Building Leases

Review Policies and Improve Practices

May 2004

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b) Wait until the open hand symbol changes to pointer .
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MEMORANDUM

Date: May 20, 2004

To: Diane Linn, Multnomah County Chair
Maria Rojo de Steffey, Commissioner, District 1
Serena Cruz, Commissioner, District 2
Lisa Naito, Commissioner, District 3
Lonnie Roberts, Commissioner, District 4

From: Suzanne Flynn, Multnomah County Auditor

Subject: Building Leases Audit

The attached report covers our audit of Building Leases. This audit was included in our FY03-04 Audit Schedule.

The negotiation and administration of building leases are critical to the effectiveness of the landlord-tenant relationship. As of October 2003, the County leased 354,298 square feet in 35 buildings in 39 different leases budgeted for almost $4 million. The County also had 40 leases with nonprofit, government, and business tenants that were budgeted for revenues of $1.1 million. While we saw some improvements in lease negotiation and administration recently, there are weaknesses that remain.

We found two policy areas that need the Board of County Commissioners' attention. In a 1993 audit, our office recommended that the County develop an overall policy on leasing County-owned space. That policy was not developed. We found the need for such a policy even greater today. We estimated that the County provided a $626,000 subsidy to its tenants in FY03-04.

Secondly, competing objectives have impacted the County policy that long-term County programs should be located in owned, not leased, property. From January 1999 to October 2003, leased space has increased 2.3% while owned space has also increased by 14.5%. In 1995 when the County approved this policy leased space accounted for 13% of total space. As of October 2003, leased space was 11.5% of the total.

We have discussed our findings and recommendations with management in the Department of Business and Community Services and the Division of Facilities and Property Management. A formal follow-up to this audit will be scheduled within 1-2 years.

We would like to acknowledge and thank the management and staff in Facilities and Property Management for the cooperation and assistance extended to us.

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Executive Summary

The County is both a tenant and landlord of building space. As of October 2003, the County owned 2,720,361 square feet and leased 354,298 square feet from others. The amount of owned space has increased 14.5% since January 1999 while leased space has increased 2.3% in the same time period. In FY03-04 leased space expenditures were budgeted at $4 million. The County also leased out 135,496 square feet to others or about 5% of its total owned space for estimated revenue in FY03-04 of $1.1 million.

The negotiation and administration of building leases is critical to the effectiveness of the landlord-tenant relationship. The purpose of this audit was to determine if building leases were properly initiated, maintained, and renewed or terminated, and whether the County was following adopted policy to house long-term programs in owned space.

All leases, as a tenant or landlord, were administered by the Facilities and Property Management Division (FPM) in the Department of Business and Community Services. The majority of the work was assigned to the Real Property Management Section. During the audit, the staff in this Section, new to administering leases, made significant progress in improving the County's operations in this area. However, we found areas of concern that still need to be addressed.

As a tenant, the County was sometimes in a weakened negotiating position due to premature contact with potential landlords, inadequate planning, and incomplete analysis. Negotiating a lease occurs in a business environment where the landlord's objective is to obtain the best price possible. In some cases, revealing information about the County's specific plans or needs and proceeding without alternatives put the County in a weak negotiating position and most likely increased costs. The fact that the County does not adequately plan for space needs far enough in advance limited finding good alternatives. Further, agreements were not analyzed to the depth needed to determine if offers by landlords represent the best option.

To ensure that the County is not overcharged, leases should be monitored and enforced. The standard practice of using landlord lease forms increases the complexity in monitoring lease performance. Further, the County does not have a system in place to proactively monitor leases. We found instances where better enforcement could have avoided unnecessary costs. To the Department's credit, staff recently took advantage of audit language to discover an overcharge. A better monitoring system would reduce the risk of overcharges occurring.

Recently, the County's responsibilities as a landlord have increased significantly. From FY98-99 to FY03-04 square footage of County-owned leased property increased 49% and revenues will almost double. Processes to administer these leases have not functioned well in the past and will need to be improved to keep pace with this growth. Similar to instances we found when the County was the tenant, communication between more than one representative from the County and a potential tenant has resulted in unnecessary costs and poor documentation.

County-owned property represents an important asset and property management should be conducted in a business-like manner. Many of the County's tenants are nonprofit organizations that have close ties to County services. However, this should not prevent the County from managing these properties. We found incomplete lease records, late or uncollected rent payments, missing verification that tenants have insurance, for-profit tenants that were not paying property taxes, and late lease renewals.

The County leased some of its properties below market rates and below its costs. Most of these subsidies are to nonprofit organizations providing services for the County but a few are to for-profit businesses. The estimated total amount charged below cost for all *known* tenants of County-owned property is $626,000 annually. This is more than total revenues of $553,000 collected from tenants in FY02-03. In one longstanding lease to a for-profit business, the annual rent charged was $19,000 below the cost, and $28,300 below an estimated market rate. The County lacks a policy regarding the decision to subsidize tenants and to regularly provide analysis to the Board of County Commissioners.

In 1995 the County approved a plan stating that long-term County programs should be located in owned, not leased, property. It was recognized that for larger, more stable programs, leasing was a costly approach with no residual value. At that time leased space accounted for 12% of total County space. Despite the fact owned space increased 14.5% from January 1999 to October 2003, leased space also increased 2.3%.

We found that competing objectives such as forming partnerships with other jurisdictions, co-location with other services, and development of mixed-use buildings had impacted the County's ability to meet this goal.

Background

The County is both a tenant—leasing properties for its own space needs and a landlord—leasing County-owned or leased space to others. Currently, 11.5% of the County's space is leased from others. As of October 2003, the County owned 2,720,361 square feet and leased 354,298 square feet.

County as a Tenant

Leasing is used when there is insufficient space in owned properties to meet temporary service needs or to provide short-term services in a particular geographical area. Leasing of space for long-term programs could also be an interim step towards locating those programs in owned space. While it is the County's financial policy to locate long-term programs in owned space, leasing space may be used to meet other objectives such as co-locating with service providers or supporting mixed-use development.

In June 2003, the County had 58 leases, totaling 393,945 square feet in 49 buildings. Recently, both the number of leases and the amount of leased space have declined. By October 2003, the number of leases declined to 41 leases, totaling 354,298 square feet in 35 buildings. Facilities Management budgeted $3,947,858 for these 35 leased buildings for FY03-04.

The Department of County Human Services (CHS) occupies the most leased space followed by the Health Department and the Library. One building, the Commonwealth Building, occupied by CHS, accounts for 40% of FY03-04 lease expenditure budget and 30% of the total square footage.

Building lease expenditure budget by department FY04

Exhibit 1

Department	Budget	Percent Total	Buildings	Square Footage
CHS	$2,615,888	66%	9	184,163
Health	$ 379,800	10%	6*	31,377
Library	$ 305,000	8%	6	22,242
Community Justice	$ 242,170	6%	6	22,582
CBS	$ 185,200	5%	3	58,426
SCP	$ 122,000	3%	2*	6,676
State Court	$ 80,500	2%	2	19,000
Sheriff	$ 10,800	0%	1	8,400
District Attorney	$ 6,500	0%	1	1,432
Total	$3,947,858	100%	35*	354,298

*Total number of buildings is 35 because one building is shared by the Health Department and Department of School and Community Partnerships (SCP). Figures do not include Facilities and Property Management Section (FPM) overhead or the Blanchard Building.

County as a landlord

The County leased its owned property to fill surplus space that is not currently used for County programs. In some cases, the County subleased space that was already leased. In most cases, leasing County-owned property supported other County program objectives such as co-locating with service providers. In addition to leasing property to nonprofits and other jurisdictions, the County also leased to several retail businesses.

In FY02-03, the County collected approximately $550,000 in rent payments. Budgeted revenue for FY03-04 is over one million dollars. Leased square feet have increased 49% from approximately 91,000 square feet in January 1999 to 135,500 in October 2003. Much of the recent growth was attributable to leases at the Gateway Children's Center and the Multnomah County East Building.

Exhibit 2 below shows the number of known leases of County-owned property active during FY02-03, the corresponding square feet, and the FY03-04 budgeted revenue by type of tenant.

County-owned leased space by tenant FY03

Exhibit 2

	Number of leases	Square Feet	FY03-04 Budget
Nonprofit	19	56,134	$341,381
Government	13	62,026	$523,704
Business	8	17,336	$213,694
	40	135,496	$1,078,779

Source: Auditor's Office

County administration of leases

All leases, as a tenant or landlord, are administered by the Facilities and Property Management Division (FPM) in the Department of Business and Community Services. Within FPM, the Real Property Management section is primarily responsible for administering leases.

FPM recently moved the Real Property Management Section (RPM) to the Contracts and Procurement Section. The Contracts and Procurement Section manager supervised the RPM section and participated in the leasing process. During our audit, significant changes occurred in the RPM Section. The current Real Estate Management staff were new to administering County leases and have been working to improve the leasing process. During our audit we saw improvements in lease documentation and the clarification of roles and responsibilities.

Other FPM sections were integral to administering leases, as well. For example, the Fiscal Section was responsible for making rent payments when the County was a tenant and collecting rent when the County was a landlord. A newly formed Asset Management Section began to consider space decisions from a Countywide perspective. The Dispatch Section responded to calls about any maintenance needs. FPM stated that Property Managers will ensure that

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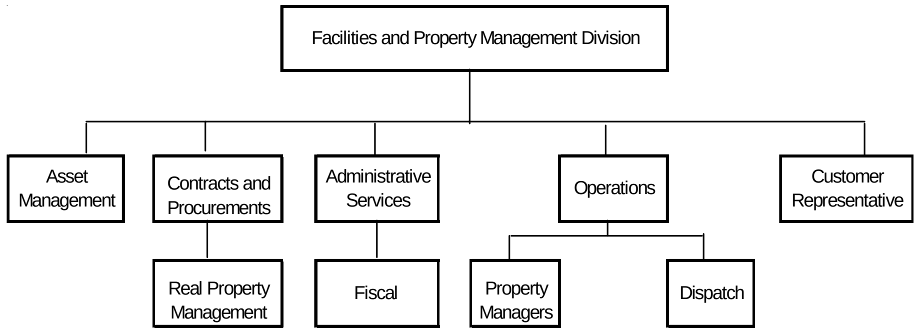
maintenance issues are resolved and documented. Exhibit 3 below shows the organizational responsibilities in FPM. For all lease administration activities, departments were charged 6% of the lease's cost in FY03-04.

Organization of lease responsibilities

Exhibit 3



Lease decisions required the cooperation of all County departments and the Board of County Commissioners. County-wide administrative procedures provided some guidance when the County is a tenant although there were no procedures that specifically addressed the County as a landlord.

When the County was a tenant and leased space with an annual rent over $100,000, Board approval of the lease was required. The Board's monitoring responsibility was delegated to the Chair if the lease's annual rent was under $100,000. Before leasing County-owned property, the Board must formally declare the property as surplus. The Board also approved all leases of County-owned property.

Scope and Methodology

The objectives of our audit were to:

1. Determine whether building leases were properly initiated, maintained, and renewed or terminated both when the County was a tenant and was a landlord.
2. Determine whether the County was following policy to house long-term programs in owned space.

The scope of our audit was limited to the County's building leases when the County was either a tenant or a landlord, and excluded parking, land, and antennae leases. We reviewed relevant regulations, policies and administrative procedures, budgets, other jurisdictions' procedures, lease forms, space standards, the 1995 and 1998 Strategic Space Plans and a draft of the 2003 Strategic Facility Plan. We also examined relevant Board briefings and several FPM initiatives that were under development.

We met with staff from the Facilities and Property Management Division, the Department of County Human Services, the Health Department, the Library, and the County Attorney's Office. We contacted other jurisdictions, researched best leasing practices, and reviewed relevant audits. We also toured county-owned and leased buildings, and obtained available building and lease data.

We reviewed all available building leases. Of those, we selected 21 leases where the County was the tenant for in-depth analysis. These 21 leases represented 88% of FY03-04 budgeted lease expenditures. We also selected 18 leases where the County was a landlord for detailed analysis. This audit was included in our FY03-04 audit schedule, and was conducted in accordance with generally accepted government auditing standards.

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Audit Results

County is not in a position to effectively negotiate leases

Negotiating lease agreements requires expertise. Without expertise, there is a significant risk that lease costs will be higher than necessary. In order to effectively negotiate, the County's representative needs to fully understand market conditions, competition, site alternatives, tenant improvements, different types of leases, and other factors. For example, a competitive position can be reduced by expressing undue interest in a single site or having no alternative spaces available. An inexperienced negotiator may also agree to unfavorable terms in the lease.

Even an experienced negotiator will lose significant negotiating leverage when the County, through public statements or contact with landlords by department personnel or elected officials, has expressed interest in a single site without having alternative spaces available. Jurisdictions we studied address this need by centralizing authority, assigning clear guidelines to those negotiating leases, and ensuring those outside of negotiations do not reduce the effectiveness of the process. Once needs are determined, communication during negotiations is limited so that the bargaining position is as strong as possible.

We found that the County did not have a clear policy specifying what roles departments or Commissioners should play in the leasing process. Clearly delineated responsibilities for the Facilities and Property Management Division (FPM) versus those of the departments and Commissioners would have strengthened the County's negotiating position.

After examining 21 files we found that in some cases, departments or Commissioners had directly contacted landlords and pursued negotiations without sufficient FPM involvement. Because Commissioners or departments were interested in a single property and landlords informally became of aware of this interest, the County's ability to effectively negotiate was weakened. In some cases, FPM was left without the ability to walk away from a particular lease negotiation which should always be an option.

Strong planning is needed before leasing space

An effective lease negotiator must have a good understanding of the County's needs. This requires a strong planning process. Lease experts recommend that tenants should plan for space needs early. Departments' program needs and financial constraints must be well understood. Effective planning should also include considering the availability of County-owned space before leasing.

Our review of lease files and interviews with FPM personnel indicated that the County did not adequately plan for space needs far enough in advance. Experts state that planning should occur at least 12 months before a decision. If the County planned earlier, increased options would improve its negotiating position.

Further, departments have not prepared service delivery plans as recommended in the 1998 strategic plan. The plan states that "to provide adequate space for program needs, in a timely, cost-effective manner that is consistent with the strategic directions, planning must occur at the department level." Regular updates to space requirements are needed, as well.

Prior to negotiating a lease, market research and analysis should be performed. We found no policy in place requiring FPM to perform market research or analysis or to document the results. While research was likely performed in some cases, we could not determine the quality or how effectively it was used to make the best leasing decision, because of poor documentation. We found several cases where the County appeared to have entered into unfavorable leases, an indication that the quality of the research, if performed, was not satisfactory. In at least one case, analysis was performed after the FPM negotiator tentatively agreed to an offer.

Research of private sector leasing practices indicated that the County could improve its negotiating position by having alternatives that would allow it to walk away from a deal. Committing to a single location puts the County at a disadvantage and increases the risk of a more expensive lease. However, we also found that when leasing alternatives were available, departments sometimes picked more expensive sites without justification.

Leases not analyzed in a comprehensive manner

We found little evidence that comprehensive analyses of lease terms were performed. In cases where County leased space had higher rent, the lease was more likely to have overall disadvantageous terms. In order to compare and analyze lease costs on a comparable basis, the full extent of lease components must be considered. Critical areas to consider that can affect lease costs include determination of:

- Which party assumes responsibility for operating expenditures such as repairs and utilities
- The purpose of rent escalation clauses
- Who bears the cost of tenant improvements
- The effect of the County's tax exempt status
- Clearly defined square footage standards
- The risk of leasing and the comparison to the option to buy

Responsibility for operating expenditures

An important component to consider in a lease decision is which party is responsible for building operating costs such as property taxes, insurance, janitorial services, utilities, and repairs and maintenance. Any analysis used to determine the best leasing option should include a comparison of the full costs, not only the base rent, but also the operating costs. The State of Oregon prefers full-service leases, those that require the landlord to pay all operating costs, because comparing other lease options is difficult and complex. If a full-service lease is not possible, operating expenditures paid in addition to rent should be estimated in best, most likely, and worst case scenarios.

Among 21 samples out of 58 leases, five leases required the County to pay all operating costs. Among those, two had the highest rent per square foot. We found no documentation that identified factors that might have necessitated this high cost. This brings into question whether the County is paying too much.

Rent escalation

Rent escalation provisions are used in leases to protect landlords from increases in operating expenditures or increases in the market rate for rents. When rent escalation clauses are included in the lease, the purpose of the clause should be clearly identified in the lease file and the rate should be appropriately related to the purpose.

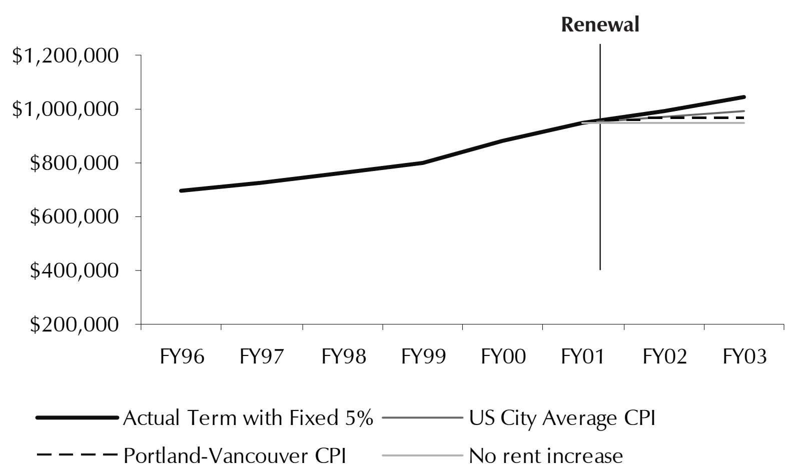
Seventeen out of 21 leases we examined included a rent escalation provision. Of those, 11 were leases requiring the County to pay some portion of operating expenditures. Five leases that required the County to pay virtually all operating expenditures also had some type of escalation provision. The purpose of these escalation clauses was not clearly identified causing us to question whether the rates were appropriate. Further, we are concerned that the County did not fully understand the impact of rent escalations. The compounding effect of rent escalations in leases can rapidly erode the benefits of reasonable starting rates.

In Case 1, the County agreed to a 5% annual rent escalation at the inception of the lease in FY96. The County entered FY01 renewal negotiations with an expectation that space needs would be increasing. According to documentation, FPM agreed to increase the rental rate and renewed the lease early to achieve a lower rate. However, the County also accepted a 5% rent escalation rate. We were unable to find any documented mitigating factors that explained why the County accepted these terms.

Because this lease also involved a large amount of space, the impact of 5% rent escalation was even larger. We calculated that in FY03 alone the County could have saved $78,956 if it had used the Portland-Vancouver CPI, $54,725 if it had used the US City Average CPI, and $97,072 if the lease had included no rent increase.

Rent increase term impact
Case Study #1

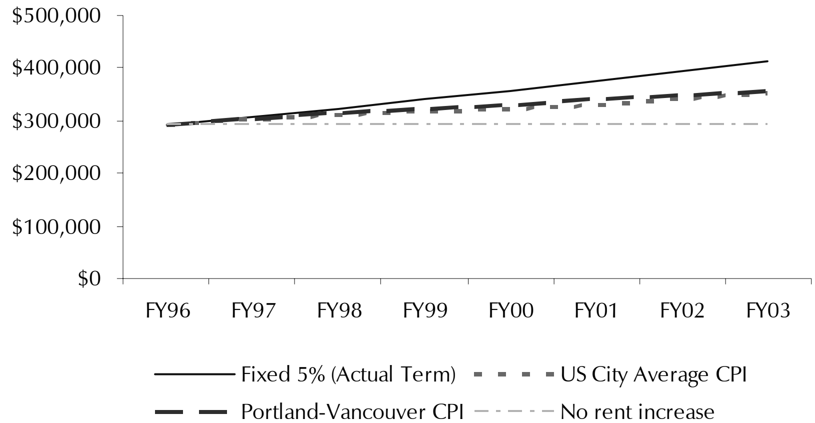
Exhibit 4



In Case 2, the County accepted 5% annual rent escalation at the inception of the lease in FY96. In FY03 alone, the County could have saved $56,900 if it had tied the rate to Portland-Vancouver CPI, $62,224 if it had used US City Average CPI, and $119,434 if the County had not accepted an annual rent increase. Again, because of poor documentation, we were unable to determine why the County agreed to such a rate.

Rent increase term impact
Case Study #2

Exhibit 5



We believe that a fixed escalation rate of 5% is a questionable practice. Using an area CPI index is a common practice and usually a better alternative. According to our analysis, in the last 10 years, the Portland Area CPI has never reached 5% and only three times in the last twenty years as shown in exhibit 6 below. In some recent leases we have seen, FPM has negotiated more favorable escalation clauses lower than the 5% rate.

Years when consumer price index was 5% or over

Exhibit 6

	Last 10 Years		Last 20 Years	
	Over 5%	Average CPI	Over 5%	Average CPI
Portland-Vancouver	0	2.7%	1	3.1%
Portland-Salem	0	2.8%	3	3.2%

Tenant improvements

Leases may state who pays for improvements to the leased property. In some cases, it is difficult to persuade the landlord to pay for tenant improvements because the modifications may limit the property's future use. When the County did pay for lease improvements, we could not determine whether sufficient efforts were made to negotiate more favorable terms for other aspects of the lease.

For example, both the Northwest Library and Sellwood Library leases required the County to pay for significant tenant improvements, which cost $699,000 and $701,000, respectively. Although these two leases are among the most expensive, we found no evidence that the leases took the cost of the tenant improvements into consideration to negotiate more favorable terms.

Property tax responsibility

Under Oregon Revised Statute 307.112, landlords are eligible for a property tax exemption if the tenant is a public entity and the lease agreement reflects savings below market rent. We found other jurisdictions use this statute as a negotiating tool to secure lower rental costs. Among 21 sampled expenditure leases, nine assigned property tax responsibility to the County. Among the nine leases, six were with private sector landlords that are not property tax-exempt. It was not clear whether the County effectively used their property tax-exempt status to reduce rental costs.

Square foot definition

More than one-half of the leases that we reviewed did not have a square-footage standard stated in the lease. Making cost comparisons is impossible unless the definition of square footage is clear.

The amount of usable square feet is the actual area that can be occupied. This measure should be obtained and used to analyze different offers in a comparable manner. We found FPM often used rentable square feet to compare rents but this standard includes un-usable space such as common areas.

To illustrate, while two lease alternatives may have the same rentable square feet, one of the leases may have 30% unusable space and the other 5%. If both leases quote the same amount based on rentable square feet, in reality the lease with the 5% unusable square feet is a much better deal.

To properly evaluate leases, other jurisdictions require specifying the type of square footage in the lease. The State of Washington requires the use of the Building Owners and Managers Association square foot standards and usable square feet. The State of Oregon uses space standards to arrive at usable square footage needs, and then converts them into rentable square feet.

Lease versus buy analysis

The County should analyze leases carefully to determine if leasing makes economical sense. The cost of the lease could exceed the market value of the property, especially for long-term leases. A lease versus buy decision compares the estimated value of the cost of leasing in today's dollars to the cost of purchasing. Not only does this analysis help determine whether it is economical to lease but also whether a landlord's offer is reasonable. Other factors may also affect the lease-buy decision such as availability of funding to purchase, not wanting to pay building maintenance costs, or preserving flexibility to change location or building size. We reviewed one long-term lease to compare lease costs to the property's market value.

We found the County paid more in lease payments than the property's market value with little of the typical leasing advantages such as not being responsible for operating costs. Further, the County will be left with no residual property value after the lease expires and any value from the County-paid tenant improvements will be lost.

Leasing was almost $700,000 or 90% more expensive than the market value as determined by the Division of Assessment and Taxation for the 30-year Sellwood Library lease. The estimated value of lease payments in today's dollars was

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about $1.5 million while the market value of the property was $811,060 at the time the lease was initiated. In this case, the County tried to purchase the space but the landlord was not interested in selling. According to the lease agreement, the County was responsible for building maintenance as well. FPM did perform a cost comparison between leasing and renovation of the existing library site; however, such analysis was performed after FPM informally agreed on the landlord's offer and was virtually of no use in the actual negotiation. Preference for the leased location and size also influenced this decision.

Sensitivity analysis

A sensitivity analysis assesses lease risks by estimating costs of leases in different scenarios. In most cases, cost estimates rely on certain assumptions that can vary over time. Cost estimates in different scenarios allow decision makers to understand impacts of rent escalations based on the Consumer Price Index (CPI), operating expenditures payments outside of the base rent, tenant improvements, and any other variable factors.

The County's lease analyses were not elaborate enough to assess lease risks. For example, some analyses simply noted that rent escalated by a fixed rate or CPI, not estimating its impact for future years. Further, we found large discrepancies between cost estimates provided to the Board and actual costs. For example, tenant improvement cost estimates for the Northwest and Sellwood Libraries were estimated between $100,000 and $300,000 for each library. Actual costs were $699,000 for the Northwest Library and $701,000 for the Sellwood Library.

Ability to control costs limited by lease language

Effective lease language can help control costs by addressing the County's unique circumstances as a tenant. Lease language also serves as the basis for monitoring and enforcement. Systematic monitoring ensures that the County is not overcharged for its leased space. Clearly articulated lease language will help to better enforce the lease when necessary.

Some government entities commonly use their own standard lease form. For example, the State of Oregon uses its standard lease form 99% of the time and Washington County, Oregon, uses its own form 100% of the time.

We found that it was the County's customary practice to use landlords' lease forms. Landlords' standard leases are typically written in favor of landlords and do not cover the unique situations that government entities face. While a skilled negotiator or attorney can modify any form so that it contains effective language accepting the landlords' lease form makes it harder to modify language during negotiation and easier to overlook critical negotiation points. Further, once the County occupies leased space, different lease forms from different landlords can increase the time spent on ongoing administrative tasks and make lease enforcement more difficult.

Monitoring not systematic

To ensure that the County is not overcharged, leases should be monitored and significant changes to leases should be approved by the Board of County Commissioners (BOCC). To accomplish this, systems should be in place for:

- Monitoring periodic adjustments
- Auditing operational expenditures
- Tracking expirations
- Approving changes

FPM did not have a system in place to proactively monitor lease adjustments. Lack of sufficient monitoring and verification of adjustments puts the County at risk for overcharges. We found lease costs were generally adjusted at a landlord's request rather than initiated by FPM. Adjustments to the lease can be based on a variety of factors including the CPI, a fixed percentage, or a schedule. Although we found no evidence that landlords' adjustment figures were incorrect, FPM did not appear to verify CPI figures with publicly available data.

Most leases reviewed where the County was responsible for operating expenses lacked clear audit language defining adjustments and did not require the landlord to provide supporting documents. Only two out of 21 cases included some type of audit language as a control to discover overcharges.

We did find one case where FPM staff recently took full advantage of the audit language to discover an overcharge. This lease required the landlord to provide the County with supporting documents for operating expenditure charges. After obtaining the supporting documents, FPM found that it had overpaid $68,514 during a two-year period and is now in the process of recovering the overcharge. We commend FPM for taking this initiative. This example demonstrates why language should be in place to allow full examination of all leases.

FPM did not have an effective system in place to track lease expirations. Although County Administrative Procedures require FPM to notify departments 90 days prior to the lease's expiration date, we found that frequently landlords or departments notified FPM first. Monitoring lease expirations is an opportunity for the County to update and reconsider departments' space needs, consider other space options, gauge the landlord's performance, and renegotiate more favorable lease terms. One County manager suggested knowing about Departments' space plans for all building leases at least 18 months in advance so that better space options could become a more viable alternative.

We reviewed one lease where the landlord contacted FPM about five months prior to its expiration. FPM notified the landlord of the County's intent to renew the lease for the next two years. The landlord sent a renewal offer but gave only six days to respond. Though the renewal offer included a higher escalation percentage and the landlord had a history of service problems, FPM accepted the offer without trying to renegotiate the lease.

Resolution 99-157 delegates lease approval responsibility to the Chair if the annual rent is under $100,000. Leases over $100,000 must be reviewed by the Board of County Commissioners (BOCC). Unfortunately, the resolution does not address material changes that can happen to the lease after the BOCC reviews it or during lease renewals.

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In one case, a material change in lease terms occurred after the BOCC's review. The lease had 3,576 square feet when presented to the BOCC. After approval, the actual lease was modified to increase the size of the area leased by 800 square feet, increasing the starting annual rent by $13,600.

In another case, changes were made when the lease was renewed. We found one lease renewal, which was over $100,000 in annual rent, that did not go before the Board for approval.

The County did not enforce leases

Lease costs are also controlled through enforcing the terms of lease. This requires clear language defining landlord responsibilities and remedies for non-compliance, and a process to follow when an agreement must be enforced.

We found several instances where better enforcement could have avoided unnecessary costs. The County did not enforce leases after a landlord repeatedly refused or delayed required services. Insufficient FPM involvement or notification decreased the County's ability to ensure performance. Despite these problems, the County renewed these leases without modifying the language to address the landlord's maintenance responsibilities.

In one example, a water pipe burst and caused offices to close for three days. The landlord hesitated to fix the problem and only provided a minimal fix after repeated complaints from the department. Due to the delay in resolving the problem, many employees took additional days off work because of the mildew and wet carpets. The landlord eventually replaced the carpet and dried behind the walls but did not complete paint repairs.

In this case, we found insufficient lease language to address response time and remedies for landlord non-performance to enforce the lease. In part, this was due to the County's agreeing to use the landlord's standard lease language. In fourteen out of 21 leases we sampled, remedies for a landlord's non-performance were not defined.

Any maintenance concern for County-owned or leased buildings should be directly referred to FPM Dispatch. FPM would then be responsible for documenting maintenance issues and be better positioned to properly enforce the lease. Also, landlords' reputations and the past record with the County should be considered prior to negotiating and signing leases.

County not approaching landlord responsibilities consistently

Recently, leasing of County-owned property has grown significantly. From FY99 to FY04 square footage of County-owned leased property increased 49% and revenues will almost double. Processes to administer these leases have not functioned well in the past and will need to be improved to keep pace with this growth.

Properly initiating and maintaining leases as a landlord involves a myriad of activities that can only be accomplished in a well-functioning system. There was no guidance for departments because County-wide policy and procedures were inadequate. Although there were some written procedures for cases where the County is a tenant, there were no written procedures to address situations where the County is a landlord. This results in an environment where departments can make leasing decisions without full regard to County-wide objectives or sufficient levels of accountability.

Specialized expertise is needed to guide the leasing process. Other jurisdictions generally had a centralized function managing the lease process. We found procedures in other jurisdictions that spelled out clear roles and responsibilities for leasing its owned property and policy that described overarching objectives. Other jurisdictions also had clearly stated objectives about leasing their property.

Formalizing leasing objectives and procedures is particularly important in cases where turnover has occurred. During the audit, all staff dealing with leases were new and had little guidance.

In the past, FPM became involved at the beginning, middle or end of the process depending upon the department. Sometimes negotiations with a prospective tenant were completed by the department and FPM would simply be responsible for preparing a lease document.

In one case, a department representative entered into a verbal agreement with a prospective tenant to occupy County space in two different buildings. The County proceeded to make tenant improvements to the space. The prospective tenant then backed out of the agreement leaving the County with no recourse. The space in one of the buildings went vacant for over two years costing the County $55,000 to refit the property for the new tenant and an estimated $76,000 in forgone rent.

In other cases tenants have been occupying County-owned space without a signed lease in place. FPM should not only be involved from the very beginning of the lease process, but there should be a signed lease agreement in place for every lease before any tenant improvements are made and before the tenant moves into the space.

Additionally, we found there was insufficient documentation to describe how lease decisions had been made and to capture basic information about the leases. Sometimes all the lease file contained was a copy of the lease. Documentation was poor at the department level, too. To compound the problem further, there was significant turnover in departments, so even a history of unwritten lease details was largely lost.

Although FPM was beginning to develop better leasing practices and had made progress towards practicing centralized control over leases during the audit, it had still not begun to formalize Countywide leasing procedures.

FPM did not have a record of all leases of County-owned property

We could not verify whether all leases of County-owned property had been accounted for. We toured several County facilities and found tenants occupying County space in four different buildings that did not have a signed, enforceable lease agreement on file.

We found five leases in the East County Building that had not been billed for over two years. All five tenants went without a lease for almost two years. Two of the tenants still did not have signed leases in place by December 2003. As of June 30, 2003 the County had not collected approximately $50,000 from these unbilled leases that it is now in the process of collecting. For one tenant, about $8,000 was written off. There is a significant risk that other tenants could not repay once they got behind in their rent.

It is possible FPM had some knowledge of these leases. For example, property managers were most likely aware that there was a new tenant in the building. During the audit, FPM was involved in preparing or starting to prepare a lease document for at least two of the five tenants in the East County Building. But, we found that FPM did not have adequate internal procedures detailing tasks, roles and responsibilities to properly carry out lease administration.

While strong internal procedures are needed to ensure tenants are billed, they are also needed to ensure that tenants are billed for the proper amount. Some leases require rent adjustments during the term of the lease. The Fiscal Section in FPM should receive updates on any changes to the lease. We found two leases that had not been billed for the correct amount because lease adjustments were not made. At the end of FY03, two tenants owed the County a total of about $2,500 because of improper billing. The errors were eventually caught by FPM and they are in the process of collecting the unpaid rent.

Rent payments have frequently been late or not collected

To administer leasing of County property in a business-like manner, there should be the expectation that tenants pay rent on time. We found that about a third of the tenants leasing from the County were delinquent for FY02-03 payments one month after the fiscal year ended. These outstanding payments represent about 9% of total rent due for the fiscal year.

Some of the delinquent and late paying tenants are nonprofit organizations and others are for-profit businesses. Many of the nonprofit tenants work with CHS. The County appears reluctant to enforce payment agreements with some nonprofit tenants. FPM and CHS have recently agreed on how to deal with delinquent payments from nonprofit tenants. For businesses that do not pay their rent on time, FPM has chosen in the past not to aggressively pursue timely payment.

Amounts owed have been written off in the past. During FY02-03 one tenant paid only 3 of 12 payments during the year. We were told by FPM staff that in the past one business terminated a lease owing over $10,000. Even excluding five tenants that did not pay for over two years, the average time for lateness of payment was about two months. Although some leases allow assessment of a finance charge for late payment, the County has never charged it.

FPM has not verified that tenants carry appropriate levels of insurance

County leases require tenants of County-owned property to carry liability, property damage, and personal injury coverage to protect the County and the tenant. Typically, coverage limits are not less than one million per occurrence for bodily or personal injury or property damage.

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Insurance coverage of the tenant should be monitored by FPM. When the lease is signed, proper evidence of insurance should be provided. In addition, evidence of insurance certificates should be verified over the term of the lease. Most lease files did not have any evidence that proper insurance was in force—either at the inception of the lease or afterwards.

According to Risk Management, the Contracts Unit uses a system where the insurance provider automatically mails the Unit certificates when a contractor renews their insurance. To minimize administrative costs, the same type of system could be set up for leases.

Businesses in County-owned space do not always pay taxes

No process was in place to ensure that businesses leasing from the County paid property taxes. We found three businesses out of seven that had leased property from the County during FY02-03 that were not on the County's tax rolls and had not paid property taxes. The County is missing an opportunity to increase revenues by ensuring that business tenants of County-owned space are paying property taxes.

Depending upon how the lease is written, property taxes may be included in the rent or may not. In cases where taxes are included in the rent, the County Assessment and Taxation Division should send the tax bill to FPM. Where the property taxes are not included in the rent, Assessment and Taxation should send the bill to the tenant.

FPM did not send lease information to Assessment and Taxation to place business tenants on the tax rolls. FPM should provide Assessment and Taxation a copy of the lease at initiation and an updated report of existing leases each year.

Leases of County-owned property have not been renewed on time

FPM should have a system in place to monitor the lease's term and provide timely notice of renewal to the tenant. Also, leases of County-owned property should be reevaluated at the time of renewal. We found 14 out of the 40 leases of County property on file were on holdover status during FY02-03. Holdover status effectively puts the lease on a month-to-month basis and keeps all existing provisions of the lease, including the rent charged, in place. Seven of the 14 leases had been on holdover status for over two years. One lease had been on holdover status for 20 years.

Leases on holdover status accounted for approximately 8% of FY03-04 budgeted revenue. Although some of the leases on holdover status are rent-free, for those that are not, the County is missing an opportunity to increase revenues. Further, when leases are not renewed on time, there is a risk that the rent will not be adjusted to cover increased costs. We were unable to determine why so many leases were on holdover status.

County has not evaluated total rent subsidies to tenants

The County has chosen to lease some of its properties below market rates and below cost. Some tenants are not charged rent while others are charged amounts below the cost of the property to the County. In some cases, tenants are subsidized because they are providing services with other County programs. The benefits received from co-locating nonprofit service providers with County programs may exceed the lost rental income.

Using FPM FY03-04 budget information, the estimated total amount charged below cost for all *known* tenants of County-owned property is $626,000 per year. This is more than total revenues of $553,000 collected from tenants in FY02-03. Nonprofit tenants currently in the East County Building account for about 54% of the amount charged below cost. The estimated amount charged below cost for business tenants is approximately $34,000 per year.

This estimated $626,000 subsidy represents a real cost to the County. The building costs not allocated to the subsidized tenants will have to be paid by the other programs in those buildings. Not only does this practice put the funding decisions outside the budget process, but also may put some federal programs at risk if the County charges over cost for space for some types of grant funds.

With the growth in leasing of County-owned property, the amount of rental subsidies has substantially increased. The long-term impact of these costs is significant and has not been comprehensively evaluated. Subsidizing tenants is a complex issue that requires more guidance and justification than has occurred in the past.

Instead of using costs, the amount subsidized is best calculated comparing the rent charged to the market rate. Information was not available in FPM's lease files to document market rates. Because the costs of the East County Building are greater than the market rate, the aggregate amount subsidized using a market rate is likely less than the aggregate amount charged below costs.

On a lease by lease basis, the market rate may be greater than the cost or the inverse may be true. The County should know and use both the cost and market rates when leasing its property. In one long standing lease to a for-profit business, the annual rent charged was $19,000 below the cost, and $28,300 below an estimated market rate.

While subsidizing for-profit businesses does not appear to be an appropriate use of County property, most of the subsidies are to nonprofit organizations providing services for the County. There may be legitimate reasons for subsidizing tenants, but we could not make that determination based on the available documentation or interviews with personnel.

County lacks policy to address subsidizing tenants of County-owned property

The need for an overall policy on leasing County-owned space was reported in a previous audit by our Office in 1993 but that policy was not developed. The need for such policy is even greater today. We looked at other jurisdictions for guidance in this area and found that a policy should be in place to address:

- The market rate and the cost to the County on a lease by lease basis and in the aggregate.
- A comparison of costs to the benefits of subsidizing tenants.
- Below cost subsidies should be calculated and clearly documented through the County's budget process
- Additional services provided by tenants in lieu of rent. Such services should be clearly defined and monitored.

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- Equity among tenants. The policy should address why some tenants receive subsidies or different levels of subsidies than other tenants. Because subsidies can be directly tied to contracted services, including the amount of subsidized rent in Requests for Proposals should be considered.
- Mission alignment of the County with the tenant.
- Long-term encumbrances on County property. This issue was brought up in a prior audit and not addressed.
- Continuation of the lease. While Board approval is required for leases of County-owned property, an adequate analysis should be provided and continued leasing (renewal) should be approved by the Board, as well.

County space policy

County financial policy states that "it is the policy of the Board to purchase or lease/purchase facilities, instead of renting, when the programs or agencies being housed in the facility are performing essential government functions."

An overdependence on leases was recognized in the 1995 Strategic Space Plan. The plan stated that "for larger, relatively stable County programs, leasing space is a costly approach with no residual value to the County." The report stated that leasing space is a good alternative for programs modest in size that need to be geographically located, for programs with temporary funding, and for programs which tend to dramatically change in size over time. In 1995, leased space made up 12% of the total property portfolio. In August 1995, the County approved Resolution 95-174 adopting the 1995 Strategic Plan.

The 1998 strategic plan updated information and made recommendations regarding the County's space needs based on changes since the 1995 plan. One of the plan's recommendations reiterated the 1995 plan's leasing goal, stating that long-term County programs should be located in owned, not leased property. In 1998, leased space increased to 12.7% of the total property portfolio.

Another goal of the 1998 plan was to pursue public partnerships when feasible to address facility requirements. Shared occupancy of existing public facilities could address space needs of the County, other jurisdictions, and nonprofit organizations. The 1998 plan recommended that the County aggressively pursue co-location opportunities with other public partners including cities, school districts, and nonprofits. The 1998 plan also promoted Metro's 2040 plan by supporting mixed used developments.

Competing objectives impact space policy

Though there is a policy to reduce leased space for long-term programs, both County-owned and leased property has increased. Whether deliberate or not, space decisions based on forming partnerships with other jurisdictions, co-location, or mixed-use objectives have taken priority over ensuring that long-term programs are housed in owned space. In some cases, the County made the decision to locate long-term programs in leased space when it was more cost-effective to purchase.

We researched the changes in both leased and owned property from January 1999 through October 2003 and found that although there were substantial increases in the amount of owned property, the amount of leased space also increased. We were conservative in our analysis and included the Blanchard Building in the owned space category despite the fact it is administered as a lease.

Changes in owned versus leased space 1999 to 2003

Exhibit 7

	Owned Square Feet	Leased Square Feet	Total Square Feet
As of 1/99	2,376,079	346,406	2,722,485
Increases	450,096	112,350	562,466
Decreases	105,814	104,458	210,272
As of 10/03	2,720,361	354,298	3,074,659
Net Increase	344,282	7,892	352,174
Growth rate	14.5%	2.3%	

Source: Auditor's Office

Excluding the new Wapato Jail and Hillsdale Library, the County has added 450,096 square feet in owned property. Newly purchased or constructed buildings include the Multnomah Building, East County Building, Gateway Children's Center, North Health Clinic, and new Hollywood Library.

Some of the increase in leased space can be attributed to the conversion of owned space at the Ford Building to leased space. Other significant increases in leased property include additions to the Commonwealth Building, Aging Services West at the YWCA, La Clinica de la Salud, and the new Sellwood Library.

Reductions in owned property were the result of selling the Ford Building, and the Sellwood and Hollywood libraries. About 38% of the lease reductions occurred from January 2003 to October 2003. In addition, an increasing amount of County-owned space was being leased instead of used to house County programs. Over the last four years, the County has almost doubled leasing of its own space. These increases have been largely driven by leasing space at the Gateway Children's Center and the East County Building.

The County occupied part of the Ford Building as leased space although some occupants went to the Multnomah Building. During the development of the 1998 strategic plan, a feasibility study was conducted regarding future use of the Ford Building. At that time the recommendation was made to upgrade the building for office use. The 1995 plan recommended retaining the Ford Building for storage purposes.

Plans changed in early 2000 when the County decided to enter into a 99-year lease for 46,300 sq. ft. from PPS at the Blanchard Building in an effort to provide financial support to Portland Public Schools. The Ford Building was subsequently sold with about 57,400 sq. ft. leased back to the County because occupants such

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as Central Stores and Archives had not yet moved into other space—Central Stores has since moved into leased space and County Archives into owned space.

Competing objectives increased costs

We found that the County has had a tendency to pay high rent to lease space and charge low rent for County-owned property in order to support co-location or partnership objectives. Yet, the County has not comprehensively examined the long-term costs of pursuing these objectives to the benefits.

Within the last four years, the County has also entered into expensive leases with the YWCA, La Clinica de la Salud/La Clara Vista Family Resource Center, the Sellwood Library and the Northwest Library. Exhibit 8 below summarizes these leases.

Leases with highest costs per Square Foot in FY03

Exhibit 8

Building	Actual Lease Costs per square foot	Tenant Improvements paid by County	Type of Space
NW Library	$28.99	$699,000	Library
Sellwood Library	$22.71	$701,000	Library
La Clinica de la Salud*	$21.58	$10,000	Clinic
YWCA	$19.25	$80,000	General Office and Common Area
La Clara Vista*	$17.41		General Office

* Leases in the same building
Source: Auditor's Office

The County leased space from the YWCA to co-locate services with Aging and Disability Services. Entering into this 12,132 square foot lease created a senior center in the downtown area.

With the La Clinica de la Salud/La Clara Vista Family Resource Center lease, the County provided the nonprofit landlord with grants and loans to build a mixed-use, low-income housing complex. Departments subsequently committed to move into 7,632 square feet of the building and informally negotiated with the landlord prior to FPM's involvement.

The County entered into a 30-year lease for the Sellwood Library in 2000. The County attempted to purchase the space but the owner did not wish to sell. Other alternatives were not pursued and the County paid an expensive premium for this mixed-use building. Our analysis shows that it was much more expensive to lease the building than to purchase comparable space. Additionally, the County paid $701,000 for tenant improvements.

With the Northwest Library, co-location, partnership or mixed-use objectives are not a factor—a decision was made to locate this long-term program in leased space. In addition to paying $699,000 for tenant improvements for this 10-year lease, the County pays $28.99 per square foot.

While each of these leases met a specific County objective, the cost of meeting that objective might not have been analyzed relative to the benefit. In a report to the Board of County Commissioners in March 2004, FPM compared industry average cost per square foot guidelines from the Building Owners and Managers Association ($17.59) to a County cost per square foot of $12.50. The five leases above are significantly higher than the County average and in most cases the BOMA standard.

Recommendations

1. To improve the overall lease process,
    A. The County should approve a policy designating the lead responsibility for negotiating leases and outlining roles and responsibilities of others involved in the process.
    B. FPM should update current leasing procedures for the County as a tenant and develop new procedures for leasing County-owned property.
2. Procedures outlining lease initiation for those situations where the County is a tenant should include:
    A. Department communication of space needs to FPM including a determination that funding is available for space requests and outlining the cost of any rent subsidies.
    B. Use of a County standard lease form .
    C. Recommended lease language to avoid complex administration and control costs if the County lease form is not used.
    D. Analysis and comparison of lease offers in a comprehensive manner.
3. To properly maintain leases,
    A. FPM should develop a process to enforce leases.
    B. FPM should develop procedures to systematically monitor payments and collect rent.
    C. FPM should verify insurance coverage by non-County tenants leasing County properties and set up a system to monitor continued coverage.
    D. FPM should notify the Division of Assessment and Taxation to ensure that property taxes are billed and paid.
4. To properly renew or terminate leases when the County is either a tenant or a landlord,
    A. Any material changes made to the lease after the Board's review should be referred back to the Board.
    B. FPM should develop a system to monitor expirations.

5. To ensure that rent subsidies to non-profit organizations are consistently applied, the County should:
   - A. Establish criteria for subsidizing tenants, including the following factors:
     - •Mission alignment of the County with the service providers.
     - •The County's financial ability in short and long terms.
     - •Equity among service providers.
     - •Costs versus benefits to subsidize the organizations.
   - B. Periodically evaluate subsidies in aggregate and on a lease-by-lease basis in light of both market rates and costs.
6. To avoid virtual subsidies to businesses having no public purpose, FPM should renew leases and update rates to the market rates in a timely manner.
7. To promote an efficient and best use of facilities, the County should:
   - A. Set priorities among different policies and the resulting use of owned or leased space.
   - B. Clarify under what conditions leasing can be allowed.

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Responses to the Audit

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Diane M. Linn, Multnomah County Chair

501 SE Hawthorne Blvd., Suite 600
Portland, Oregon 97214
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Email: mult.chair@co.multnomah.or.us

May 17, 2004

Ms. Suzanne Flynn, Auditor
Multnomah County
501 SE Hawthorne Blvd., #601
Portland, OR 97214

Dear Ms. Flynn,

Thank you and your staff for your audit on Building Leases. The executive summary of improvements needed and suggested recommendations will help strengthen the County's leasing program overall – which improves an important business function that the County had been historically weak at performing.

When I became Chair in June of 2001 I soon recognized that improvements were needed in our Facilities Management function, and hired Doug Butler as Director in January of 2002 to address these needs. Since that time Doug has enacted better business accountability and many process improvements, which made an impact noted in your audit. I believe with the recent reorganization of the leasing function and through the recruitment of qualified professionals that will use your audit recommendations as guidance, the County will have an exemplary program in place during this next year.

In these times of budget challenges, managing our County Assets has never been more important. Your crucial point of planning well in advance of lease renewals and terminations will provide the County with much better options on how facilities dollars are spent. Also the management review and planning of owning vs. leasing space is of paramount importance to the efficient use of tax dollars in our future.

Thank you again for your timely analysis and excellent recommendations to continue the improvement of our Building Leasing business function.

Sincerely,

Diane M. Linn, Chair
Multnomah County

c: Doug Butler, Facilities Manager

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MULTNOMAH COUNTY OREGON

DEPARTMENT OF BUSINESS AND COMMUNITY SERVICES
FACILITIES AND PROPERTY MANAGEMENT DIVISION
401 N DIXON ST
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May 17, 2004

Suzanne Flynn
Multnomah County Auditor
Multnomah County Auditor's Office
501 S.E Hawthorne, Room 601
Portland, OR 97214

Subject: Facilities Division Response to Building Lease Management Audit

Dear Suzanne:

Thank you for your thoughtful and insightful analysis of the County's lease management. As the lead agency within the County for this work, the Facilities and Property Management Division (FPM) appreciates your efforts to improve performance.

We are in total agreement with all of the recommendations in the report. We particularly appreciate your specificity in outlining these recommendations. We intend to use your guidance as a roadmap for our continuing improvement initiative in this area and your detailed approach will be particularly helpful in that process. There have clearly been substantial weaknesses in the County's planning, management, and execution of leases. We have made improvements in this area a major priority during the past year and, as noted in your audit, have made significant progress. With the assistance of your audit, we intend to continue making improvements in this area and aim to achieve the standards suggested by the audit by the end of FY 2005.

We found it difficult to assess the relevance or application of many of the specific findings since we were unable to determine which leases were included in the samples. Without this information it is difficult to determine whether they are historic or current, whether the findings were universal or focused on specific leases or types of leases, whether there were extenuating or unique circumstances, etc. We do not believe this reduces the reliability or accuracy of the recommendations; it simply makes it more challenging to understand the context for findings and to apply the recommendations. We hope your staff will be available for further consultation to help us more fully understand the basis for individual findings.

Several items seem worthy of note to help provide a context for the findings of your report. They are offered not to refute any of the findings but rather to offer an additional perspective:

1- The Chair's Office and I agreed when I was hired about two years ago, that lease management was an area in need of substantial improvement. We have been hampered by major budget and FTE cuts and, more recently, the loss of both of the staff dedicated to this work. We have backfilled with other (less experienced) staff in the interim and have made significant gains in many of the areas noted in the audit. There is still significant work to do but it is worth noting what has been accomplished to date:

   - Completed the shift of maintenance/operations responsibility from Depts. to FPM
   - Completed the shift of lease research, negotiation, and documentation to FPM
   - Transferred the remaining collections/payments duties from Depts. to FPM
   - Completed a reorganization to allocate additional staff/expertise to lease mgmt.
   - Began development of plans, policies, and procedures to guide this work
   - Lease Processing Workflow Documented
   - Real Property Routing Approval Form Developed
   - Lease Approval Resolution Template Developed
   - Request for Space Change Form Initiated
   - Developed Prioritized Work Plan Action Item List
   - Created Electronic Lease Data master file for tracking all leases
   - Created a Lease Matrix for Dispatch to summarize tenant-landlord duties
   - Pre-Negotiation Memo developed & implemented to capture all major deal terms
   - Implemented File Checklists and file standards
   - Request for Lease Termination Form implemented
   - Standard Lease Templates developed
   - Improved "Tax Exempt" and "Termination" Clause developed
   - Permits/Short-Term Lease Template developed
   - Lease Payment Processing Workflow procedure developed
   - Lease Termination Operations Checklist developed
   - Developed Master Lease Payment List to aid accurate & timely payments/collections
   - Electronic Tax Payment Spreadsheet developed to facilitate tracking
   - Tax Exempt Form Letter instituted for landlords/tenants
   - Overall improvements in lease documents and file documentation

2- The determination of whether and when to lease space is more complex than a simple cost benefit analysis. The audit notes that leasing space is a more costly approach for larger, more stable programs. In addition to the direct financial comparison, it is important to note that a number of current factors encourage the consideration of leasing. These include:
   a. Uncertain program funding and requirements
   b. Major projected Countywide shortfalls
   c. Severely limited capital funds
   d. The potential need for interim space as the County repositions/consolidates its space

3- The audit notes to difficulties of managing leases with non-profit organizations and encourages a strong, business-like management approach. We certainly agree on both counts and offer several additional perspectives to bring these recommendations into context:
   a. Non-profit organizations are receiving the benefit of discounted rates because a program sees them as an integral part of their service delivery plan; these arrangements are not being made simply to support a worthy charitable purpose.
   b. Facilities has been working over the past two years to eliminate any direct subsidy of lease rates. If space is to be leased at a discounted rate, a County Department must agree to pay the standard rates and therefore absorb the burden of the discount.
   c. Facilities has substantially improved its monitoring and collection systems for all leases and current collection rates show significant improvement. Because of the nature of the affected non-profits and their role in delivering needed services, collection methods are predictably gentler than a typical for-profit business. We don't believe this approach will result in poor payment practices.

4- The County currently has 110 leases – 55 to others and 55 from others – of which 15 are out of date. We are in full agreement that this is a problem and have been focusing a major effort on getting all leases current. We have designated large/higher risk leases as our highest priority and those that remain are generally smaller and often have extenuating/complicating circumstances. Of the 55 leases where County space is leasing from others, 4 are out of date. All 4 of these out-of-date agreements are in negotiations and are for small, low-cost arrangements primarily with other governments and non-profits. The remaining 11 out-of-date leases regard the lease of space to others. All but one of these leases are in active negotiation and should be ready for Board approval by the end of June. (NOTE: The one lease that will remain is the lease of the Hooper Detox Center Building to the Central City Concern. This is a long-standing arrangement of more than 20 years and FPM will work to put a valid lease in place in the next several months.)

In conclusion, we fully endorse the recommendations of the audit and feel we have a good start down the right path to see them implemented. We thank you and your staff for your thoughtful consideration of our input and your assistance in making our efforts more effective. We would particularly like to thank your staff, Craig Hunt and Rie Anderson, for their hard work and consideration on this project.

Sincerely,

Doug Butler

Doug Butler
Director
Facilities and Property Management Division
Department of Business and Community Services
Multnomah County, Oregon