

**Performance Audit 19-10:  
Real Estate Management**

**August 2020**

**City Auditor**

Stan Sewell, CPA, CGFM, CFE

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# OFFICE OF INTERNAL AUDIT

## Stan Sewell, City Auditor

August 28, 2020

To: Mayor Andy Berke  
City Council Members

Subject: Real Estate Management (Report #19-10)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of Real Estate Management. Our audit found the Real Property Office performs its designated function well. However, we found there was no digital means to maintain lease information, reporting to Council and Administration was lacking, written policies were not in place and lease management needed improvement. In order to address the noted areas for improvement, we recommended actions to update City Code, upgrade database functionality, provide annual reporting and place written policies and procedures on the intranet.

We thank the management and staff of the Economic and Community Development and Information Technology departments for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE  
City Auditor

Attachment

cc: Audit Committee Members  
Kerry Hayes, Chief of Staff  
Maura Sullivan, Chief Operating Officer  
Daisy Madison, Chief Financial Officer

Donna Williams, Administrator, ECD  
Brent Messer, Chief Information Officer  
Richard Beeland, Deputy Director, ECD  
Gail Hart, Real Property Office Manager  
Jim Arnette, Tennessee Local Government Audit

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## AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2019 Audit Agenda. The objectives of this audit were to determine if:

- ECD Real Property Office has written policies and procedures in place to ensure effective management of real property.

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## BACKGROUND

The Chattanooga Real Property Office of the Economic and Community Development Department (ECD) is charged with management of real property owned by the City. It is staffed by one full-time and one part-time employee. Both paper and electronic records (database) are kept for each current, and previously owned, parcel noting the county parcel number, square footage, assessed valuation, brief property description, etc.

In conjunction with the City Attorney's Office, the Real Property Office endeavors to ensure all new and renewed property leases are put in place using proper methodology.

The Code Enforcement group of the Economic & Community Development Department is responsible for ensuring surplus/back-tax property is properly maintained, with the Public Works Department maintaining all other City-controlled properties. Outside organizations in control of City-owned property are responsible for maintaining those properties.

The City currently owns 1,258 properties, many of which are used for City purposes. Some are used by City affiliated organizations. Many are back-tax seizures and several have been declared surplus.

There are five principals for management of real property for local governments:<sup>1</sup>

- Classify properties as to function;
- Build a property database;
- Create a department dedicated to asset management;
- Formulate a strategic role for real estate management in attaining municipal goals; and,
- Implement portfolio management practices.

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<sup>1</sup> Urban Institute Guidebook on Real Property Asset Management for Local Governments, 2012

The Real Property Office uses a property database detailing each parcel by location, value, size, etc. They also track the department using the property, and classify each parcel as to type of use. A strategic plan has not been created nor have portfolio management practices been implemented.

## STATISTICS

**Summary of City-owned Property by Use  
(Includes City Property Managed by Other Organizations)  
December, 2019**

	<u>Parcels</u>	<u>Amount</u>
Ecocomic & Community Development	81	\$ 57,899,100
Public Works Department	338	47,247,900
Youth and Family Development	56	19,113,200
Chattaogga Police Department	10	5,552,500
Chattanooga Fire Department	34	1,380,400
Public Library	4	327,900
Chattanooga Dept of Transportation	5	157,200
Surplus Property	133	1,839,900
Back Tax -cleared Redemption period	303	3,703,800
Pending (Back Tax -in Retrieval period)	43	107,900
City Managed Property	<u>1,007</u>	<u>137,329,800</u>
Chattanooga Metropolitan Airport Authority	36	27,122,600
Health & Education Housing	10	14,499,600
Chattanooga Development Resource Center	10	12,330,100
Chattanooga Neighborhood Enterprise	32	1,280,400
Chattanooga Neighborhood Enterprise-Surplus	1	2,800
Electric Power Board	161	4,773,400
Humane Educational Society	1	149,800
Property Managed by Other Entites	<u>251</u>	<u>60,158,700</u>
Totals	<u>1,258</u>	<u>\$ 197,488,500</u>

Source: Property Office records

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## FINDINGS AND RECOMMENDATIONS

### Written policies and procedures are not in place.

Informal operating procedures are in place for some processes, but there are no written policies in place on the City intranet for use by departments performing activities related to property management. The Property Management office has prepared written procedures during the course of this audit.

New employees, or employees not regularly performing real property related tasks, do not have an authoritative source to access for guidance on property matters. With changes to personnel, some procedures could be performed incorrectly or skipped, leading to an improper handling of property transactions.

Control Environment of the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee*, Component 1, requires “development of a manual that provides sufficient documentation of internal control to communicate to personnel their responsibilities, as well as to monitor and evaluate the controls”.

#### Recommendation 1:

We recommend the Real Property Office formalize policies and procedures for property management and place them on the City intranet to provide guidance to individuals/departments. The policies and procedures should align with a proposed ordinance we recommend later in this report.

***Auditee Response:** We concur with the audit findings and recommendations. Written policies exist for most situations and detailed step-by-step instructions are in a shared Google drive for any City employee who needs access. We will make sure the instructions are also on the City’s intranet.*

### Property administration needs to be strengthened.

#### Regular reporting to Council and Administration is not performed.

Real estate best practices suggest governments should maintain a property inventory that is complete, accurate, and relevant to decision-makers informational needs. Best practices also require a summary report on property asset management be provided to decision-makers at least annually.<sup>2</sup> There are no mandatory requirements for this reporting, but best practice provides it should meet the needs of those

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<sup>2</sup> Urban Institute Guidebook on Real Property Asset Management for Local Governments, 2012

for whom it was created. Examples of information to be included in the reporting are:

- Parcel number
- Location
- Assessed value
- Year of assessment
- Dimensions of property
- Year acquired
- Current use
- Custodial agency

There is no scheduled reporting to the City Council or Administration of properties held by the City. Reporting is not regularly produced showing the parcels owned, the use or status of the parcels (in-use, held for economic development, surplus, etc.) Reporting on status and values of parcels are prepared only upon a specific request for data related to a property.

Regular assessments to determine if City properties are being put to their highest and best use are not performed. No determination is made if unused properties have prospective City use or the parcels should be declared surplus and sold.

City administration determines parcels to be held for development and when those properties are to be removed from the reserved list. However, Administration is not furnished regular reporting detailing reserved parcels. Properties held for a future use that do not come to fruition are sometimes held in reserve years after the intended project fails to materialize. The Property Management Office has no rules/policies requiring they periodically send Council/Administration a listing of parcels held for development.

Component 4, Information and Communication, from the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee* requires municipalities to: “Review and evaluate whether data has been processed into quality information that allows management to make informed decisions and evaluate whether the local government is achieving its objectives.”

### **Policies are not in place regarding acquisition and disposition of property for City use.**

Currently, when administrators need to purchase or lease property, the interested department typically finds a prospective location (through associates) and informs ECD of their interest in leasing/purchasing that property. ECD is responsible for facilitating the purchase of



property. Under the current scenario, the purchaser knows the City is interested in the property, which may result in an inflated asking price.

ECD is in process of issuing an RFP for a realtor(s) to act as a blind property agent for purchases by the City.

Additionally, Component 3, Control Activities, from the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee* requires municipalities to design control activities to achieve objectives and respond to risks.

### **Lease management is not centralized.**

Contract administration works best when responsibility and authority are clearly assigned and procedures documented. Specific procedures do not exist for directing how leases should be managed, and by whom. No Citywide policies or procedures have been established for real property lease management. No department owns or manages the City's leasing process, as identified previously in Audit 12-05.

There is currently not a policy requiring departments consult the Real Property Office prior to negotiating a lease. As a result, there is not a complete listing of older City leases. For the past several years the City Attorney's Office has ensured the Real Property Office is involved in the preparation of new leases being considered, as well as the renewal of older leases.

No area has overall responsibility to develop leases, collect lease payments and track non-cash lease obligation compliance. Most departments do not track lease compliance well, as lease management is not a critical segment of departmental activities.

The Real Property Office tracks the leases of which they are aware, but does not manage the leases nor track payments or non-cash obligation compliance. Ballet TN and UTC leases are examples of non-cash transactions not monitored. Currently, there are no policies or procedures to ensure all lease terms are tracked, appropriate payments received and any issues addressed.

If the Real Property Office is aware of a lease, they notify the appropriate department the lease under its management will expire several months in advance of expiration. Many times the lease expires prior to the department taking action. Several weeks pass during the process of negotiating and receiving approval for new or renewed leases. For example, billboard leases have been managed by several different departments. With the exception of one lease, all billboard leases in the City have been expired for some time. ECD is consolidating the leases and plans to manage billboard leases going forward.

Component 4, Information and Communication, from the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee* requires municipalities to: “Review and evaluate whether data has been processed into quality information that allows management to make informed decisions and evaluate whether the local government is achieving its objectives.”

**There is no formal oversight of properties leased to/from other entities.**

There is no formal oversight of City owned properties that are managed by other entities. Newer leases have a clause enabling the City to inspect properties. However, formal inspection of leased buildings does not take place. If Code Enforcement Inspectors see a property managed by outside entities is unkempt, they notify ECD management.

Municipalities have a responsibility to ensure their properties are well-maintained. Currently, the City does not have a system in place to ensure upkeep of properties under the care of outside entities is being properly maintained.

**Recommendation 2:**

We recommend ECD lead the effort to add an ordinance to City Code requiring the following:

- Council and Administration receive regularly scheduled reporting related to real property holdings, detailing parcels used for City purposes, parcels used by outside entities, parcels reserved for economic development, as well as properties not identified for a particular use.
- Formation of a standing committee with representatives from departments involved in property management to determine future real property needs and make recommendations regarding unused property.
- When procurement of property is necessary, ECD be informed of the need and ECD locate and procure property acceptable to the requesting department to fulfill the stated need.
- Property Management Office be given authority for management of property leases, whether the City is lessor or lessee. This recommendation was previously made in Audit 12-05.
- All properties managed by or leased to outside entities be inspected and a report on those properties be produced annually and distributed to Council and Administration.

**City property management database is not reconciled to official County records**

**Auditee Response:** *We concur with the audit finding and recommendation. A realtor is now in place and is being utilized. Ballet TN and UTC leases are managed by YFD Recreation.*

County records are the official property records. The City database is set up with identical fields in the same order as county records. Additions/sales/changes to the City database are entered manually.

When verifying City records, County records are accessed manually to insure correct details and values are in the City real property database. This method of comparison is time intensive and inefficient.

**Recommendation 3:**

We recommend the Property Management Office develop a spreadsheet methodology to compare City-owned properties downloaded from the county database to Property Management database records. The Property Management Office should also consult with DIT regarding the possibility of automating the process of performing the comparison and identifying differences.

**Auditee Response:** *We concur with the audit finding and recommendation.*

**Lease management functionality should be added to the property database.**

Information regarding property leases is tracked manually. Due dates and follow-ups are tracked by calendar entries. DIT had plans to program a database to manage lease information. However, the Real Property Office has not requested DIT move forward with the programming.

Component 4, Information and Communication, from the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee* requires “necessary quality information be available to achieve the organizations objectives.”

**Recommendation 4:**

We recommend the Real Property Office grant approval for DIT to modify the property database to include appropriate lease information. Programming should include the ability enter lease-related dates, track payments, non-cash compensation details and the ability to compile reporting to inform personnel of upcoming lease expirations and out-of-date insurance policies.

**Auditee Response:** *We concur with the audit finding and recommendation.*

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## **APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS**

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers real property management from January 1, 2019 to December 31, 2019. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from City real property records and the Hamilton County Assessor website. Original records and copies, as well as electronic records, were used as evidence and verified through examination.

To develop our recommendations, we reviewed industry best practice documents and State of Tennessee requirements.

The sample size and selection were statistically generated using a desired confidence level of 90 percent, expected error rate of 5 percent, and a desired precision of 5 percent. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in the County Assessor system and Property Management Office database. We assessed the reliability of the data contained in the two systems and conducted sufficient tests of the data. Based on these assessments and tests, we concluded the data was sufficiently reliable to be used in meeting the audit's objectives.

We conducted this performance audit from December 2019 to June, 2020 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.

### **City of Chattanooga Fraud, Waste, and Abuse Hotline**

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[www.chattanooga.gov/internal-audit](http://www.chattanooga.gov/internal-audit)