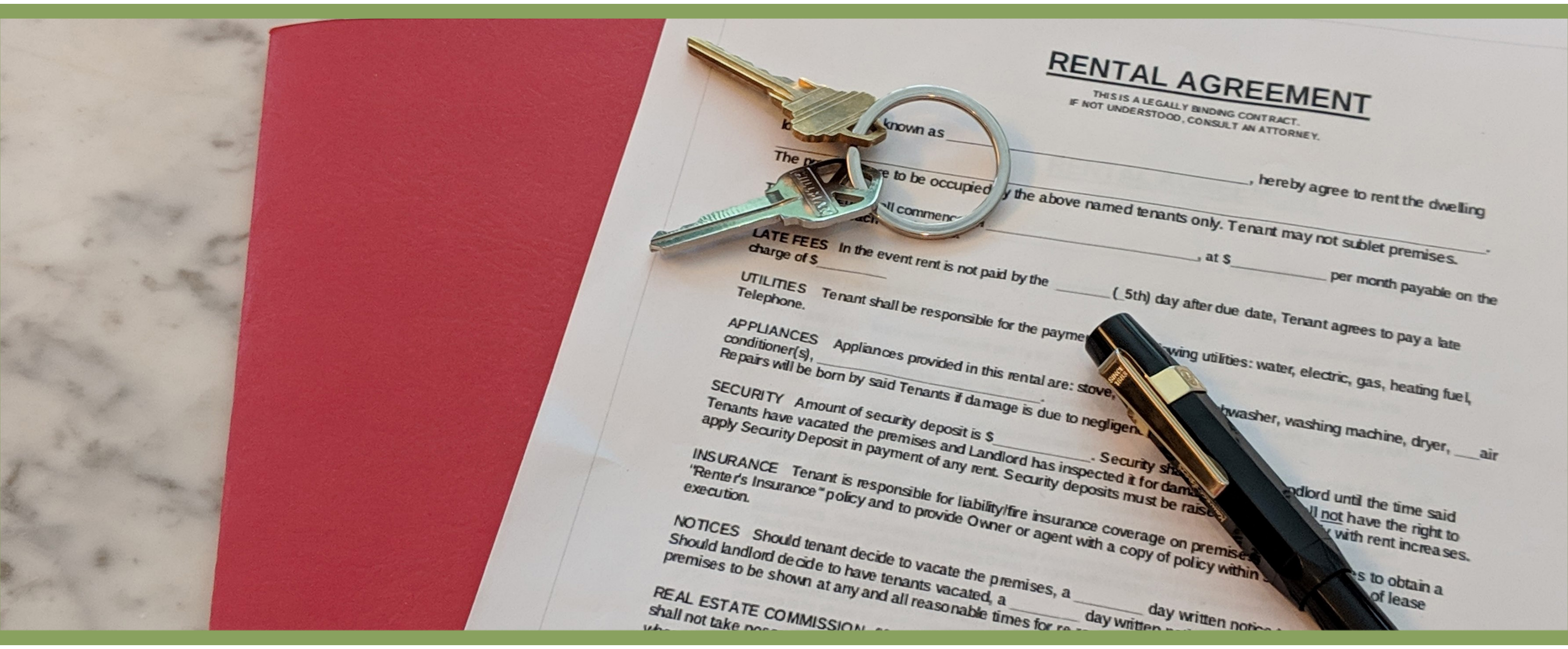
City of Austin
Office of the City Auditor

DRAFT

Audit Report

City Leases

May 2019



The City lacks central oversight of the leasing process and does not use a strategic approach to make decisions about City leases or meet department space needs. This is due in part to: poorly defined leasing responsibilities, an incomplete space inventory, and inadequate long-term planning. Beyond that, the City's current leasing processes do not ensure that leases are developed in the best interest of the City and do not always protect the City from legal risk and misuse of resources, as there is not effective coordination of lease negotiations or clear policies guiding lease development, particularly lease agreements with nonprofit organizations. Even when leases are better developed, they are not effectively monitored to ensure receipt of all deliverables which results from inadequate oversight and unclear monitoring roles among the involved departments.

Ultimately, these weaknesses make it more difficult to ensure departments can carry out City business and move away from leased space. These weaknesses have also exposed the City to increased legal risk, lost revenue and waste of City resources, and uncertainty about whether tenants are delivering expected services to the public. More importantly, current leasing processes do not ensure leases are aligned with the City's best interests.

Contents

Objective and Background 2
What We Found 4
Recommendations and Management Response 12
Scope and Methodology 16

Cover: Photo by OCA staff, March 2019.

Objective

How are decisions about City leases made and are they in the best interest of the City?

Background

The City currently has many facility needs. Overcrowded, sub-standard, and inflexible space for City operations has created operational challenges throughout the City. To address these needs, the City leases buildings and facilities from outside entities for City use. The City spent approximately $17 million to lease space from outside entities in fiscal year 2018. City management projected that leasing space from outside entities would cost the City $75 million more over the next 30 years compared to using City-owned space. According to City management, the City is currently working to create a lease-exit strategy and an action plan to accelerate the City's move from leased to permanently-owned space. However, the City's historical pattern of locating facilities in Central Austin where they may be more accessible to the public presents a costly challenge.

In addition to leasing space from outside entities, the City acts as the lessor or "landlord" to lease[1] City-owned properties to third party organizations or "tenants". Some of these third parties are for-profit entities that pay market rate rent.[2] Others are nonprofit entities that generally pay below market rate rent, which is the City's way of assisting nonprofits with furthering their community-based missions. Exhibit 1 shows the types and number of leases the City has entered, along with the number of each lease type reviewed in this audit.

Exhibit 1: The City's Real Estate Office Manages a number of leases, most commonly with the City as the tenant

64 Leases with outside entities for City use	5* Reviewed in audit
15 Leases to for-profits	3 Reviewed in audit
18 Leases to non-profits	6* Reviewed in audit

*One lease where the City is the tenant and three leases to nonprofits reviewed in this audit were not included in the data provided by the Real Estate Office.
SOURCE: OCA analysis of Real Estate Office data which does not include all City leases, October 2018.

[1] The City has different types of legal agreements that govern the use of its properties by third parties. Examples of such agreements include leases, licenses, and concession agreements. For purposes of this report, we refer to all these agreements as leases, and the entities that use City-owned properties under these legal agreements as "tenants".

[2] We refer to these as "revenue leases" in this report.

Several entities are involved in the management of the City's leasing activities. The City's Office of Real Estate Services (the Real Estate Office) aims to provide real estate expertise to acquire property rights for City purposes, lease property required by various departments, administer land management activities, and engage in other real estate services. Additionally, the Real Estate Office participates in the Strategic Facilities Governance Team (SFGT), along with representatives from the Building Services and Financial Services departments, which was created to evaluate City departments' requests for actions pertaining to facilities. Some departments, such as the Aviation Department[3], develop and manage leases separate from the Real Estate Office and SFGT, and many other City departments[4] are responsible for monitoring leases to ensure tenant compliance with lease terms.

In 2012, the City spent $1.4 million on consultant services to provide guidance on how to more effectively make facilities-related decisions. The resulting Strategic Facilities and Logistics Roadmap made several recommendations to enhance City leasing practices and was intended to guide future decisions regarding City facilities, "ensuring they are made in the City's best long-range interests." The City has recently hired a consultant to develop an administrative space occupancy study that will provide additional recommendations on short-term and long-term needs and guidance on a lease exit strategy.

[3] According to a Fiscal Year 2017 survey administered by the Controller's Office, the Aviation Department managed 31 leases for space, all of which specify the City as the landlord.

[4] Departments include: Animal Services, Austin Convention Center, Building Services, Economic Development, Neighborhood Housing and Community Development, and Parks and Recreation, among others.

What We Found

Summary

The City lacks central oversight of the leasing processes and does not use a strategic approach to make decisions about City leases or meet department space needs. This is due in part to: poorly defined leasing responsibilities, an incomplete space inventory, and inadequate long-term planning. Beyond that, the City's current leasing processes do not ensure that leases are developed in the best interest of the City and do not always protect the City from legal risk and misuse of resources, as there is not effective coordination of lease negotiations or clear policies guiding lease development, particularly lease agreements with nonprofit organizations. Even when leases are better developed, they are not effectively monitored to ensure receipt of all deliverables which results from inadequate oversight and unclear monitoring roles among the involved departments.

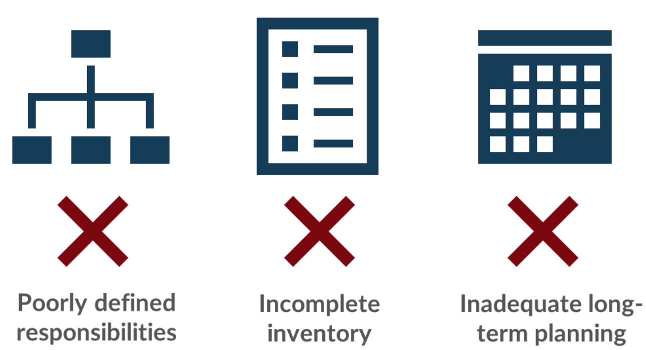
Ultimately, these weaknesses make it more difficult to ensure departments can carry out City business and move away from leased space. These weaknesses have also exposed the City to increased legal risk, lost revenue and waste of City resources, and uncertainty about whether tenants are delivering expected services to the public. More importantly, current leasing processes do not ensure leases are aligned with the City's best interests.

Finding 1

The City lacks central oversight of leasing processes and does not use a strategic approach to make decisions about City leases and meet department space needs. This makes it more difficult to ensure departments can carry out City business, move away from leased space, and manage leasing activities.

There are several issues with the way the City currently manages leasing activities, as shown in Exhibit 2. These issues include: poorly defined leasing responsibilities, an incomplete space inventory, and inadequate long-term planning. Additionally, there is no central oversight or ownership of leasing activities citywide. As a result, the City is not managing leasing with a strategic approach which ultimately compromises the City's ability to pursue less costly alternatives to leasing, meet City workforce needs, safeguard resources, and ensure City assets are used in the City's best interest.

Exhibit 2: There are several issues with the City's leasing process



SOURCE: OCA analysis of City leasing process, January 2019.

The City's 2012 Strategic Facilities and Logistics Roadmap Report recommended the City centralize all real estate and facility functions in one department. Best practices also emphasize the need for local governments to centralize management of their real estate functions.

There are several departments involved in the leasing process, but there is confusion as to which department has responsibility for each leasing activity. We noted multiple instances in which it was unclear which department was primarily responsible for managing leasing activities. For example, there are three departments involved with a particular license agreement, but there was confusion among the three departments as to which department manages that agreement. In another instance, there was confusion between two departments concerning which was responsible for collecting documents required to execute a lease agreement. In a third example, we noted unclear delineation of responsibilities for monitoring the completeness and accuracy of rent payments submitted to the City.

While the Real Estate Office is responsible for providing real estate expertise to acquire and lease property for City purposes, they are not always involved in all stages of the leasing process. In one of the reviewed agreements in which the City was the landlord, the Real Estate Office was not involved in the lease development or monitoring and the tenant later raised concerns with the terms stated in the agreement. In another lease agreement, the Real Estate Office did not get involved until late in the leasing process which eventually resulted in the City paying for, but not being able to occupy, that facility.

The City's 2012 Strategic Facilities and Logistics Roadmap Report recommended the City ensure it continuously updates its space inventory. This report also recommended the City move away from leasing and instead use City-owned property to meet departments' space needs.

The City does not maintain a complete and accurate inventory of all leased and City-owned space[5]. In addition to not having a complete inventory of all City-owned property, the Real Estate Office does not track leases managed by other departments, such as Aviation concession leases and licenses to rent City parkland. Also, we surveyed City departments regarding space needs and found there was not a consistent, Citywide mechanism to document space needs and 4 of 18 departments (22%) stated they do not have any formal mechanism to document space needs. Departments further noted that the City does not always account for new facility needs when new programs or additional staff are added, especially when this occurs outside of the budget process.

Despite this, the City continues to enter leases (at least 8 new leases in fiscal year 2018) without a clear long-term plan to move from leased space to City-owned property. We reviewed four leases in which the City was the tenant and found in three (or 75%) of cases there was no indication of a long-term plan to move from leased space to City-owned property at the end of that lease. City management asserted that the City is currently working with a consultant to develop guidance on a lease exit strategy.

While the City created the Strategic Facilities Governance Team (SFGT) in 2013 to guide the City's facility usage and leasing decisions, the group has not been successful in ensuring all leases are aligned with the City's interests. The SFGT is charged with reviewing and approving department space requests. However, the team has not historically met

[5] The April 2013 Audit of Real Estate Management recommended that the Office of Real Estate Services create a team of stakeholders to identify and implement a comprehensive solution to tracking City-owned property efficiently and effectively.

In 2013, the City created the Strategic Facilities Governance Team (SFGT), consisting of the Real Estate Office Director, the Deputy Chief Financial Officer, and the Building Services Officer. The SFGT was created to review and make decisions about departments' requests for space with the goal of moving toward a more holistic, Citywide approach to space management. According to a June 2018 memo from the City Manager, representatives from the City Manager's Office were supposed to be added to the SFGT to ensure Citywide focus. At the time of this audit, there is no evidence this has occurred.

or documented its decisions in a consistent manner[6]. For example, staff in the Financial Services Department and the Real Estate Office maintain an excel spreadsheet with fields to indicate the cases reviewed and decisions made by the SFGT, but the spreadsheet is not kept up to date and lacks evidence of decision outcomes concerning a number of requests. Due to a lack of complete and accurate documentation, it is unclear if the SFGT has reviewed all the submitted department requests.

In a survey of departments, 5 of 13 (or 38%) reported having some interaction with the SFGT stated they had concerns with how the team functions. Specifically, departments expressed concerns that the SFGT:

- seems to base decisions on emergent issues as opposed to a long-range strategic plan;
- can cause delays in the leasing process; and
- does not provide alternative options for departments to consider when requests to lease new space are denied due to a lack of funds.

Confusion about which department has responsibility for different aspects of the leasing process is caused by a lack of accountability, clear ownership, and oversight of the City's leasing process. Further, there is not one party responsible for leasing and City staff has increased considerably in recent years creating additional space constraints and challenges. The SFGT has not been successful in ensuring all leases align with the City's best interests due in part to the extensive work needed to address the backlog of leasing problems. Additionally, people responsible for the SFGT are tasked with meeting the demands of their regular jobs in addition to the demands of the SFGT.

A 2013 Real Asset Management Audit recommended that the Real Estate Office work with stakeholders involved in real estate to identify a comprehensive solution for efficiently and effectively tracking City-owned property. While the Real Estate Office has been working to implement this recommendation, at the time of this audit, they have not developed a complete and accurate inventory of City-owned space.

Because the City lacks a complete and accurate space inventory, it does not have adequate information to guide space management and leasing decisions. Without an effective strategy to guide the City's leasing activities and long-term plans to address space needs, there is increased risk that the City may not be able to move away from leased space which may ultimately result in greater cost to the City. In addition, the City may not be able to ensure department space needs are met. This may also result in inconsistent management of leases and space-constrained employees becoming dissatisfied with inadequate workspaces. Further, the City may eventually make critical long-term decisions based on bad information if there is not a complete and accurate space inventory available to guide decision-making. Beyond that, an incomplete or inaccurate space management inventory increases the risk that the City mismanages use of its owned space.

[6] In January 2019, the SFGT group distributed a memo stating they now convene on the last Wednesday of each month to review department requests.

Finding 2

The City's current leasing processes do not ensure that leases are developed in the best interest of the City, and do not always protect the City from legal risk and misuse of resources.

Various departments across the City are involved in the leasing process and the Real Estate Office does not exercise centralized oversight of the City's real estate activities. We noted several leases were developed in a manner that exposed the City to increased legal risk and failed to protect the interests of the City.

City leases are not always effectively coordinated or executed. We identified two instances where poor lease negotiations resulted in financial loss to the City. One lease reviewed in this audit did not include a previously negotiated exhibit that would have allowed the City to utilize a $50,000 credit for services at the leased site. As a result, the City appears to be unable to take advantage of this credit. Second, the City did not effectively coordinate negotiations to ensure leased space was suitable for its intended purpose prior to entering into the lease agreement. This resulted in waste and potential misuse of City resources amounting to approximately $774,000 as of May 2019. As of May 2019, the City continues to be unable to occupy that facility for its intended purposes.

Best practices recommend that organizations entering into lease agreements include clauses to protect the organization's best interests.

Some lease agreements are missing key clauses that protect the City's interests. Best practices recommend that organizations entering into lease agreements include clauses to protect the organization's best interests. While not all leases require the same contract clauses, we noted inconsistencies between agreements with some containing select clauses that others did not even though the agreements themselves are similar. We reviewed clauses in eight lease agreements where the City functions as the landlord and several of these agreements lacked key clauses designed to protect the City's interests. As shown in the exhibit below, missing clauses include those that give the City the right to audit the tenant and clauses related to dispute resolution.

Exhibit 3: Agreements with the City as the landlord are missing key clauses

Right to Audit
Missing from 5 agreements

Dispute Resolution
Missing from 4 agreements

SOURCE: OCA analysis of lease agreements, January 2019.

Best practices recommend that leases should be renewed timely to reflect the needs of both the landlord and the tenant as well as the current business environment.

Leases are not always renewed timely. In a review of leases where the City was the landlord, the City did not renew leases timely, resulting in periods where tenants occupied City properties without valid lease agreements. In one instance, the tenant occupied the property for a combined period of 18 years without a valid formal agreement. Another lease expired on September 30, 2018 and was renewed on November 30, 2018.

If key clauses are missing from agreements and leases are not timely renewed, the City may incur legal risks. Specifically, the City may not be adequately protected from lawsuits against the tenant of a City property if there is not a valid lease agreement in place between the City and the tenant. Beyond legal risk, the City may not be able to hold the tenant accountable for expected deliverables if the City fails to maintain formal agreements with tenants.

Lease agreements required tenants to provide certain documentation, and City staff to track and maintain such documentation, to verify the tenants' compliance with specific lease obligations.

Records are not adequately maintained. Lease files were not well organized and were missing evidence of decision making on a variety of issues. Specifically, the City did not maintain necessary documentation to show that the tenants were always up to date with insurance requirements (discussed further in finding 3). Although the Real Estate Office maintains an excel spreadsheet that is intended to document information on leases, this spreadsheet is not consistently updated. The department has created a new filing structure and record keeping protocols that may help ensure files are better organized going forward.

The City's 2012 Strategic Facilities and Logistics Roadmap Report recommended the City view each asset with consideration for its highest and best use.

The City lacks a consistent process for developing and awarding leases of City-owned space to nonprofits at below-market rents. The City leases 18 properties to nonprofit entities at below-market rents. For 12 of the 18 leases (or 67%), the rent charged is $0 or $1 per year. Rent charged varies and lease terms range from one to eighty years as shown in Exhibit 4.

Exhibit 4: City-owned property is leased to non-profits for various rental amounts and lengths of time

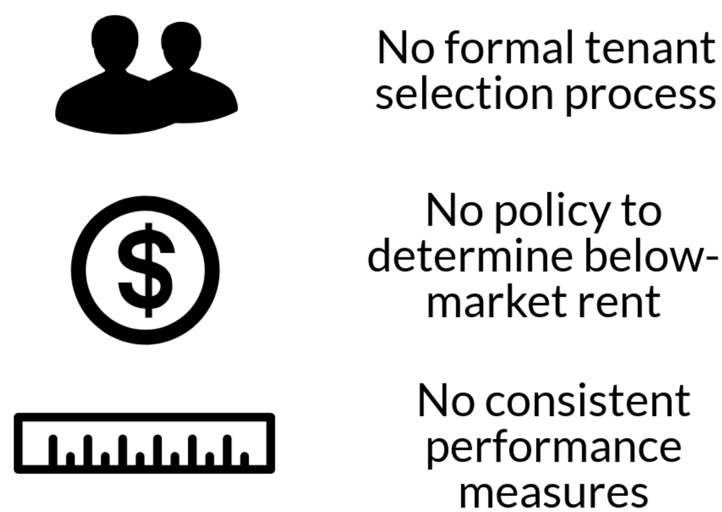
Annual Rent	Number of Leases	Services Provided	Term Length Range*
$0	6	Education, Outdoor Recreation, Community Development, Workforce Development, Performing Arts	1 - 80 years
$1	6**	Economic Development, Health Services, Education	4 - 20 years
$2 to $10,000	3	Education, Performing Arts, Child Care	49.5 - 50 years
More than $10,000	3	Economic Development, Workforce Development, Child Care	5 - 10 years

*Three leases do not have specific expiration dates and were excluded.
**One of these is a lease with a tenant who primarily provides education services, but the property is subleased to a health provider so that lease is categorized as "health services" in this table. Notably, the City leases this property for $1 per year and the tenant leases the property to a sublessor for approximately $1,400 per month according to documentation from the Real Estate Office.
SOURCE: OCA analysis of lease agreements, January 2019.

Rent to nonprofit entities is set at a nominal rate on the presumption that these entities provide social good to the community and those contributions are considered beneficial to the City in lieu of market rent. Despite this, the City does not have a formal policy in place to guide the leasing of City-owned properties to nonprofits at below-market rent. There is no formal application, review, or approval process for awarding leases to nonprofits at below-market rents. In addition, there is no policy that outlines:

- the types or priority of nonprofits the City wishes to lease to;
- the requirements that nonprofits need to meet to lease City-owned property; and
- how annual rent should be established at below-market rates for these tenants.

Exhibit 5: The City does not have a consistent process to lease property to non-profits



SOURCE: OCA analysis of lease agreements, January 2019

Based on a review of lease files and public discussion recordings, there was little to no documentation regarding how tenants were selected and how rent rate decisions were made regarding nonprofit tenants.

We surveyed six peer cities regarding their processes for managing leases to nonprofits. The results of the survey varied greatly as there is not a consistent approach to managing these leases.

There is not a consistent process to determine performance measures for nonprofits in lieu of below-market rent. Four of six (or 67%) lease agreements to nonprofits reviewed in this audit did not contain clear performance measures. One of these lease agreements has been in existence for approximately 46 years. Another lease agreement contained performance measures for some years of the agreement, but it is not clear how these performance measures were developed or why they were subsequently reduced in future agreements. Specifically, this lease to a nonprofit entity providing workforce development services contained a performance measure of serving 100 clients in the 2012 agreement, but this measure was reduced to serving 70 clients in the 2017 agreement without explanation.

Staff in the Real Estate Office asserted that the department is in the process of reviewing and revising the City's lease agreements with nonprofit organizations to include performance measures. As with other leases, management of leases to nonprofits is decentralized among several departments with no single City department providing oversight.

The weaknesses noted may result in leases to nonprofits that do not align with City priorities. Leasing space to outside entities also means that space is not available for use by the City's workforce which may more directly advance City goals. Without a repeatable process for application, review, and approval of nonprofit leases, there is an increased risk that some nonprofits may receive preferential treatment from the City. Additionally, the public may be concerned about a lack of transparency in the City's leasing process.

Without clearly stated performance expectations for nonprofit tenants, the City may not be able to justify or defend its decisions to lease City-owned properties at nominal amounts of rent. Unclear performance measures may make it difficult for the departments responsible for monitoring agreements to hold nonprofits accountable or to determine if the City received all deliverables expected.

Finding 3

Agreements with nonprofit and for-profit tenants are not effectively monitored to ensure receipt of all lease deliverables, resulting in financial loss to the City and uncertainty about whether tenants are delivering expected services to the public.

Most lease agreements specify requirements that a tenant leasing City-owned property must meet. Departments responsible for monitoring these leases are responsible for ensuring tenants comply with all lease terms and requirements.

In addition to the weaknesses discussed above concerning the development of lease agreements, we found departments responsible for monitoring lease agreements did not always ensure the City received all applicable deliverables even when they were required by lease agreements.

Staff did not effectively verify the accuracy of tenants' reported revenue and the corresponding rent owed to the City. We reviewed three revenue lease agreements that required the tenant to pay rent to the City based on a percentage of the tenant's revenue. In one of these leases, the tenant generally submitted reports to the City, but staff did not use independent information (such as bank statements from a third party) to verify the accuracy and completeness of the reports. Instead, they relied solely on the reported profits provided by the tenant. In another lease, the City did not review the tenant's reports at all. Staff in the Real Estate Office assumed that the department receiving the reports was responsible for verifying the accuracy and completeness of this information. However, department staff asserted this was the responsibility of the Real Estate Office. This lease has been in existence since September 2005.

Staff did not effectively verify that required performance reports were submitted for all nonprofit tenants. For some leases with nonprofits, the City required tenants to submit reports demonstrating they met the performance expectations included in the lease. For two of these leases, the tenant did not submit required performance reports. For an additional nonprofit lease, the tenant inconsistently submitted reports and staff did not verify the accuracy of the reported data. Management claimed that the department was not able to verify the tenant's reported data because they believed the lease agreement did not give them authority to review the tenant's records. However, review of the lease showed it did give the City this authority.

Rent owed to the City was not paid in a timely manner and fees for late payments were not assessed. None of the three for-profit tenants reviewed in this audit made rent[7] payments timely. All these lease agreements included provisions to assess late fees when the tenant did not pay rent timely. We saw no evidence that late fees were assessed to any of the tenants reviewed in this audit and there is no documentation explaining why they were not assessed. One tenant paid a portion of their monthly rent an average of 157 days late for over a year. This tenant did not pay any of this rent portion from September 2018 to January 2019.

We also noted two nonprofit tenants have not been consistently paying rent to the City, though the required rent for these entities is nominal. The Real Estate Office is taking action to collect this rent now.

Utility rent was not collected, resulting in a financial loss to the City. Two revenue leases reviewed (managed by separate departments) required the tenant to pay for submetered utility charges (for electrical, gas, chilled water, and water services). However, the City did not enforce this requirement by invoicing the tenant for these charges, resulting in financial loss to the City. According to the Real Estate Office and staff in the monitoring department, the City was unable to invoice these tenants because submeters (that would have allowed staff to determine the portion of the overall utility charges applicable to that tenant) had not been installed. In both leases, the tenants were responsible for installing the submeters as part of the initial tenant improvements. For one of these leases, the City did not invoice the tenant for utility charges for approximately 13 months but started invoicing for these charges in September 2018 after submeters were properly installed. The submeters for the other tenant have not been properly installed. However, because of this audit the City invoiced this tenant for utility charges going back to the lease commencement date based on the prorated square footage leased.

The City is supposed to track insurance certificates to ensure that tenants always have required insurance coverage.

Staff did not consistently ensure that entities leasing City-owned properties maintained up to date insurance coverage, exposing the City to increased legal risk. In nine leases reviewed, lease agreements required City staff to obtain a copy of the insurance certificate from tenants. However, in five out of nine (or 56%) of these agreements, there was no evidence in lease files indicating that staff consistently collected and reviewed the insurance certificates throughout the lease term. Without enforcement of lease terms, tenants may not maintain adequate insurance which may unnecessarily expose the City to legal risk if anything detrimental happened to, or on, City property.

Causes of the weaknesses noted include inadequate oversight over management of City leases and unclear monitoring roles among the involved departments. Inadequate monitoring of agreements to verify tenant performance increases the risk that the City may not receive all the revenue and other deliverables due. Additionally, the City may be exposed to excessive and unnecessary liability if a person sues a tenant of a City facility that does not properly maintain insurance.

[7] Rent may include base rent (a flat fee to lease a space) or sales-based rent (a variable fee based on the amount of sales revenue generated by the tenant).

Recommendations and Management Response

1

In order to meet department space needs and effectively use City-owned space, the Director of the Office of Real Estate should:

a. take Citywide ownership of the leasing process and seek clarification regarding Real Estate Office authority from the City Manager as needed;

b. create a comprehensive space inventory of all properties owned by the City as previously recommended and also include the properties leased by the City;

c. develop a long-term plan to guide space management and leasing decisions based on existing and projected space needs considering the City's goal of transitioning from leased to permanently-owned space; and

d. implement policies and procedures to guide space management and leasing decisions.

Management Response: Agree

Proposed Implementation Plan: Oversight of all of the City's real estate and leasing functions presents many challenges due to the multiple functions and types of temporary to long-term uses of city owned real estate including license agreements, temporary use agreements and leases. Several departments within the City have real estate staff that oversee some of their own real estate transactions and property including Aviation and Austin Energy, and other departments that handle temporary agreements such as PARD and Watershed. The Office of Real Estate's strategy to implement the plan will be to work with all relevant departments on determining what authority can be delineated to each department for their needs while creating central oversight of the organization. ORES is currently finalizing a space inventory system of fee-simple owned property, our next phase will be to implement the leased properties into the system. ORES will work with CTM and BSD to understand what adjacencies can be made across the system in regards to overall portfolio management. The Strategic Facilities Governance Team will continue to work with the City's Development advisor to provide recommendations on long-term facilities needs and planning for administrative, warehouse and service yard space and provide periodic updates to Mayor on Council on the recommendations and implementation.

Proposed Implementation Date: December 31, 2020

2

In order to ensure that City leases are developed effectively, the Director of the Office of Real Estate, in coordination with other applicable departments, should clearly define and communicate the roles and responsibilities for the lease development process.

Management Response: Agree

Proposed Implementation Plan: The Office of Real Estate Services has initiated contact with other City of Austin departments identified in the audit in an effort to define and communicate the roles and responsibilities for the lease development process. ORES will coordinate with the SFGT and other applicable departments in identifying and finalizing roles and responsibilities for the lease development process to include the entire lease life cycle. These roles and responsibilities will be captured in the revised Facilities Action Request Form. Communication regarding the roles and responsibilities will be provided by the ORES Director to all City departments.

Proposed Implementation Date: October 1, 2019

3 **In order to ensure transparency relating to decisions to lease City properties to nonprofits at or below market rent, the Director of the Real Estate Office should work with relevant City entities to develop a formal policy for these leases. The Policy should specify:**

a. the criteria for tenant selection, rent determination, and defining performance deliverables; and

b. a standard application, review, and approval process.

Management Response: Agree

Proposed Implementation Plan: ORES will coordinate with the Strategic Facilities Governance Team, relevant City Departments, City Manager and City Council to develop a formal policy for nonprofits leases at or below market rents. Currently, ORES has implemented two initial approaches to the implementation of nonprofit leases and below market rent leases. The first approach is to follow City Council resolutions when the lease criteria have been stated in the resolution. The second approach is based on fair market rent value and public benefits that result in a cost benefit analysis, to justify terms and conditions of the leases. Moving forward:

a. ORES will provide a proposed policy for the criteria stated above for City Manager and City Council review and approval. Efforts will be taken to align criteria with City of Austin Strategic Direction 2023 as applicable.

b. ORES will create a standard application, review and approval process for City Manager and City Council review and approval.

Proposed Implementation Date: December 31, 2020

4 **In order to avoid risks related to tenants occupying City properties without a valid lease agreement, the Director of the Real Estate Office should ensure that all leases are timely renewed.**

Management Response: Agree

Proposed Implementation Plan: In order to ensure all leases are renewed timely, ORES must be aware of all leases that exist citywide. From time-to-time, ORES is made aware of leases executed and managed by other City Departments without ORES' involvement. The Director of ORES will formally request all Departments to provide information on all existing leases initiated outside of ORES. ORES will implement a process to identify lease expiration dates for larger lease agreements at a minimum of 12 months in advance of expiration and for smaller lease agreements a minimum of 6 months in advance of expiration.

Proposed Implementation Date: October 1, 2020

5

In order to ensure that City lease agreements are effectively monitored, the Director of the Real Estate Office should:

a. ensure that responsibilities for monitoring lease agreements are clearly defined, assigned, and communicated to all responsible parties;

b. work with applicable departments to develop policies and procedures for monitoring compliance with lease agreement terms. The policies and procedures should detail leases where the City functions as the landlord or tenant and should address:

- **i. reconciliations of rent and other payments due to the City;**
- **ii. frequency of reconciliations;**
- **iii. tracking of reporting requirements;**
- **iv. coordination between responsible parties; and**
- **v. maintenance and retention of documentation**

c. provide oversight of leasing activities to ensure leases are effectively monitored citywide.

Management Response: Agree

Proposed Implementation Plan: Historically, ORES has been under staffed in the Leasing and Property Management area. New resources were added, and we anticipate filling three (3) vacancies to be fully staffed by August 31, 2019. When fully staffed the Director of ORES will reassess if additional resources are needed. After all vacancies are filled, we anticipate it will take approximately twelve (12) months to assess deficiencies, explore efficiencies, and effective monitoring of lease agreements. At the end of the twelve months, ORES may reassess the implementation timeline and request additional resources for the Leasing and Property Management Section.

a. The Director of ORES will formally and clearly formulate all responsibilities for monitoring lease agreements and will communicate all roles and responsibilities to other City of Austin Departments identified in the audit, and all Departments for all new upcoming leases.

b. ORES will work with applicable City Departments in developing policies and procedures for monitoring compliance with lease agreements. The policies and procedures will address all functions where the City acts as a landlord or tenant. ORES has already updated the Request for Facilities Action form to enhance and improve information provided by the City Departments. In addition, ORES has developed new leasing and property management procedures and guidelines, lease payment processes, space needs questionnaire, new agent tools, including term sheets, process flow charts, checklists, standard terms, lease clauses, and templates to assist with the following:

i. rent and other payment reconciliations

ii. developing a regular schedule for frequent reconciliations

iii. developing tools for tracking of reporting requirements

iv. coordinating between all responsible parties

v. ORES already implemented a new procedure for the maintenance and retention of documents. Currently we are using a new file system for all leasing documents, including scanning new documents.

c. ORES will develop a strategy to provide oversight of leasing activities to ensure leases are effectively monitored Citywide. The challenges to the strategy will be a successful and comprehensive identification and implementation of space inventory of all properties owned and leased by the City, as described in recommendation one (1) above. The new strategy may reveal a need for additional resources to fully implement this recommendation.

Proposed Implementation Date: December 31, 2021

Management Response

MEMORANDUM

To: Corrie Stokes, City Auditor
From: Alex Gale, Interim Officer, Office of Real Estate Services (ORES)
Date: May 17, 2019
Subject: Audit of City Leases – Management Response

I have reviewed the draft report of the Audit of City Leases provided by your office, and I appreciate the opportunity to provide a response to your findings and recommendations. We concur with the recommendations provided in the report and have developed an action plan (attached) to implement the proposed strategies.

The Office of Real Estate Services sees this as an opportunity to improve upon our processes and policies so that we may better manage and oversee the City's leasing functions. Implementing the proposed strategies will enhance our charge to maximize the City's real estate assets for the benefit of our community.

Please contact me at (512) 974-1416 if you have any additional questions or concerns.

cc: Spencer Cronk, City Manager
Rodney Gonzales, Assistant City Manager

Scope

The audit scope included active City leases and license agreements.

Methodology

To complete this audit, we performed the following steps:

- Interviewed key personnel in the Real Estate Office and other City departments to obtain an understanding of their roles and responsibilities related to developing and monitoring of City leases;
- Reviewed Real Estate Office and other City departments' policies and procedures for leasing of City properties;
- Selected a judgmental sample of lease files and reviewed supporting documentation to determine if leases were developed in the best interest of the City;
- Selected a judgmental sample of leases and tested the key lease terms to determine if the leases are being effectively monitored for deliverables including: completeness and accuracy of payments received, existence of insurance, and periodic performance reports;
- Conducted a survey of a sample of City departments to determine their satisfaction with the City's leasing process;
- Conducted a survey of peer cities and compared Austin's leasing process to the surveyed cities;
- Reviewed best practices regarding leasing of properties;
- Evaluated the risk of fraud, waste, and abuse relating to the City's leasing process; and
- Evaluated internal controls related to the City's leasing process.

Audit Standards

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Office of the City Auditor was created by the Austin City Charter as an independent office reporting to City Council to help establish accountability and improve City services. We conduct performance audits to review aspects of a City service or program and provide recommendations for improvement.

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