



Performance Audit of the Internal Controls Over the City's Real Estate Portfolio and Property Management

Report 05-FY 2019/20 | June 2020

OFFICE OF THE CITY AUDITOR
Eduardo Luna, *City Auditor*



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June 26, 2020

Honorable Mayor and City Council
City of Beverly Hills, California

Transmitted herewith is the Performance Audit of the Internal Controls Over the City's Real Estate Portfolio and Property Management. The Results in Brief is presented on page 5. Management's response to our audit recommendations can be found on page 40 of the report.

I delayed the release of this report, originally scheduled for March 2020, due to the COVID-19 pandemic and the need for City management and all employees to shift efforts towards addressing the emergency. The recommendations for improving internal controls provided in this report are vital to improving the City's real estate operations. Moreover, the recommendations are also essential in facilitating the City's reconstitution planning, including, but not limited to, the institution of infection control protocols, reviewing, revising, and developing as necessary, tenant-related policies, and properly tracking commercial property expenses to ensure cost-recovery of COVID-19 related activities. **Exhibit A** provides an overview of the report recommendations, the internal control related theme, COVID-19 relevance, and auditor observations, where applicable.

We would like to thank the management and staff within the Policy and Management, Finance, and Public Works Departments for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information are greatly appreciated. The audit staff responsible for this audit report is Shawneé Pickney.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Eduardo Luna".

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Exhibit A: Audit Recommendations, Relevance to COVID-19 Planning, and Auditor Observations

Theme	Rec #	Recommendation Language	Auditor Observations
Oversight and Accountability <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives 	1	<p>In order to strengthen its oversight and management of commercial lease properties, the City Manager should designate a person that is accountable and responsible for the oversight and management of real estate operations. Duties should include, but not be limited to, conducting an analysis of the staff and resources necessary to implement the objectives identified in the Asset Management Plan (AMP). (Priority 1)</p>	
Oversight and Accountability Policies and Procedures Inventory <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives Infection Control Policies and Procedures Infrastructure Tracking Expenditures and Cost-Recovery 	2	<p>In order to strengthen its oversight and management of commercial lease properties, the City should develop an Asset Management Plan (AMP) that clearly articulates a strategic vision for the use of its properties. The AMP should include, at minimum, the following:</p> <ul style="list-style-type: none"> Goals for commercial properties; Updated policies and procedures for asset management operations; A requirement to maintain full inventory of assets; A requirement for periodic review of inventory and progress towards established goals; An accounting of all properties, including revenue, function, and condition; and A requirement for an annual public presentation at City Council and/or relevant City Council committees. (Priority 1) 	<p>As of May 2020, in its Department Reconstitution Plan, Policy and Management included COVID-19 Commercial Lease Guidance to identify City (as Landlord) and tenant responsibilities related to temperature monitoring, installing signage, HVAC modifications, etc. These policy decisions should be formalized via inclusion in the AMP.</p>
Oversight and Accountability Policies and Procedures <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives 	3	<p>The Policy and Management Department, in consultation with Finance and Public Works Departments, should continue its review of Administrative Regulations (ARs) and revise or develop guidance to ensure that the organizational structure and current staff roles and responsibilities align. The updates should also ensure that financial and inventory entry duties are appropriately divided. (Priority 1)</p>	
Oversight and Accountability Performance Monitoring <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives Infection Control 	4	<p>In order to ensure that tenant maintenance is completed timely and is completed based on a specified level of service, the Policy and Management Department, in consultation with the Public Works Department, should establish baseline performance metrics. These metrics, should be periodically reviewed and be included in the Asset Management Plan. (Priority 3)</p>	

Theme	Rec #	Recommendation Language	Auditor Observations
Financial Transparency and Financial Reporting Reliability Policies and Procedures <u>COVID 19</u> <ul style="list-style-type: none"> • Policies and Procedures • Tracking Expenditures and Cost-Recovery 	5	<p>To comply with lease provisions and to compel commercial lessees to pay timely, the Policy and Management Department, in consultation with the Finance Department, should develop standard lease late fee language for use in all lease negotiations. Specifically, they should compel lessees to pay timely by issuing invoices and collecting late fee payments, and at minimum, they should identify:</p> <ul style="list-style-type: none"> • A standard payment penalty, so that the percentage of rent paid, immediate amount paid, and/or interest payments due are the same for all leases. If it is determined that interest is part of the payment penalty, interest payment terms should be the same for all leases. • The time stamp, specifying a date for when all rent payments are due and for when late fees begin to accrue, for example, after written notice, business or calendar days after due date, etc. The time stamp should be the same for all leases. • The marker for when a payment is considered late; for example, if not postmarked or received by a specified date. • Enforce late fee terms by issuing invoices for late fees and collecting late fee payments. (Priority 2) 	<p>Any financial business relief policies (temporary or permanent) resulting from COVID-19 should be included in the AMP for reference during current and future emergencies.</p> <p>The City should still standardize its lease fee language used in negotiations, including collection of late fee payments and associated protocols.</p>
Financial Transparency and Financial Reporting Reliability Policies and Procedures <u>COVID 19</u> <ul style="list-style-type: none"> • Infrastructure • Tracking Expenditures and Cost- Recovery 	6	<p>In order to improve the tracking and assessment of Common Area Maintenance (CAM), the City Manager, or his designee, should develop and implement a policy that describes its methodology for assessing CAM fees for use in all lease negotiations. Specifically, at minimum, the City should:</p> <ul style="list-style-type: none"> • Identify how CAM fees will be calculated, including specifying the information necessary for the review (e.g. maintenance expenditures, utilities, square footage, etc.). (Priority 2) 	
Financial Transparency and Financial Reporting Reliability <u>COVID 19</u> <ul style="list-style-type: none"> • Policies and Procedures • Tracking Expenditures and Cost-Recovery 	7	<p>The Policy and Management Department and the Finance Department, in consultation with the City Attorney, should assess how the City will enable: 1) updated late fee terms; and 2) updated CAM assessment clauses. For example, discussing whether updates to lease terms will occur as leases terminate, for all new leases, or via amendments to all leases. The results of which should be communicated via written memo, directive, etc. to staff and City Council. (Priority 2)</p>	

Theme	Rec #	Recommendation Language	Auditor Observations
Financial Transparency and Financial Reporting Reliability <u>COVID 19</u> <ul style="list-style-type: none"> • Infrastructure • Tracking Expenditures and Cost-Recovery 	8	<p>In order to improve its tracking of general maintenance at its commercial properties, the Public Works Department, in consultation with the Finance Department, should continue development of Infor to capture labor, time, and parts and materials costs. Periodic updates on progress, performed at least biannually, should be provided to City Council on progress. (Priority 2)</p>	
Policies and Procedures <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Policies and Procedures • Infrastructure 	9	<p>In order to ensure that the City is not completing maintenance that should be the responsibility of the tenant, the Public Works Department should:</p> <ul style="list-style-type: none"> • Formalize written policies and procedures for reviewing maintenance requests, specifying roles and responsibilities of staff, determining when the City completes maintenance that is the tenant's obligation, and formalizing a method for tenant billbacks when City completes maintenance under the tenant's purview. • Consult with the City Attorney and the Policy and Management Department regarding the standardization of maintenance clauses. (Priority 2) 	
Inventory <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Policies and Procedures • Infrastructure • Tracking Expenditures and Cost-Recovery 	10	<p>In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should update and or develop policies and procedures that, at minimum, include:</p> <ul style="list-style-type: none"> • A clear description of the staff responsible for updating the inventory. • Guidance on the frequency of inventory review, which should occur, at minimum, on a yearly basis and as the status of properties change. • Guidance that specifies the type of information that should be entered or tracked, including, at minimum, a unique ID, lease type, square footage, lease start and end dates, monthly rent, security deposit and line of credit information, property categorizations, and vacant spaces. • Guidance that specifies how information should be entered into the property management system (e.g. the use of the effective, rent commencement, lease commencement, delivery dates, etc.) The Policy and Management Department should work in consultation with the Public Works Department to ensure that information such as the address, is consistent across Yardi and Infor. (Priority 1) 	

Theme	Rec #	Recommendation Language	Auditor Observations
Inventory <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Policies and Procedures • Infrastructure • Tracking Expenditures and Cost-Recovery 	11	In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should review and update its existing inventory on the scheduling frequency determined per Recommendation 10. (Priority 1)	
Inventory <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Infrastructure • Tracking Expenditures and Cost-Recovery 	12	In order to ensure that Yardi is configured to accurately report vacant properties, the Policy and Management Department should provide updates on its progress towards reconfiguring the system to City Council and applicable Council Committees. Updates should include an anticipated timeline for completion. (Priority 2)	
Financial Transparency and Financial Reporting Reliability <u>COVID 19</u> <ul style="list-style-type: none"> • Tracking Expenditures and Cost-Recovery 	13	In order to ensure that the City has all security deposits/line of credit information recorded in Yardi, the Policy and Management and Finance Departments should review the eight leases that were identified as not having the aforementioned information in Yardi as was cited in lease documents. Additionally, the City should collect and/or negotiate payments and update Yardi to reflect agreed upon terms and/or the amount collected. (Priority 1)	

Source: OCA generated based on a review of the audit recommendations, Committee of Sponsoring Organizations of the Treadway Commission (COSO), and COVID-19 guidance.

Results in Brief

We conducted a review of the internal controls over the City of Beverly Hills' (City) real estate portfolio and property management with an originally scheduled report release date for March 2020. However, at that time, an international disaster emerged when a novel coronavirus – known as COVID-19 – became a pandemic. The pandemic required: 1) the enactment of stay-at-home orders at state and local levels; and 2) a shift in priorities for all City staff to manage and respond to the immediate emergency.

Although we completed our review prior to the pandemic, the findings and recommendations detailed in this report serve to improve real estate operations, as well as, facilitate emergency reconstitution planning as it pertains to the City's commercial-leased properties.

During the period of our review, the City owned approximately 57 commercial-leased properties that generated approximately \$18.6 million in revenue during Fiscal Year 2018/19. In 2016, the City reorganized its real estate operations, including hiring new personnel and segregating key functions, after the discovery of improper activity by the former Real Estate and Property Manager. As part of our review, we found that generally rent is escalated and assessed as required.

Notwithstanding these positive changes, we found that the City needs to take additional steps to strengthen management oversight of its real estate operations to increase transparency, better safeguard its assets, assess staff and resource capacity, and monitor the implementation of internal policies and procedures.

Most notably, the following observations need the City's attention:

- The City has not addressed findings and recommendations from a 2016 audit highlighting issues with the collection of rent late fee payments and inconsistencies between lease inventory and lease documents. These deficiencies remain unresolved because the City lacks proper management oversight, adequate staffing and resource capacities, clear policies and procedures, and a strategic plan necessary for the management of the City's commercial-leased properties. (**Finding 1**) Additionally:
 - During the period of our review, the City experienced difficulty with collecting rent late fee payments because lease clauses are not standardized.¹ There are also inconsistent markers for indicating when the calculation of a late fee should begin (e.g. whether a payment is late if it is not postmarked or received by a specified date). (**Finding 2**)
 - The City's lease inventory is not always accurate and complete because the City did not have the personnel necessary to conduct periodic reviews of its database. Also, there are no policies and procedures that standardize data entry. (**Finding 3**)

¹ It should be noted that during the pandemic, the State of California and Los Angeles County imposed Stay-at-Home orders which restricted travel to conducting essential tasks or to working in essential businesses. As a result, some lessees experienced temporary closures, lessened business activity, and ultimately decreased revenue. To assist businesses, state, county, and local level governments provided various financial relief efforts including business loans and grants and fee, tax, and rent deferrals.

- As required per a 2013 Amendment for one of its leases, the City has no record of a security deposit totaling \$22,000, nor can the lessee provide any supporting documentation to substantiate that they paid. Since the City experienced previous improper activity in its real estate operations, it should strengthen controls for reviewing its inventory data, including ensuring that financial information is properly tracked and updated.
- Administrative guidance is outdated and does not reflect the shifting department and staff roles and responsibilities resulting from a reorganization of real estate operations. While the Policy and Management Department is in the process of revising relevant documents as part of a citywide review of all administrative regulations (ARs), it is essential that roles and responsibilities within real estate operations be formalized to ensure appropriate segregation of duties. (**Finding 1**)
- The City has not established service level expectations for maintenance performed at its commercial-leased properties. Since Public Works manages maintenance for City facilities and commercial-leased tenants, service level goals would set clear expectations for the quality of work completed, minimize duplication of efforts, and provide a basis by which to assess staff and resource capacity needs. (**Finding 1**)
- The City did not always assess common area maintenance charges as required per lease terms, because the previous property management team did not track base year data. We found that the City has not been tracking general maintenance costs for work completed by Public Works Facilities staff at its leased properties due to a lack of standardized maintenance clauses in tenant leases. Also, during the period of our review, the City did not have a central repository for tracking maintenance expenditures. However, Public Works implemented the Facilities Module in its asset management system, Infor, which tracks labor costs, time, and work order status, and is expected to capture the costs or parts and materials after additional configurations. (**Finding 2**)

As noted, the City has taken steps to improve its real estate operations, but more change is needed. We made **13** recommendations. The City's responses to our recommendations are included on page **40** of this report. To the credit of the personnel involved in real estate operations, efforts to implement a few of the recommendations are already in progress.

Background

Comprising 5.7 miles within Southern California, the City of Beverly Hills (City) is home to over 34,000 residents and entertains millions of visitors each year. In addition to other interests, visitors are drawn to Beverly Hills for its destinations on and around Rodeo Drive and throughout the City. The City owns and acquires property for uses such as parking, open space, and commercial business. These properties create public benefits and generate revenue. During the period of our review, the City owned approximately 57 leased properties, with businesses such as Ferragamo, Williams-Sonoma, and Google, and recreational and theatre spaces such as Beverly Hills Tennis and the Wallis Annenberg Center for the Performing Arts. As shown in **Appendix II**, between Fiscal Years 2016/17 to 2018/19, the City generated approximately \$17 million, \$17.8 million, and \$18.6 million in revenue respectively from its leased properties.

In 2016, the City took action to improve oversight of its leased properties after the discovery of improper activity by the former Real Estate and Property Manager. The previous Property Manager directed and oversaw multiple aspects of real estate operations, including day-to-day operations, lease negotiations, tenant relations, rent collection, and property management. As part of the City's corrective action, the City reorganized its real estate operations and split responsibilities amongst three departments. **Exhibit 1** highlights some of the duties of each department.

Exhibit 1: Division of Real Estate Responsibilities

<u>Policy and Management Department</u>	<u>Public Works Department</u>	<u>Finance Department</u>
<ul style="list-style-type: none">• Oversees New Business• Lease Management Activities• Negotiates Purchases and Sales	<ul style="list-style-type: none">• Maintenance• Tenant Relations• Project Administration	<ul style="list-style-type: none">• Monitors Rent Payments• Collects Rent Payments

Source: OCA generated based on interviews, the FY 2019/20 Proposed Budget, and draft administrative regulations.

To manage its operations, the City uses Yardi – a real estate property management system that houses lease inventory information. It also uses Munis, which is an enterprise-resource-planning system to record lease revenue.

The Importance of Implementing Effective Internal Controls to Manage the City's Asset Portfolio

This report focuses on the control environment over the City's real estate operations. As defined by the Committee of Sponsoring Organizations' (COSO) *Internal Control – Integrated Framework*, an internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an organization will be achieved. Internal controls include the plans, methods, and policies and procedures used to fulfill the mission, strategic plan, goals, and objectives of the entity.

Elements of internal control guidance include a focus on:

- The efficiency and effectiveness of operations, including establishing operational and financial performance goals, and safeguarding assets;
- The entity's compliance with applicable laws, regulations, and industry standards; and
- The reliability, timeliness, and transparency of internal and external financial and non-financial reporting.

Guidance emphasizes that when an entity develops an effective control system, it is better able to adapt to evolving demands, risks, and priorities. Management is responsible for designing and implementing an effective internal control system. According to the United States Government Accountability Office (GAO), management sets the entity's objectives, implements controls, and evaluates the internal control system.

Oversight of the City's Lease Portfolio

Industry guidance provides government entities with frameworks that promote the effective oversight of assets.² As shown in **Exhibit 2**, core components of the frameworks include: developing an asset management plan, managing inventory, and using quality data.

² This includes publications from the Urban Institute Center on International Development and Governance (Urban Institute), the GAO, and other publications.

Exhibit 2: Six Key Characteristics of an Asset Management Framework

Core Component	Description
Establishing Formal Policies and Procedures	<ul style="list-style-type: none">• Clearly defined governance regime that includes a strategic Asset Management Plan (AMP).• The AMP ties to the organization's mission and objectives, defines asset management scope, and defines the roles and responsibilities for staff.
Maximizing Value of the Asset Portfolio	<ul style="list-style-type: none">• Development of an asset management policy to identify value of assets to achieve mission and objectives.• Investment in assets that derive the greatest value.
Maintaining Leadership Support	<ul style="list-style-type: none">• Organizational leadership clearly articulates support for asset management and provides necessary resources for success.
Using Quality Data	<ul style="list-style-type: none">• Collection, analysis, and verification of the accuracy of asset data, including inventory and data on each asset's condition, age, maintenance cost, and criticality to the organization.
Promoting a Collaborative Culture	<ul style="list-style-type: none">• Promotion of a culture of information sharing and organization-wide decision making regarding the use of assets.
Evaluating and Improving Asset Management Practices	<ul style="list-style-type: none">• Evaluation of performance of the organization's asset management and implementation of necessary improvements.

Source: Office of the City Auditor (OCA) generated based on a review of the United States Government Accountability Office (GAO) analysis of the ISO 55000 standards, asset management literature, and interviews with experts as described in its 19-57 Federal Real Property Asset Management Report.

Asset Management Plans

A comprehensive Asset Management Plan (AMP) is a tool that can assist local governments in: 1) articulating a strategic vision; 2) managing day-to-day activities; 3) facilitating a collaborative approach for information sharing and decision-making; 4) monitoring, evaluating and improving performance; 5) providing stewardship of public assets; and 6) ensuring timely operational maintenance and repairs at municipal properties. It can also help local governments make economically and socially-justified decisions on property reallocation, change of use, and disposal.

At minimum, an AMP should include, but not be limited to:

- The **formulation of goals and principles** of the local governments' asset management.
- A requirement for **full inventory and accounting of all properties** for asset management purposes.
- A requirement for **periodic review** to measure progress and assure its continued relevance.

- A ***categorization of properties by function***, with mandatory properties defined as essential to government functions, discretionary properties defined as voluntarily supported for social, political, or other reasons, and surplus properties defined as properties that are not mandatory or discretionary. These categorizations allow municipalities to determine which properties are vital for meeting various City goals, such as the desire to develop housing or retain local business.
- ***Transparency of information*** on land, by including enough information to meet the needs of the public, stakeholders, and decision-makers on the performance, financial, and strategic use of the municipality's assets.

Control Activities in Real Estate Operations

As part of its monitoring activities, and in an effort to improve the performance of its asset portfolio, the Urban Institute advises municipalities to improve leasing procedures and contracts, increase the rent collection rate, and track revenue and expenditures associated with each asset. It also asserts that municipalities should investigate reasons for low collection rates and take action to remedy and increase collection, including eviction for tenants that do not pay rent. Additionally, municipalities should track revenues and expenditures associated with each asset. The degree of details recorded may vary and should depend on the needs of management. However, at a minimum, municipalities should track the costs of labor and materials.

Moreover, inventory should be actively managed since a local government's capital assets represent its most significant investment of municipal resources. Municipalities should collect accurate and thorough data that includes, but is not limited to, property unique identifiers, addresses, acres, and asset categories (such as mandatory, discretionary, or surplus). To maintain accurate and complete data, municipalities should perform periodic inventories and fully investigate any discrepancies.

Audit Results

Finding 1: The City Should Strengthen Internal Controls Associated with the Management Oversight of Its Real Estate Operations to Better Safeguard Its Assets

In order to maximize its investments, guidance advises entities to implement internal controls that enhance the efficiency and effectiveness of operations, safeguard assets, and monitor progress towards the achievement of goals.³ We found that the City needs to strengthen its internal controls related to the management oversight of real estate operations.

We found that the City has not addressed findings from a 2016 audit conducted by Macias Gini & O'Connell LLP (MGO). An objective of the audit was to confirm that commercial lease terms and collections are accurately reflected in the City's property management system. However, the 2016 audit found that the City was not collecting, to a great extent, late fees on lease payments. It also found that many differences existed between the City's lease inventory, recorded in Yardi, and the lease terms contained in the actual lease documents. As we discuss in greater detail in **Findings 2 and 3**, these deficiencies remain unresolved because the City lacks proper management oversight, adequate staffing and resource capacities, and clear policies and procedures for managing the City's commercial-leased properties.

According to the GAO, an internal control deficiency exists when management, or those charged with governance, fail to assess the effect of a deficiency previously communicated to them and do not either correct the deficiency or conclude that it does not need to be corrected. To that end, organizations should evaluate and communicate internal control deficiencies in a timely manner to those responsible for taking corrective action, including senior management, or other designated personnel.

The GAO also notes that when an entity experiences impropriety, it can present a heightened risk of fraud. This is significant since, in 2016, the City reorganized its real estate operations after the discovery of improper activity by the former Real Estate and Property Manager. The previous Property Manager directed and oversaw multiple aspects of real estate operations, including day-to-day operations, lease negotiations, tenant relations, rent collection, property management, and other related duties. As part of its corrective action, the City reorganized and split its real estate operations between the Policy and Management, Public Works, and Finance Departments. The City also began hiring and/or promoting staff to create appropriate checks and balances. However, long-standing internal control deficiencies still remain unresolved and hinder the City's ability to conduct proper stewardship of its assets.

Existing Real Estate Operations Guidance Does Not Align With Current Staff Roles and Responsibilities

We found that City Administrative Regulations (ARs) do not reflect the current operational structure of the City's commercial real estate operations. We should note that Policy and

³ Internal control guidance promulgated by the United States Government Accountability Office (GAO) and the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Management Department staff is aware of the need for revisions and is in the process of updating and/or drafting pertinent ARs.

Based on our review, staff roles and responsibilities, as outlined in the City's Administrative Regulations (ARs), are outdated. For example, Administrative Regulation 4A.2 Real Property Control (AR 4A.2), effective September 1, 1977, was designed to provide direction on how to create and maintain a record of every land parcel in which the City holds or seeks any interest. The AR assigns responsibility for maintaining inventory and furnishing applicable data to the Public Services City Engineer. However, during the period of our review, Finance Department staff entered property information in both Yardi and MUNIS. According to Finance, due to the lack of other available resources, it assumed these responsibilities even though it was not tasked with these duties. In addition to not aligning with the organizational structure outlined in AR 4A.2, duties were not appropriately segregated which is another internal control weakness that heightens fraud risk.

Administrative Regulation 4B.1 Management of City-Owned Commercial Properties (AR 4B.1), effective March 26, 1982, was designed to preserve and enhance the value of City-owned real property through coordinated administration and enforcement of commercial lease agreements. As shown in **Exhibit 3**, a comparison of the existing AR and the draft of proposed updates highlights a shift in responsibilities for oversight of real estate activities.

Exhibit 3: A Shift in Departments and Personnel Responsible for Various Duties between the City's Administrative Regulation 4B.1 Management of City-Owned Commercial Properties and Proposed Updates

Job Responsibility	Existing AR 4B.1	Draft Administrative Regulation 4B.1
Negotiate proposed lease terms	City Council Committee	Policy and Management Department
Prior to Council Action, insure receipt of any required security deposits	City Clerk	Policy and Management Department
Prior to Council Action, insure submittal of all required bonds and insurance documents	City Clerk	Public Works Department

Source: OCA generated based on review of the Administrative Regulation 4B.1 Management of City-Owned Commercial Properties, dated March 26, 1982 and the Working Draft of Administrative Regulation 4B.1, dated July 29, 2019.

One of management's primary governance responsibilities is to develop an organizational structure with appropriately assigned authority and responsibilities. To that end, the person in charge of entering inventory and property information should not have access to the financial functions associated with those properties.

The City Has Not Established Service Level Expectations for Maintenance Performed at Commercial-Leased Properties

Additionally, we found that the City has not established performance metrics that, at a minimum, specify service level expectations for maintenance completed at its leased properties.⁴ For example, there is no guidance on whether there should be different service levels for maintenance completed internally at City facilities and maintenance completed for lessees, who may expect a higher level of service as paying tenants.

According to Public Works staff, existing performance indicators for Facilities relate to work orders for preventative maintenance not reactive maintenance. It is imperative that the City establish service level expectations as it can impact customer service and lessee satisfaction, effect staffing capacity and resources, lead to duplication of efforts, and damage the City's reputation.

Facilities staff completes various maintenance activities within the City. Specific duties include maintenance and repair functions at City facilities, implementation of small construction projects, and managing contracts for custodial, special events, building systems and engineering, and elevator maintenance services. Facilities also provides support to the City's commercial lease tenants, including janitorial services, lamp replacements, building maintenance, plumbing service, and repairs to heating, venting, and air conditioning (HVAC) systems. According to Public Works, staff is working to be responsive with its given resources. Clearly stated service level expectations would assist Public Works staff in determining how to properly allocate available resources.

Management Oversight Would Strengthen the City's Operational Internal Control Environment

The City should strengthen its management oversight of its real estate operations. Specifically, the City has not designated a person, or established a position, that is ultimately accountable for monitoring and evaluating the presence, sufficiency, and effectiveness of internal controls. That accountability would include: 1) following through with corrective actions for previously identified deficiencies; and 2) ensuring, through continuous evaluation of staffing and resource capacities, that the organizational structure keeps pace with the evolution of the City's operations.

In organizational maturity models, the City's real estate operations currently fall between initial and transitional phases where planning is mostly informal, misalignment of objectives and organizational structures exist, and senior management is not actively involved and able to champion for staffing and other needed resources.⁵ To that end, there has been no assessment regarding the sufficiency of staff resources. For example, according to the Finance Department,

⁴ The City developed a Strategic Plan for years 2011-2016 with goals that included developing uniform achievable standards for all leased facilities, when possible, examining the most efficient and effective means to maintain properties and associated maintenance costs, and assigning existing resources and workforces to provide the best maintenance possible with an annual review and modification of standards based on resources availability. That Strategic Plan has since lapsed.

⁵ Organizational Maturity Models provide a common framework to describe an organization's evolution in developing its people, processes, and technologies for improving organizational performance. On a scale of 1-5, Levels 1 and 2 are initial and transitional stages with informal, decentralized, and unsupported operations. In Level 3-5 organizations, operations are more structured, adaptable, transparent, and streamlined.

although management of Yardi shifted to their purview, they did not receive any additional staff to manage Yardi activities. Finance staff handle real estate activities in addition to their primary job responsibilities. Moreover, staff within real estate operations are navigating their new roles and responsibilities, with minimal or informal guidance, or are developing procedures as the demands of their respective positions dictate.

Additionally, the establishment of a person responsible for oversight would assist in facilitating communication and transparency between departments conducting real estate activities and stakeholders. An Asset Management Plan (AMP) is a tool that can assist local governments with articulating a strategic vision, managing day-to-day activities, and monitoring and improving the portfolio's performance. An AMP would:

- 1) Explicitly state short and long-term goals for the use of City assets;
- 2) Provide an accounting of assets and their financial performance; and
- 3) Increase transparency and provide the public, stakeholders, and decision-makers with accurate information about the City's stewardship of its assets.

Currently, the City does not have a comprehensive AMP. The City's FY 2019/20 Proposed Budget (Budget) only provides a broad statement to lease vacant properties and complete planned acquisitions and administrative updates. Additionally, the Budget does not include itemized detail on the revenue generated by each lease. While the scope of this audit focused on leased properties, the development of the AMP can expand to cover the strategic use and future acquisitions of other City assets as well.

Absent management oversight, a clearly defined organization structure with clearly stated roles and responsibilities, policies and procedures and service level expectations, and a clearly defined strategy for the use of leased properties, the City cannot properly plan, execute, assess, monitor, and communicate its progress towards attaining its real estate goals. Additionally, property-related decisions made by the City may appear ad-hoc or result in a public perception that certain tenants are favored or afforded special treatment.

For example, the Log Cabin property on North Robertson Boulevard was at the center of a dispute between the City and the Lions Club of West Hollywood (Lions Club). One of the underlying issues is that the lease expired in 1977 and the Lions Club has not paid the yearly rent of \$1 since then. Moreover, according to a City press release, dated January 13, 2020, a contractor surveyed the property and found portions of the building in poor condition. If the City had appropriate internal controls over its inventory, it may have identified the lease payment issue, appropriately strategized for the use of the site, and communicated plans on the use of the Lions Club sooner.

Lastly, without improvements, the City risks blemishing its reputation with dissatisfied lessees and poorly maintained spaces.

Recommendation 1

In order to strengthen its oversight and management of commercial lease properties, the City Manager should designate a person that is accountable and responsible for the oversight and management of real estate operations. Duties should include, but not be limited to, conducting an analysis of the staff and resources necessary to implement the objectives identified in the Asset Management Plan (AMP). (Priority 1)

Recommendation 2

In order to strengthen its oversight and management of commercial lease properties, the City should develop an Asset Management Plan (AMP) that clearly articulates a strategic vision for the use of its properties. The AMP should include, at minimum, the following:

- Goals for commercial properties;
- Updated policies and procedures for asset management operations;
- A requirement to maintain full inventory of assets;
- A requirement for periodic review of inventory and progress towards established goals;
- An accounting of all properties, including revenue, function, and condition; and
- A requirement for an annual public presentation at City Council and/or relevant City Council committees. (Priority 1)

Recommendation 3

The Policy and Management Department, in consultation with Finance and Public Works Departments, should continue its review of Administrative Regulations (ARs) and revise or develop guidance to ensure that the organizational structure and current staff roles and responsibilities align. The updates should also ensure that financial and inventory entry duties are appropriately divided. (Priority 1)

Recommendation 4

In order to ensure that tenant maintenance is completed timely and is completed based on a specified level of service, the Policy and Management Department, in consultation with the Public Works Department, should establish baseline performance metrics. These metrics, should be periodically reviewed and be included in the Asset Management Plan. (Priority 3)

Finding 2: The City Should Strengthen Internal Controls Related to Commercial Lease Oversight, Including Standardizing Late Fee and Maintenance Terms and Tracking Maintenance Expenditures

The City's commercial lease documents include provisions that set its expectations for timely rent payments by tenants. The documents outline damages, in the form of late fees, for when tenants do not meet outlined obligations. These charges and fees compensate the City for lost revenue and can be used for maintaining the City's properties. Additionally, some lease documents also include common area maintenance (CAM) charges which are fees paid by tenants to compensate the City for the costs of operating, repairing, and maintaining shared areas. CAM may include items like landscaping and parking lot maintenance.

In 2016, Macias Gini & O'Connell LLP (MGO) completed a review of the accuracy of the City's lease terms and collections reflected in its property management system (Yardi). MGO found that the City was not collecting, to a great extent, late fees on lease payments. Our findings are consistent with MGO in that the City is still having difficulty with assessing and collecting late fees for its commercial leases.

We found that the City cannot consistently implement lease provisions related to late fee payments and CAM charges because there is no position of authority responsible for the oversight of daily operations. Additionally, lease clauses are not standardized and calculating late fees can be difficult because there are no consistent markers that indicate when fees begin (e.g. postmarked or received by date). According to Finance, due to the aforementioned reasons, the City took the position that since it could not enforce late fees equitably among all tenants, it would not assess late fees even in the limited cases where an estimate could be determined. Moreover, we found that the City did not track relevant maintenance information needed for the calculation of CAM charges and other maintenance costs. We should note that efforts are underway in Public Works to develop its asset management system, Infor, to capture such data.

Tenants Do Not Always Make Timely Payments and are Not Assessed Late Fees

In our review of lease ledgers and rent aging reports, we found that lessees carry balances and/or do not make payments timely, even after notification. While tenants eventually paid, and the late payments due may appear immaterial relative to the rental amount, it underscores how rent-related matters can go unaddressed for long periods of time. Although Finance conducts a monthly review of accounts, and notifies tenants and relevant staff and management within the Finance, Policy and Management, and Public Works Departments about accounts in arrears, the City does not invoice or charge interest to late accounts, which may compel tenants to pay timely. Moreover, as highlighted in **Finding 1**, there is no position of authority for escalating lease issues and resolving tenant issues.

Another contributing factor for the City not assessing and collecting late fees is the lack of standardization in lease clauses. In our review, 50 of 57 leases included late fee clauses and, as shown in **Appendix III**, had 30 variations of late fee terms. These clauses range in payment penalties from 2 percent to 10 percent of required payment, immediate payments of \$200 to

\$1500, and interest payments (which are either in addition to the aforementioned penalties or as the solitary fee). There are variations to interest payment terms as well.

Lease terms also differ in using business days or calendar days for establishing grace periods and establishing whether a payment is late after written notification. Additionally, the City has not determined a late fee marker date, such as a postmarked or received by date, to indicate when late fee charges should begin. Moreover, the City's property management system, Yardi, does not have the capacity to track numerous iterations of late fee terms and interest requirements. Finance staff manually completing such calculations would be an administrative burden and would, according to Finance, potentially outweigh the revenue generated by the late fees. Due to the aforementioned reasons, according to Finance, the City took the position that since it could not enforce late fees equitably among all tenants, it would not assess late fees even in the limited cases where an estimate could be determined.

We should note that as of February 2019, in one of its newly negotiated leases, the Policy and Management Department used payment clause language that it intends to make standard for all commercial leases. The language asserts that unpaid amounts shall bear interest from the date the unpaid amount is past due and an immediate payment of \$500 is due if monthly rent is not paid within five business days after due date. Moreover, the Policy and Management Department is drafting standardized lease language that is under review.

The City Did Not Always Assess Common Area Maintenance Charges, As Required in Lease Terms

Lease agreements typically outline general maintenance responsibilities of the tenant and the City. For example, tenants are generally required to keep, maintain, and preserve the interior portions of the premises. Whereas, the City is usually responsible for keeping, maintaining, and preserving the structural portions of a building, such as the foundation, parking areas, and landscaping. In some instances, leases include CAM charges.

The City has 12 leases with CAM clauses and did not assess CAM charges in four instances (25 percent). Additionally, we found that the City missed a scheduled 2014 CAM assessment for a fifth lease. The City did not charge CAM fees because the previous property management staff did not track base year data. CAM calculations per the lease terms include Base Operating Expenses and the specified years for the four leases ranged between 2011 and 2013.⁶ This reason, coupled with personnel changes, means that the City will not bill CAM charges during the periods covered in those leases.

The City missed a CAM charge because, according to Finance, it could not locate 2014 information from the previous property management team records and previous staff associated with real estate operations no longer work for the City. Based on available information Finance found that the tenant had been paying more than the rent and CAM amounts charged and an eventual true-up brought the tenant's account current. Moreover, as shown in **Appendix IV**, there is no consistent methodology for the calculation of CAM fees. Calculations vary and are

⁶ Base Operating Expenses are the operating expenses for a lease in a specified year.

based on base year operating expenses, square footage of rentable area, or the tenant's share of the common area.

The City Is Not Tracking Maintenance Completed at Its Leased Properties

We also found that the City has not been tracking general maintenance costs for work completed by Public Works Facilities staff at its leased properties. This is, in part, due to the lack of standardized maintenance clauses which, according to real estate operations staff, has made the administration of this work difficult to track per lease. For example, Public Works asserted that they may exercise caution and complete a maintenance request, even if the tenant is responsible per lease terms. To that end, the City does not have a formalized process for identifying when Facilities should conduct maintenance that may be under the tenant's purview and determining how that service should be invoiced.

During the period of our review, the City did not have a central repository for capturing its maintenance requests and related expenses. Public Works stated that prior to the reorganization of the City's real estate operations, information related to work order completion may have been kept via email or via written invoices. Moreover, the previous Property Manager would field requests and handle details, of which no documentation exists.

However, Public Works is in the process of configuring its asset management system – Infor – to manage service requests and related work order information for maintenance completed by City facilities, including work completed for lessees of the City's commercial properties. The Facilities Module in Infor, which went live in September 2019, is expected to track labor costs, time, and the status of work orders. With refinement over time, Infor is also expected to capture the cost of parts and materials after Public Works configures the inventory management module. Data tracked in Infor will provide information necessary for an accurate accounting of the City's maintenance expenses and provide the necessary documentation to bill tenants for applicable expenses.

Additionally, we found that processes and procedures for determining if the City is responsible for completing certain tenant maintenance requests need improvement. The Public Works Department does not have formalized policies and procedures for addressing commercial lessee service requests; specifically, it does not have a written procedure for determining if the City is obligated to complete maintenance. Although policies are not written, Public Works asserted that it discusses cases and is exploring new processes for improving coordination between its Facilities Staff and its Tenant Relations Coordinator related to triaging service requests and communicating next steps with tenants.

Industry Guidance Advises Municipalities to Increase Rent Collection and Track Maintenance Costs

Industry guidance promulgated by the Urban Institute Center on International Development and Governance advises municipalities to comply with lease clauses, including collecting late fees. It requires municipalities to investigate reasons for low collection rates and take action to remedy and increase collection. The timing of the City's end dates for some of its leases presents an opportunity to assess late fee policies and make wholesale changes. As shown in **Exhibit 4**,

there are approximately 36 leases with end dates between 2020 and 2023, with 10 of those ending in 2020.

Exhibit 4: Total Number of Commercial Leases Terminating By Year

Year of Lease End Date	Total Leases	There are 36 leases with Lease End dates between 2020 and 2023.
2020	10	
2021	7	
2022	12	
2023	7	
2024	3	
2028	3	
2030	1	
2031	1	
2036	2	
2044	1	
2068	1	
No Information in Yardi	4	
No Lease Date Entered	5	
Total Leases	57	

*Auditor Note: Information based on lease dates as entered in Yardi for report run date of August 19, 2019. Based on our review, the City may need to update Lease End dates in Yardi for accuracy. See **Finding 3**.*

Source: Office of the City Auditor (OCA) generated based on a review of Lease End dates as entered in Yardi Tenancy Schedule report run August 19, 2019. Also, some tenants may have renewal lease terms requiring rent payments at the market rate, but that would leave other clauses unchanged.

Furthermore, guidance states that expenditures for maintaining capital asset investments should be tracked, including documenting the costs of labor and materials. City leases with CAM clauses require the City to furnish tenants with a statement detailing actual operating expenses. Additionally, guidance advises that lease language should be as complete as possible as to the services to be performed in the common areas and paid for by the tenants.

Lastly, the GAO requires entities to establish and document policies and procedures in the appropriate level of detail. In the City's case, this would include detailing a methodology for how the City calculates its CAM charges, developing policies and procedures for the entry of maintenance expenditure data in Infor, and triaging maintenance requests.

By not addressing management oversight needs, the City is not in a position to identify tenant issues and resolve them timely. In addition, the City is missing an opportunity to collect damages when tenants do not abide by lease agreements. Without standardized clauses outlining late fee expectations and a CAM calculation methodology, the City cannot ensure consistency in its monitoring of tenant obligations. By not tracking maintenance expenses in a centralized repository, the City cannot accurately assess maintenance needs and expenditures. Moreover, without labor, time, and parts and material information, the City cannot assess the staffing needs and resources necessary to provide a desired quality of service for lessees. Lastly, without established policies and procedures outlining service expectations and other

operations, the City may be duplicating efforts or providing subpar quality in the field and/or expending resources (financial and staff) for work that is the responsibility of the lessee.

Recommendation 5

To comply with lease provisions and to compel commercial lessees to pay timely, the Policy and Management Department, in consultation with the Finance Department, should develop standard lease late fee language for use in all lease negotiations. Specifically, they should compel lessees to pay timely by issuing invoices and collecting late fee payments, and at minimum, they should identify:

- A standard payment penalty, so that the percentage of rent paid, immediate amount paid, and/or interest payments due are the same for all leases. If it is determined that interest is part of the payment penalty, interest payment terms should be the same for all leases.
- The time stamp, specifying a date for when all rent payments are due and for when late fees begin to accrue, for example, after written notice, business or calendar days after due date, etc. The time stamp should be the same for all leases.
- The marker for when a payment is considered late; for example, if not postmarked or received by a specified date.
- Enforce late fee terms by issuing invoices for late fees and collecting late fee payments. (Priority 2)

Recommendation 6

In order to improve the tracking and assessment of Common Area Maintenance (CAM), the City Manager, or his designee, should develop and implement a policy that describes its methodology for assessing CAM fees for use in all lease negotiations. Specifically, at minimum, the City should:

- Identify how CAM fees will be calculated, including specifying the information necessary for the review (e.g. maintenance expenditures, utilities, square footage, etc.). (Priority 2)

Recommendation 7

The Policy and Management Department and the Finance Department, in consultation with the City Attorney, should assess how the City will enable: 1) updated late fee terms; and 2) updated CAM assessment clauses. For example, discussing whether updates to lease terms will occur as leases terminate, for all new leases, or via amendments to all leases. The results of which should be communicated via written memo, directive, etc. to staff and City Council. (Priority 2)

Recommendation 8

In order to improve its tracking of general maintenance at its commercial properties, the Public Works Department, in consultation with the Finance Department, should continue development of Infor to capture labor, time, and parts and materials costs. Periodic updates on progress, performed at least biannually, should be provided to City Council on progress. (Priority 2)

Recommendation 9

In order to ensure that the City is not completing maintenance that should be the responsibility of the tenant, the Public Works Department should:

- Formalize written policies and procedures for reviewing maintenance requests, specifying roles and responsibilities of staff, determining when the City completes maintenance that is the tenant's obligation, and formalizing a method for tenant billbacks when City completes maintenance under the tenant's purview.
- Consult with the City Attorney and the Policy and Management Department regarding the standardization of maintenance clauses. (Priority 2)

Finding 3: The City Should Strengthen Its Internal Controls Related to the Reliability of the Information it Generates and Disseminates for Its Real Estate Assets

We reviewed the City's inventory information, including a review of lessee rent amounts. We found that the monthly rent amounts entered in Yardi were correct and escalated per lease clauses based on a Tenancy Schedule run on August 19, 2019. Also, for the six leases with percentage sales clauses, we found that generally the accounts were reviewed and assessed when applicable.

However, we found that the City needs to strengthen its internal controls related to the reliability of the information it generates and disseminates on its leases to internal and external parties. Specifically, we found that the City's lease inventory is not always accurate and complete as it pertains to recorded information such as addresses, square footage, lease start and end dates, and security deposit information. Internal control guidance asserts that it is essential for management to obtain or generate and use relevant and quality information to conduct proper oversight of its operations. In order for a local municipality to effectively manage its assets, it needs to have an accurate and complete account of the assets it owns.

In 2016, Macias Gini & O'Connell LLP (MGO) completed a review of the accuracy of the City's lease terms and collections reflected in Yardi, its property management system. MGO found many differences between information contained in Yardi and the lease terms contained in the actual lease documents. We made similar observations and highlight the reasons for the differences, which include a lack of staff resources and appropriate written guidance that establishes relevant policies and procedures for managing commercial-leased properties.

We conducted field reviews to assess whether the addresses listed in Yardi match tenant physical locations. We reviewed a total of 48 leases for address verification.⁷ We found that address fields in Yardi contained generic descriptions, such as "Gardens Building." However, most lease documents provide more detailed information with an address number, street name, city, and zip code. Information in Yardi did not reflect lease address documentation in at least 65 percent of the leases in our review. We also reviewed unit information for 38 leases and found that unit descriptions were incorrect for at least 20 percent of leases reviewed.⁸

According to Policy and Management, address information exists in Yardi, but reports do not always display the building addresses and uses the property descriptor. Also, data input into the system was not consistent. As such, reports pulled from Yardi are not always complete. It is imperative that Yardi include a consistent address nomenclature for the location of properties. Policy and Management notes that they are reviewing the most appropriate way to report address information.

⁷ There were a total of 57 leases, of which we excluded nine wireless leases.

⁸ There were a total of 57 leases, of which we excluded nine wireless leases, six that did not have a unit number as part of the address, and four that were not in the Tenancy Schedule.

Square Footage Information in Yardi Was Either Not Entered or Did Not Always Match Commercial Lease Documents Reviewed

To assess the accuracy of square footage information, we reviewed a total of 53 leases for square footage, lease start, and lease end verification.⁹ In our review of square footage information entered in Yardi, we found that 17 commercial leases had no square footage entered, of which 11 (21 percent) were wireless leases and six (11 percent) were retail, office, or public space leases.

Yardi should contain square footage information for all properties, but leases such as Beverly Hills Tennis, Southwest Wine & Spirits, and Whole Foods Market do not have any square footage information in the system. Additionally, we found that square footage information entered in Yardi for 8 commercial leases (15 percent) does not match lease documents. Moreover, there was at least one additional commercial lease where the source of the square footage information cited in a City Council Staff Report is in question since the lease documents reviewed did not specify any square footage for the space.

According to staff within real estate operations, in 2018, the Policy and Management Department obtained bids to measure the square footage and obtain layouts of all leased-spaces in order to update Yardi with accurate information. However, after reviewing costs, cited between approximately \$100,000 and \$290,000, the City did not proceed. The City needs to determine a way to establish square footage estimates for its commercial-leased properties since square footage is critical in establishing common area maintenance (CAM) charges and rent amounts.

Commercial Lease Start and End Dates in Yardi Did Not Always Match Lease Documents Reviewed

We found that 12 of the 53 commercial leases we reviewed (23 percent) had start dates in Yardi that did not match the lease start dates outlined in lease documents.¹⁰ Additionally, we found issues with the lease end dates for 8 leases (14 percent).

Of the eight leases, four leases did not have matching lease end dates, one lease terminated in June 2017 and is still included in the Yardi inventory, and three leases did not have any lease end date entered. Of the three leases with no end date, one of those leases renews annually unless cancelled, one lease expired in 2010 and is month-to-month, and the remaining lease is terminable by the City upon 60-day notice.

It is essential that Yardi include accurate lease start and end dates because these terms impact other lease transactions such as the expected date of the first rent payment, rent escalation, lease renewal dates, and the activation of holdover clauses.

⁹ There were a total of 57 leases, of which we excluded four leases that were not entered in Yardi.

¹⁰ The 12 leases included start dates between 1998 through 2014.

As Required Per a 2013 Amendment for One of Its Leases, the City Has No Record of a Security Deposit Totaling \$22,000, and the Lessee Did Not Provide Any Supporting Documentation to Substantiate That They Paid

We found that security deposit and/or line of credit (LOC) information in Yardi was not always updated. Specifically, we found that two security deposits and three LOC amounts were not entered into Yardi to reflect amounts specified in the leases. Finance has updated these five leases in Yardi as a result of our notification. We also found that, per a 2013 amendment for one of its leases, the City has no record of an approximately \$22,000 security deposit. Moreover, according to Finance, the lessee does not have documentation to substantiate that they provided the security deposit to the City.

There are approximately eight additional leases that did not have security deposit information entered in Yardi, but where lease documents appear to indicate that a security deposit should be on file. We are recommending that Policy and Management and Finance review these leases to ensure that security deposit information is properly reflected in Yardi. Also, since the lessee is unable to produce documentation of payment, we recommend that the City review and collect and/or negotiate the security deposit payment. The City should also update Yardi to reflect agreed upon terms and/or the amount collected.

This example underscores the importance of having clearly defined roles and responsibilities in managing the City's real estate assets. As discussed in **Finding 1**, the City's Administrative Regulation 4B.1 Management of City-Owned Commercial Properties (AR 4B.1) is outdated. AR 4B.1 assigns the responsibility of insuring receipt of any required security deposit to the City Clerk. However, the City Clerk does not handle this activity, and when the City completed its reorganization, it did not reassign this duty.

According to Finance, due to the lack of other available resources, it assumed the duty of tracking security deposits in Munis but did not have the proper staff resources to update the information in Yardi. Finance is currently working with Policy and Management to make Yardi the central repository for security deposit information. Moreover, Policy and Management hired a Management Analyst, whose duties will include management of property data in Yardi.

Overall, Entries for Lease Type Were Correct, But the City's Inventory Does Not Categorize Properties by Function

We reviewed a total of 43 leases for property type categorization.¹¹ We found that the City's inventory correctly listed the property type, such as retail and office, for approximately 95 percent of its commercial leases.

Guidance promulgated by the Urban Institute Center on International Development and Governance also advises municipalities to categorize properties by function since local governments manage and support various aspects of urban planning, economic development, and housing. We found that the City does not categorize its properties. Specifically, the City does not identify: 1) mandatory properties, defined as essential to government functions;

¹¹ There were a total of 57 leases, of which we excluded 9 wireless leases. We also excluded four leases that were not entered in Yardi and one lease that had been terminated.

2) discretionary properties defined as voluntarily supported for social, political, or other reasons; and 3) surplus properties defined as properties that are not mandatory or discretionary. These categorizations would allow the City to determine which properties are vital for meeting various City goals, such as the desire to develop housing or retain local business.

Additionally, classification of land should also include vacant properties. We found that the City's vacancy data in Yardi is not accurate and that the City relies upon staff familiarity to identify vacant properties. For example, the vacancy data in Yardi shows the Lion Club of West Hollywood lease has been vacant for over 30,000 days (since 1935), but the site has been in use by the tenant. According to Policy and Management, the previous staff did not activate the lease which is necessary for the system to recognize the property as occupied, and that created a long vacancy period. We also observed that the vacancy data shows nine units as vacant in one of the City's spaces. However, the space was reconfigured to two units. Policy and Management is aware of the need to the data and is currently working with Yardi to make necessary improvements.

The City's Inventory Was Not Always Accurate and Complete Due to A Lack of Dedicated Personnel to Manage Inventory and Policies and Procedures that Standardized Data Entry

The City's asset inventory is not always accurate and complete because it does not conduct periodic reviews of its asset inventory. There was no personnel dedicated to manage, review, and update the property management system. As previously discussed, the City reorganized from one Property Manager, overseeing every facet of real estate operations, to dividing real estate duties amongst various City divisions.

According to Finance, without centralized ownership of property management, Finance's priority upon assuming revenue collection was to ensure security deposits were updated in Munis and that rents were being collected and lease payments escalated in accordance with their respective lease terms. According to Finance, it also did not receive additional staff resources and thus used existing resources for managing the newly designated tasks. Moreover, Finance notes that it did not assume ownership of Yardi, nor was the goal established of building up Yardi to be the central repository for all lease and tenant information. However, it is working with the Policy and Management Department to use Yardi in this manner.

To that end, Policy and Management is in the process of drafting a regulation that will require that Policy and Management maintains an up-to-date inventory of all City-owned property. In November 2019, Policy and Management hired a Management Analyst whose duties will include oversight of Yardi information.

Additionally, there is no written guidance to provide direction about how to enter information into the City's property management system. For example, there is no standard guidance for entering lease start dates. Currently, lease start dates included the lease commencement date, which were not always the most current; the lease effective date when the lease has more recent amendment dates; or the delivery date when the lease states that the lease terms begin on the commencement date. Moreover, as discussed in **Finding 1**, City Administrative Regulation 4A.2 Real Property Control (AR 4A.2) related to inventory management, including

who manages inventory data and what is included (e.g. location, current use, cost, area, etc.) is outdated.

Internal control guidance requires that entities build, maintain, and actively manage a thorough and accurate inventory of its assets. Guidance advises that entities should periodically monitor, fully investigate, and remedy any identified discrepancies between its commercial-leased inventory and lease documents. To that end, municipalities should update their inventory when there is a change in a property's status. An accurate and thorough inventory facilitates continual and iterative internal and external communication about the municipality's progress towards achieving its stated real estate objectives. We should note that while the scope of our audit focused on commercial-leased properties, the active management of inventory could extend to the City's various assets and facilities.

Without an accurate and complete inventory of assets, the City does not have relevant information for decision-making and cannot provide clear information to the public on its stewardship of public funds and investments. Additionally, by not documenting policies and procedures in written guidance, the City is reliant upon institutional knowledge, which diminishes with the departure of key staff.

Recommendation 10

In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should update and or develop policies and procedures that, at minimum, include:

- A clear description of the staff responsible for updating the inventory.
- Guidance on the frequency of inventory review, which should occur, at minimum, on a yearly basis and as the status of properties change.
- Guidance that specifies the type of information that should be entered or tracked, including, at minimum, a unique ID, lease type, square footage, lease start and end dates, monthly rent, security deposit and line of credit information, property categorizations, and vacant spaces.
- Guidance that specifies how information should be entered into the property management system (e.g. the use of the effective, rent commencement, lease commencement, delivery dates, etc.) The Policy and Management Department should work in consultation with the Public Works Department to ensure that information such as the address, is consistent across Yardi and Infor. (Priority 1)

Recommendation 11

In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should review and update its existing inventory on the scheduling frequency determined per Recommendation 10. (Priority 1)

Recommendation 12

In order to ensure that Yardi is configured to accurately report vacant properties, the Policy and Management Department should provide updates on its progress towards reconfiguring the system to City Council and applicable Council Committees. Updates should include an anticipated timeline for completion. (Priority 2)

Recommendation 13

In order to ensure that the City has all security deposits/line of credit information recorded in Yardi, the Policy and Management and Finance Departments should review the eight leases that were identified as not having the aforementioned information in Yardi as was cited in lease documents. Additionally, the City should collect and/or negotiate payments and update Yardi to reflect agreed upon terms and/or the amount collected. (Priority 1)

Conclusion

The City of Beverly Hills (City) owns an extensive portfolio of properties that it leases to commercial tenants for investment purposes and public benefit. These spaces include restaurants, office buildings, retail locations, telecommunications spaces, and public places. Given the importance of these assets for generating General Fund revenue, and contributing to the City's reputation as a premier destination for people to live, work, and visit, it is imperative that the City establish appropriate internal controls to ensure proper stewardship and safeguarding of its assets. This includes giving appropriate attention to management oversight, clearly delineating roles and responsibilities, ensuring sufficient staff and resource capacities, and developing and tracking accurate and complete data.

Internal controls help entities improve accountability, identify organizational objectives, and monitor progress towards achievement of its goals. An effective internal control system also helps entities adapt to shifting environments, evolving demands, and new priorities. To the credit of the personnel involved in real estate operations, efforts are currently underway to make improvements. These efforts must be sustained and the internal controls continually evaluated for optimal efficiency and effectiveness.

Recommendations

Recommendation 1

In order to strengthen its oversight and management of commercial lease properties, the City Manager should designate a person that is accountable and responsible for the oversight and management of real estate operations. Duties should include, but not be limited to, conducting an analysis of the staff and resources necessary to implement the objectives identified in the Asset Management Plan (AMP). (Priority 1)

Recommendation 2

In order to strengthen its oversight and management of commercial lease properties, the City should develop an Asset Management Plan (AMP) that clearly articulates a strategic vision for the use of its properties. The AMP should include, at minimum, the following:

- Goals for commercial properties;
- Updated policies and procedures for asset management operations;
- A requirement to maintain full inventory of assets;
- A requirement for periodic review of inventory and progress towards established goals;
- An accounting of all properties, including revenue, function, and condition; and
- A requirement for an annual public presentation at City Council and/or relevant City Council committees. (Priority 1)

Recommendation 3

The Policy and Management Department, in consultation with Finance and Public Works Departments, should continue its review of Administrative Regulations (ARs) and revise or develop guidance to ensure that the organizational structure and current staff roles and responsibilities align. The updates should also ensure that financial and inventory entry duties are appropriately divided. (Priority 1)

Recommendation 4

In order to ensure that tenant maintenance is completed timely and is completed based on a specified level of service, the Policy and Management Department, in consultation with the Public Works Department, should establish baseline performance metrics. These metrics, should be periodically reviewed and be included in the Asset Management Plan. (Priority 3)

Recommendation 5

To comply with lease provisions and to compel commercial lessees to pay timely, the Policy and Management Department, in consultation with the Finance Department, should develop standard lease late fee language for use in all lease negotiations. Specifically, they should compel lessees to pay timely by issuing invoices and collecting late fee payments, and at minimum, they should identify:

- A standard payment penalty, so that the percentage of rent paid, immediate amount paid, and/or interest payments due are the same for all leases. If it is determined that interest is part of the payment penalty, interest payment terms should be the same for all leases.
- The time stamp, specifying a date for when all rent payments are due and for when late fees begin to accrue, for example, after written notice, business or calendar days after due date, etc. The time stamp should be the same for all leases.
- The marker for when a payment is considered late; for example, if not postmarked or received by a specified date.
- Enforce late fee terms by issuing invoices for late fees and collecting late fee payments. (Priority 2)

Recommendation 6

In order to improve the tracking and assessment of Common Area Maintenance (CAM), the City Manager, or his designee, should develop and implement a policy that describes its methodology for assessing CAM fees for use in all lease negotiations. Specifically, at minimum, the City should:

- Identify how CAM fees will be calculated, including specifying the information necessary for the review (e.g. maintenance expenditures, utilities, square footage, etc.). (Priority 2)

Recommendation 7

The Policy and Management Department and the Finance Department, in consultation with the City Attorney, should assess how the City will enable: 1) updated late fee terms; and 2) updated CAM assessment clauses. For example, discussing whether updates to lease terms will occur as leases terminate, for all new leases, or via amendments to all leases. The results of which should be communicated via written memo, directive, etc. to staff and City Council. (Priority 2)

Recommendation 8

In order to improve its tracking of general maintenance at its commercial properties, the Public Works Department, in consultation with the Finance Department, should continue development of Infor to capture labor, time, and parts and materials costs. Periodic updates on progress, performed at least biannually, should be provided to City Council on progress. (Priority 2)

Recommendation 9

In order to ensure that the City is not completing maintenance that should be the responsibility of the tenant, the Public Works Department should:

- Formalize written policies and procedures for reviewing maintenance requests, specifying roles and responsibilities of staff, determining when the City completes maintenance that is the tenant's obligation, and formalizing a method for tenant billbacks when City completes maintenance under the tenant's purview.
- Consult with the City Attorney and the Policy and Management Department regarding the standardization of maintenance clauses. (Priority 2)

Recommendation 10

In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should update and or develop policies and procedures that, at minimum, include:

- A clear description of the staff responsible for updating the inventory.
- Guidance on the frequency of inventory review, which should occur, at minimum, on a yearly basis and as the status of properties change.
- Guidance that specifies the type of information that should be entered or tracked, including, at minimum, a unique ID, lease type, square footage, lease start and end dates, monthly rent, security deposit and line of credit information, property categorizations, and vacant spaces.
- Guidance that specifies how information should be entered into the property management system (e.g. the use of the effective, rent commencement, lease commencement, delivery dates, etc.) The Policy and Management Department should work in consultation with the Public Works Department to ensure that information such as the address, is consistent across Yardi and Infor. (Priority 1)

Recommendation 11

In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should review and update its existing inventory on the scheduling frequency determined per Recommendation 10. (Priority 1)

Recommendation 12

In order to ensure that Yardi is configured to accurately report vacant properties, the Policy and Management Department should provide updates on its progress towards reconfiguring the system to City Council and applicable Council Committees. Updates should include an anticipated timeline for completion. (Priority 2)

Recommendation 13

In order to ensure that the City has all security deposits/line of credit information recorded in Yardi, the Policy and Management and Finance Departments should review the eight leases that were identified as not having the aforementioned information in Yardi as was cited in lease documents. Additionally, the City should collect and/or negotiate payments and update Yardi to reflect agreed upon terms and/or the amount collected. (Priority 1)

Appendix I: Objectives, Scope, and Methodology

In accordance with our Fiscal Year 2019/20 Annual Audit Work Plan, we performed an audit of the Policy and Management Department's Real Estate and Property Management Division. The scope of the review covered Fiscal Years (FY) 2016/17 through 2018/19, and periods prior and including FY 2019/20, when applicable, based on lease clauses or audit testing. Our objectives were to:

- 1) Identify the universe of City assets and determine if the City has mechanisms in place for managing its asset portfolio;
- 2) Determine the value of the City's assets and any potential uncollected revenue from late, missing, or unenforced escalation clauses; and
- 3) Assess the City's staff capacity and organizational structure for managing real estate operations.

To identify the universe of assets, we ran reports in Yardi, the City's real estate property management system, and reviewed lease documents. We conducted field observations of lease sites and reviewed City guidance, such as Administrative Regulations, related to the management of the City's commercial properties. Additionally, we reviewed real estate industry guidance and audit reports to identify asset management frameworks and practices for comparison against the City's current operations.

To determine the value of the City's assets, for each lease, we reviewed the FY 2016/17 through 2018/2019 rent revenue in Munis, the City's financial system, and summarized the totals for each year. To assess whether the City is collecting its lease revenue, we reviewed each tenant's lease clauses pertaining to rent escalations, late fees, maintenance charges, and percentage sales, and traced financial information in both Yardi and Munis.

To assess the City's staff capacity and organizational structure, we reviewed existing and draft policies detailing roles and responsibilities of staff involved in the real estate operations. We also conducted interviews and reviewed industry guidance.

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.

Appendix II: Fiscal Years 2016/17, 2017/18, and 2018/19 Lease Revenue

	Leased Properties	FY 2016/17	FY 2017/18	FY 2018/19
1	Ferragamo (S-FER International)	\$2,242,990	\$2,403,229	\$2,475,326
2	Participant Media, LLC	\$2,168,415	\$2,231,378	\$2,299,301
3	David Yurman	\$1,439,380	\$1,507,548	\$1,750,218
4	Euromarket Designs, Inc.	\$1,602,578	\$1,604,818	\$1,608,605
5	Lakeshore Entertainment Group, LLC	\$1,135,320	\$1,172,659	\$1,212,754
6	Williams-Sonoma	\$1,150,045	\$1,176,695	\$1,211,996
7	Richemont North America, Inc.	\$809,530	\$833,816	\$861,644
8	Forward BH (Keller Williams)	\$770,353	\$794,718	\$817,305
9	Google Inc.	\$724,990	\$746,739	\$769,142
10	Whole Foods Market	\$782,851	\$872,774	\$767,452
11	Rite Aid Corp	\$623,636	\$634,125	\$655,806
12	UMRO Realty Corp	\$473,925	\$462,216	\$451,089
13	Southwest Wine & Spirits	\$353,362	\$360,993	\$371,157
14	FREM Investments, LLC	\$276,443	\$284,737	\$323,332
15	Art of Shaving	\$318,482	\$355,682	\$310,178
16	THE W. McDevitt Company, Inc.	\$262,248	\$263,528	\$270,116
17	Johnson & Johnson	\$150,194	\$154,693	\$223,288
18	Granite Escrow Services, Inc.	\$158,222	\$162,957	\$167,834
19	Psomas	-	-	\$139,392
20	Beverly Hill Conference & Visitors Bureau	\$121,080	\$125,790	\$129,563
21	Wine Societe	\$103,890	\$123,666	\$126,952
22	BH Tennis	\$94,124	\$97,015	\$120,922

	Leased Properties	FY 2016/17	FY 2017/18	FY 2018/19
23	Fedex Kinko	\$107,561	\$111,088	\$112,939
24	Lucerne Hardware	\$99,048	\$104,001	\$109,201
25	City of West Hollywood	\$32,000	\$96,000	\$108,257
26	Restaurant Business Strategies, LLC	\$101,764	\$97,779	\$99,940
27	Beverly Hills Market	\$77,053	\$78,758	\$80,513
28	Jae In Lee	\$68,624	\$67,864	\$70,649
29	New Cingular Wires dba AT&T - PD	\$46,762	\$48,165	\$69,239
30	Bailey's Bakery	\$60,649	\$61,095	\$63,463
31	Daniel Maltzman	\$57,295	\$59,014	\$60,784
32	AT&T Wireless	\$60,000	\$60,000	\$60,000
33	Cingular FS#2 (T-Mobile)	\$65,492	\$74,549	\$59,389
34	F.P.L.R., Inc. (Raphael)	\$27,299	\$45,937	\$56,829
35	Kelly's Coffee	\$51,052	\$52,738	\$54,527
36	Verizon Wireless	\$50,478	\$51,993	\$53,552
37	Cingular PD (T-Mobile)	\$50,017	\$51,517	\$53,363
38	New Cingular Wireless PCS, LLC	\$48,665	\$52,338	\$49,453
39	Sprint PCS Assets	\$44,840	\$47,486	\$48,951
40	Beverly Custom Cleaners	\$41,470	\$43,241	\$47,587
41	Mercedes Benz of Beverly Hills	\$42,000	\$42,000	\$42,000
42	Al's Newstand	\$34,884	\$38,876	\$40,199
43	Maples Counseling Center	Lease Became Active in 2019	Lease Became Active in 2019	\$30,618
44	Outfront Media LLC	\$10,583	\$30,000	\$30,000
45	AT&T - 1201 Coldwater Canyon	\$24,941	\$25,560	\$25,521
46	AT&T Wireless - Greystone	\$19,200	\$19,200	\$19,200

Leased Properties		FY 2016/17	FY 2017/18	FY 2018/19
47	Heidi Novian	\$16,535	\$17,273	\$17,460
48	Verizon Wireless Flagpole FS#2	\$17,595	\$17,895	\$15,607
49	Academy of Motion Picture Arts & Science	-	\$12,558	\$12,289
50	B.H. City Employee Federal Credit Union	\$10,000	\$12,000	\$12,000
51	Gusto Camden, LLC	Lease Became Active in 2019	Lease Became Active in 2019	\$3,458
52	AT&T	-	\$1,845	\$972
53	Wallis Annenberg Center for the Performing Arts	\$100	\$100	\$100
54	Lion's Club of West Hollywood	No Project Code	No Project Code	No Project Code
55	United States Postal Service	No Project Code	No Project Code	No Project Code
56	Beverly Hills CPR	No Project Code	No Project Code	No Project Code
57	Circus Clowns, LLC	Lease Became Active FY 2020	Lease Became Active FY 2020	Lease Became Active FY 2020
	Total	\$17,027,967	\$17,790,644	\$18,571,430

Note: Rent amounts include base rent totals and, when applicable, common area maintenance (CAM), percentage sales, and parking revenue.

Source: OCA generated based on a review of lease revenue as recorded in MUNIS.

Appendix III: Commercial Lease Late Fee Clauses

	Lease Clause	Number of Leases
1	10% of required payment; on or before 10th day after payment due	12
2	10% of required payment; on or before 10th day after written notice	2
3	10% of required payment; on or before 15th day after payment due	2
4	10% of required payment; on or before 5th day after payment due	1
5	2% of required payment; on or before 10th day after notice that payment is due	1
6	3% of required payment plus interest; within 5 days after written notice (equal to 2% per annum plus prevailing prime rate)	1
7	3% of required payment plus interest; within 5 days after written notice (interest equal to 2% per annum plus prevailing prime rate)	1
8	4% of amount due if no payment within 10 business days after written notice plus interest (interest at lesser of 10% per annum or the highest rate permitted by law)	1
9	4% of amount due if not received within 10 business days after written notice that it is past due.	2
10	4% of late payment charge plus interest; on or before 10th day after payment is due (interest lesser of 10% per annum or the maximum rate permitted by law)	2
11	4% of late payment charge plus interest; within 5 business days after payment is due (interest greater of 10% per annum or 2% per annum plus prevailing prime rate)	1
12	5% of late payment charge plus interest; within 5 business days after payment is due (Interest lesser of 10% per annum or 2% per annum plus prevailing prime rate)	1
13	5% of late payment charge plus interest; within 5 business days after payment is due (interest lesser of 8% per annum or 2% per annum plus prevailing prime rate)	1
14	5% of required payment not made plus interest; within 5 days after written notice (interest equal to 2% per annum plus prevailing prime rate)	1
15	5% of required payment plus interest; within 10 days after payment due (interest equal to greater of 10% per annum or 2% per annum plus prevailing prime rate)	2
16	6% of required payment not made within 5 days after the due date plus interest (equal to greater of 12% per annum or 2% per annum plus prevailing prime rate)	3
17	6% of required payment plus interest; paid within 5 business days after payment due (interest equal to greater of 12% per annum or 2% per annum plus prevailing prime rate)	1
18	6% of required payment plus interest; Within 5 days after the due date (interest equal to greater of 12% per annum or 2% per annum plus prevailing prime rate)	1

	Lease Clause	Number of Leases
19	6% of required payment; on or before 10th day after Landlord gives notice; Landlord agrees to waive first such late payment, in any 12-month period, as long as payment is made on or before the 25th day after Landlord gives notice	1
20	6% of required payment; on or before 10th day after payment due	3
21	Greater of 5% of delinquent amount and \$250 if not paid by later of 5 days after due date and 5 days after tenants receipt of written notice from Landlord plus interest (equal to prime interest rate plus 2 percentage points from the date such amount originally due to and including the date of payment)	1
22	Immediate payment of \$1500 if required payment not made within 10 days after due date plus interest (equal to prime interest rate plus 2 percentage points from the date such amount originally due to and including the date of payment)	1
23	Immediate payment of \$200 if rent not received within 10 days after due date. Rent shall bear interest at highest rate permitted by law, from the date unpaid amount initially due and including the date of payment.	1
24	Immediate payment of \$500 if required payment not made within 5 days after due date plus interest (equal to prime interest rate plus 2 percentage points from date such amount originally due to and including the date of payment)	1
25	Immediate payment of \$500 if required payment not made within 5 days after due date plus interest (equal to prime interest rate plus 2 percentage points)	1
26	Immediate payment of \$500 if required payment not made within 8 days after due date plus interest (interest at prime interest rate plus 2 percentage points from the date amount originally due)	1
27	In event either party is in default of lease terms, the non-defaulting party shall deliver written notice and the defaulting party has 14 days from receipt to cure. If a cure cannot be effected in 14 days, the defaulting party may continue such cure past 14 days from notice if it commences such cure within 14 days from notice and pursues such cure to completion.	1
28	Interest at lesser of 10% per annum or maximum rate permitted by law	1
29	Interest from date due until paid at rate equal to lesser of 133 1/3 of prime rate and maximum rate that a non-exempt lender is permitted to charge on loans	1
30	Interest from due date at greater of 8% per annum or the default rate required to be paid under Loan Documents, accruing daily but not compounded.	1
31	No Late Fee Clause	7
	Total Leases	57

Source: Office of the City Auditor (OCA) generated based on a review of City commercial lease clauses.

Appendix IV: Common Area Maintenance (CAM) Clauses

	Lessee	CAM Clause	CAM Fee Assessed
1	Granite Escrow Services, Inc.	\$66.10 per month, plus CPI adjustment every second anniversary	Missed
2	FREM Investments, LLC	Base Year Operating Expenses for Calendar Year 2011	No
3	Google Inc.	Base Year Operating Expenses for Calendar Year 2012	No
4	Participant Media, LLC	Base Year Operating Expenses for Calendar Year 2013	No
5	UMRO Realty Corp	Base Year Operating Expenses for Calendar Year 2014	No
6	Gusto Camden, LLC	All operation, management, ownership, maintenance and repair actually incurred by Landlord, attributable to space, not parking facilities.	Yes
7	Euromarket Designs, Inc.	First 12 months, fixed amount of \$2.00 multiplied by the Floor Area, paid in equal monthly installments. Annually thereafter, an amount equal to the lesser of 105 percent of CAM payment in effect immediately prior or tenant's CAM payment immediately prior multiplied by CPI index.	Yes
8	Forward BH (Keller Williams)	At commencement of lease \$3016 per year, plus annual CPI adjustment; based on square footage of rentable area	Yes
9	Nate N' AL/Circus Clowns	At commencement of lease \$42,268.80 per year, with \$3,522.40 paid monthly, plus annual 3% increase annually. However, if Landlord elects, tenant shall pay proportionate share on monthly or quarterly basis.	Yes
10	Johnson & Johnson	At commencement of lease \$157.65 per month, plus annual CPI adjustment; based on square footage of rentable area	Yes
11	Wine Societe	Tenant's share is 9.94 percent equaling \$184.13 monthly; based on a reasonable estimate	Yes
12	Southwest Wine & Spirits	At commencement of lease \$2,198 per month, plus CPI adjustment every second anniversary	Yes

Source: Office of the City Auditor (OCA) generated based on a review of City commercial lease clauses and review of Yardi lease ledgers.



CITY OF BEVERLY HILLS
POLICY AND MANAGEMENT

MEMORANDUM

TO: Eduardo Luna, City Auditor

FROM: Logan Phillippo, Policy & Management Analyst
Shana Epstein, Director of Public Works
Jeff Muir, Director of Finance
("Management")

DATE: June 19, 2020

SUBJECT: Management Response to Performance Audit of the Internal Controls Over the City's Real Estate Portfolio and Property Management

This memorandum provides the management response to the Performance Audit of the Internal Controls Over the City's Real Estate Portfolio and Property Management (the "Audit") and reports Management's considerations and plans with regard to the audit's recommendations, shown in Exhibit A.

The Audit included a scope of work for 57 leases. Since the commencement of the Audit, the City has approved additional leases, seen some leases expire, and acquired two properties with a total of seven leases. Staff in the Real Estate Management program currently oversee 64 active leases and three shared ownership arrangements that require active management. These 67 items are tracked along with 27 properties defined in the City's commercial lease software, Yardi.

In summary, Management concurs with each of the Audit's recommendations.

Over the past decade, the City has continually added to its real estate portfolio and continues to pursue opportunities to acquire and develop additional properties while staff resources for tenant support and facility administration have largely remained fixed. Accordingly, as indicated in the Audit's Recommendation 1, the City first should assess the appropriate support levels and organizational structure among the Policy and Management, Public Works and Finance Departments in order to ensure implementation of best practices, delivery of the highest-quality customer service to tenants, and the appropriate planning for future developments.

The release of the Audit was originally scheduled for March 2020. At that time, Management intended to recommend additional staffing to support the tenant relations function and day-to-day property management activities, a step necessary to ensure appropriate service levels to tenants and overall program administration. However, given the anticipated fiscal impacts related to COVID-19 and City's need to reduce costs, other options should also be assessed. Though not specifically referenced in the audit, supplemental contract property management services could greatly assist with the day-to-day building management and facilities maintenance activities, provided the appropriate City guidance and oversight for onboarding a third-party management company is first in place.

A summary of additions to the City's real estate portfolio over the past ten years is included below.

- In 2010, the City completed construction of the approximately 72,000-square-foot office building located at 331 Foothill Road. The building has three commercial tenants.
- In 2010, the City acquired 239 South Beverly Drive, which was formerly occupied by the Chamber of Commerce. The building now has two commercial tenant spaces. One is currently vacant.
- In 2012, the City completed construction of the approximately 21,500 square-foot commercial building located at 9400 South Santa Monica Boulevard. The building has four commercial tenants and a tenancy-in-common arrangement with the Chamber of Commerce.
- In 2013, The Wallis Annenberg Center for the Performing Arts opened, after several years of planning. While The Wallis manages the facility, the arrangement requires contract administration and oversight. Additionally, in 2019, the City agreed to contribute up to \$1 million annually to The Wallis, requiring more administrative involvement.
- In 2016, the City completed acquisition of 1945 South La Cienega Boulevard, which was formerly owned by the Coffee Bean & Tea Leaf. The City, as landlord, is currently overseeing a project to renovate the building and a future office tenant will begin its tenant improvements in the fall 2020.
- In 2017, the City acquired 8421 Wilshire Boulevard. Los Angeles Metropolitan Transit Authority ("Metro") maintains a temporary construction easement through September 2025. Staff is undergoing planning for the future use of the site.
- In 2018, the City acquired the single-family residential property located at 1721 Monte Cielo Court due to the site's strategic proximity to existing water infrastructure.
- In 2019, the City approved a memorandum of agreement with Metro, which provides for acquisitions at 9393 Wilshire Boulevard and 9385 Wilshire Boulevard, an access easement at 1940 Century Park East, and right of first negotiation at two other properties.
- In 2019, the City acquired 327-335 South Robertson Boulevard and assumed six commercial leases. Staff is undergoing planning for the future use of the site.
- In 2019, the City acquired 8423 Wilshire Boulevard and assumed one commercial lease.
- With regard to future acquisitions, the City is seeking to acquire additional property along South Robertson Boulevard, two properties along South La Cienega Boulevard, property contiguous to La Cienega Park, and other key properties near the future site of La Cienega Station and Rodeo Station. Financial impacts related to COVID-19 may delay these activities. Staff also reviews other potential acquisitions and joint-development opportunities on an ad-hoc basis.
- With regard to future development, the City is evaluating options to develop recently acquired properties and is seeking to build affordable housing at multiple locations. The City is also evaluating options for the 61,000-square-foot vacant office building at 336 Foothill Road. Financial impacts related to COVID-19 may delay these activities.

Exhibit A: Audit Recommendations, Relevance to COVID-19 Planning, and Auditor Observations

Theme	Rec. #	Recommendation Language	Management Response and Anticipated Completion Date
Oversight and Accountability <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives 	1	<p>In order to strengthen its oversight and management of commercial lease properties, the City Manager should designate a person that is accountable and responsible for the oversight and management of real estate operations. Duties should include, but not be limited to, conducting an analysis of the staff and resources necessary to implement the objectives identified in the Asset Management Plan (AMP). (Priority 1)</p>	<p>Management Concur</p> <p>Timeframe 6 – 12 Months</p> <p>This employee should conduct an analysis of the City's existing program structure and determine how best to allocate staff and time to asset management and property management duties. The City should reorganize this function accordingly. The position should also evaluate options to supplementing existing program support through contract property management.</p> <p>Implementation of many of these recommendations require input and direction from this designated employee. As such, some recommendations will include the abbreviation "Rec. 1" to indicate implementation is contingent upon Recommendation 1.</p>
Oversight and Accountability Policies and Procedures Inventory <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives Infection Control Policies and Procedures Infrastructure Tracking Expenditures and Cost-Recovery 	2	<p>In order to strengthen its oversight and management of commercial lease properties, the City should develop an Asset Management Plan (AMP) that clearly articulates a strategic vision for the use of its properties. The AMP should include, at minimum, the following:</p> <ul style="list-style-type: none"> Goals for commercial properties; Updated policies and procedures for asset management operations; A requirement to maintain full inventory of assets; A requirement for periodic review of inventory and progress towards established goals; An accounting of all properties, including revenue, function, and condition; and A requirement for an annual public presentation at City Council and/or relevant City Council committees. (Priority 1) 	<p>Management Concur</p> <p>Timeframe 6 – 12 Months (Rec. 1)</p> <p>The Asset Management Plan (AMP) will require extensive interdepartmental coordination and City Council direction and will also require the implementation of Recommendations 1, 3, 4, 8, 9, 10, 11 and 12.</p>
Oversight and Accountability Policies and Procedures	3	<p>The Policy and Management Department, in consultation with Finance and Public Works Departments, should continue its review of Administrative Regulations (ARs) and revise or develop guidance to ensure that the organizational</p>	<p>Management Concur</p> <p>Timeframe 3 – 6 Months (Rec. 1)</p> <p>An existing administrative regulation regarding management of commercially-leased properties has not been updated since 1982. Prior</p>

Management Response: Exhibit A

6/19/2020

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Theme	Rec. #	Recommendation Language	Management Response and Anticipated Completion Date
<u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives 		structure and current staff roles and responsibilities align. The updates should also ensure that financial and inventory entries duties are appropriately divided. (Priority 1)	to the Audit's commencement, the Policy and Management Department updated this administrative regulation, but did not finalize, pending input from this Audit. Policy and Management has additionally drafted two administrative regulations, regarding Real Property Acquisition and Real Property Disposition, that had never previously existed. Finalization of these administrative regulations should be placed on hold until the analysis referenced in Recommendation 1 is completed. A fourth administrative regulation relating to Real Property Control, not updated since 1984 will also be updated.
Oversight and Accountability Performance Monitoring <u>COVID 19</u> <ul style="list-style-type: none"> Ensures operational compliance with COVID-19 directives Infection Control 	4	In order to ensure that tenant maintenance is completed timely and is completed based on a specified level of service, the Policy and Management Department, in consultation with the Public Works Department, should establish baseline performance metrics. These metrics, should be periodically reviewed and be included in the Asset Management Plan. (Priority 3)	Management Concur Timeframe 6 – 12 Months (Rec. 1)* In addition to administrative regulations that define and assign the roles of each department, the Policy and Management Department should additionally establish a service-level agreement with the Public Works Department as it relates to Facilities Maintenance and Project Administration related services and expectations. This resource requirement should be included in the staffing analysis referenced in Recommendation 1. As these service levels are defined, an analysis of resources required to deliver these new service levels should be conducted as well. The City's approach will also depend on whether supplemental contract property support is implemented. * Timing may vary contingent upon staff levels needed to accomplish agreed upon, established service levels.
Financial Transparency and Financial Reporting Reliability Policies and Procedures <u>COVID 19</u> <ul style="list-style-type: none"> Policies and Procedures Tracking Expenditures and Cost-Recovery 	5	To comply with lease provisions and to compel commercial lessees to pay timely, the Policy and Management Department, in consultation with the Finance Department, should develop standard lease late fee language for use in all lease negotiations. Specifically, they should compel lessees to pay timely by issuing invoices and collecting late fee payments, and at minimum, they should identify: <ul style="list-style-type: none"> A standard payment penalty, so that the percentage of rent paid, immediate amount paid, and/or interest payments due are the same for all leases. If it is determined that interest is part of the 	Management Concur Timeframe: 6 Months 30 differing late fee clauses were identified by the Audit among 57 total leases with 7 leases absent any late fee clause. Because the terms of late payments in each lease are not standardized, Management has faced significant challenges with implementing late fee collections due to limitations in the lease administration software, Yardi. After a cost-benefit analysis (late payment fees are small compared to the overall rent collected), limited staffing, and the fact that late fees, which are varied among all leases, could not be calculated among all tenants in Yardi, Management did not recommend assessing late fees.

Management Response: Exhibit A

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Theme	Rec. #	Recommendation Language	Management Response and Anticipated Completion Date
		<p>payment penalty, interest payment terms should be the same for all leases.</p> <ul style="list-style-type: none"> • The time stamp, specifying a date for when all rent payments are due and for when late fees begin to accrue, for example, after written notice, business or calendar days after due date, etc. The time stamp should be the same for all leases. • The marker for when a payment is considered late; for example, if not postmarked or received by a specified date. • Enforce late fee terms by issuing invoices for late fees and collecting late fee payments. (Priority 2) 	<p>Since the onboarding of an additional Management Analyst position November 2019 to support the lease administration function, Management has been able to allocate more resources to the update and administration of Yardi and the associated programming of late fees. This step, combined with the implementation a process for determining an appropriate marker for a when a payment is considered late, should allow the City to assess late fees. The City is also implementing a payment portal that will allow tenants the option to pay online, which will assist with this process for tenants who choose to eventually utilize this feature.</p> <p>Standardization of late payment language as of February 2019 has been incorporated it into lease amendments and all new leases. The standard language requires a \$500.00 late fee payment. The unpaid amount bears interest at an interest rate defined as the prime interest rate published by the Wall Street Journal plus two percentage points.</p>
<p>Financial Transparency and Financial Reporting Reliability</p> <p>Policies and Procedures</p> <p><u>COVID 19</u></p> <ul style="list-style-type: none"> • Infrastructure • Tracking Expenditures and Cost- Recovery 	6	<p>In order to improve the tracking and assessment of Common Area Maintenance (CAM), the City Manager, or his designee, should develop and implement a policy that describes its methodology for assessing CAM fees for use in all lease negotiations. Specifically, at minimum, the City should:</p> <ul style="list-style-type: none"> • Identify how CAM fees will be calculated, including specifying the information necessary for the review (e.g. maintenance expenditures, utilities, square footage, etc.). (Priority 2) 	<p>Management Concur</p> <p>Develop Process – Six Months</p> <p>Update Clauses – As lease amendments occur</p> <p>Enforcing Clauses – Upon updating and tracking of underlying data needed to calculate CAM fees</p> <p>Management can establish a consistent methodology for calculating common area maintenance (CAM) fees and include consistent CAM fee calculations into new and amended leases; however, the City also needs to proceed with determining square footage estimates and will reexamine opportunities for obtaining this information through bids to perform this work, as this data is critical to many CAM fee calculations and rent fees.</p> <p>As the CAM policy and methodology is being developed, the City Manager, or his designee, will consult with both Finance and Public Works, as appropriate, to evaluate the feasibility with implementing the proposed CAM methodology. This approach will ensure the adopted methodology and policy can be readily implemented with the proper systems and processes.</p>
<p>Financial Transparency and Financial Reporting Reliability</p>	7	<p>The Office of Policy and Management and the Finance Department, in consultation with the City Attorney, should assess how the City will enable: 1) updated late fee terms; and 2) updated CAM assessment clauses. For example, discussing whether updates to lease</p>	<p>Management Concur</p> <p>Written Memo – 3 Months</p> <p>Standardize Lease Template – 1 Month</p>

Management Response: Exhibit A

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Theme	Rec. #	Recommendation Language	Management Response and Anticipated Completion Date
<u>COVID 19</u> <ul style="list-style-type: none"> • Policies and Procedures • Tracking Expenditures and Cost-Recovery 		<p>terms will occur as leases terminate, for all new leases, or via amendments to all leases. The results of which should be communicated via written memo, directive, etc. to staff and City Council. (Priority 2)</p>	<p>Use Standardized Lease Templates – As new leases occur</p> <p>The Policy & Management Department has drafted a standardized set of late payment language for new leases and has developed a lease template to assist with streamlining lease administration activities. The lease terms referenced in the audit will be updated for all new leases and for substantial lease amendments. It should be noted that leases are a product of negotiation and future leases may have deviations from standardized terms, depending on the negotiating party's bargaining power, but Management will endeavor to utilize clauses as standardized as possible. The Policy and Management Department, Finance Department and City Attorney's Office will assess how the City will implement late fee clauses and how to define when a lease payment is deemed late. Management will additionally determine a consistent methodology for assessing CAM fee charges and communicate this information via written memo.</p>
<p>Financial Transparency and Financial Reporting Reliability</p> <p><u>COVID 19</u></p> <ul style="list-style-type: none"> • Infrastructure • Tracking Expenditures and Cost-Recovery 	8	<p>In order to improve its tracking of general maintenance at its commercial properties, the Public Works Department, in consultation with the Finance Department, should continue development of Infor to capture labor, time, and parts and materials costs. Periodic updates on progress, performed at least biannually, should be provided to City Council on progress. (Priority 2)</p>	<p>Management Concur</p> <p>Use Infor to track maintenance expenses – Mid-2021</p> <p>Communication to Council – Biannually</p> <p>Staff will continue efforts to develop Public Works work order and asset management system (Infor) to track labor, material and parts costs. At this time, City labor and vehicle costs are currently tracked in Infor; the system is currently unable to identify direct materials/supplies costs. Efforts have resumed to build out the Infor inventory management function, which entails a major overhaul of the Public Works Department's existing processes and systems. It is anticipated that the completion of the Infor inventory management function will be in 2021, in which case, then the cost of materials and supplies related to property maintenance can be fully tracked. The City's approach will also depend on whether supplemental contract property support is implemented.</p> <p>Annual updates on the Infor project implementation are provided to the Public Works Commission; the most recent update was provided at its December 12, 2019 Commission meeting. Furthermore, annual updates are provided to the City Council as part of the Council's priority setting sessions. Periodic updates on selected Department projects are provided to the City Manager's office at bi-weekly project review meetings, including the status of the inventory management module and general updates of the enterprise-wide asset management system (Infor).</p>

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Policies and Procedures <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Policies and Procedures • Infrastructure 	9	<p>In order to ensure that the City is not completing maintenance that should be the responsibility of the tenant, the Public Works Department should:</p> <ul style="list-style-type: none"> • Formalize written policies and procedures for reviewing maintenance requests, specifying roles and responsibilities of staff, determining when the City completes maintenance that is the tenant's obligation, and formalizing a method for tenant billbacks when City completes maintenance under the tenant's purview. • Consult with the City Attorney and the Office of Policy and Management regarding the standardization of maintenance clauses. (Priority 2) 	Management Concur Public Works Policies and Procedures – 6 Months Public Works will formalize its policies and procedures for reviewing and specifying staff roles and responsibilities as it relates to maintenance requests and billbacks. Public Works intends to further expand functionalities within Infor to record and generate the necessary supporting documentation for billbacks, as applicable. The City's approach will also depend on whether supplemental contract property support is implemented.
Inventory <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Policies and Procedures • Infrastructure • Tracking Expenditures and Cost-Recovery 	10	<p>In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should update and or develop policies and procedures that, at minimum, include:</p> <ul style="list-style-type: none"> • A clear description of the staff responsible for updating the inventory. • Guidance on the frequency of inventory review, which should occur, at minimum, on a yearly basis and as the status of properties change. • Guidance that specifies the type of information that should be entered or tracked, including, at minimum, a unique ID, lease type, square footage, lease start and end dates, monthly rent, security deposit and line of credit information, property categorizations, and vacant spaces. • Guidance that specifies how information should be entered into the property management system (e.g. the use of the effective, rent commencement, lease commencement, delivery dates, etc.) The Policy and Management Department should work in consultation with the Public Works Department to ensure that information such as the address, is consistent across Yardi and Infor. (Priority 1) 	Management Concur Document Process – 6 Months Updating Square Footage – As spaces become vacant or upon hiring of a consultant to measure all spaces citywide. With the onboarding of the new Management Analyst position in November 2019, Policy and Management is now actively reviewing and updating information in the property management software, Yardi. With regard to square footage, Management is currently measuring and creating floorplans for properties as leased spaces become vacant. Management has also developed preliminary guidance on the type of information that should be entered and tracked. Management will also reexamine options to hire an outside architect/consultant to measure all leased spaces city-wide

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Inventory <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Policies and Procedures • Infrastructure • Tracking Expenditures and Cost-Recovery 	11	In order to improve the accuracy and completeness of its commercial lease inventory, the Policy and Management Department should review and update its existing inventory on the scheduling frequency determined per Recommendation 10. (Priority 1)	Management Concur Timeframe – Completed Yardi has been updated based on guidance in development per Recommendation 10. The Scheduling frequency will be included and implemented, per Recommendation 10.
Inventory <u>COVID 19</u> <ul style="list-style-type: none"> • Infection Control • Infrastructure • Tracking Expenditures and Cost-Recovery 	12	In order to ensure that Yardi is configured to accurately report vacant properties, the Policy and Management Department should provide updates on its progress towards reconfiguring the system to City Council and applicable Council Committees. Updates should include an anticipated timeline for completion. (Priority 2)	Management Concur Timeframe – Completed A discussion of the inventory will be included with the AMP as it is developed.
Financial Transparency and Financial Reporting Reliability <u>COVID 19</u> <ul style="list-style-type: none"> • Tracking Expenditures and Cost-Recovery 	13	In order to ensure that the City has all security deposits/line of credit information recorded in Yardi, the Policy and Management and Finance Departments should review the eight leases that were identified as not having the aforementioned information in Yardi as was cited in lease documents. Additionally, the City should collect and/or negotiate payments and update Yardi to reflect agreed upon terms and/or the amount collected. (Priority 1)	Management Concur Review of Security Deposits in Yardi – Complete Outstanding Security Deposit Timeframe – 3 Months Information regarding security deposits has been reviewed and updated in Yardi to reflect the correct required amounts. The City has no record of having received the additional \$22,040.00 security deposit. The tenant has been made aware of the issue and not provided sufficient documentation that the deposit has been paid (since notified in January 2020). Due to COVID-19 and the sensitivity of tenants' ability to pay rent, these conversations have been placed on hold. Management will continue to follow up with the tenant and escalate matters to the City Attorney and provide updates to City Council if not resolved by the timeframe designated above.

Source: OCA generated based on a review of the audit recommendations and COVID-19 guidance.