



**Office of the Auditor General**

**Audit of City Leases**

**Tabled at Audit Committee**

**April 8, 2019**

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Original signed by:

Auditor General

## Executive summary

### **Purpose**

The Audit of City Leases examined whether leased City-owned property are being managed efficiently and effectively and whether lease arrangements are in compliance with City policies and legislative requirements. The audit evaluated whether the system, practices and procedures supporting the Leasing Section are safeguarding City assets and maximizing revenue to the City when appropriate.

The Audit of City Leases was included in the 2018 Audit Work Plan of the Office of the Auditor General (OAG), approved by City Council on November 22, 2017.

### **Background and rationale**

The Leasing Section is a business unit within the Corporate Real Estate Office (CREO) with a mandate to administer leasing procedures for the City as a whole that are consistent, transparent and equitable. In order to meet this mandate, sound governance and consistent leasing practices and procedures must be applied.

The Leasing Section facilitates the revenue and acquisition leasing process on behalf of client groups within the City. This includes receiving lease requests, lease negotiations, arranging renewals and terminations, recording transaction details in SAP, providing financial support and consulting on lease interpretation and conflict resolution.

The Leasing Section is led by the Program Manager who oversees five Real Estate Advisors (REA). The Manager of Realty Initiative and Development consults with and supports the Program Manager and the Director on leasing activities and execution of lease agreements. The Director of CREO provides direction, executes lease agreements within the delegation of authority, and represents CREO at Finance and Economic Development Committee and Council (FEDCO).

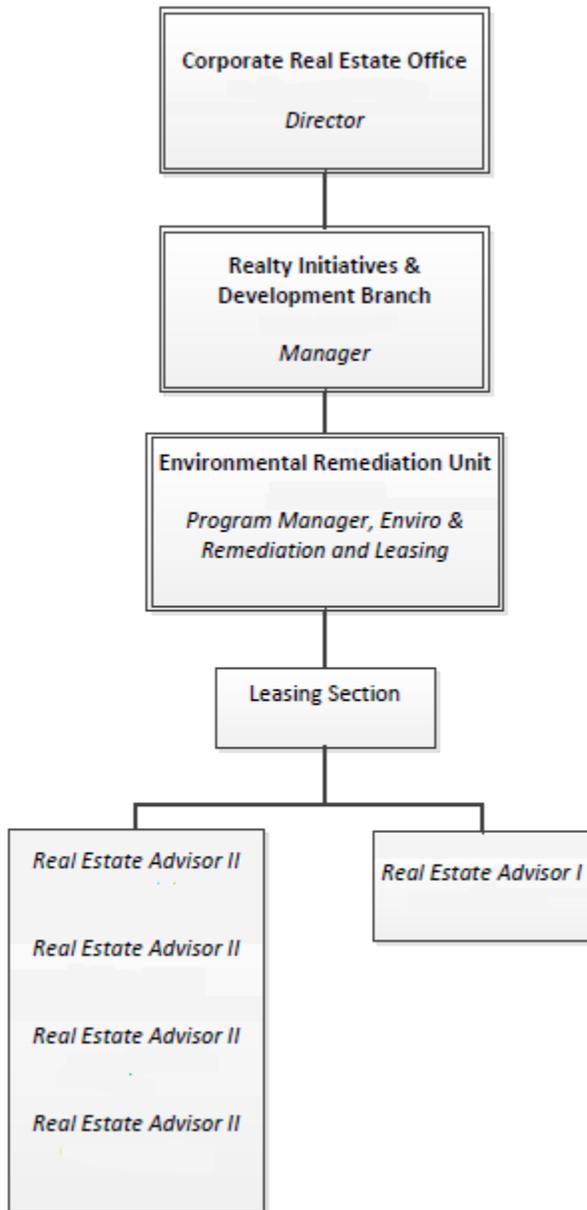


Figure 1: Leasing Section organization chart

In order to achieve City objectives, the Leasing Section arranges both revenue leases and acquisition leases.

A revenue lease refers to the leasing of City property to an outside group or individual. The City of Ottawa has a large inventory of property acquired over the years to support City services and activities. Properties are made available to community groups, private sector companies or other entities by means of a lease. As a result of amalgamation in 2001, the City inherited numerous lease agreements made by former municipalities. In

2017, a total of 260 revenue leases generated \$8.2 million of revenue; whereas, in 2016, 272 revenue leases generated \$6.6 million of revenue. The increase of almost \$2 million was due to the increase in lease revenue from the Lansdowne retail lease.

An acquisition lease is entered into on behalf of a City client group that requires space not available from within the City's portfolio. The client group is responsible for providing the lease requirements and to justify and secure budget funds for the required space. The Leasing Section is responsible for reviewing the request with the Accommodations Branch of CREO to determine whether the program can be accommodated within City-owned space, identifying a suitable property and securing a lease. In 2017, the City spent \$25.2 million on 174 acquisition leases; whereas, in 2016, \$25.9 million was spent on 179 acquisition leases.

In 2005, the Office of the Auditor General conducted an Audit of Real Estate Management that included within the scope an examination of policies and procedures, leasing activities, documentation standards and system limitations.

## Findings

Our audit included interviewing City staff, reviewing lease files and examining SAP reports to the extent they were available. Limitations were encountered because SAP is not inherently a real estate management program and could not produce information required for the audit. We were unable to obtain a complete listing of the lease files that we planned to sample. This was a significant limitation to our ability to perform the audit. Moreover, copies of SAP reports generated in 2016 and 2017 for the lease expiry process were not retained. Accordingly, we were unable to test the termination and renewal process.

The audit focused on processes, practices and controls in six key areas, which were selected, based on risk:

- Departmental governance and oversight;
- Revenue leasing processes and practices for commercial, community and residential leases;
- Processes to ensure that internal space is identified and used prior to entering into an acquisition lease;
- Billing and collection processes;
- Bookings and subleases entered into by client departments; and
- Compliance with City by-laws and legislative requirements.

The key findings of the audit are as follows:

### **1. Lack of a leasing policy**

A policy for the leasing of City-owned properties does not exist. CREO does not have clearly defined and communicated roles and responsibilities in relation to their Leasing function.

In the past, there were instances when the Leasing Section was only made aware of legacy leases established by former municipalities when disputes arose. Some client departments withhold available space within facilities for future use instead of notifying the Leasing Section. Other clients trade space with other departments without consulting the Leasing Section or even enter into their own leasing arrangements. Client groups that attempt to manage leases without consulting the Leasing Section do not have the necessary real estate expertise and may be exposing the City to risk or may not be maximizing lease revenue.

A leasing policy would define CREO's role as the Corporate landlord within the City, prevent the activities mentioned above and ensure that the Leasing Section is engaged by client groups when necessary. A policy could provide increased direction on determining lease rates, building operating cost allocations and define eligibility criteria for prospective community lease tenants.

This finding was previously noted in the OAG's 2005 Audit of Real Estate Management. It was recommended that management ensure appropriate policies and procedures are put in place for Leasing to ensure a consistent and effective approach. In the 2009 Follow-up to the Audit of Real Estate Management, it was found that policies and procedures were not yet documented for Leasing. Though a leasing flow chart and process were documented, they were not comprehensive enough to ensure a consistent approach to leasing.

### **2. Non-compliance with the City's *Records Management Policy and Procedures***

A review of 27 lease files showed that files were often incomplete, and decisions were not always documented and retained. Key documents that were missing included property valuation, proof of insurance, lease terms summary, manager sign-off and support for other key business decisions. Moreover, some files were not actively monitored throughout the lease term as evidenced by the absence of documentation over many years. The maintenance of lease files is not in compliance with the City's *Records Management Policy and Procedures*. The policy states that any document that contains "work-related decisions and actions are Official Business Records (OBRs) that

must be captured in Records Management System (RMS) or Business Information Management System (BIMS)”.

Staff indicated that certain documents that were missing from the files could be in a REA’s email or on their desk. This is not in compliance with the *Records Management Policy and Procedures* where it states that Outlook should not be used to keep OBRs.

Over the life of the lease, there are different REAs assigned to work on a file. A file with missing key documents would make it impossible for a new REA to understand what happened in the past, including justification for decisions, support for determining the rental rate and communications with the client group. In addition, incomplete documentation would hinder the Program Manager’s review of the lease file.

The issue of documentation standards was previously noted in OAG’s 2005 Audit of Real Estate Management. It was found that approximately one-third of files were incomplete in terms of containing all required documentation. The 2005 audit recommended the establishment of a checklist and sign-off procedure to ensure all steps are completed and properly documented. This would assist management’s ability to monitor performance and facilitate the transfer of files between staff.

While checklists were created for commercial and residential leases, they are not signed-off and consistently used by staff to ensure that all leasing steps are completed and properly documented.

### **3. Inadequate evidence of oversight within the Leasing Section**

The CREO Handbook was created in 2009 as per a recommendation in the 2005 Real Estate audit report. It was recommended that management should ensure that appropriate policies and procedures were put in place for leasing and other key activities to ensure consistent and effective approaches would be followed by staff. This handbook contains a Leasing section that outlines procedures and guidelines for revenue and acquisition leases. The handbook also contains a process checklist to “ensure that all staff are processing the transactions in the same format and following approved policies and procedures.” Other key information contained in the Handbook include authorities governing Leasing, roles and responsibilities, types of City properties and delegated authorities.

Decisions related to the day-to-day operations such as setting up the terms of a new lease or renewing an existing lease are left to the discretion of the REA assigned to the file, with limited oversight from the Program Manager. The lack of Program Manager

review prior to committing the City to a lease agreement is contrary to CREO Handbook procedures.

The CREO Handbook requires the Program Manager to review the following items:

1. Draft lease agreement;
2. Delegated Authority Report (DOA);
3. Agreement Summary; and
4. Final lease agreement.

Draft lease agreements were rarely kept on file, and there was no documented evidence of the Program Manager's review of key lease terms. In comparison with two of the older lease files that we examined, there was evidence of the previous Program Manager's review of draft lease agreements, including comments and markup giving evidence to review of the key terms of the agreement.

The DOA report was signed off by the Program Manager in each of the files that we sampled. This report is created when a new lease or renewal has been completed. It contains high-level information such as the background, consultation, environmental implications and financial implications. The DOA report is often signed at the same time as the final lease agreement and sometimes after the lease is already signed and the term has commenced. Therefore, the DOA report is used more as an information document, rather than a review of the lease terms prior to committing to the lease.

The Agreement Summary is a single page document that lists the tenant's address, property information, lease parameters, SAP accounting information and consideration details. The document was not found in every lease file; and when it was present, we did not always see evidence of the Program Manager's sign-off.

Final lease agreements were signed-off by the Program Manager. However, at times, the sign-off date was after the term of the lease had already commenced.

The limited oversight is concerning as REAs are performing their duties in an environment where key procedures are seen by staff as guidelines. Failure to perform key procedures would not be detected and corrected. In addition, when REAs have the ability to set lease terms with limited oversight, this makes the process vulnerable to conflicts of interest.

Currently, management does not review a listing of expired leases or leases on overhold<sup>1</sup> in a given period. Expired leases would benefit from management review in order to ensure that tenants of expired leases have in fact vacated the property or that they are continuing to pay while remaining on overhold or awaiting a lease renewal. Leases on overhold require management review to determine whether the property should continue to be leased on a month-to-month basis at renegotiated rates or whether there is better use for the City property.

The audit noted that there is adequate quarterly reporting on transactions within the Leasing Section to the Finance and Economic Development Committee. The 2016 and 2017 quarterly reports contained a list of new, amended, renewed and extended revenue leases. The total amount expended along with the individual that approved the transaction were disclosed.

#### **4. Procedures for revenue leases as outlined in the CREO Handbook are not consistently followed**

Leasing procedures and checklists are outlined in the CREO Handbook. The audit found that the existing procedures were lacking guidance for the determination of rental rates and direction for management oversight. There was also a lack of guidance around monitoring the provisions contained within the leases throughout the lease term, and the billing and collections process.

Furthermore, we observed that procedures and checklists that were meant to be mandatory critical steps were viewed by staff instead as optional guidelines. There was a wide variation in the way each lease file was managed and how procedures were followed and documented.

The CREO Handbook identifies the following five critical steps for the revenue leasing process:

1. In order to determine the rental rate, market research must be conducted to determine an accurate market value of the property.
2. For any new tenants occupying City public buildings or residential property, a criminal record check and a credit check is required. For existing tenants,

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<sup>1</sup> A lease goes into “overhold” when the term of a commercial lease expires and the tenant continues to occupy the leased premises at the landlord’s consent; the tenancy becomes a month-to-month lease.

confirmation must be made with Accounts Receivable to ensure that the account is in good standing prior to renewals.

3. For non-standard lease templates, CREO needs to consult with Legal Services to review and approve the draft lease agreement.
4. At the conclusion of the negotiation of the lease agreement, the Program Manager will review and approve the draft Delegated Authority Report, the Agreement Summary and the draft lease agreement.
5. The completed lease agreement and Delegated Authority Report must be sent to the appropriate Delegated Authority for signature.

A sample of new lease files were selected to assess compliance with these steps.

Only 38 per cent of sampled files contained a complete market valuation. For the remaining files, we were unable to determine the basis for the rate charged on the lease. Without a complete market valuation, there is the risk that the City could be charging below market value for its properties and thereby decrease the annual revenue collected by the City.

None of the sampled files contained any evidence of a criminal record check or a credit check. A criminal record check is needed to provide the City with critical information to evaluate a prospective tenant. Without the completion of a credit check, there is less assurance over the ultimate collection of the rental revenue and increased risk of having to involve Legal Services with collections and eviction procedures.

Only 13 per cent of sampled files showed evidence of a complete and meaningful Program Manager review of the required documents. Without a meaningful review of draft versions of the Agreement Summary, the Delegation of Authority Report and the Lease Agreement, errors made on key components of the executed lease agreement could go undetected. This was identified in one instance where the term of the lease in the final executed lease agreement was incorrect.

In all sampled files, the City official with the appropriate signing authority as per the Delegation of Authority Report signed the lease.

#### **5. Insurance certificates required under lease agreements have not been received or requested**

The audit found that the monitoring of insurance coverage on City-owned properties was ineffective. All sampled lease agreements contained a requirement for the tenant to obtain insurance coverage. Only 33 per cent of the files had complete documentation of

insurance coverage. There is a risk that tenants have not been in compliance with the terms of the lease and acquired the necessary insurance. This could make the City liable for any damages that would have been covered by the tenants' insurance policy.

## 6. Inconsistent management of residential lease files

The CREO Handbook identifies the following six key steps in the residential leasing process:

1. Review the tenant's application;
2. Complete the Residential Lease Agreement Template;
3. Prepare a DOA report seeking approval from the Program Manager;
4. Sign the Residential Lease Agreement with the lessee;
5. Have the lessee complete the Pre-Authorized Payment Plan; and
6. Request proof of insurance.

At the time of the audit, the Leasing Section only had four residential leases. In the case of one residential lease file reviewed, there was no evidence of five out of the six key steps. There was only evidence of a single step where the REA appeared to have reviewed the tenant's application. This file was missing a copy of the residential lease agreement between the tenant and the City. A legal lease agreement is important because it dictates the rights and obligations of the tenant and landlord. See table 1 below for additional details. In contrast, in the second sampled residential lease file, there was evidence of all six key steps performed and documented in the lease file.

Table 1: Details of a sample residential lease file

<b>Lease file: Residential</b>
<ul style="list-style-type: none"> <li>• In 2009 and 2010, the City spent \$1.2 million to acquire eight residential properties that were located in the vicinity of a trunk sewer that was experiencing differential structural settlement (i.e. the ground was sinking).</li> <li>• One of the eight properties continues to be inhabited by a tenant.</li> <li>• No residential lease agreement between the tenant and the City exists.</li> <li>• The only lease agreement on file was signed on July 10, 2005 between the tenant and the former owner of the property. Upon purchase of the property, the City assumed the existing residential tenancy agreement.</li> <li>• The City never asked the tenant to provide proof of insurance. Given the nature of the residential property and the known differential structural settlement issues, this poses risk to the City.</li> </ul>

## **7. Lack of guidance on leasing to community groups**

There is no consistent framework in place for leasing City space to community groups. The Leasing Section has not developed a checklist with key steps required to initiate, renew and/or terminate a community group lease, nor a community lease agreement template with standard terms and conditions. There is no policy containing eligibility criteria that must be met in order to qualify to rent City space at below market rent.

Moreover, no financial assessment is performed on community groups that are interested in renting City space. While some groups receive a subsidy from the City and requesting a higher rent amount would only result in them requiring a larger subsidy, other groups have sources of revenue that would enable them to pay for operating costs or even a percentage of the fair market value rate.

Leasing to community groups should be done in accordance with City priority and should complement the City's mandated programs and services. However, the City has no process in place to assess and identify gaps in services where below market value community leases would most benefit its residents.

While CREO reports to FEDCO on all lease transactions, including new community leases, they are not advised of the subsidy amounts for below market rent leases. The Leasing Section does not track nor report the opportunity cost of providing City space to community groups at a discount.

## **8. Overhold leases are inadequately monitored and rental rates are rarely renegotiated**

The Leasing Section identified 27 leases that have been on overhold for an average of 32 months. The longest overhold periods pertained to two leases, each of which had been in overhold for over 15 years.

By default, each of the expired leases are extended under the same terms and conditions of the original lease and tenants continue to pay the same rent. The lack of renegotiation of lease rates has the potential to cost the City additional rental revenue. Moreover, continuing leases on overhold for a lengthy period of time may not be the best use of City property.

The Leasing Section uses either a short form or long form lease template for commercial leases. Only the long form template contains an overholding clause that requires the monthly rent during the overholding period to be 150 per cent of the amount payable during the last month of the term. The CREO Handbook provides no

procedures on how overhold leases are to be administered and which lease template is to be used.

Of the overhold leases examined, 80 per cent did not have their rent rates renegotiated, and 60 per cent did not have any documentation in the file for over eight years. During the overholding period, lease files were often reassigned to different staff that did not create the original lease and due to the lack of documentation in the file, would not have a complete understanding of the history of the lease. Without this knowledge, staff would have difficulty understanding what was to be done going forward. It was also noted that Program Manager review and approval is not required prior to continuing a lease on overhold.

Table 2: Details of a sample overhold lease file

<b>Lease file: Overhold commercial lease</b>
<ul style="list-style-type: none"> <li>• In 1991, the Regional Municipality of Ottawa-Carleton (RMOC) purchased 194 acres of land from the National Capital Commission (NCC) for \$250,000 with the intention of using the property as a future snow dump.</li> <li>• In 1990, the NCC was leasing 92 acres of the land to a farmer for \$237 per month.</li> <li>• In 1992, the RMOC signed a lease for the same 92 acres for \$158.33 per month. It is unclear why staff decided to charge a lower rent than what the tenant was previously paying the NCC.</li> <li>• The remaining 102 acres purchased by the City is designated as a protected wetland and cannot be leased out for farming purposes.</li> <li>• In 1993, a new lease was signed for a rental rate of \$170 per month.</li> <li>• In 2001, another lease was signed with the rent continuing at \$170 per month.</li> <li>• The lease expired on March 31, 2003 and has been on overhold ever since.</li> <li>• No effort was made to renegotiate the rent rate over a 20-year period. In fact, the monthly rent charged over the last 20 years is less than the rent charged by the NCC in 1990.</li> <li>• There is evidence in the file that an REA attempted to determine a fair market value per acre rate for the property. However, rental rate renegotiation was never pursued with the tenant.</li> <li>• Based on the fair market value estimates found in the file, over the last 20 years, the City lost an estimated amount between \$30,000 to \$180,000 of lease revenue.</li> <li>• The tenant stopped paying the City as of February 28, 2017 despite continuing to occupy and utilize the land.</li> <li>• Upon investigation, the missing lease payments amounting to \$3,230 were caused by a temporary staff member not following a manual control in the billing process.</li> </ul>

## **9. Outdated generic cost per square foot**

In 2013, the City of Ottawa conducted a study that identified that the average operating cost for City property was approximately \$10 per square foot. When market value is not determinable or when leasing to community groups at below market value rates, the Leasing Section looks to cover the operating costs of the space at a minimum. The 2013 rate is still being utilized on current leases. Without an updated study to determine the average cost per square foot, the City is likely incurring costs above the previously appropriate \$10 per square foot rate.

## **10. Lack of inventory of City property that tracks vacancies**

In 2017, the City spent \$25.2 million on acquisition leases. In order to avoid unnecessary spending and maximize the use of City property, it is important for staff to verify that there is no available space within the City prior to looking externally for an acquisition lease. While CREO does keep an inventory of City-owned assets in SAP, this listing is not complete and does not track vacancies.

The acquisition leasing checklist within the CREO Handbook indicates that when entering into an acquisition lease, the REA is to ensure that the “request has been reviewed by the Corporate Asset Management Division (now “Accommodations Branch”) to determine whether or not the program can be accommodated within City-owned space.” The audit found that there are instances where the Accommodations Branch is not consulted prior to an acquisition lease because of the specific space requirements needed. In instances where the Accommodations Branch is consulted, the discussion and results are not always documented in the lease file.

Inquiries of possible available space within the City are directed to the Section Manager of Accommodations and Planning, who based on her experience, knowledge and understanding of City facilities often determines that there is no available space within the City. Other than the information contained in Archibus<sup>2</sup> on the City’s administration buildings, there is no mechanism to manage other valuable City property and track whether they are occupied or vacant. For other City facilities, the Accommodations Branch has CAD (computer-aided design) drawings. However, these drawings may not

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<sup>2</sup> ARCHIBUS is an integrated workplace management system that will allow Accommodations to quickly access a centralized repository of the City’s administration buildings (e.g. City Hall, Ben Franklin, etc.). Accommodations has begun inputting data into the system, but does not expect to realize full functionality until early 2019.

be up to date and do not give any indication as to whether there is any leasable space within the facilities.

**11. Billing and collection of rental income is not always timely and accurate**

As of July 1, 2018, all of the City’s revenue leases are a predetermined amount that are to be paid periodically throughout the lease term. During the scope period of the audit, there was one lease agreement that had a variable rental amount calculated based on the tenant’s sales revenue. The audit found that the reported revenues were questionable and that collection was always delayed. Details of this lease are outlined in table 4 below.

Table 3: Details of a lease agreement with a variable rental amount

<b>Lease file: Cafeteria within City building</b>
<ul style="list-style-type: none"> <li>• Lease agreement was signed on June 26, 2014, for a period of three years, with two extensions of one year each.</li> <li>• The cafeteria was 1,878 square feet and located within a City building.</li> <li>• It was to operate five days per week for a minimum of 52.5 hours.</li> <li>• The annual operating rent was \$6,000 per year. The second component was a rental amount calculated at 3 – 4 per cent of the tenant’s net sales.</li> <li>• On a quarterly basis, the tenant was to provide audited revenue statements to the City and make payment for the variable rental amount.</li> <li>• “Audited revenue statements” as required by the lease agreement were never requested from the tenant. The tenant’s GST/HST return were accepted instead. It was incorrectly assumed that the GST/HST return provided assurance that the sales revenue figure was accurate.</li> <li>• In 2018, the tenant expressed interest in extending the lease agreement for another seven years. The delegated authority report indicated that “under the original contract, the operator was to provide audited revenue statements to the City on a quarterly basis. Over the years, this was problematic with the City having to send constant reminders to the operator to provide the revenue statements and the net sales proceeds.” Despite having never received audited revenue statements and having to send constant reminders, the lease was extended.</li> <li>• There was no explanation in the file as to why the lease was not opened up to a Request for Proposal (RFP) once the 2014 contract expired.</li> <li>• In 2016, the tenant reported \$156,875 in sales revenues or \$650 per day (\$169,379 in 2017). These amounts appear to be low given the significant expenses with running a cafeteria.</li> <li>• Reported revenues are also significantly lower than what the tenant expected on their proposal, where they estimated revenue for 2017 of \$282,000. Despite this, the tenant requested a lease extension. Staff never questioned the low revenues reported by the tenant.</li> <li>• The extension was granted, and the rent as of July 1, 2018 was changed to a flat amount of \$1,000 + HST/month with annual increases of 0.5 per cent. This was calculated based the historical sales revenue claims made by the tenant.</li> </ul>

**Lease file: Cafeteria within City building**

- A comparable 1,303 square foot cafeteria servicing a similar number of City employees in another building was paying \$4,755 per month. This is significantly more than the \$1,000 per month paid by the tenant. There was no evidence in the lease file as to why the significantly lower rent was justified.
- The percentage of sales revenue rent payment was always paid late. Payment was not made for many months and even over a year after the quarter ended. This is in violation of the lease agreement where it stipulates that payment is to be remitted “on a quarterly basis (together with the Operator’s audited revenue statements)”.
- The invoice for the variable rent was always issued late because of the tenant’s delay in providing proof of their sales revenue figure for the quarter. The REA failed to follow-up in a timely manner with the tenant when the sales revenue figure was not provided. This resulted in the significant delay in the ultimate collection of the rental payment.
- The lease file did not contain evidence of all insurance certificates required for the duration of the lease.

When examining the billing process, the audit found that while billing details entered into SAP were accurate, a manual control in the billing process is prone to error. As part of the billing process, the REO is to manually identify the leases that expired in the month and contact the REA assigned to the lease file for direction as to whether to continue, renew or terminate the lease. If these leases are to continue, the lease end date must be adjusted in SAP for it to show up on the Rent Roll report sent to Finance for issuing invoices to tenants. If the REO fails to notice that the lease is at its expiration date in SAP and does not adjust the end date, an invoice will not be issued.

In 2017, the manual control in the billing process was not always followed by staff. This resulted in missed payments on an overhold lease. No invoice has been issued to the tenant since February 2017, and no rent has been collected even though the tenant continues to use City property. Up until September 30, 2018, the City did not collect on \$3,230 of lease revenues.

## **12. Lease arrangements are not consistently in compliance with the Ontario Municipal Act**

The leasing of municipal property is guided by the Ontario Municipal Act, Commercial Tenancies Act and by the City’s official plan and policies. The Commercial Tenancies Act outlines the relationship, rights and obligations between commercial landlords and tenants. The Leasing Section is in compliance with this Act.

The Ontario Municipal Act, section 106 states that the municipality shall not assist industrial or commercial enterprises by leasing or selling any property of the municipality at below fair market value. Our examination of commercial lease files found very little

documentation supporting the rental rates determined by the REAs. In most files, there is no justification that rates charged to tenants are at or above the fair market value. We would have expected to see evidence of research done for comparable properties and consultation with CREO's Valuations Unit. Of the commercial overhold leases sampled, 75 per cent did not have their rent rates renegotiated during lengthy overholding periods and are likely not representative of current market rates. When commercial lease rental rates are below the fair market value, the City is not in compliance with the Ontario Municipal Act.

## **Conclusion**

This report raises concerns on how the City manages its revenue lease portfolio. Based on our review of a sample of lease agreements, it is our view that key processes are lacking in certain areas and not followed in others.

While the CREO Handbook is a good starting point containing key procedures and checklists, it needs to be updated and enhanced with additional procedures to ensure that City leases are managed efficiently and effectively. Currently, key requirements in the CREO Handbook are not being followed. The audit found that there was often no consultation with the Valuations Unit or research to ascertain market rent, oversight review and approval was insufficient, insurance requirements were not met and background check requirements were not fulfilled.

We have recommended that CREO Handbook procedures need to be applied as mandatory processes rather than optional guidelines. Increased management oversight is also required to ensure that lease terms are justified, and key decisions are reviewed before the City enters into leasing agreements.

The Leasing Section would benefit from a leasing policy that defines its role and responsibilities as the Corporate landlord within the City and recognizes the Ontario Municipal Act requirements.

Our audit found that lease files were insufficiently monitored; and in some cases, appeared to be forgotten over a number of years. This was especially apparent upon examination of overhold leases. Most of the leases did not have renegotiated rental rates despite lengthy overhold periods, and there appeared to be no activity on some files for several years.

The implementation of the recommendations made in this report will help the City manage its revenue leases more effectively and efficiently, address control deficiencies

identified during the course of this audit and, where appropriate, generate additional revenue.

## Potential savings

The following are potential saving and revenue maximization opportunities for City Leasing:

- Conducting thorough fair market value assessments prior to determining lease rates on new commercial and residential revenue leases would maximize the revenue from leased property.
- Automatic rate increases and or renegotiations of lease rates would maximize the revenue collected on overhold leases.
- Recouping missing lease payments since March 31, 2017 (i.e. 19 months missing) on the farmland lease would increase leasing revenue.
- Regular monitoring of ongoing leases would ensure that billings are made on a timely basis, and revenue is collected without delay.
- Conducting an updated study on the City's operating cost per square foot and applying this rate as a minimum for community leases with the financial ability to pay would ensure that costs are covered by the tenant.
- Conducting financial assessments on groups applying for below market community leases would determine the financial capacity of the applicant organization. With this knowledge, the lease rate could be maximized accordingly.

## Recommendations and responses

### Recommendation #1

That CREO develop a leasing policy for application across the City. The policy should include:

- The Leasing Section's role as the sole owner of Corporate real estate;
- Responsibilities and accountabilities for CREO's Leasing Section; and
- A description of the bookings and sub-lease criteria that client groups must adhere to for all rentals.

**Management response:**

**Management response:**

Management agrees with this recommendation.

CREO will develop a City-wide Leasing Policy that will include the parameters outlined in the Recommendation. This will be completed by Q4 2019 as part of comprehensive policy development and implementation.

**Recommendation #2**

That management update the CREO Handbook to include detailed procedures required for the negotiation of leases, the determination of rental amounts, the Program Manager's review and approval of key documents and lease terms, the monitoring of provisions contained within the leases and the billing and collection process.

**Management response:**

Management agrees with this recommendation.

Detailed procedures as outlined in the Recommendation will be updated in the CREO Handbook by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #3**

That management ensure leasing procedures are clearly identified and differentiated from guidelines. That all Leasing Section staff be provided with training to ensure understanding of the procedures and the key controls within.

**Management response:**

Management agrees with this recommendation.

Further to management's response to Recommendation 2, procedures (formal processes) and guidelines (best practices) will be clearly differentiated and developed as part of comprehensive policy and procedure development. CREO senior staff will also provide training to all Leasing Section staff to ensure understanding of the procedures and the key controls within. This will be completed by Q4 2019.

**Recommendation #4**

That management develop a lease file system that is in compliance with the *Records Management Policy and Procedures*, consistently applied throughout the department and clearly identifies the documentation that must be retained. Consideration could be given to keeping electronic files. All Leasing Section staff should be provided with training on the standards on maintaining lease files.

**Management response:**

Management agrees with this recommendation and it has been partially implemented.

Training was provided in Q4 2018, by Information Management, to all Leasing Section staff on the standards related to maintaining lease files.

A lease file system that is in compliance with the City's Records Management Policy and Procedures will be developed by Q3 2019. This system will enhance existing record keeping and will clearly identify the documentation that must be retained to ensure consistent application across the department. Via this process, management will also assess opportunities and the feasibility of streamlining records management to move towards more electronic files.

**Recommendation #5**

That management ensure REAs are advised of their assignments and are held accountable for maintaining the required documentation during the lease term, the renewal period and any overholding period.

**Management response:**

Management agrees with this recommendation.

CREO senior staff will work with Information Management to establish the required documentation during the lease term, the renewal period and any overholding period as per the City's Records Management Policy and, will clarify assignments and accountabilities with REAs on an ongoing basis. This will be completed by Q2 2019.

**Recommendation #6**

That management ensure that review takes place prior to the signing of a new lease or of a renewal. Included in the lease file should be evidence that key terms in the draft lease agreement were reviewed and approved.

**Management response:**

Management agrees with this recommendation and it has been implemented.

Management ensures that review takes place prior to the signing of a new lease or renewal. This review is documented by the Program Manager signing the staff report. The staff report is the public document authorizing the appropriate authority to execute the lease agreement on behalf of the City. This practice will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #7**

That management periodically review a listing of expired leases and leases on overhold in a given period.

**Management response:**

Management agrees with this recommendation.

Staff will run reports on expired leases and leases on overhold via the SAP Real Estate Module on a quarterly basis. These listings will be provided to senior CREO staff for review and direction. This process will be outlined in guidelines being developed for CREO staff. This ongoing process will be initiated, and therefore deemed complete by Q2 2019.

**Recommendation #8**

That management provide enhanced training on the SAP Real Estate Module to REAs.

**Management response:**

Management agrees with this recommendation.

ITS will provide enhanced training on the SAP Real Estate Module to REAs by Q2 2019. Management will also review the current system to determine whether it is adequate for all of Real Estate Services' information needs.

**Recommendation #9**

That REAs conduct market research that is reviewed by the Valuations Unit. Evidence should be documented and retained in lease files and reviewed by the Program Manager prior to the signing of a lease agreement or renewal.

**Management response:**

Management agrees with this recommendation and it has been implemented.

REAs do conduct market research and coordinate with the Valuations Unit. REAs have been directed to ensure that appropriate evidence of that market research is retained in the project file and is reviewed by the Program Manager. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #10**

That REAs ensure that a criminal record check and a credit check is received from tenants interested in occupying City public buildings or residential properties.

**Management response:**

Management agrees with this recommendation.

Requirements for tenant criminal record and credit checks will be incorporated into the City-wide Leasing Policy and Procedures being developed as outlined in management's response to Recommendation 1. This will be completed by Q4 2019.

**Recommendation #11**

That REAs retain a copy of the Agreement Summary, Delegation of Authority Report, draft Lease Agreement and final Lease Agreement in each lease file with evidence of the Program Manager's review.

**Management response:**

Management agrees with this recommendation and it has been implemented.

CREO has worked with Information Management to clarify which documents referenced in the Recommendation are Official Business Records (OBRs) as per the City's Record Management Policy. Evidence of the Program Manager's review is documented by the Program Manager signing a copy of all staff reports that authorize execution of Lease Agreements. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #12**

That management establish responsibility and accountability for monitoring insurance certificates. Procedures should be developed and implemented to ensure that REAs request, track and retain insurance certificates for the duration of the lease agreement.

**Management response:**

Management agrees with this recommendation.

Management is currently developing a corporate-wide Insurance Certificate Policy that will establish responsibility and accountability for monitoring insurance documents with client departments.

Corresponding procedures will ensure that REAs request, track and retain insurance certificates for the duration of the lease agreement.

As part of comprehensive policy and procedure development, both the Insurance Certificate Policy and CREO-specific procedures will be completed by Q4 2019.

**Recommendation #13**

That management ensure staff request proof of insurance for 2072 Sunland Drive.

**Management response:**

Management agrees with this recommendation.

Management has requested proof of insurance for this property and expects to receive it by the end of Q1 2019.

**Recommendation #14**

That management develop specific and measurable eligibility criteria to assess applicant community groups. A financial assessment should also be conducted for all groups interested in entering into a community lease. Evidence of completion of the eligibility review and financial assessment should be retained in the lease file.

**Management response:**

Management agrees with this recommendation.

Management will develop specific and measurable eligibility criteria to assess applicant community groups by Q4 2019.

The requirement for financial assessment and evidence of completion of the eligibility review, will be incorporated in the City-wide Leasing Policy to be completed by Q4 2019 as part of CREO's comprehensive policy and procedure development.

**Recommendation #15**

That management establish priorities for providing below market rent space to community groups.

**Management response:**

Management agrees with this recommendation.

Management will establish priorities for providing below market rent space to community groups by Q4 2019 as part of CREO's comprehensive policy and procedure development. Such criteria will be presented to Council for approval.

**Recommendation #16**

That management develop procedures to be included in an updated CREO Handbook that requires rental rates to be renegotiated during overholding periods. Program Manager's review and approval should also be required prior to allowing a lease to continue on overhold and for subsequent years while the lease continues on overhold.

**Management response:**

Management agrees with this recommendation.

Detailed procedures that require rental rates to be renegotiated during overholding periods will be updated in the CREO Handbook by Q4 2019 as part of comprehensive policy and procedure development.

The Program Manager's review and approval will be confirmed by email and/or other formal correspondence, which will be retained in the file as Official Business Records.

**Recommendation #17**

That management consider having an overholding clause in both the long form and short form commercial lease agreement template. If the clause is waived, the exception should be documented in the file and sign-off must be provided by the appropriate level of approval.

**Management response:**

Management agrees with this recommendation.

In consultation with Legal Services, management will consider having an overholding clause in both the long form and short form commercial lease agreement template. If the clause is waived, the exception will be documented in the file and sign-off will be provided by the appropriate level of approval. This will be completed by Q2 2019.

The process of documenting the waived clauses will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #18**

That REAs renegotiate new leases in a timely manner when it has been determined that a formal lease with the tenant will continue or resume.

**Management response:**

Management agrees with this recommendation and it has been implemented.

As a business practice, lease renewal activities are prioritized based on potential revenue generated. REAs have been directed to renegotiate new leases as per the Recommendation and with the support of other City departments, as required.

**Recommendation #19**

That management renegotiate the farmland lease based on current fair market value research and endeavour to recoup the missed lease payments since March 1, 2017.

**Management response:**

Management agrees with this recommendation.

Commencement of negotiations with regard to the farmland lease will begin, as per the Recommendation, by Q2 2019.

**Recommendation #20**

That management set out the procedures that must be followed prior to lease expiry to ensure that the City does not lose revenue.

**Management response:**

Management agrees with this recommendation.

Management will set out the procedures that must be followed prior to lease expiry by Q4 2019 as part of CREO's comprehensive policy and procedure development.

**Recommendation #21**

That management update the 2013 study to determine the current operating costs per square foot at City properties. When appropriate, the cost per square foot should be used as a minimum rent to ensure costs are being covered.

**Management response:**

Management agrees with this recommendation.

In partnership with Recreation, Cultural and Facility Services, CREO will coordinate an update of the 2013 study to current rates. It is expected that these updated rates will accurately reflect current operating costs in facilities. When appropriate, the cost per square foot will be used as a minimum rent as per the Recommendation. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #22**

That management ensure there is a complete, accurate and up-to-date listing of City land and property. The listing should be used to keep track of any vacancies. The Accommodations Branch should use this listing to help the Leasing Section identify available space within the City prior to entering into acquisition leases.

**Management response:**

Management agrees with this recommendation.

The Accommodations function was transferred to CREO in 2016 as part of a City-wide reorganization, which has improved the relationship between accommodations and leasing staff; enhancing its role as the corporate landlord. In 2017, the software platform, Archibus, was purchased and is now being implemented to document the use of space in the City's four main administration buildings.

Management will use tools such as SAP and Archibus to establish a complete, accurate and up-to-date listing of City land and property to assist the Accommodations Branch in implementing this Recommendation.

To facilitate training and the establishment of processes for the development and maintenance of such a listing with ITS, this recommendation will be completed by Q4 2019.

**Recommendation #23**

That REAs always document their consultations with the Accommodations Branch as to whether there is any available lease space within the City prior to entering into an acquisition lease.

**Management response:**

Management agrees with this recommendation.

Staff will document all consultations with the Accommodations Branch in staff reports as of Q1 2019. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #24**

That the Leasing Section ensure tenants are in compliance with the terms of their lease agreements (payment terms, requirements to provide documents, proof of insurance, etc.).

**Management response:**

Management agrees with this recommendation.

As part of CREO's comprehensive policy and procedure development, management will develop detailed procedures to ensure compliance as outlined in the Recommendation. This will be completed by Q4 2019.

**Recommendation #25**

That management ensure that training is provided on how to complete the billing process. A secondary review of the manual procedures involved in the billing process should also be considered.

**Management response:**

Management agrees with this recommendation.

With the support of ITS, management will ensure that training is provided to relevant staff on how to complete the billing process. As part of this process, a secondary review of the manual procedures involved in the billing process will be considered and potentially formalized. This will be completed by Q3 2019.

**Recommendation #26**

That management finalize the “collection of overdue accounts” process as soon as possible.

**Management response:**

Management agrees with this recommendation.

As indicated by the auditor, there is currently a ‘collection of overdue accounts’ process in place in the Leasing Section. In consultation with Revenue Services, management will finalize the process by Q2 2019.

**Recommendation #27**

That management develop detailed procedures to guide REAs on how to determine, support and document a fair market value rental rate for every new commercial lease and commercial lease renewal to ensure compliance with the Ontario Municipal Act.

**Management response:**

Management agrees with this recommendation.

As is longstanding practice, CREO will continue to leverage the expertise of its Valuations Unit and the accredited appraisers in that unit to conduct market value assessments for the Leasing Unit.

Management will develop detailed procedures to complete the requirements of the Recommendation by Q4 2019 as part of CREO’s comprehensive policy and procedure development.

**Recommendation #28**

That CREO notify MPAC about the tenants at 5441 Hawthorne Road. Once the assessment is complete, CREO should begin collecting property taxes to maintain compliance with the Assessment Act.

That CREO seek a legal opinion with the City Solicitor's Office on the matter of property tax collection and the *Services Contract with a rental component for tenancy*.

**Management response:**

Management agrees with this recommendation.

CREO will notify MPAC about the tenants at 5441 Hawthorne Road. Following receipt of supplementary assessment information from MPAC, Revenue Services will begin billing and collecting any property taxes owing.

In Q2 2019, CREO will seek a legal opinion with the City Solicitor's Office on the matter of property tax collection and the *Services Contract with a rental component for tenancy*, and from that opinion, determine next steps, as appropriate.

**Recommendation #29**

That CREO update the Handbook to include alerting MPAC to new commercial tenants when applicable and provide training to relevant staff who will be responsible for negotiating and executing leases where property tax may be a factor.

**Management response:**

Management agrees with this recommendation.

As per management's response to Recommendation 2, detailed procedures as outlined in the Recommendation will be updated in the CREO Handbook by Q4 2019.

Senior CREO staff will provide training by Q2 2019 to relevant staff who will be responsible for negotiating and executing leases where property tax may be a factor. To support timely operations, the practice of notification to MPAC will commence by Q3 2019 for new leases.

**Recommendation #30**

That CREO review other similar commercial leases to confirm that property tax allocations are in compliance with the Assessment Act.

**Management response:**

Management agrees with this recommendation.

CREO will review active commercial leases to confirm that property tax allocations are in compliance with the Assessment Act, with the support of Revenue Services, as required. As this requires extensive review of all active commercial leases, staff will notify MPAC on an ongoing basis as the review progresses. The full review of commercial leases will be completed by Q3 2020.

## Detailed audit report

### **Audit of City Leases**

#### **Introduction**

The Audit of City Leases was included in the 2018 Audit Work Plan of the Office of the Auditor General (OAG), approved by City Council on November 22, 2017.

#### **Background and context**

##### **Corporate Real Estate Office**

The Corporate Real Estate Office's (CREO) mandate is to provide innovative real estate solutions and expert real estate leadership to the City of Ottawa. CREO enables other departments to deliver programs and services by providing land, buildings and a variety of supporting real estate services. CREO manages the valuations, acquisition, environmental remediation, accommodation, leasing, portfolio planning and disposition of real property. The business unit consists of 45 employees with two core functions: Realty Services and Realty Initiatives and Development.

##### **Leasing Section**

The City of Ottawa has a large inventory of land and facilities acquired over the years to support City-mandated services and activities. To help achieve City objectives, it is often appropriate to make specific land and facilities available to community groups, private sector companies or other entities by means of a lease.

The Leasing Section's mandate is to put in place and administer leasing procedures for the City as a whole that are consistent, transparent and equitable. The Leasing Section facilitates the revenue and acquisition leasing process on behalf of client groups within the City. This includes the initial lease request from a client group, lease negotiations with the third party and recording the lease in SAP (Systems Applications and Products in Data Processing). The Leasing Section uses SAP as its main IT application. Staff enter all pertinent lease information into SAP, which includes soft copies of the official signed lease documents and amendments. The Leasing Section also provides lease interpretation and conflict resolution services when requested by client groups.

The four key staff responsibilities with the Leasing Section are:

1. The Director of CREO is responsible for providing direction to the Manager and Program Manager, execution of lease agreements within the prescribed delegation of authority and representing CREO at Finance and Economic Development Committee and Council.
2. The Manager, Realty Initiative and Development advises, consults with and supports both the Program Manager and the Director on leasing activities and execution of lease agreements within the prescribed delegation of authority.
3. The Leasing Program Manager is responsible for overseeing the day-to-day operations of the Leasing Section and providing overall direction.
4. Five Real Estate Advisors (REA) negotiate and prepare revenue leases, acquisition leases and other agreements (e.g. licences of occupation, etc.).

### **Revenue leasing**

Revenue leasing, also referred to as “leasing out” refers to the leasing of a City asset to an outside group or individual. In revenue leases, the City acts as a landlord. The revenue lease process involves receiving lease requests from third parties, having REAs identify available space in consultation with the Accommodations Branch and client departments within the City, negotiating new third-party leases, approving lease renewals, arranging for terminations of existing leases and recording transaction details in SAP. It is the client group’s role to continue monitoring the third-party usage of leased assets throughout the term of the lease.

As a result of amalgamation in 2001, the City inherited lease agreements made by former municipalities. The types of leases include commercial, residential, and leasing to community groups. Community groups are offered space for the delivery of Council recognized and endorsed program and/or service. These leases are often provided at below market rent or a nominal amount.

In 2017, 260 revenue leases generated \$8.2 million of revenue. In 2016, 272 revenue leases generated \$6.6 million of revenue.

Table 4: Breakdown of 2016 and 2017 revenue leases

Source of revenue lease	2016	2017
Commercial	\$6,278,191	\$7,738,676
Residential	\$95,386	\$83,123
Community	\$272,140	\$375,785
<b>Total</b>	<b>\$6,645,717</b>	<b>\$8,197,584</b>

### Acquisition leasing

Acquisition leases are entered into on behalf of a City client group that requires space not available from within the City's portfolio. The client group is responsible for providing the lease requirements (i.e. dimensions, location, length of time and other applicable parameters) and to justify and secure a budget for the required space. It is CREO's responsibility to identify a suitable property and lease it.

In 2017, the City spent \$25.2 million on 174 acquisition leases. In 2016, the City spent \$25.9 million on 179 acquisition leases.

### Audit objectives and criteria

The overall objective of this audit was to assess whether leased City-owned property are being managed efficiently and effectively and whether lease arrangements are in compliance with City policies and other legislative requirements. The audit evaluated whether the system, practices and procedures supporting the Leasing Section are providing the City with reasonable assurance that its assets are safeguarded and controlled and that revenues to the City are maximized when appropriate.

Based on a prioritized assessment of risk, the objectives of the audit are to:

#### Audit objective #1

Assess whether leased City-owned property are being managed efficiently and effectively. This includes ensuring that City assets are safeguarded and controlled and that revenues are maximized when appropriate.

**Criteria:**

- A governance and organizational structure to support an effective leasing function is defined and communicated
- Revenue leasing processes and practices for commercial, community and residential leases are in place and operating effectively
- Processes are in place to ensure that available internal space is identified and used prior to entering into an acquisition lease
- The billing and collection of rental income is timely and accurate
- Only short-term, low-dollar-value bookings and subleases are entered into by client departments

**Audit objective #2**

Assess whether lease arrangements are in compliance with City policies and other legislative requirements.

**Criteria:**

- The Leasing Section is in compliance with City by-laws and legislative requirements

**Scope**

The scope of our audit included all operational and governance activities of the Leasing Section of CREO including other branches and units that perform direct or indirect supporting activities for revenue leasing. These branches and units include the Valuations Unit, Acquisitions Unit, Accommodations Branch, Legal Services, Corporate Accounts Receivable and Collections Unit, and Corporate Portfolio Planning.

The process of identifying available space within the City prior to acquisition leasing was also in scope.

The period examined was January 1, 2016 to date. Any leases effective during this period were considered in scope. For instance, while some revenue leases were established pre-amalgamation, these were in scope if they were generating revenue to the City during the defined period.

## Scope Limitations

As described in our Audit Approach and Methodology section below, our audit included interviews with City staff members and reviewing and examining SAP reports to the extent they were available. However, there were limitations with the audit process due to the following factors:

- SAP is not inherently a real estate management program. Therefore, it was unable to produce reports or information required for the audit. For example, we were unable to extract a complete listing for the lease files that we planned to sample. This was a significant limitation to our ability to perform the audit.
- Specific examples of SAP limitations include:
  - It cannot provide a complete list of valid leases that generated revenue during a selected period. If a lease has payment terms where the entire rental amount was prepaid at the beginning of the term, it will not appear on this listing.
  - When SAP generates a population of leases for a particular year, the list will only capture leases that were valid throughout the full 12-month period. If a lease's status changed during the year, it would not appear in the listing.
  - When lease terms are updated, for instance, payment terms are changed from annual to monthly, staff must re-create the complete lease entry rather than making an amendment to the terms. This updated lease is counted towards the "new lease listing" for that year, when in fact, it is not a new lease.
  - When a lease is terminated, it is no longer easily identifiable in SAP. To generate a list of expired leases, CREO staff is required to work with Information Technology Services (ITS) and manually manipulate SAP reports to create a listing.
  - SAP is unable to generate a listing of leases that are on overhold<sup>3</sup>.
- Copies of SAP reports generated in 2016 and 2017 for the lease expiry process were not retained. Accordingly, we were unable to test the efficiency and effectiveness of the termination and renewal process.

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<sup>3</sup> A lease goes into "overhold" when the term of a commercial lease expires and the tenant continues to occupy the leased premises at the landlord's consent; the tenancy becomes a month-to-month lease.

## **Audit approach and methodology**

The audit work in this report was conducted in accordance with the OAG Audit Standards. While the OAG adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of the Institute of Internal Auditors.

As part of our regular audit process, we obtained management's agreement with the findings in this report.

The audit methodology included the following activities:

- Interviews with staff members involved in acquisition leasing, revenue leasing and financial support for leasing;
- Review of relevant documentation, e.g. CREO Handbook, organizational charts, lease file, by-laws, procedures, leasing guidelines, checklists, SAP reports, etc.; and
- A variety of audit testing techniques including the testing of a sample of lease files, and reviewing supporting documentation for each of the selected areas of examination.

## **Audit observations and recommendations**

- A) Assessment of whether leased City-owned property are being managed efficiently and effectively. City assets should be safeguarded and controlled and revenues maximized when appropriate.**
- 1) A governance and organizational structure to support an effective leasing function is not clearly defined and communicated**

### **Lack of a leasing policy**

The CREO Handbook indicates that the Leasing Section is to “establish leasing policies for the Corporation as a whole”. A policy for the leasing of City-owned properties does not exist.

In the past, there were instances when the Leasing Section was only made aware of legacy leases established by former municipalities when disputes arose. Instead of notifying the Leasing Section, some client departments would withhold available space within their facilities for future use. Other client departments would trade space with

other departments without consulting the Leasing Section or even enter into their own leasing arrangements without involving CREO.

A leasing policy would define CREO's role as the Corporate landlord within the City and prevent the activities mentioned above. The policy should also define the parameters (i.e. value, length of time, square footage) for which departments could enter into their own bookings and sub-leases. Direction would be provided on determining lease rates, building operating cost allocations and define eligibility criteria for prospective community lease tenants. A leasing policy provides the opportunity for the Leasing Section to better meet its mandate of administering leasing procedures that are consistent, transparent and equitable.

### **Recommendation #1**

That CREO develop a leasing policy for application across the City. The policy should include:

- The Leasing Section's role as the sole owner of Corporate real estate;
- Responsibilities and accountabilities for CREO's Leasing Section; and
- A description of the bookings and sub-lease criteria that client groups must adhere to for all rentals.

### **Management response:**

#### **Management response:**

Management agrees with this recommendation.

CREO will develop a City-wide Leasing Policy that will include the parameters outlined in the Recommendation. This will be completed by Q4 2019 as part of comprehensive policy development and implementation.

### **Procedures outlined in CREO Handbook are not followed**

Leasing procedures and checklists are outlined in the CREO Handbook. The creation date and the last updated version dates of this document are unknown.

Based on our sample file review, there was a wide variation in the way each REA manages their lease file and which procedures are followed and documented. This has resulted in an inconsistent approach to determining rental rates, maintaining documentation and ongoing lease monitoring.

The audit found gaps in the procedures currently in the Handbook. The procedures do not include detailed steps required for the negotiation of leases, the determination of

rental rates, the Program Manager's review and approval of key documents and lease terms, the monitoring of provisions contained within the leases and the billing and collection process.

Throughout the audit, we observed that procedures and checklists are used more as guidelines. Procedures are a series of mandatory detailed steps for implementation to accomplish an end; whereas, guidelines are recommended but non-mandatory processes that serves as advice on how to act in a given situation. Leasing staff indicated that the checklists that cover the procedures required for revenue leases are not signed-off, and each of the steps are not always carried out or documented in the lease file.

Including detailed mandatory procedures in the CREO Handbook would provide guidance for all staff responsible for the administration of leases as well as facilitate the training of future staff.

### **Recommendation #2**

That management update the CREO Handbook to include detailed procedures required for the negotiation of leases, the determination of rental amounts, the Program Manager's review and approval of key documents and lease terms, the monitoring of provisions contained within the leases and the billing and collection process.

#### **Management response:**

Management agrees with this recommendation.

Detailed procedures as outlined in the Recommendation will be updated in the CREO Handbook by Q4 2019 as part of comprehensive policy and procedure development.

### **Recommendation #3**

That management ensure leasing procedures are clearly identified and differentiated from guidelines. That all Leasing Section staff be provided with training to ensure understanding of the procedures and the key controls within.

#### **Management response:**

Management agrees with this recommendation.

Further to management's response to Recommendation 2, procedures (formal processes) and guidelines (best practices) will be clearly differentiated and

developed as part of comprehensive policy and procedure development. CREO senior staff will also provide training to all Leasing Section staff to ensure understanding of the procedures and the key controls within. This will be completed by Q4 2019.

### **Non-compliance with the City's *Records Management Policy and Procedures***

Based on our sample file review, we observed that lease files are often incomplete, and decisions are not always documented and retained. The format in which lease files are kept is inconsistent as each REA maintains their lease file in a different way. Files were often missing key documents, for example, property valuation, proof of insurance, lease terms summary, manager sign-off and support for other key business decisions. Moreover, some files appear to show no evidence of active monitoring by a REA throughout the lease term.

The maintenance of lease files is not in compliance with the City's *Records Management Policy and Procedures*. The policy states that any document that contains "work-related decisions and actions are Official Business Records (OBRs) that must be captured in RMS (Records Management System) or BIMS (Business Information Management System)".

We were informed that certain documents that were missing from the files could perhaps be in a REA's email or on their desk. This is not in compliance with the *Records Management Policy and Procedures* where it states that Outlook should not be used to keep OBRs.

When reviewing the lease files, it was often difficult to follow the history of the lease and the key decisions made because not all the pertinent information was kept in the file. We often had to contact several REAs that worked on the file to get a full understanding of the history of the lease.

Incomplete lease files are problematic because over the life of the lease, there are different REAs assigned to work on the file. A file with missing key documents would make it impossible for a new REA to understand what happened in the past. In addition, the Program Manager would be unable to review the file and understand the context, how decisions were made and how rental rates were determined.

#### **Recommendation #4**

That management develop a lease file system that is in compliance with the *Records Management Policy and Procedures*, consistently applied throughout the department and clearly identifies the documentation that must be retained. Consideration could be given to keeping electronic files. All Leasing Section staff should be provided with training on the standards on maintaining lease files.

#### **Management response:**

Management agrees with this recommendation and it has been partially implemented.

Training was provided in Q4 2018, by Information Management, to all Leasing Section staff on the standards related to maintaining lease files.

A lease file system that is in compliance with the City's Records Management Policy and Procedures will be developed by Q3 2019. This system will enhance existing record keeping and will clearly identify the documentation that must be retained to ensure consistent application across the department. Via this process, management will also assess opportunities and the feasibility of streamlining records management to move towards more electronic files.

#### **Recommendation #5**

That management ensure REAs are advised of their assignments and are held accountable for maintaining the required documentation during the lease term, the renewal period and any overholding period.

#### **Management response:**

Management agrees with this recommendation.

CREO senior staff will work with Information Management to establish the required documentation during the lease term, the renewal period and any overholding period as per the City's Records Management Policy and, will clarify assignments and accountabilities with REAs on an ongoing basis. This will be completed by Q2 2019.

#### **Leasing risk assessment was completed**

In 2016, CREO completed a risk assessment that was detailed and included comments that addressed management's action plan. Included in the assessment were risks related to revenue leases.

One noted risk was that there are legacy agreements of former municipalities carrying unknown obligations for the City, which may result in: 1) costs (if renewals pass, automatically renew, to comprehensively mitigate insurance, safeguard property and lifecycle costs); and 2) liability (insurance, maintenance, environmental, personal use, squatters' rights). As part of the risk assessment, management indicated that CREO continues to find legacy agreements each year and they are entered into SAP to be tracked, allowing the City the ability to request insurance, prepare for lifecycle renewal and reclaim City land.

This risk gives evidence to the fact that the current lease inventory in SAP is not complete. There may be legacy leases that the Leasing Section is not yet aware of. While the Program Manager could not ascertain any legacy revenue leases that have been identified in the last five years, two legacy acquisition leases that CREO was made aware of in the last two years, 2016 and 2017, were identified. The Leasing Section only learns about legacy leases when an issue comes up and the client group approaches CREO with a concern.

Instances like these demonstrates that client groups may not consistently understand CREO's role in administering leases.

Other than low-dollar value and short-term bookings, all leases should be reported to and tracked by the Leasing Section. Client groups that attempt to manage leases without consulting CREO do not have the necessary real estate expertise and may be unknowingly exposing the City to risk or may not be maximizing lease revenue.

### **Leasing Section's role is not clearly defined and communicated**

While CREO is the City's official leasing agent, other departments play a large role in determining the need for leases and in monitoring the use of assets. Client groups are responsible for establishing program requirements; identifying, quantifying and documenting needs for new space or changes to existing space; seeking advice from CREO regarding leasing options; providing senior management approvals for leasing initiatives; monitoring third-party usage of leased assets; and providing cost centers for internal charge-backs.

CREO does not have clearly defined and communicated roles and responsibilities in relation to their Leasing function. There is no written communication from CREO to client departments, informing them of their respective roles in leasing arrangements. While we were informed that CREO does occasionally meet with the Directors and Managers of some City departments to communicate its role in Leasing, there is no

evidence of this communication. Without formally documenting or communicating CREO's roles and responsibilities in relation to the Leasing Section, client groups may not know when they should be involved. There is a risk with verbal meetings that information can be missed and may not be conveyed by management to their staff.

Moreover, the composition of City staff is constantly changing with turnover within client groups and periodic departmental reorganizations. The Leasing Section's role needs to be periodically communicated through a reliable means to ensure that they are engaged by client groups when necessary.

### **Enhanced oversight required within the Leasing Section**

The Leasing Section is led by the Program Manager and supported by five REAs. The responsibilities of REAs are to negotiate leases and other instruments like licenses of occupation, prepare the corresponding agreements, prepare reports to Committee and Council and liaise with Legal to complete transactions, when required.

Decisions related to the day-to-day operations of the Leasing Section such as setting up the terms of a new lease or renewing an existing lease are left to the discretion of the REA assigned to the lease file, with limited oversight from the Program Manager. Amongst the files we reviewed, there was often no evidence of the Program Manager's review prior to signing the lease. This is contrary to CREO Handbook procedures where the REA is to prepare a draft lease agreement for the Program Manager's review and approval. After the Program Manager initials the draft agreement, it is forwarded to the tenant for their signature. We saw minimal documented evidence of the Program Manager's review of draft lease agreements.

Moreover, there was little evidence that key decisions and lease terms were reviewed by the Program Manager prior to committing the City to a lease agreement. Negotiations with the tenant are left up to the individual REAs assigned to the file. We were informed that discussions between the REAs and the Program Manager were done on an ad hoc basis, and may take place at unit meetings.

For some of the older leases that we reviewed, there was evidence of the previous Program Manager's review of lease agreements, for example, comments and markup on the draft agreement and sign-off with initials on every page of the final agreement.

The Program Manager does appear to review every Delegation of Authority (DOA) Report that is created when a new lease or renewal has been completed. This report is based on a standard template that includes high-level information such as the background, consultation, environmental implications and financial implications.

From the sample file review performed for the audit, it appears that the DOA Report is often signed-off at the same time as the lease agreement and sometimes after the lease is already signed by the tenant and the term has commenced. Management has indicated that this is a common practice to ensure that there are no further changes to the report. However, in the chronology of processes, the Program Manager should review and approve the agreement and DOA prior to the lease being sent to the tenant for signature.

Therefore, the DOA report is used more as an information document, rather than a review of the lease terms prior to committing to the lease. According to leasing procedures, a draft DOA report, along with a draft lease agreement should be presented to the Program Manager for signing prior to the lease being signed by the tenant.

We did not see any evidence of the Program Manager's sign-off on the Agreement Summaries. The Agreement Summary is a single page document that lists the tenant's address, property information, lease parameters, SAP accounting information and consideration details.

The limited supervision is concerning as REAs are performing their duties in an environment where key procedures are seen as guidelines. Failure to perform key procedures would not be detected and corrected because there is limited management review. In addition, when REAs have the ability to set lease terms with limited oversight, this makes the process vulnerable to conflicts of interest.

The Program Manager has monthly meetings with the Manager of Reality Initiatives and Development. The minutes of these meetings are not documented. The meeting agendas provided identify that topics of discussion include issues on specific lease files, high profile lease files or any leases where there may be litigation. Similarly, the Manager of Reality Initiatives and Development and the Director of CREO have daily interactions on various lease files and meetings on a monthly basis where issues on specific leases are discussed.

Management does not review a listing of expired leases or leases on overhold in a given period. These are higher risk lease files that may require rate renegotiation and management review to ensure that they are not overlooked.

### **Recommendation #6**

That management ensure that review takes place prior to the signing of a new lease or of a renewal. Included in the lease file should be evidence that key terms in the draft lease agreement were reviewed and approved.

**Management response:**

Management agrees with this recommendation and it has been implemented.

Management ensures that review takes place prior to the signing of a new lease or renewal. This review is documented by the Program Manager signing the staff report. The staff report is the public document authorizing the appropriate authority to execute the lease agreement on behalf of the City. This practice will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #7**

That management periodically review a listing of expired leases and leases on overhold in a given period.

**Management response:**

Management agrees with this recommendation.

Staff will run reports on expired leases and leases on overhold via the SAP Real Estate Module on a quarterly basis. These listings will be provided to senior CREO staff for review and direction. This process will be outlined in guidelines being developed for CREO staff. This ongoing process will be initiated, and therefore deemed complete by Q2 2019.

**Adequate reporting to the Finance and Economic Development Committee**

The Director of CREO reports to FEDCO (Finance and Economic Development Committee) quarterly on transactions within the Leasing Section. The report is titled “Delegation of Authority – Acquisition and Sale of Land and Property”.

Our audit reviewed the 2016 and 2017 quarterly reports and noted that they contained a list of new, amended, renewed and extended revenue leases made in the quarter. The total amount expended along with the individual that approved the transaction are disclosed.

**Increased training on SAP needed**

While SAP has its limitations, it is still capable of generating a variety of useful reports on the lease inventory. During the audit, there were five staff within the Leasing Section, that used the SAP Real Estate Module to generate reports on a regular basis.

There is significant risk with so few staff able to use SAP. Workforce attrition could result in significant knowledge loss.

In 2017, a “RE Module Step by Step Transactions” manual was created. It provides detailed steps with SAP screenshots to create a revenue lease contract, change a revenue lease contract, rent increase and execute the rent roll in SAP. This manual is a good starting point and should be expanded further to include the preparation of key reports and find information on specific leases.

### **Recommendation #8**

That management provide enhanced training on the SAP Real Estate Module to REAs.

### **Management response:**

Management agrees with this recommendation.

ITS will provide enhanced training on the SAP Real Estate Module to REAs by Q2 2019. Management will also review the current system to determine whether it is adequate for all of Real Estate Services’ information needs.

## **2) Revenue leasing processes and practices are not operating effectively and require update**

### **Failure to complete critical steps in the revenue leasing process**

In order to gain an understanding of the leasing process and the critical steps in the procedures, the audit team conducted interviews with staff and reviewed the CREO Handbook’s Leasing Procedures and Guidelines. The following five critical steps were identified:

1. In order to determine the rental rate to be charged for the duration of a lease agreement, the REA needs to conduct market research to determine an accurate market value of the property being leased.
2. For any new tenants occupying property in City public buildings or residential property, the REA needs to obtain a criminal record check and a credit check. For existing tenants, the REA needs to confirm with Accounts Receivable that the account is in good standing prior to renewals.
3. CREO and Legal Services worked together to develop standard lease templates for the various types of leases. In the event that the standard lease template is adjusted during negotiations with the prospective tenant, CREO needs to consult with Legal Services to review and approve the draft lease agreement.

4. At the conclusion of the negotiation of the lease agreement, the Program Manager will review and approve the draft Delegated Authority Report, the Agreement Summary, and the draft lease agreement.
5. The completed lease agreement and Delegated Authority Report are sent to the appropriate Delegated Authority for signature.

A sample of eight new lease files (created between January 1, 2016 – December 31, 2017) were selected to assess the compliance with the critical steps identified above.

To assess the first critical step, the audit team reviewed the lease file and expected to find evidence of the REA's market value assessment. Our testing showed that only three out of eight files contained a complete market valuation. In the five sampled leases that did not have a valuation, we were unable to determine the basis for the rate charged on the lease.

Without a complete market valuation, there is the risk that the City could be inadvertently charging below market value for its properties. Charging below market value rent would decrease the annual revenue collected by the City.

To assess the second critical step, we expected to find the completed criminal record check and credit check for the tenant. The testing showed that this process was not being completed as none of the eight files contained any evidence of a criminal record check or a credit check.

Without the completion of a credit check, the Leasing Section has less assurance over the ultimate collection of the rental revenue over the duration of the lease. There is the increased risk of having to involve Legal Services with collections and eviction procedures.

The audit was unable to assess the third critical step, involving the Leasing Section's consultation with Legal Services. Based on interviews with REAs, we understood that most lease agreements utilize pre-approved standard lease templates. We did not identify any leases that deviated from the lease templates.

To assess the fourth critical step, we expected to find draft versions of the Delegation of Authority Report, Agreement Summary and lease agreement with evidence of a complete and comprehensive review by the Program Manager. We were only able to identify one file of eight that showed evidence of a complete and meaningful review of the required documents. This file had signatures on each page from the Program Manager and contained numerous markings that indicated the Program Manager had

reviewed all aspects of the draft documents. The remaining seven files contained no indication that a review had been completed other than the signature of the Program Manager at the end of the Delegation of Authority Report, and when applicable on the final lease agreement.

Without a meaningful review of draft versions of the Agreement Summary, the Delegation of Authority Report, and the Lease Agreement, errors could be made on key components of the executed lease agreement. For example, the Program Manager can identify the key items reviewed (check mark, initial, etc.), and include a signature and the date of the review.

We identified one sample where the term of the lease identified in the final executed lease agreement was incorrect. The Delegated Authority Report, and the final lease agreement identified that the lease should have a term of five years; however, the specific dates entered into the lease are from 1 January 2016 to 31 December 2021, a six-year term. Through interview with CREO staff, we confirmed that the lease was intended to terminate on December 31, 2020. To assess the fifth critical step, we expected to find the correct signatory per the Delegation of Authority process identified in the leasing procedures. In all eight sampled files, the City official with the appropriate signing authority as per the Delegation of Authority Report signed the lease.

### **Recommendation #9**

That REAs conduct market research that is reviewed by the Valuations Unit. Evidence should be documented and retained in lease files and reviewed by the Program Manager prior to the signing of a lease agreement or renewal.

### **Management response:**

Management agrees with this recommendation and it has been implemented.

REAs do conduct market research and coordinate with the Valuations Unit. REAs have been directed to ensure that appropriate evidence of that market research is retained in the project file and is reviewed by the Program Manager. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

### **Recommendation #10**

That REAs ensure that a criminal record check and a credit check is received from tenants interested in occupying City public buildings or residential properties.

**Management response:**

Management agrees with this recommendation.

Requirements for tenant criminal record and credit checks will be incorporated into the City-wide Leasing Policy and Procedures being developed as outlined in management's response to Recommendation 1. This will be completed by Q4 2019.

**Recommendation #11**

That REAs retain a copy of the Agreement Summary, Delegation of Authority Report, draft Lease Agreement and final Lease Agreement in each lease file with evidence of the Program Manager's review.

**Management response:**

Management agrees with this recommendation and it has been implemented.

CREO has worked with Information Management to clarify which documents referenced in the Recommendation are Official Business Records (OBRs) as per the City's Record Management Policy. Evidence of the Program Manager's review is documented by the Program Manager signing a copy of all staff reports that authorize execution of Lease Agreements. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Insurance certificates required under lease agreements have not been received or requested**

Prior to August 29, 2016, the Legal Department was responsible for tracking and monitoring third-party insurance certificates, with the information kept in a central database. Subsequently, City departments became responsible for tracking insurance requirements and renewals on their own contracts and agreements with third parties. Based on the lack of insurance certificates on file and discussions with REAs, it appears that not all REAs have been made aware of the change in responsibility and understand that they are to keep track of insurance requirements for their lease files.

The audit looked at a sample of 18 community and commercial leases and conducted testing to identify if the lease agreement included a requirement for the tenant to obtain insurance coverage and if a copy of the insurance certificate was retained in the file.

The audit found that the monitoring of insurance coverage on City-owned properties was ineffective. All 18 sampled lease agreements contained a requirement for the

tenant to obtain insurance coverage. Only six files had complete documentation of insurance coverage, leaving 12 files without any evidence of insurance coverage or incomplete evidence of coverage. Two existing lease samples that were tested contained some proof of insurance; however, neither file contained evidence of insurance covering the testing periods of 2016 and 2017. One such lease file contained an insurance certificate from January 2018 to January 2020. However, this file did not contain any proof of insurance from inception in 2012 through to 2017. This file was included in the 12 samples that were not compliant with the requirement to collect and maintain proof of insurance.

Without evidence of valid insurance coverage, there is a risk that the tenant has not been in compliance with the terms of the lease and acquired the necessary insurance. This could make the City liable for any damages that would have been covered by the tenants' insurance policy.

**Recommendation #12**

That management establish responsibility and accountability for monitoring insurance certificates. Procedures should be developed and implemented to ensure that REAs request, track and retain insurance certificates for the duration of the lease agreement.

**Management response:**

Management agrees with this recommendation.

Management is currently developing a corporate-wide Insurance Certificate Policy that will establish responsibility and accountability for monitoring insurance documents with client departments.

Corresponding procedures will ensure that REAs request, track and retain insurance certificates for the duration of the lease agreement.

As part of comprehensive policy and procedure development, both the Insurance Certificate Policy and CREO-specific procedures will be completed by Q4 2019.

### **Inconsistent management of residential lease files**

According to the Leasing Section, as at 2017, there are only four ongoing residential leases. The CREO Handbook, under "Residential Agreement Checklist" identifies the following six key steps in the residential leasing process:

1. REA reviews the tenant's application;
2. Complete Residential Lease Agreement Template reviewed by REA;
3. REA prepares Delegated Authority Report seeking approval of lease agreement from Program Manager;
4. Sign the Residential Lease Agreement with the lessee;
5. Lessee completes the Pre-Authorized Payment Plan (PAP); and
6. Lessee provides proof of insurance.

The audit team sampled two residential lease files. In the first residential lease file, there was no evidence of five out of the six key steps listed above. There was only evidence of a single step where the REA appeared to have reviewed the tenant's application. This file was missing a copy of the residential lease agreement between the tenant and the City. A legal lease agreement is important because it dictates the rights and obligations of the tenant and landlord. Without a signed lease agreement, the City could be unknowingly exposing itself to risk and liability. In contrast, in the second sampled residential lease file, there was evidence of all six key steps performed and documented in the lease file.

### **Sample residential lease file**

In 2009 and 2010, the City spent \$1.2 million to acquire eight residential properties that were located in the immediate vicinity of a trunk sewer that experienced differential structural settlement (i.e. the ground was sinking).

One of the eight properties continues to be inhabited by a tenant. The lease file contained no residential lease agreement between the tenant and the City. The only lease agreement on file was signed on July 10, 2005 between the tenant and the former owner of the property. Upon purchase of the property, the City assumed the existing residential tenancy agreement.

If there are any disputes, the lease represents what was agreed upon by the parties.

Furthermore, the City never asked the tenant to provide proof of insurance. Given the nature of the residential property and the known differential structural settlement issues, this poses risk to the City.

### **Recommendation #13**

That management ensure staff request proof of insurance for 2072 Sunland Drive.

#### **Management response:**

Management agrees with this recommendation.

Management has requested proof of insurance for this property and expects to receive it by the end of Q1 2019.

### **Lack of guidance on leasing to community groups**

At present, there is no consistent framework in place for leasing City-owned space to community groups. The Leasing Section has not developed a checklist to outline the steps required to initiate, renew and/or terminate a community group lease.

There is no policy containing eligibility criteria that must be met in order to qualify to rent space from the City at below market rent. Upon amalgamation, the City inherited a number of community leases approved by former municipalities. The City does not have any mechanism to ensure that a tenant's activities remain consistent with City objectives and Council priorities.

Moreover, community groups differ in their financial capacity to pay rent. The Leasing Section does not perform any financial assessment on community groups that are interested in renting City space. Some groups receive a subsidy from the City and requesting a higher rent amount would result in the group requiring a larger subsidy. In these instances, the rent amount would be set at a nominal fee. However, other groups may have sources of revenue that would enable them to pay for utilities, operating costs or even a percentage of the fair market value rate. In order to determine this, the Leasing Section needs to perform a financial assessment of community groups applying for below market rent.

The goal of leasing to community groups is to provide space to organizations that help the City achieve its goals and complements the City's mandated programs and services. Leasing to community groups should be done in accordance with City priority. However, the City has no process in place to assess and identify gaps in services where below market value community leases would most benefit its residents.

While CREO reports to FEDCO on all lease transactions, including new community leases, they are not advised of the subsidy amounts for below market rent leases. The Leasing Section does not track nor report the opportunity cost of providing City space to community groups at a discount.

**Recommendation #14**

That management develop specific and measurable eligibility criteria to assess applicant community groups. A financial assessment should also be conducted for all groups interested in entering into a community lease. Evidence of completion of the eligibility review and financial assessment should be retained in the lease file.

**Management response:**

Management agrees with this recommendation.

Management will develop specific and measurable eligibility criteria to assess applicant community groups by Q4 2019.

The requirement for financial assessment and evidence of completion of the eligibility review, will be incorporated in the City-wide Leasing Policy to be completed by Q4 2019 as part of CREO's comprehensive policy and procedure development.

**Recommendation #15**

That management establish priorities for providing below market rent space to community groups.

**Management response:**

Management agrees with this recommendation.

Management will establish priorities for providing below market rent space to community groups by Q4 2019 as part of CREO's comprehensive policy and procedure development. Such criteria will be presented to Council for approval.

**Overhold leases are inadequately monitored and rental rates are rarely renegotiated**

Typically, a tenant has no right to remain on the premises after the end of the lease term as per the lease agreement. However, if the tenant remains in possession of the premises after the end of the term with the consent of the landlord but without entering into a new lease, the tenant is deemed to be occupying the premises on a month-to-month basis under the same terms. This situation is called an overhold lease.

The Leasing Section was unable to generate a report from SAP that identifies the lease agreements that are expired and on overhold. Staff manually identified 27 leases on overhold. We could not verify the completeness and accuracy of the listing provided.

Management does not collect data or review statistics on overhold leases (ex. number, length of time, reason for overhold, rental rate renegotiation). According to the list provided, the average length of time the leases have been on overhold was over 32 months. By default, each of the expired leases is extended under the same terms and conditions of the original lease and tenants continue to pay the same rent. The lack of timely termination or renewal of leases has the potential to cost the City additional rental revenue.

The Leasing Section uses either a short form or long form lease template for commercial leases. While the long form template has a standard overholding clause, the short form template does not. The overholding clause in the long form stipulates that the "monthly rent during the overholding period should be 150 per cent of the monthly amount payable during the last month of the term". Our audit reviewed various commercial lease files and only saw this clause in one lease agreement. It appears that most commercial leases use the short form template that does not contain the overholding clause. The CREO Handbook provides no procedures on how overhold leases are to be administered and which commercial lease template is to be used.

In order to assess the rationale for leases to continue on overhold, the length of time leases continue on overhold and whether rental rates are renegotiated during this period, we examined five overhold lease files. It was noted that all five leases had some rationale that required the lease to continue on overhold. Four out of five overhold leases did not have their rent rates renegotiated during the overholding period. The remaining one had a clause in the original lease that stipulated the rent increase if the lease went into overholding.

Three out of the five sampled overhold leases did not have any documentation in the file for over eight years. In addition, files are often reassigned to different REAs that do not have a complete history of the lease and do not understand what is to be done going forward. Two out of the five sampled lease files have both been on overhold for 189 months (i.e. 15.75 years). Our examination of the lease files also concluded that no Program Manager review or approval is required prior to continuing a lease on overhold.

**Recommendation #16**

That management develop procedures to be included in an updated CREO Handbook that requires rental rates to be renegotiated during overholding periods. Program Manager's review and approval should also be required prior to allowing a lease to continue on overhold and for subsequent years while the lease continues on overhold.

**Management response:**

Management agrees with this recommendation.

Detailed procedures that require rental rates to be renegotiated during overholding periods will be updated in the CREO Handbook by Q4 2019 as part of comprehensive policy and procedure development.

The Program Manager's review and approval will be confirmed by email and/or other formal correspondence, which will be retained in the file as Official Business Records.

**Recommendation #17**

That management consider having an overholding clause in both the long form and short form commercial lease agreement template. If the clause is waived, the exception should be documented in the file and sign-off must be provided by the appropriate level of approval.

**Management response:**

Management agrees with this recommendation.

In consultation with Legal Services, management will consider having an overholding clause in both the long form and short form commercial lease agreement template. If the clause is waived, the exception will be documented in the file and sign-off will be provided by the appropriate level of approval. This will be completed by Q2 2019.

The process of documenting the waived clauses will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**Recommendation #18**

That REAs renegotiate new leases in a timely manner when it has been determined that a formal lease with the tenant will continue or resume.

**Management response:**

Management agrees with this recommendation and it has been implemented.

As a business practice, lease renewal activities are prioritized based on potential revenue generated. REAs have been directed to renegotiate new leases as per the Recommendation and with the support of other City departments, as required.

**Sample overhold lease file: City property being used as farmland**

One particular commercial lease in overhold aptly demonstrates the findings described above. In 1991, the City of Ottawa purchased 194 acres of land from the National Capital Commission (NCC) for \$250,000 with the intention of using the property as a future snow dump.

In 1990, the NCC was leasing 92 acres of the land to a farmer for \$237 per month. In 1992, after taking ownership of the land, the Regional Municipality of Ottawa-Carleton signed a lease for the same 92 acres for \$158.33 per month. It is unclear as to why staff decided to charge a lower rent than what the tenant was previously paying the NCC. In 1993, a new lease was signed that brought the rent up to \$170 per month. In 2001, another lease was signed with the rent continuing at \$170 per month. The lease expired on March 31, 2003 and has been on overhold ever since.

Upon review of the file, the audit team found that no effort was made to renegotiate the rent rate over a 20-year period. In fact, the monthly rent charged over the last 20 years is less than the rent charged by the NCC in 1990. There is evidence in the file that an REA attempted to determine a fair market value per acre rate for the property. However, rental rate renegotiation was never pursued with the tenant. Based on the fair market value estimates found in the file, over the last 20 years, the City lost an estimated amount of between \$30,000 to \$180,000 of lease revenue.

The City could have attempted to renegotiate the rate with the farmer. There is a risk that the farmer could not have accepted the proposed increase, at which point the City could re-evaluate its use and or ownership of the property.

Moreover, the tenant stopped paying the City as of February 28, 2017 despite continuing to occupy and utilize the land. The Leasing Section was unaware that payments from the tenant had ceased until it was identified during the course of our audit. Upon investigation, the missing lease payments amounting to \$3,230 was caused by a temporary staff not following a manual control in the billing process. This is described in detail later in the report.

### **Recommendation #19**

That management renegotiate the farmland lease based on current fair market value research and endeavour to recoup the missed lease payments since March 1, 2017.

#### **Management response:**

Management agrees with this recommendation.

Commencement of negotiations with regard to the farmland lease will begin, as per the Recommendation, by Q2 2019.

#### **Lease expiration process could not be examined**

The audit team was unable to examine the lease renewal process because the Leasing Section was unable to provide a list of properties that had been renewed during 2016 and 2017. As detailed in the scope limitations section, SAP is unable to generate reports that identify leases that have been renewed. Once a lease is renewed in SAP, it cannot be identified as a renewal. Staff were only able to provide a list of leases that had a rental start date in 2016 and 2017, but were unable to differentiate between new leases and lease renewals without a manual review of the lease files.

Similarly, due to limitations with SAP reports, Leasing Section staff were unable to generate a complete and accurate list of leases that expired in 2016 and 2017. Once a lease expired, it was no longer an easily identifiable item in SAP. CREO staff must work with ITS, and manually manipulate the SAP reports to create a listing. Due to the manual manipulation of the underlying SAP data, the OAG was unable to obtain a complete and accurate list of expired leases; therefore, a report of expired leases could not be assessed.

The audit team was informed that the Leasing Section has a process that identifies leases that are expiring in the following 12 months, then assigns them to the REAs. The REA is responsible for contacting the client group, and the tenant to determine if they would like to renew the lease and continue the negotiation process. The audit team was informed that none of the documents surrounding this process were retained in 2016 and 2017; and therefore, it could not be examined.

This process lacks a follow-up mechanism to confirm that all expiring leases identified are followed up in a timely manner. Given the inability for SAP to maintain a listing of expired lease agreements, there is a risk that the tenant could continue to occupy the property beyond the original lease term; and the City will lose revenue.

**Sample lease expiry file**

One particular lease file demonstrates the risk identified above. In February 2007, the City entered into a lease agreement with a private company to lease land to be used as a private parking lot. The lease had a five-year term, expiring in June 2012, with three renewal periods of five years each. The lease includes the specification that “Options to renew shall be exercised not later than three months prior to the expiration of the license”.

The lease expired on June 30, 2012. The file for this lease does not indicate that it was ever flagged for an upcoming expiration and subsequent renegotiation. In February 2013, emails show that staff had met with the tenant in January 2013 and that the tenant wished to renew the agreement. The REO identified that the tenant had not been invoiced for 2012 and that the last payment received was on July 1, 2011 for the final year of the original lease. The expired file was reassigned to a new REA in May 2015. A subsequent lease was signed with the same tenant in January 2016. The audit team confirmed that during the 42 months from when the original lease expired to the signing of the second lease, no payments were collected. Internal documentation confirmed that CREO was aware that the tenant “...did not exercise their renewal option, stopped paying rent, and continued to occupy the lands”. During those 42 months, the tenant continued to occupy the property, and the City did not collect any rental revenue. The City lost between \$37,000 to \$51,000.

**Recommendation #20**

That management set out the procedures that must be followed prior to lease expiry to ensure that the City does not lose revenue.

**Management response:**

Management agrees with this recommendation.

Management will set out the procedures that must be followed prior to lease expiry by Q4 2019 as part of CREO’s comprehensive policy and procedure development.

### **Outdated generic cost per square foot**

In 2013, the City of Ottawa conducted a study to determine the generic average operating cost per square foot for City property. The result of this study identified that the average cost is approximately \$10 per square foot. The audit team was informed that for all leases, the Leasing Section attempts to set the rent at the current market value of the property. However, when market value is not determinable or when leasing to community groups at below market value rates, the Leasing Section will look to cover the operating costs of the space at a minimum.

Many leased spaces are separately metered, so the operating costs of that space can be reliably determined based on actual costs incurred over prior periods. When the space is not separately metered (i.e. when the lease space is a subset of a larger building), actual operating costs cannot be determined. In these instances, CREO will utilize the generic cost per square foot from the 2013 study as a minimum rent to ensure costs are being covered.

From the sample lease files examined, the audit team did not identify any instances where the generic cost per square foot was the basis of the rent charged. Through discussion with Leasing Section staff, we understood that the rate is still being utilized on current leases. Without an updated study to determine the average cost per square foot, the City is likely incurring costs above the previously appropriate generic \$10 per square foot rate.

### **Recommendation #21**

That management update the 2013 study to determine the current operating costs per square foot at City properties. When appropriate, the cost per square foot should be used as a minimum rent to ensure costs are being covered.

### **Management response:**

Management agrees with this recommendation.

In partnership with Recreation, Cultural and Facility Services, CREO will coordinate an update of the 2013 study to current rates. It is expected that these updated rates will accurately reflect current operating costs in facilities. When appropriate, the cost per square foot will be used as a minimum rent as per the Recommendation. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

### **3) Prior to entering into an acquisition lease, the City needs to consider whether there is usable space within the City**

#### **Lack of an inventory of City property that tracks vacancies**

In 2017, the City spent \$25.2 million on acquisition leases. In order to avoid unnecessary spending and maximize the use of City property, it is important for CREO's Leasing Section to verify that there is no available space within the City prior to looking externally for an acquisition lease.

While CREO does keep an inventory of City-owned assets in SAP, the REA responsible for maintaining the listing indicated that it is not complete. Also, this inventory of City land and property does not track whether assets are occupied or have vacancies.

#### **Consultation with the Accommodations Branch**

The acquisition leasing checklist within the CREO Handbook indicates that when entering into an acquisition lease, the REA is to ensure that the "request has been reviewed by the Corporate Asset Management Division to determine whether or not the program can be accommodated within City-owned space." The Program Manager clarified that in actual fact, the REA is to inquire with the Accommodations Branch as to whether there is any City-owned space available.

The audit found that there are many instances where the Accommodations Branch is not consulted prior to an acquisition lease because of the specific space requirements needed (e.g. specific location, large square footage). In instances where the Accommodations Branch is consulted (e.g. small administrative space requirement) prior to searching externally for an acquisition lease, the consultation and results are not always documented in the lease file. The inquiry could be a conversation or phone call.

Two acquisition lease files were sampled as part of this audit to determine whether reasonable steps were taken to determine whether there was available space within the City before entering into an acquisition lease.

- One of the sampled acquisition lease was for approximately 3,000 square feet of warehouse space for storing core samples from the Light Rail Transit project. The term was for five years (July 1, 2016 to June 30, 2021), at a cost of approximately \$50,000 per year. The City has the option to renew for one further five-year term. Upon review of the file, we did not see any documented evidence of inquiries with the Accommodations Branch as to whether there was available City space prior to entering into the acquisition lease. However, upon discussion with the REA and

the Section Manager of Accommodations and Planning, though it is not documented, the Accommodations Branch was involved and did inquire of City works yards as to whether there was any space to store these core samples. It was determined that there was no suitable City space because a large facility was required and the samples had to be easily accessible.

Inquiries from the Leasing Section of possible available space within the City are directed to the Section Manager of Accommodations and Planning, who based on her experience, knowledge and understanding of City facilities often determines that there is no available space within the City. Other than the information contained in Archibus<sup>4</sup>, there is no spreadsheet or tracking mechanism used to determine what City property is occupied or vacant at any given time.

In 2017, the Accommodations Branch started electronically documenting the space in the City's four administration buildings. To complete this task, the Archibus software was identified as the best possible technological solution, and therefore was acquired by CREO.

For other City facilities, the Accommodations Branch has CAD (computer-aided design) drawings. However, these drawings may not be up to date because changes made to space are not always communicated to Accommodations. In addition, these drawings do not give any indication as to whether there is any usable space within City facilities.

For several years, the Accommodations Branch has not been able to locate any available City space prior to an acquisition lease. However, on occasion, when a client group approaches the Leasing Section requesting assistance in leasing additional workspace, the Accommodations Branch has worked with the client group to utilize the space they already have instead of leasing additional space.

### **Recommendation #22**

That management ensure there is a complete, accurate and up-to-date listing of City land and property. The listing should be used to keep track of any vacancies. The Accommodations Branch should use this listing to help the Leasing Section identify available space within the City prior to entering into acquisition leases.

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<sup>4</sup> ARCHIBUS is an integrated workplace management system that will allow Accommodations to quickly access a centralized repository of the City's administration buildings (e.g. City Hall, Ben Franklin, etc.). Accommodations has begun inputting data into the system, but does not expect to realize full functionality until early 2019.

**Management response:**

Management agrees with this recommendation.

The Accommodations function was transferred to CREO in 2016 as part of a City-wide reorganization, which has improved the relationship between accommodations and leasing staff; enhancing its role as the corporate landlord. In 2017, the software platform, Archibus, was purchased and is now being implemented to document the use of space in the City's four main administration buildings.

Management will use tools such as SAP and Archibus to establish a complete, accurate and up-to-date listing of City land and property to assist the Accommodations Branch in implementing this Recommendation.

To facilitate training and the establishment of processes for the development and maintenance of such a listing with ITS, this recommendation will be completed by Q4 2019.

**Recommendation #23**

That REAs always document their consultations with the Accommodations Branch as to whether there is any available lease space within the City prior to entering into an acquisition lease.

**Management response:**

Management agrees with this recommendation.

Staff will document all consultations with the Accommodations Branch in staff reports as of Q1 2019. This will be formalized by Q4 2019 as part of comprehensive policy and procedure development.

**4) Corporate Real Estate Office's billing and collection of rental income is not always timely and accurate**

As of July 1, 2018, all of the City's revenue leases are a predetermined set amount that are to be paid periodically, most commonly monthly, throughout the lease term. Prior to this date, during the scope period of the audit, there was only one lease agreement that had a variable rental amount calculated based on the tenant's sales revenue.

### **Sample lease file: Cafeteria within City building**

The audit team reviewed the cafeteria lease file to assess whether the rental income was accurately calculated and collected over the term of the lease.

The lease agreement was signed on June 26, 2014, for a period of three years, with two subsequent extensions of one year each. The cafeteria was approximately 1,878 square feet and located within a City building. Access to the cafeteria is restricted to City employees with access to the building. It was to operate five days per week for a minimum of 52.5 hours per week.

There were two components to the rent to be paid to the City. The annual operating rent was a set amount of \$6,000 per year (i.e. monthly payments of \$500 + HST, payable on the first day of each month). The second component was a rental amount calculated at 3 – 4 per cent of the tenant's net sales. On a quarterly basis, the tenant was to provide audited revenue statements to the City and make payment for the variable rental amount.

Review of the lease file showed that “audited revenue statements” as required by the lease agreement were never requested from the tenant. In place of audited revenue statements, the REA managing the lease file accepted the tenant's GST/HST return as proof for the sales revenue figure. It was incorrectly assumed that since the GST/HST return was submitted to the CRA, there was assurance that the sales revenue figure was accurate. The total sales amount reported on the GST/HST return is a self-reported figure that is not audited.

In early 2018, the tenant expressed interest in extending the lease agreement for another seven years. The delegated authority report prepared by the REA for the amended lease agreement indicated that “under the original contract, the operator was to provide audited revenue statements to the City on a quarterly basis. Over the years, this was problematic with the City having to send constant reminders to the operator to provide the revenue statements and the net sales proceeds.” Despite having never received audited revenue statements and having to send constant reminders to get the sales amount reported on the GST/HST return, the amended agreement was signed and the lease was extended.

There was no documented explanation in the file as to why the lease was not opened up to a Request for Proposal (RFP) once the initial 2014 contract expired. Upon discussion with the REA, we were informed that in 2014, the original submission request only resulted in three submissions in which only two met the basic requirements

of the submission criteria. Based on the lack of interest in the original RFP and the satisfactory services provided by the tenant, staff extended the lease with the existing vendor. However, the lack of interest in 2014 may not be indicative of present market conditions in 2018. Also, given the lack of cooperation from the tenant in providing timely revenue statements, the Leasing Section should have explored other options prior to extending the lease.

Furthermore, according to the GST/HST returns for 2016, the tenant earned \$156,875 in total sales revenues, or \$650 per day (\$169,379 in 2017). These amounts appear to be quite low given that there are significant labour costs (four staff at 52.5 hours per week), supplies costs and other expenses with running a cafeteria.

In addition, the reported revenues are significantly lower than what the tenant expected on their proposal, where they estimated an annual revenue for 2017 of \$282,000.

Despite this, in early 2018, the tenant requested a lease extension of seven additional years. Staff have never questioned the low revenues reported by the tenant. The extension was granted and the rent as of July 1, 2018 was changed to a flat amount of \$1,000 + HST/month with annual increases of 0.5 per cent. This rent was calculated based on the historical sales revenue claims made by the tenant.

The lease file did show evidence that the REA inquired as to the amount of rent paid by a comparable cafeteria on City property that is open to the public.

It was noted that another cafeteria measuring 1,303 square feet located within a City building was paying \$4,755 per month.

This is significantly more than the approximately \$1,000 per month paid by the tenant. The two City buildings in which the cafeterias are located service a similar amount of City employees. There was no evidence in the lease file as to why the significantly lower rent was justified. Upon examination of the collection of rental income, the audit found that the percentage of sales revenue rent payment was often paid late. Payment was not made for many months and even up to over a year after the quarter ended. This is in violation of the lease agreement where it stipulates that "payment by the Operator for percentage of net sales to the City is due, and is to be remitted to the City by the Operator, on a quarterly basis (together with the Operator's audited revenue statements)". The table below shows when payment was received by the City for the corresponding rental period.

Table 5: Date payment received by cafeteria lease tenant

<b>Rental period</b>	<b>Amount</b>	<b>Payment received date</b>
October 1, 2015 – June 30, 2016 (three quarters)	\$3,660.50	November 2016
July 1, 2016 – December 31, 2016 (two quarters)	\$2,275.15	July 2017
January 1, 2017 – September 31, 2017 (three quarters)	\$3,748.68	February 2018
October 1, 2017 – December 31, 2017 (one quarter)	\$1,332.70	April 2018

Discussion with the Revenue Financial Specialist responsible for billing lease tenants clarified that the tenant is only obligated to pay once they receive an invoice from the City. The invoice was often issued late, but paid promptly by the tenant when received. However, the delay in the issuance of the invoice was caused by the tenant’s delay in providing proof of their sales revenue figure for the quarter. The REA assigned to the file failed to follow-up in a timely manner with the tenant when the sales revenue figure was not provided. This resulted in the significant delay in the issuance of the invoice and the ultimate collection of the rental payment.

The lease agreement also indicates that if the account is overdue, the tenant will be charged an annual compounded interest rate of 16.08 per cent by the City on all overdue amounts. No interest penalty has ever been levied by the City on the tenant.

This file shows that REAs are not actively monitoring their ongoing lease files. It appears that there was a one-year delay in noticing that the tenant had not paid for the previous year’s percentage of sales revenue rent. For instance, in 2017, the tenant did not provide the City with any GST/HST return summaries as proof of its sales revenue figure. It was not until the REA made a request in April 2018, that the return summaries were provided.

The 2014 lease agreement required a certificate of insurance be provided to the City prior to entering the lease for the cafeteria and that upon any renewals. The lease file does not contain any insurance certificate upon the signing of the original lease (covering July 14, 2014 – June 30, 2017) and upon the first renewal (July 1, 2017 – June 31, 2018). However, there was evidence of an insurance certificate covering the period from July 13, 2018 to July 13, 2019.

### **Recommendation #24**

That the Leasing Section ensure tenants are in compliance with the terms of their lease agreements (payment terms, requirements to provide documents, proof of insurance, etc.).

#### **Management response:**

Management agrees with this recommendation.

As part of CREO's comprehensive policy and procedure development, management will develop detailed procedures to ensure compliance as outlined in the Recommendation. This will be completed by Q4 2019.

#### **Manual control in the billing process is prone to error**

Every month, the REO runs the Revenue Rent Roll Comparison Report in SAP. The REO uses this report to determine which lease agreements have expired in the month or are expiring in the near future. The REO is to manually identify the leases that expired in the month and contact the REA assigned to the lease file for direction as to whether to continue, renew or terminate the lease. If these leases are to continue, the REO needs to adjust the lease end date in SAP for it to show up on the Rent Roll report. If the REO fails to notice that the lease is at its expiration date in SAP and does not adjust the end date, the lease will not show up on the Rent Roll report sent to Finance for issuing invoices to tenants. This error will not be caught in the future, as the lease will not show up on the following month's Revenue Rent Roll Comparison Report. The Revenue Finance Specialist receives the monthly Rent Roll report, produces invoices and sends them to the tenants.

The REO normally responsible for the billing process is experienced and is following the established procedures. However, in 2017, the manual process of identifying the expired or soon-to-expire contracts and checking with the REA on whether to renew or terminate was not always followed by alternate staff. This resulted in the missed payments found during the file review of an overhold lease. It is important to ensure that other employees acting in the role are trained and understand how to complete the billing process to ensure that no billings are missed.

The overhold lease's expiry date in SAP was set to February 28, 2017. When the temporary REO ran the Revenue Rent Roll Comparison Report for February 2017, she did not notice that the lease had expired. The temporary REO was supposed to contact the REA for direction as to whether the lease should be renewed in SAP. In this case,

because the expiry date was not changed in SAP, it got dropped off the monthly rent roll. No invoice has been issued to the tenant since February 2017, and no rent has been collected even though the tenant continues to use City property. Up until September 30, 2018, the City has lost out on \$3,230 of lease revenues.

### **Recommendation #25**

That management ensure that training is provided on how to complete the billing process. A secondary review of the manual procedures involved in the billing process should also be considered.

### **Management response:**

Management agrees with this recommendation.

With the support of ITS, management will ensure that training is provided to relevant staff on how to complete the billing process. As part of this process, a secondary review of the manual procedures involved in the billing process will be considered and potentially formalized. This will be completed by Q3 2019.

### **Draft collection process is being followed**

The Leasing Section's collection process is currently in draft state. The process was changed in June 2018 to place more of the responsibility of collecting rent in arrears on Collections rather than CREO. However, collection decisions are still done at the direction of CREO's REAs.

The draft collection process in place as of June 2018 is as follows:

- On a monthly basis, Collections sends a list of past due accounts to CREO's REO;
- The REO reviews the list, consults with the respective REAs and indicates to Collections as to whether to proceed or hold off on collection;
- Collections proceeds with either a reminder letter or a follow-up phone call;
- If the invoice remains unpaid, Collections contacts the REA to advise that a demand is required; and
- If a demand is sent and payment is not received by the due date on the letter, Collections will contact CREO and send the Bailiff to deal with the tenant.

Our audit reviewed the list of overdue accounts created by Collections as at June 21, 2018. Based on the sampled accounts, the process described above is being followed.

## **Recommendation #26**

That management finalize the “collection of overdue accounts” process as soon as possible.

### **Management response:**

Management agrees with this recommendation.

As indicated by the auditor, there is currently a ‘collection of overdue accounts’ process in place in the Leasing Section. In consultation with Revenue Services, management will finalize the process by Q2 2019.

### **B) Assessment of whether lease arrangements are in compliance with City policies and other legislative requirements**

#### **1) Lease arrangements are not consistently in compliance with the Ontario Municipal Act**

The leasing of municipal property is guided by Provincial legislation (Ontario Municipal Act, Commercial Tenancies Act) and by the City’s official plan and policies. The Commercial Tenancies Act outlines the relationship, rights and obligations between commercial landlords and tenants. The Leasing Section is in compliance with this Act.

The Ontario Municipal Act, section 106 states that the municipality shall not assist industrial or commercial enterprises by leasing or selling any property of the municipality at below fair market value. Our examination of commercial lease files found very little, if any documentation supporting the rental rates determined by the REAs. In most files that we reviewed, there is no indication that rates charged to tenants are at or above the fair market value. We would have expected to see evidence of research done for comparable properties and consultation with CREO’s Valuations Unit.

Our review of lease files found two out of four sampled new commercial leases had no evidence of market research to determine rental rates. Of the commercial overhold leases sampled, three out of four did not have their rent rates renegotiated during the overholding period and are likely not representative of current market rates.

One sampled lease with a calculated rental amount had no justification that the rental rate was representative of the fair market value. The audit results show that rental rates charged by the Leasing Section may be below the fair market value and that the City may not be in compliance with the Ontario Municipal Act.

### **Recommendation #27**

That management develop detailed procedures to guide REAs on how to determine, support and document a fair market value rental rate for every new commercial lease and commercial lease renewal to ensure compliance with the Ontario Municipal Act.

### **Management response:**

Management agrees with this recommendation.

As is longstanding practice, CREO will continue to leverage the expertise of its Valuations Unit and the accredited appraisers in that unit to conduct market value assessments for the Leasing Unit.

Management will develop detailed procedures to complete the requirements of the Recommendation by Q4 2019 as part of CREO's comprehensive policy and procedure development.

### **Property taxes**

During the course of the audit, OAG staff became aware of one lease that is not in compliance with the Assessment Act with respect to property taxes and one Services Contract with a rental component for tenancy.

According to the Assessment Act, all real property in Ontario is liable to assessment and taxation, subject to a number of specific exemptions. One such exemption is any land owned by a municipality is exempt from the property tax liability. However, the municipal land is not exempt if occupied by a tenant who would be taxable if the tenant owned the land. Therefore, the majority of tenants occupying municipal land should be paying property tax on its leased or rented space. As the landlord, the City is required to contact the Municipal Property Assessment Corporation (MPAC) to alert them that a tenant is occupying a space that needs to be assessed.

### **Sample lease file: Cafeteria within City building (1500 St Laurent)**

In July 2014, the City entered into an agreement with the tenant to act as an operator for a cafeteria within the City building. While reviewing the contract, the OAG identified a clause that specifies, "The Operator shall pay all applicable property taxes including, without limitation, realty taxes, if any, levied on the Kitchen Area." The OAG looked up the property tax records for the address and was unable to find any property tax payments since the inception of the lease in 2014.

The OAG contacted CREO to determine if any property taxes have been paid at this location for the kitchen area. CREO confirmed that no property taxes are being paid on the leased portion of this property. CREO noted that if MPAC does assess the kitchen area, staff will make arrangements to collect property taxes at that time.

**Sample lease file: City property being used as farmland (5441 Hawthorne Road)**

On August 21, 1991, the City of Ottawa purchased a 194-acre land from the National Capital Commission (NCC) with the intention of using the area to dump snow in the future. At the time of purchase, the NCC was leasing 92 acres of the land to a tenant who was using the property for farmland.

The OAG was unable to confirm if any property taxes have ever been paid on this property since the City purchased it from the NCC. The OAG can confirm that no property taxes have been paid since amalgamation in 2001.

**Recommendation #28**

That CREO notify MPAC about the tenants at 5441 Hawthorne Road. Once the assessment is complete, CREO should begin collecting property taxes to maintain compliance with the Assessment Act.

That CREO seek a legal opinion with the City Solicitor's Office on the matter of property tax collection and the *Services Contract with a rental component for tenancy*.

**Management response:**

Management agrees with this recommendation.

CREO will notify MPAC about the tenants at 5441 Hawthorne Road. Following receipt of supplementary assessment information from MPAC, Revenue Services will begin billing and collecting any property taxes owing.

In Q2 2019, CREO will seek a legal opinion with the City Solicitor's Office on the matter of property tax collection and the *Services Contract with a rental component for tenancy*, and from that opinion, determine next steps, as appropriate.

**Recommendation #29**

That CREO update the Handbook to include alerting MPAC to new commercial tenants when applicable and provide training to relevant staff who will be responsible for negotiating and executing leases where property tax may be a factor.

**Management response:**

Management agrees with this recommendation.

As per management's response to Recommendation 2, detailed procedures as outlined in the Recommendation will be updated in the CREO Handbook by Q4 2019.

Senior CREO staff will provide training by Q2 2019 to relevant staff who will be responsible for negotiating and executing leases where property tax may be a factor. To support timely operations, the practice of notification to MPAC will commence by Q3 2019 for new leases.

**Recommendation #30**

That CREO review other similar commercial leases to confirm that property tax allocations are in compliance with the Assessment Act.

**Management response:**

Management agrees with this recommendation.

CREO will review active commercial leases to confirm that property tax allocations are in compliance with the Assessment Act, with the support of Revenue Services, as required. As this requires extensive review of all active commercial leases, staff will notify MPAC on an ongoing basis as the review progresses. The full review of commercial leases will be completed by Q3 2020.