A Report
to the
Board of
Supervisors

County Real Estate Leases

*Improvements are Needed in
Financial Data and
Management Strategy*

January ■ 2008

*Maricopa County
Internal Audit
Department*

Ross L. Tate
County Auditor

The mission of Maricopa County is to provide regional leadership and fiscally responsible, necessary public services so that residents can enjoy living in a healthy and safe community.

The mission of the Internal Audit Department is to provide objective, accurate, and meaningful information about County operations so the Board of Supervisors can make informed decisions to better serve County citizens.

The County Auditor reports directly to the Maricopa County Board of Supervisors, with an advisory reporting relationship to the Citizen's Audit Advisory Committee.

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January 31, 2008

Andrew Kunasek, Chairman, Board of Supervisors
Fulton Brock, Supervisor, District I
Don Stapley, Supervisor, District II
Max W. Wilson, Supervisor, District IV
Mary Rose Wilcox, Supervisor, District V

We have completed our FY 2007-08 review of County real estate leases in accordance with our annual audit plan. We selected specific areas to review through a systematic, risk-assessment process. Overall, we found that improvements can be made within the County's real estate lease processes.

Highlights of this report include the following:

- Real estate lease data could be improved
- Current controls do not always ensure compliance with County policy
- Best practice leasing strategy requires advanced tools and data

We reviewed information in this report with the Department of Finance Real Estate Division, the Facilities Management Department, and associated department directors. We appreciate the excellent cooperation provided by all departments. If you have any questions, or wish to discuss the information presented in this report, please contact Eve Murillo at 506-7245.

Sincerely,

Ross L. Tate

Ross L. Tate
County Auditor

Executive Summary

Issue 1 Real Estate Lease Data Could Be Improved (Page 7)

The Department of Finance Real Estate Services could improve real estate lease management by consistently defining, recording, and tracking all real estate lease transactions. When real estate lease information is not accurately recorded, management does not have appropriate information to make informed and fiscally responsible decisions. The Department of Finance should improve its real estate lease processes.

Issue 2 Current Controls Do Not Always Ensure Policy Compliance (Page 10)

As an advisor to the Board of Supervisors, the Facilities Review Committee (FRC) is charged with review and recommendation for all real estate transactions that reach the Board of Supervisors' agenda. Of 40 leases the auditors selected for review, seven (18%) were not reviewed by the FRC before submission to the Board of Supervisors. In a separate test, 14 out of 20 (70%) selected leases had been reviewed by the FRC, but did not fully comply with County real estate lease policies. When FRC reviews are not complete and fully documented, County leadership cannot be assured that space requirements are consistently met and that County standards are maintained. Facilities Review Committee lease review and documentation procedures should be strengthened.

Issue 3 Best Practice Leasing Strategy Requires Advanced Tools (Page 15)

Developing and communicating a formal County strategy for real estate investment is a key, high-level control for safeguarding resources. The County does not have a documented real estate leasing strategy that is formally communicated to County decision makers. The County Manager's Office should consider coordinating responsible agencies to provide the necessary information and data that will assist County Management in real estate decision making and support the County's Capital Improvement process.

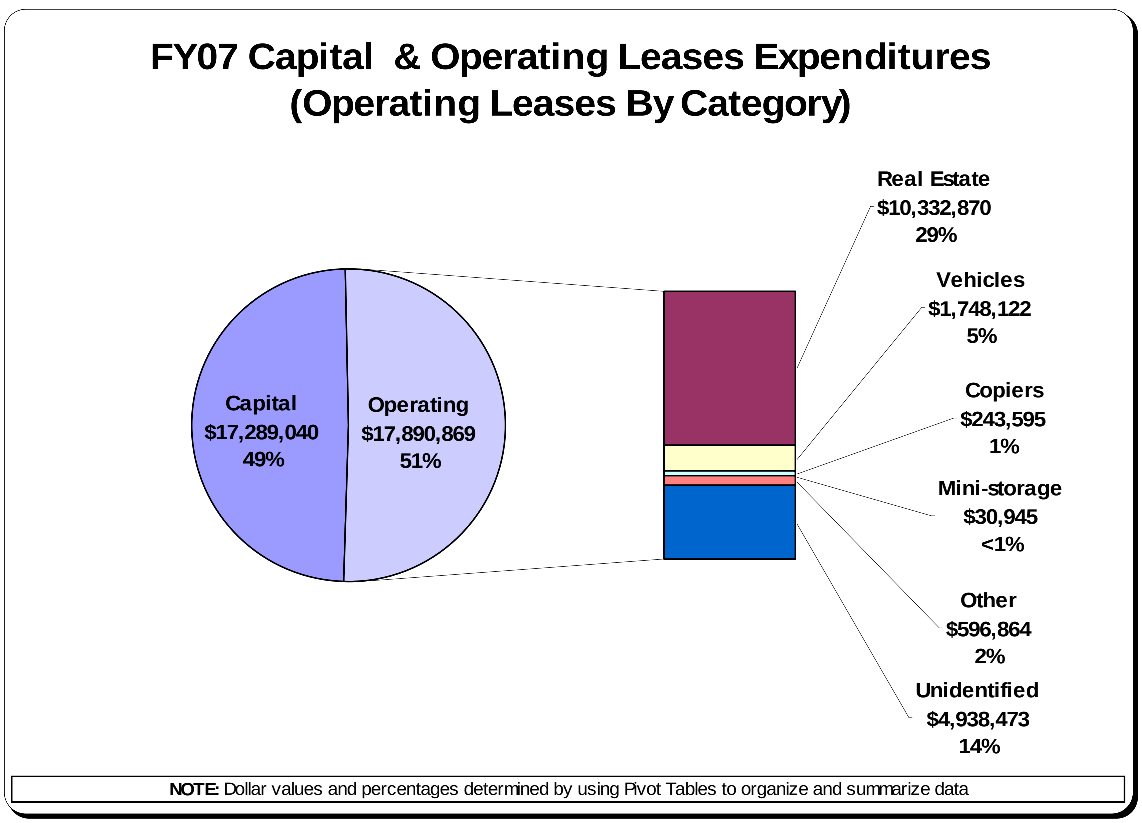
Introduction

Background

County leases are divided into two general categories: capital and operating. Capital leases include information technology equipment, other large office equipment, and heavy machinery. Assets financed in this manner are usually owned by the County at the end of the lease. Operating leases include rented real estate, rented vehicles, and rented storage space. Ownership is not transferred with this type of lease.

Management reports that prior to implementing County policy A1920 in 1999 no effective, centralized real estate leasing controls existed. Policy A1920 established the Facilities Review Committee (FRC). These actions and the establishment of a Real Estate Services function have resulted in improved oversight.

County fiscal year (FY) 2007 lease expenditures totaled approximately $35 million, of which $17.9 million was for operating leases**.** Real estate accounts for the largest share of operating leases at about $10.3 million, and also represents the single largest lease expenditure, capital or operating.



Source: IA analysis of Advantage 2.0 data. "Unidentified amounts" lacked transaction-specific detail that would identify the lease and verify the operating lease category.

Organizational Responsibility for County Real Estate Leases

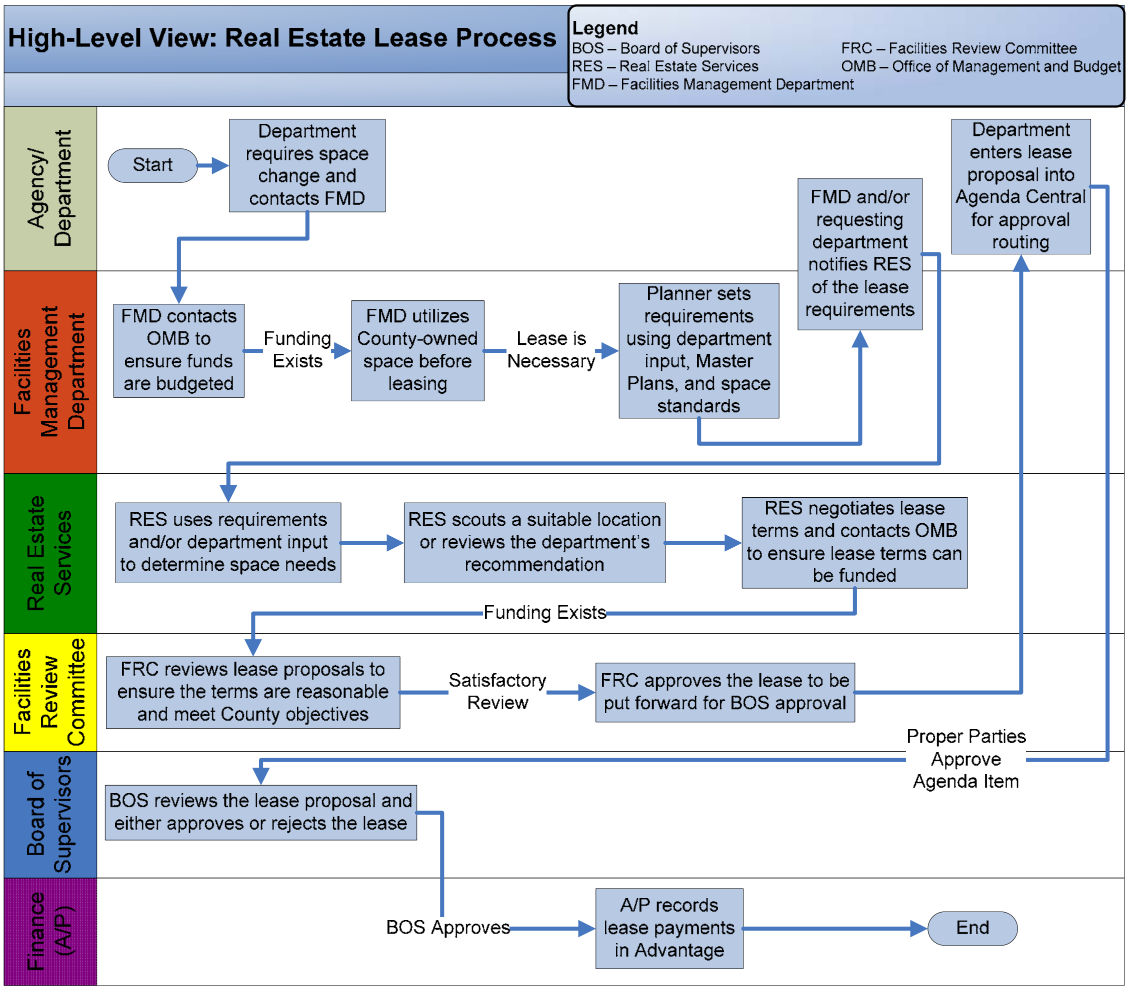
According to the Real Estate Manager, the Real Estate Services (RES) group within the Department of Finance (DOF) should represent the County in locating required real estate lease space and negotiating real estate lease transactions. A process of determining whether or not leased space is needed has been defined.

First, a department considering a real estate transaction should contact the Facilities Management Department (FMD) to see if County space exists to fill the need. If adequate space is not available, FMD reviews the department's Facilities Master Plan then works with the department to create or update the department's Space Program. The department then contacts RES, who reviews the Space Program and any related business case or requirements presented by the department. Using an estimated lease cost, RES checks with either the Office of Management and Budget (OMB) or the department's budget representative to ensure funds exist to cover the lease terms.

Once the necessary budget is confirmed, RES negotiates the terms of the lease contract. The FRC receives the details of the proposed transaction. Once the FRC has given its endorsement of the proposed lease, the proposed lease transaction goes before the Board of Supervisors for approval. RES maintains a copy of the lease agreement and pertinent documents in its lease files. RES also places a scanned copy of the lease agreements in its electronic files.

RES maintains a real estate database for leases that are processed through its offices. DOF also relies on the Clerk of the Board of Supervisors to alert RES of any Agenda Items presented for approval that could include real estate transactions. The Clerk of the Board (COB) reviews Agenda Items and adds RES as an approver for items related to real estate. OMB reviews departmental budgets and investigates unapproved purchases.

Thus, the Board of Supervisors, department leadership, FMD, RES, and FRC each have responsibilities for the analysis, approval, recording, and budgeting of County real estate leases. The graph below shows how each stakeholder works with the others.



Source: Interviews conducted by Internal Audit

The RES function operated within the Facilities Management Department until 2002 when it was moved to DOF. Several County units are responsible for maintaining financial or operating information about real estate leases.

- The DOF Accounts Payable unit records real estate lease expenditures against maximum annual contracted costs. Expenditures that exceed approved limits require additional approval.
- Each department with real estate leases records transactions in the County financial system.
- RES tracks key lease elements including total annual rent, rent per square foot, and expiration dates.

County Real Estate Policy

In 1999, County leadership recognized the need for strategic real estate planning by issuing Policy A1920—Facilities Capital Improvement Program. The policy states that "The efficient management of current space and planning future physical facilities is necessary to meet the County's future service requirements."

County Policy A1920 requires that:

- FRC shall review real estate leases prior to the Board of Supervisors
- Real estate leases cannot be negotiated for terms exceeding five years
- Real estate leases cannot be renewed for more than an additional five years
- Total annual leasing expenditures including tax, insurance, and maintenance may not exceed fair rental value
- All County real estate leases must conform to the County space guidelines
- Funds must be available

Facility Master Plans (guiding principles for long term space requirements) have been required since the beginning of this policy (1999). According to the Facilities Management Department (FMD), County agencies funded their own master plans. In FY 2005, centralized funding became available, and FMD began using consultants to develop departmental Facility Master Plans to guide space usage. The Master Plan process is used to forecast an agency's future space needs (usually 10 years of future growth) based on estimated personnel growth, location, type of space, and other key factors so that informed decisions can be made about locating new space. Space planning programs are prepared by FMD and are designed to ensure that the type and amount of space required conform to County space guidelines and the needs of the department. Some of the leases included in this review were prepared without Facility Master Plans.

Scope and Methodology

Audit Objectives

The objectives of this audit were:

- To determine if the County has a strategic plan for real estate (owned and leased space), and whether it is adequately implemented and communicated to decision makers
- To verify that County leased real estate is recorded on the County's financial records accurately and promptly
- To determine how the percentage of owned and leased space has changed over the last five years

Audit Timeframe and Methodology

We reviewed real estate lease activities for FY 2003 through FY 2007, which included approximately 160 real estate leases throughout the County. To analyze how County-owned and leased space has changed over the last five years, we developed a database using information from the RES real estate database, terminated lease files, individual lease documents, and occupancy survey data. To verify data, we independently calculated each lease component such as monthly rent, square footage, and additional charges based on reviews of lease documents and amendments, where they were available.

Auditing Standards

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

Issue 1 Real Estate Leasing Data Could be Improved

Summary

The Department of Finance Real Estate Services could improve real estate lease management by consistently defining, recording, and tracking all real estate lease transactions. When real estate lease information is not accurately recorded, management does not have appropriate information to make informed and fiscally responsible decisions. The Department of Finance should improve its real estate lease processes.

Criteria

Definitions Real estate leases should be accurately and consistently identified in the County's financial and reporting systems in order to provide data users and decision makers useful information with which to make informed and fiscally responsible real estate leasing decisions. However, RES' real estate database does not track all County real estate leases. In part, the RES database is incomplete because RES staff does not consistently define real estate leases when inputting transactions into their lease tracking system.

Although "lease" is not defined in County real estate policies, the RES Manager defines a real estate lease as a written agreement that conveys a leasehold interest in real property from the owner to the tenant for an agreed upon period of time and amount of compensation. The Thomson Gale law encyclopedia states a real estate lease is a contractual agreement by which one party conveys an estate in property to another party, for a limited period, subject to various conditions, in exchange for something of value, but still retains ownership.

Rental Taxes Arizona Revised Statute 42-5069(D) on commercial lease classifications states that the tax base for the commercial lease classification is the gross proceeds of sales or gross income from the business, but reimbursements to the lessor for utility service shall be deducted from the tax.

Condition

RES sometimes includes "special use permit," "license agreement," or "space use agreement," in the real estate data base. Several County agencies using properties owned by outside entities are not identified as leases by RES and thus are not tracked. For example, Human Services Head Start locations are sometimes negotiated as special use permits with an outside agency, such as a school or church. We reviewed eight non-standard agreements (Intergovernmental Agreements, Memoranda of Understanding, and contracts) and found that RES incorrectly categorized five, a 62 percent exception rate. Four of these exceptions were non lease contracts tracked in the real estate database; separate testing showed a different lease not recorded in the real estate database.

RES does not have procedures to require database updates or reconciliation with other databases. We found that the RES real estate database is not:

- Populated with historic data
- Updated consistently for lease amendments
- Tied in or reconciled to actual lease expenditures

Our comparisons between RES records and other County databases show that some RES records may be incomplete or out of date. For example, our comparison of RES records to the FMD Building List showed that nine leased buildings were not tracked by RES. Each of these locations belonged to the Library District, for which RES provided support.

We also compared data from Advantage 2.0 (County finance system) with 10 lease contracts. After accounting for variable expenditures, we found no significant differences between expected contract payments and actual FY 2007 real estate expenditures. DOF records the maximum expenditure amounts for the life of the lease into Advantage 2.0 to guard against expenditures exceeding the contract maximum. DOF relies on County agencies to reconcile contract amounts to actual transactions. We found variable operational costs, such as utilities, CAM (common area maintenance), and janitorial services, are not consistently included in these maximum expenditure calculations entered into Advantage 2.0.

Although we did not find significant variances between expected total contract amounts and actual expenditures, some individual transactions did not conform to the contract terms. For example, one agency was overcharged $2,300 for its share of real estate taxes when compared to the Treasurer's Office data. Also, it appears that at least four of the sampled leases were overcharged a total of more than $3,000 for rental taxes because state statutes allow lessors to deduct lessee utility reimbursements from their state rental tax liability.

Cause

RES does not consistently define, track, and manage real estate lease transactions because:

- The RES real estate database is not currently kept up to date
- RES is not involved early enough in the lease approval process to ensure proper lease negotiation, tracking, and management for all potential lease transactions

County leasing agencies do not consistently monitor lease contract transactions and may not be familiar with applicable tax rules. Rental and real estate tax payments are the responsibility of the lessor. Since there is no overpayment penalty, lessors tend to tax the entire transaction to protect themselves against Department of Revenue audit findings.

Effect

When real estate lease transactions are not accurately recorded in the County's reporting systems, management does not have sufficient information to make informed and fiscally responsible real estate leasing decisions.

Based on our review of sample operating expense detail, we estimate that the County could potentially save several times the $5,000 in identified overcharges by ensuring that

- Rental tax is correctly reduced by all applicable utility reimbursements
- Real estate charges are accurately assessed
- CAM and other operating charges are assessed according to contract terms

According to the RES Manager, future leases will contain more variable expenses as lessors shield themselves from cost unpredictability. Therefore, monitoring these costs will increase potential cost savings over time.

Recommendations

The Department of Finance should:

A. Ensure that key lease elements and historical data in the existing database are complete, accurate, and consistently defined.

B. Periodically encourage County agencies to ensure actual real estate expenditures do not exceed maximum contract totals.

C. Encourage County agencies to research potential cost savings associated with lease contracts that include cost adjustments for CAM, and rental and real estate taxes.

Issue 2 Current Controls Do Not Ensure Compliance with County Policy

Summary

As an advisor to the Board of Supervisors, the Facilities Review Committee (FRC) is charged with review and recommendation for all real estate transactions that reach the Board of Supervisors' agenda. Of 40 leases the auditors selected for review, seven (18%) were not reviewed by the FRC before submission to the Board of Supervisors. In a separate test, 14 out of 20 (70%) selected leases had been reviewed by the FRC, but did not fully comply with County real estate lease policies. When FRC reviews are not complete and fully documented, County leadership cannot be assured that space requirements are consistently met and that County standards are maintained. Facilities Review Committee lease review and documentation procedures should be strengthened.

Criteria

County Policy A1920 (approved in 1999) established the FRC. Although the RES Manager and Acting FMD Director state that Policy A1920 was intended to apply only to Capital Improvement Projects and CIP impacted leases, Section III (Applicability) states that the policy encompasses all County leases. The FMD Acting Director states efforts are under way to amend A1920 to include FRC review for all leases. We applied County Policy A1920 as our testing criteria because (1) the policy states it applies to all leases and (2) leases not related to CIP were regularly brought to the FRC for review.

As the "gatekeeper" for the Board of Supervisors' County facility decisions, FRC is responsible for ensuring compliance with the following County Policy A1920 criteria:

- Original lease terms do not exceed a total of 60 months and renewal options in total do not exceed an additional 60 months
- Total annual rental including tax, insurance, and maintenance does not exceed fair rental value
- Sampled leases conform to the prioritization criteria, cost/benefit analysis and space utilization guidelines as determined by the FRC, funds are confirmed available according to OMB

Condition

The FRC is comprised of County executive management, such as the County Manager, Chief Financial Officer, OMB and FMD management. FRC regularly meets to review real estate transactions such as leases and building projects. We reviewed a sample of 20 real estate leases to determine whether FRC review effectively implements County real estate lease policies. We found that 15 of the leases (75 percent) did not fully comply. The table below summarizes our testing by agency (some agencies had more than one lease selected).

Exception Summary Policy A1920 (Review of 20 Contracts)											
Policy Criteria	**Adult Prob.**	**Assessor**	**Environmental**	**Human Svcs.**	**Justice Cts.**	**Public Defender**	**MCSO**	**Public Health**	**Legal Adv.**	**Parks**	**Totals**
Not Approved by FRC*	-	-	1	2	-	1	-	1	-	-	5
Original Term > 60 Months**	1	1	-	1	1	1	1	-	-	-	6
Renewal > 60 Months	-	-	-	-	-	-	-	-	-	-	-
Rent Exceeded Area Fair Value	-	-	-	-	-	-	-	-	-	-	-
Does Not Fully Document Compliance with FRC Criteria***	-	-	2	2	-	1	-	2	1	1	9
Funding Unavailable	-	-	-	-	-	-	-	-	-	-	-
Totals per Agency	1	1	3	5	1	3	1	3	1	1	20

*The five exceptions noted occurred prior to August 2004.

**RES Manager asserts all contracts exceeding 60 months were negotiated in the best interest of the County and included early termination clauses.

***Prioritization, cost/benefit and space standards as outlined in the Policy.

Source: IA analysis of FRC meeting minutes and leases.

FRC Approval Review

Five of the 20 leases in our first test sample were approved by the Board of Supervisors without first being approved by the FRC. This does not comply with County policy.

We sampled an additional 20 real estate leases from FY 2003 - FY 2007 and found, by reviewing FRC meeting minutes that two leases had not been approved through the FRC. The table below lists each of the two leases that went to the Board for approval without FRC approval.

Leases Submitted to Board Prior to FRC Review

Lease #	Agenda #	Agency	Start Date
L7198	C1104001100	Adult Probation	8/1/2003
L7365	C8505007001	Air Quality--Although RES records show this was submitted, FRC minutes do not reflect review or approval.	3/1/2005

Source: Agenda Central and FRC meeting minutes

Space Program and Master Plans Comparison

FMD prepares space programs that are designed to ensure the type and amount of space required to conform with the County space guidelines and the needs of the department. Space plans are the best way in which the FRC can objectively determine that County guidelines are followed and that proposed space type is adequate. FMD planners prepared a space plan for only one of the leases we reviewed (Environmental Services) prior to its review and approval.

FMD's Facilities Master Plan is used to forecast an agency's future space needs (usually ten years future growth) based on estimated employee growth, location, type of space, and other key factors. Although Master Plans have been part of County policy since 1999, their development is outsourced and only funded at approximately $1.2 million per year.

We reviewed leases for three of the agencies with the largest real estate leases and the greatest increase in growth (Public Health, Environmental Services, and Human Services) during the audit period (FY 2003-FY 2007). Master Plans were not prepared for the time period under review for any of these agencies.

The table below shows whether each agency conformed to key FRC real estate lease planning criteria.

Review Results (# of Leases Conforming / # Reviewed)			
Planning Criteria	**Public Health** (13 Leases Reviewed)*	**Human Services** (4 Leases Reviewed)*	**Environmental** (4 Leases Reviewed)
Conformed with FMD Prepared Master Plan	Master Plans not Prepared During Period Reviewed	Master Plans not Prepared During Period Reviewed	Master Plans not Prepared During Period Reviewed
Conformed With Space Program and Guidelines	0/13 (0%)	0/4 (0%)	1/4 (25%)
Conformed with price/square footage-per lease	13/13 (100%)	4/4 (100%)	4/4 (100%)

*We excluded WIC (Public Health) and Head Start (Human Services) leases from our analysis due to the small number of FTE's and the transient nature of their locations.

Source: IA analysis of FMD space plan, space guide, leases, and published square footage data.

Annual Report Not Provided

County policy requires that FMD submit an annual report to the FRC that includes a summary of all funds expended for real estate lease. FMD has never submitted the required annual report to the FRC since the inception of this requirement in FY 1999 because, according to the Acting FMD Director, obtaining the required data is not feasible given the system limitations.

Cause

Currently, no process exists that communicates to the Board that the FRC has reviewed the real estate leases prior to Board approval. For example, the Clerk of the Board does not include the FRC as part of the pre-agenda approval process for real estate leases. It is possible for departments to bring their leases before the BOS without receiving approval from the FRC.

County policy requires that the FRC review real estate leases prior to Board approval and ensure that leases conform to the County space guidelines. However, County management and the FRC do not have all of the management information needed to support real estate leasing decisions that align with County policy and space guidelines.

Effect

A lack of sufficient, accurate, and readily available real estate lease data prevents the County from effectively analyzing current and future leasing needs. Without reliable data County Management does not have necessary information to make informed decisions that will enable them to craft a well-executed leasing strategy.

Recommendations

The Facilities Management Department should:

- **A.** Strengthen the Facilities Review Committee lease contract review and documentation procedures.
- **B.** Prepare and transmit a financial report to the Facilities Review Committee, as required by Policy A1920, that includes the financial results of all current fiscal year lease transactions.

Issue 3 Best Practice Leasing Strategy Requires Advanced Tools

Summary

Developing and communicating a formal County strategy for real estate investment is a key, high-level control for safeguarding resources. The County does not have a documented real estate leasing strategy that is formally communicated to County decision makers. The County Manager's Office should consider coordinating responsible agencies to provide the necessary information and data that will assist County Management in real estate decision making and support the County's Capital Improvement process.

Criteria

We surveyed ten U.S. entities[1] regarding real estate strategic planning, lease criteria, space standards, lease tracking systems, and lease expenditures. Additionally, we reviewed authoritative literature[2] to identify best practice information and validate our benchmark responses.

Condition

Benchmark entities typically treat real estate leasing as an integral part of capital planning. By contrast, at the County, real estate leasing operates as a semi-autonomous function. Developing and communicating a formal County strategy for real estate investment is a key high-level control for the safeguarding of resources[3]. Currently, a review and approval process is in place for real estate proposals. Department leadership at FMD, RES, and FRC provide different layers of analysis and review, but there is no single, unified strategy that guides the overall approval process.

Some benchmark entities base leasing decisions on the impact to an existing real estate portfolio. When determining whether to lease, build, buy, or consolidate, benchmark respondents stated they analyzed items such as long-term maintenance costs, flexibility requirements, and other factors. The RES Manager reports that many of the practices listed below are in place at the County.

Our survey identified the following key real estate lease practices:

- Use of financial analysis techniques such as duration matching or flexibility layering to match the right type and quantity of space at the right time. For example, to lower the risk of having expensive high levels of excess space, an early termination option could be negotiated to accommodate potential changes in agency requirements. *Source: National Association of Industrial and Office Properties*
- Selection of real estate performance targets that align real estate lease costs with County business strategies. For example, when assessing the value of office space, Multnomah County measures the annual real estate cost per employee by facility and the number of

square feet per employee to show how effectively a space is being used. *Source: 2006 GSA Real Property Performance Results*

- Maintenance of a real estate lease tracking system that increases accountability, enables benchmarking across agencies, and provides accurate data for improved decision-making. For example, Multnomah County and the State of Florida maintain up-to-date Web-based databases that track critical lease terms in a common format, monitor important lease dates, and provide easy access to lease requirements. *Source: 2006 GSA Real Property Performance Results*

The graph below shows a "dashboard" image available in the State of Florida lease system.

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Facilities Program
Florida Facilities Pool
Leases by Agency

Agency 370 Environmental Protection
Account No 37A Dept. Of Environmental Protection

Building **Douglas Building**

Lease Id	*Space Typ*	*Rate*	*SQ.FT.*	*Annual*	*FTE*	*County*
9378601	**Full Service Office**	**17.18**	**98209**	**1,687,230.62**	**402**	**LEON**
Legal Description	ENTIRE BUILDING LESS ROOMS 107, 110A AND CAFETERIA ON FIRST FLOOR AND ROOMS 610 AND 911					

Building **Fort Myers Regional Service Center**

Lease Id	*Space Typ*	*Rate*	*SQ.FT.*	*Annual*	*FTE*	*County*
9377720	**Conditioned Storage**	**5.11**	**960**	**4,905.60**	**0**	**LEE**
Legal Description	FT MYERS RSC, 2295 VICTORIA AVENUE, FT. MYERS FLORIDA 1ST FLOOR: SUITES 125 (120 SQ. FT.) AND 128 (840 SQ. FT.)					
9377705	**Full Service Office**	**17.18**	**1981**	**34,033.58**	**6**	**LEE**
Legal Description	1ST FLOOR - SUITES 166 AND 179					
9377701	**Full Service Office**	**17.18**	**23618**	**405,757.24**	**88**	**LEE**
Legal Description	3RD FLOOR - SUITES 362, 364, 368, 370, 371, 375, 377, 380, 382, 389 AND 392					

Source: Screenshot of the "Leases by Agency" report from Florida State's FACT (Facilities Accountability Communication Tool) system.

(http://dms.myflorida.com/business_operations/real_estate_development_management/building_construction/facilities_accountability_communications_tool_fact)

Cause

The County does not have a complete and effectively communicated strategic plan for leased real estate because:

- Lease information is not effectively integrated into other County real estate systems to support long-term Capital Improvement Program strategies or an analysis of broader economic indicators and competing financial needs throughout the County.
- Real estate lease information necessary to develop a meaningful long-term strategy is not tracked or reported to County decision makers.

Effect

When County Management does not effectively integrate real estate leases into a larger real property strategy (Capital Improvement), individual lease decisions may not fully support long term County financial goals.

Recommendation

The County Manager's Office should consider coordinating responsible agencies including RES, FMD, and others to provide the necessary information and data that will assist County Management in creating and executing a cohesive long-term real estate strategy that supports the goals of the County's Capital Improvement process.

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[1] Baltimore County, Fairfax County, San Diego County, City of Phoenix, Pima County, State of Arizona, Multnomah County, King County, Grand Canyon Title, and Security Title.

[2] National Association of Industrial and Office Properties and 2006 GSA Real Property Performance Results

[3] The National Association of Industrial and Office Properties (NAIOP) and Government Services Administration both recommend a well defined leasing strategy that is carefully aligned with the strategic and business goals of the entity.

Department Responses

Department of Finance Audit Response
Real Estate Leases (January 2008)

Issue #1:
The Department of Finance Real Estate Services could improve real estate lease management by consistently defining, recording, and tracking all real estate lease transactions. When real estate lease information is not accurately recorded, management does not have appropriate information to make informed and fiscally responsible decisions. The Department of Finance should improve its real estate lease processes.

Response to Issue: Concur

Comment:
The audit does not recognize the significant improvement that has been made over the years. Prior to 1999, real estate lease data was not consistently maintained and oversight was lacking. Great strides have been made to improve the data and lease management overall. We concur that further improvements could be made. Additional technology and personnel resources could enhance our processes. Cooperation from agency staff will resolve some of these challenges.

Recommendation A:
The Department of Finance should ensure that key lease elements and historical data in the existing database are complete, accurate, and consistently defined.

Response to Recommendation: Concur

Comment:
Real Estate Services is in the process of determining which information is useful to incorporate into the existing data and how much historical data should be maintained.

Target Completion Date:
9/30/08

Benefits/Costs:
Enhanced accuracy and meaningfulness of real estate information.

Recommendation B:
The Department of Finance should periodically encourage County agencies to ensure actual real estate expenditures do not exceed maximum contract totals

Response to Recommendation: Concur

Comment:
As staffing levels permit, the DOF will reinforce proper monitoring procedures with agency staff on a periodic basis.

Target Completion Date:
9/30/08

Benefits/Costs:
Improved agency accountability for real estate lease transactions.

Recommendation C:
The Department of Finance should encourage County agencies to research potential cost savings associated with lease contracts that include cost adjustments for CAM, and rental and real estate taxes.

Response to Recommendation: Concur

Comment:
As staffing levels permit, the DOF will reinforce proper monitoring procedures (including those that could results in cost savings) with agency staff on a periodic basis.

Target Completion Date:
9/30/08

Benefits/Costs:
Better agency accountability; potential cost savings; deterrent to overbillings.

Approved By:
1-28-08
1-28-08
Department Head/Elected Official — Date

T. Manos by [signature] — 1-28-08
Chief Officer — Date

[signature] for DRS — 1-28-08
County Manager — Date

Facilities Management Audit Response
Real Estate Leases (January 2008)

Issue #2:
As an advisor to the Board of Supervisors, the Facilities Review Committee (FRC) is charged with review and recommendation for all real estate transactions that reach the Board of Supervisors' agenda. Of 40 leases the auditors selected for review, eight (20%) were not reviewed by the FRC before submission to the Board of Supervisors. In a separate test, 15 out of 20 (75%) selected leases had been reviewed by the FRC, but did not fully comply with County real estate lease policies. When the FRC does not fully and properly discharge its duties, County Leadership cannot be assured that space requirements are consistently met and County standards are maintained. Facilities Review Committee lease review and documentation procedures should be strengthened.

Response to Issue: Do Not Concur

Comment:
It is the belief of current FMD management that when Policy 1920 was created in 1999 it was intended to cover leases that would be affected by proposed capital projects and not all leases that various County entities would wish to execute and that other approved County Real Estate polices cover those leases outside those impacted by the CIP. In order to resolve this issue FMD will request the FRC adopt changes to policy 1920 to address these issues so that it is clear in the future. As a note, the FRC has been reviewing all leases for the last several years, but this has not been formally adopted in the policy.

Recommendation A:
The Facilities Management Department should strengthen the Facilities Review Committee lease contract review and documentation procedures.

Response to Recommendation: Concur - Will Implement With Modifications

Comment
We believe that our process is sufficient to ensure compliance with the recommendations; the FRC just needs to propose policy to include the requirements that are already occurring.

Target Completion Date:
00/00/00

Benefits/Costs:
Ensurance that all applicable facility leases brought before the BOS will have been properly reviewed by the FRC.

Recommendation B:
The Facilities Management Department should prepare and transmit a financial report to the Facilities Review Committee, as required by Policy A1920, that includes the financial results of all current fiscal year lease transactions.

Response to Recommendation: Concur - Implementation Not Currently Possible

Comment:
Policy A1920 contains reporting requirements that would provide useful information on a variety of facility issues. In addition to the cost summary for leases, the policy requires the annual report to contain a summary of all facility related costs, uses and conditions. The problem with these requirements is that it was a mandate where resources were not allocated to implement. The compilation of this report would necessitate the allocation of funding for an FTE whose sole purpose would be to compile, validate and consolidate the information for numerous sources. Attempting to capture all facility related costs under our present financial system and the coding methodologies used by departments would make any attempt a difficult, if not an impossible task. Numerous County departments expend facilities related funds from their own operating budgets, for various reasons, that are not coded in similar fashion in the financial system, nor budgeted alike in the budget system. The concept is an excellent one that should be implemented with participation of OMB, Finance, RES, FMD and other related departments as well as the allocation of the resource requirements needed.

Facilities Management Audit Response
Real Estate Leases (January 2008)
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Target Completion Date:
N/A

Benefits/Costs:
The benefit of implementation would be to have one method\database whereby the County could truly see all the facility related expenditures made throughout the County from various funding sources so that better strategic facility decisions can be made. At the present time it is impossible to estimate the cost of implementing these recommendations at this time.

Approved By:

Department Head/Elected Official — Date 1/25/08

Chief Officer — Date 1/28/08

for DRS
County Manager — Date 1-30-08

County Manager's Audit Response
Real Estate Leases (January 2008)

Issue #3:
Developing and communicating a formal County strategy for real estate investment is a key high-level control for the safeguarding of resources. The County does not have a sufficient, well executed, and documented real estate leasing strategy that is formally communicated to County decision makers. Lack of accurate and readily available real estate lease data prevents the County from effectively analyzing current and future leasing needs and integrating these into the long term goals of the County. The County Manager's Office should consider coordinating responsible agencies to provide the necessary information and data that will assist County Management in real estate decision making and support the County's Capital Improvement process.

Response to Issue: Concur

Comment:
The County Manager's Office will review and commit in writing to a long term leasing strategy based on the county's expected growth and services delivery planning.

Recommendation A:
The County Manager's Office should consider coordinating responsible agencies including RES, FMD, and others to provide the necessary information and data that will assist County Management in creating and executing a cohesive long-term real estate strategy that supports the goals of the County's Capital Improvement process.

Response to Recommendation: Concur

Comment
Will obtain management feedback and take action to improve communication and coordination among the various agencies responsible for real estate decisions. Each Department and office has an approved facility master plan before new facilities are leased or built out. The Real Estate function will be brought in to all of these facility master planning efforts.

Target Completion Date:
01/31/08

Benefits/Costs:
Increased control over accuracy and accountability.

Target Completion Date:
01/31/08

Benefits/Costs:
Increased control over accuracy and accountability.

Approved By: David R Smith 1/15/08

David R. Smith | 01/15/08
County Manager | **Date**