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Date: November 4, 2013

To: Audit, Finance & Enterprise Committee

cc: Kari Kent, Deputy City Manager
Beth Huning, City Engineer
Kim Fallbeck, Real Estate Services Administrator

From: Jennifer Ruttman, City Auditor

Subject: Audit Report – Real Estate Leases

Pursuant to the Council-approved Audit Plan, the City Auditor's office has completed an audit of the City's real estate leases. The final report is attached. Please feel free to contact me you have any questions.

AUDIT REPORT

CITY AUDITOR

Report Date:	August 28, 2013
Department:	Engineering / Real Estate Division
Subject:	Real Estate Leases
Lead Auditor:	Bill D'Elia

OBJECTIVE

This audit was conducted to determine whether leases are awarded and administered in compliance with City policies and lease terms.

SCOPE & METHODOLOGY

To accomplish our objective, we:

- Reviewed all active leases of City property as of April 2013, and other relevant documents on file in the Real Estate Division.
- Reviewed and analyzed documents and data maintained by the Accounting Division.
- Interviewed City staff members.
- Performed other tests and procedures as necessary to meet the audit objective.

BACKGROUND

The Real Estate Services Division of the Engineering Department is responsible for managing most leases of commercial and industrial property owned by the City. Exceptions include airport properties, downtown parking lots, and a few others, some of which are managed by the Economic Development Department. At the time of this audit, the Real Estate Division was responsible for managing approximately 76 property leases, including 36 leases for sites used by communications companies for wireless communications towers or similar equipment. Communications leases are carried at market rates and generate revenues totaling approximately \$611K per year. The remaining leases involve properties leased to nonprofits and other agencies/entities with which the City has negotiated terms. These leases produce revenues totaling approximately \$236K per year.

CONCLUSION

In our opinion, the leases managed by the Real Estate Services Division have been awarded and administered in compliance with City policies and lease terms. We found that the Real Estate staff members responsible for managing leases are experienced, proficient, and knowledgeable about all aspects of the leasing process. In addition, comprehensive policies and procedures are in place to help ensure the process will continue to operate effectively in the future. Therefore, although we are recommending a few minor process improvements and policy changes, no formal corrective action plans are needed. A summary of our observations and recommendations is included below.

SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

Observation #1

Departmental policy requires Real Estate Services staff to inspect each leased property at least once per year to review its physical condition. We noted that inspections of some leased properties were not performed or were not documented. However, in most cases, reasonable alternative measures were taken by staff to ensure the properties were being adequately maintained.

Recommendations:

- 1-1. We recommend that management consider revising the departmental policy regarding inspections of leased property, to allow for more flexibility and judgment to be used in determining the required frequency of inspections for each leased property.
- 1-2. We recommend that when an inspection is performed, the date, the inspector's name, and the results should be documented in the lease file.

Observation #2

We found that some Management Policy requirements applicable to leases are outdated and no longer reflect stakeholders' expectations. Examples of this include:

- Management Policy 208 – Lease, Exchange, Sale or Trade of Land and Land Rights, states that "The negotiated sale or lease of land or land rights must have the prior written consent of the City Manager." We found that departments have not always complied with this requirement.
- Management Policy 119 – Records Management Policy for Intergovernmental Agreements, Development Agreements and Real Property Leases, states that "Real Estate Services will maintain a secure, electronic inventory database of the City's intergovernmental agreements, development agreements and real property leases." We found that real property leases have not been stored in this manner.

Based on a review of actual stakeholders' expectations, our recommendation is focused on policy revision, rather than on compliance.


Recommendations:


- 2-1. We recommend that the City Manager revise Management Policy 208 (including its appendix) to establish completely new guidelines and procedures for leasing real property.
- 2-2. We recommend that the City Manager revise Management Policy 119 to exclude real property leases from its requirements.



DATE: September 9, 2013

To: Jennifer Ruttman, City Auditor
Bill D'Elia, Senior Internal Auditor

THROUGH: Karolyn Kent, Deputy City Manager 

FROM: Elizabeth Huning, City Engineer 

SUBJECT: Engineering Department Response to the Audit Report dated August 28th, 2013 on Real Estate Leases.

This report is in response to the Real Estate Leases Audit Report forwarded to the Engineering Department/Real Estate Services by the City Auditors Office. This group strives to ensure that the Real Property Leases are executed and administered in compliance with City policies and procedures. We appreciate the assistance and feedback from the City Auditor's Office and welcome any recommendations for improvement to our procedures. The following summarizes this audit and our response.

Observation #1: Departmental policy requires staff to inspect each property at least once per year to review and document the physical condition.

Response: The Engineering Department/Real Estate Services staff will revise the departmental policy regarding inspections of properties. The policy will focus on allowing more flexibility and judgment when properties require inspections. The policy will include a tracking log to document the date in which the inspection occurred, inspectors name and the results of the inspection. The tracking log will be maintained and kept in the lease file(s).

Observation #2: Management Policies applicable to leases are outdated and no longer reflect stakeholder's expectations.

Response: The Engineering Department/Real Estate Services staff has formed a team to coordinate efforts with the City Manager's Office so that a review and coordination of revisions is completed on both Management Policy 208 and Management Policy 119. It is anticipated that suggested revisions will be submitted to the City Manager's Office within a 60 day period.

