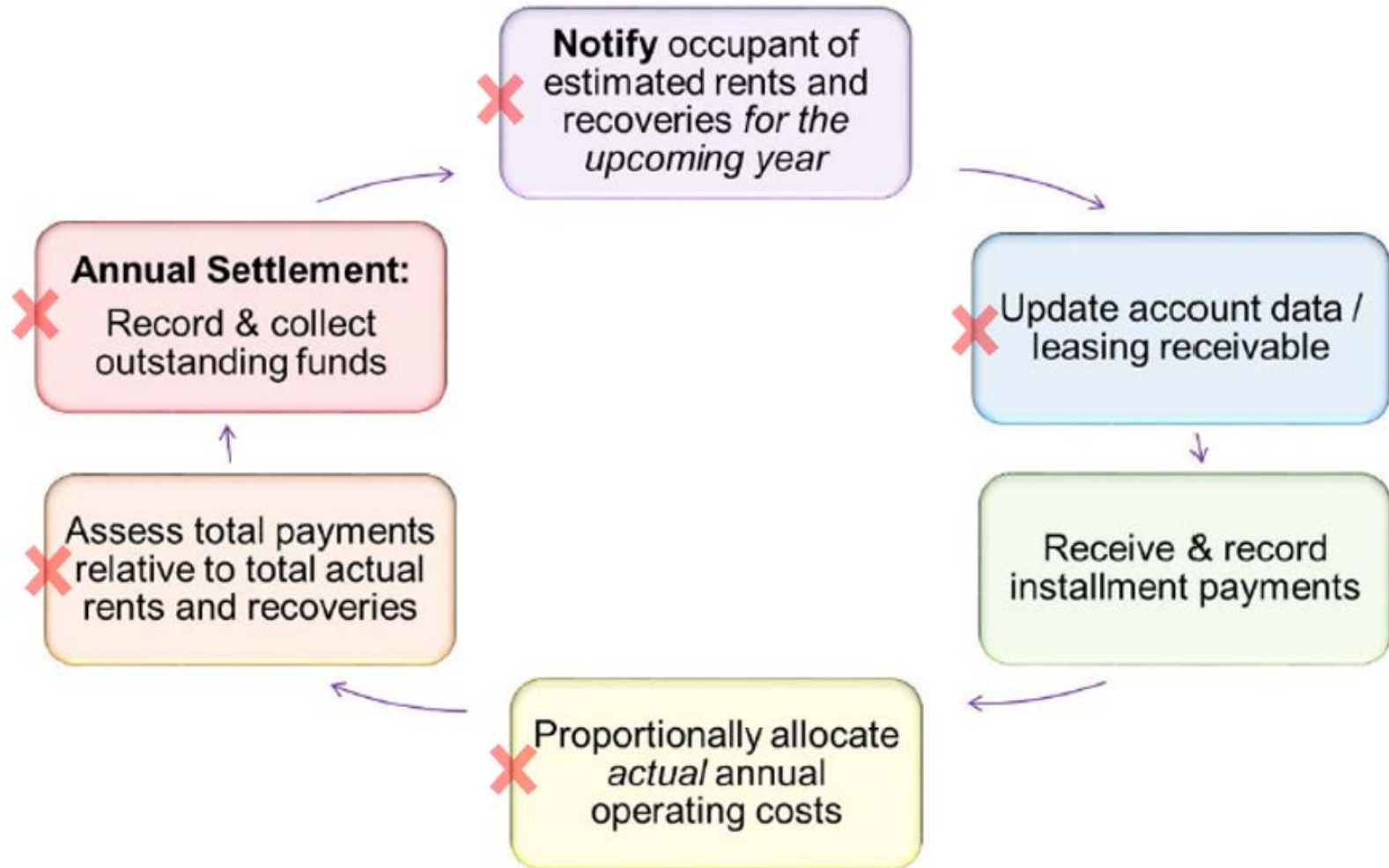
Periodic **market review / rent escalation clauses** should be **standard** for longer-term leases

Ensure increases and reviews are completed

Address expiring agreements on a timely basis

Charge overhold rents where applicable

B. Billing and Collection of Additional Rents and Recoveries



X – Activities not consistently performed

Table 1 – Locations with Unbilled Additional Rents and Recoveries

Location	2017 Estimated Unbilled Rents and Recoveries	Total Estimated Unbilled Rents and Recoveries (retroactive)
1	\$148,000	\$1,871,200
2	\$124,900	\$788,500*
3	\$80,300	\$632,100
4	\$235,100	\$631,700
5	\$27,200	\$249,600
6	\$14,800	\$110,700
7	\$2,900	\$105,600
8	\$70,700	\$83,800
9	\$23,700	\$72,500
Total	\$727,600	\$4,545,700

In our sample, **\$4.5 million** in additional rents and recoveries have not been billed and collected

B. Billing and Collection of Additional Rents and Recoveries

Recommendations:

Review leases

Identify amounts that have gone unbilled or uncollected

Monitor leases requiring % rent

Verify % rent payments against financial records

Recover cost of utilities

Install meters

Enable direct billing

Assess commercial tenancies for property taxes

Review tax refunds and rebates

Accurately reconcile, bill and collect operating cost recoveries on a timely basis

Ensure accuracy of lease information and tenant accounts in financial system

C. Roadmap for Moving City-wide Leasing Forward

As the City establishes a leasing strategy under the new centralized service delivery model, this is the opportune time to:

- ▶ define expected outcomes and develop measures to evaluate performance of the complete leasing portfolio
- ▶ implement robust City-wide policies and procedures
- ▶ determine the appropriate resourcing strategy



How the Recommendations will Benefit the City

Conclusion

- ▶ Audit highlights the need to focus on effective lease administration
- ▶ Management has agreed to all 19 recommendations
- ▶ Recommendations will help:
 - ensure City meets its program and strategic objectives, maximizes lease revenues, and recovers entitled rents and operating costs
 - provide a roadmap for setting the City up to achieve success under the new City-wide approach to real estate service delivery

Enhance Focus on Lease Administration of City-owned Properties

Management Response to Auditor General

July 13, 2018

Lease Administration of City-owned Properties

Management agrees with the recommendations in the report – many support plans underway

Background – City-wide Real Estate Transformation

- The City-wide Real Estate Review identified opportunities for a more consistent approach in dealing with real estate matters – distributed responsibility of real estate matters across multiple City divisions, agencies and corporations
- Based on the review, in July 2016 City Council approved (EX16.4) a centralized service delivery model for real estate and staff were to report back on the specifics of the model and how to implement it
- In May 2017, City Council approved (EX25.9) the new City-wide integrated real estate model and implementation plan – implementation of the model began
- To support the implementation, City Council approved (EX29.5) the consolidation of real estate authorities under the new model
- The new model started operating on January 1, 2018
- The development of a City-wide leasing strategy and practices was identified as a key activity of the new model

Lease Administration of City-owned Properties

During the course of the City Wide Real Estate Review, RES acknowledged that a further focus on leasing administration was required

Actions to date:

- Q1, 2017: Commencement of process reviews for lease administration
- Q2, 2017: Commencement of the implementation of a consolidated model
- Q4, 2017: Centralization of authorities and changes to the Municipal Code
- Q4, 2017: Created transitional plan and responsibility matrix with PF&R
- Q1, 2018: Organizational restructure of RES, with alignment around key functions including lease transactions and administration
- Q1, Q2, 2018: Continued collaboration and transition with DAC's involved in leasing activities

Dedicated team was formed to drive the implementation of gaps:

- Policy/ procedures – developmental & updates
- Business analysis, record management
- New leasing system
- Lease reconciliation / review process
- Review of agreements for action based on value / risk

Questions