OCTA

May 14, 2025

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit

Subject: Real Estate Administration, Internal Audit Report 25-506

Overview

The Internal Audit Department of the Orange County Transportation Authority has completed an audit of real estate administration. Based on the audit, controls over real estate administration could be improved. Five recommendations have been made to develop procedures for implementing fair market adjustments, improve documentation of approval for negotiated lease rates, document reviews of insurance requirements, develop procedures for periodic inspection of leased properties, and to implement procedures for collection of late payment fees.

Recommendation

Direct staff to implement five recommendations provided in Real Estate Administration, Internal Audit Report No. 25-506.

Background

The Real Property Department (Real Property), within the Capital Programs Division, has management responsibilities for properties acquired and owned by the Orange County Transportation Authority (OCTA). The Real Property Policies and Procedures Manual (Policy) outlines responsibilities including managing leases, licenses, and rights-of-entry, conducting fair market analyses of revenue generating real estate interests, monitoring tenant insurance, periodic inspection of leased properties, and coordination with the Accounting Department for revenue collection.

OCTA permanently owns and manages 695.8 acres of rail right-of-way property and acquires additional properties as part of its responsibilities in delivering highway and rail projects. As of September 2024, OCTA owned 803.58 acres of capitalized real estate property, including bus bases and transit centers. As of October 2024, Real Property manages 165 revenue-generating leases, licenses, and rights-of-entry, with annual collections of $1.69 million and $1.55 million for fiscal years 2022-23 and 2023-24, respectively.

Real Property is staffed with one manager and five real property agents (RPA). Real Property also utilizes two consultant firms, CBRE Group, Inc. (CBRE) under Agreement No. C-0-2160, and Cal Pacific Land Services, Inc. (Cal Pacific) under Agreement No. C-3-2807, to perform various activities including development of initial fair market valuations, assistance with lease negotiations, monitoring of tenant insurance coverage, and development of recommendations for periodic fair market and Consumer Price Index adjustments.

On a monthly basis, Accounts Receivable staff prepares a billing list for the RPAs' review and approval prior to mailing invoices. For any invoices outstanding 90 days or more, Accounts Receivable will send duplicate invoices and notify the RPA of the delinquency. In accordance with California Revenue and Taxation Code, Real Property prepares and files an annual Possessory Interest Report with the County of Orange and notifies the County Assessor's office of revenue-generating agreements, which the leaseholder is responsible for paying taxes on the interest in the property created.

Discussion

Results of initial fair market valuations performed by consultant firms are accepted through informal means, including email and sticky notes, rather than requiring formal reports describing methodology and support for the rate used to determine value. In addition, management has not developed procedures to ensure that periodic fair market value adjustments are implemented in accordance with agreement terms and the Policy. Internal Audit recommends management develop and implement standards for the conduct and documentation of fair market valuations and assessments and require consultant firms to provide opinions of value in writing, including descriptions of the methodology and support for the rates used. Management should also develop and implement procedures to ensure fair market analyses and related adjustments are conducted and applied in accordance with agreement terms and Policy requirements. Management agreed and indicated that an updated appraisal is underway and will be used as the basis for calculating future fair market valuation increases. Management will also develop a procedure to memorialize steps to determine fair market value calculations and decisions as to imposing such increases.

Rate adjustments not applied, or modified, due to negotiation and/or other considerations are not documented and approved as required by the Policy. Internal Audit recommends management comply with the Policy requiring documentation and approval of lease rate adjustments modified or not applied and implement procedures to ensure lease amendments are processed to reflect negotiated rate adjustments. Management agreed and will document consultant calculations, history of negotiations, and the final negotiated rate in each tenant file, and amend licenses to reflect any negotiated adjustments.

There is no evidence that insurance requirements included in lessee agreements are reviewed by the Risk Management Department (Risk Management) for sufficiency, as required by the Policy. Internal Audit recommends Real Property obtain documentation of Risk Management's review and direction as to insurance requirements. In addition, management should consider reviewing and updating license agreements that do not contain insurance requirements or other standard terms and conditions. Management agreed and will request a memorandum from Risk Management to confirm the minimum requirements for license insurance each January. If a potential licensee is requesting a unique or unusual use, the Risk Manager will be made aware so that they can determine if the insurance requirements are sufficient.

There is currently no documented, systematic process to periodically inspect leased properties to ensure compliance with agreement terms and to prevent unauthorized uses. Internal Audit recommends management develop and implement procedures for periodic inspection of properties to ensure compliance with agreement terms and identify unauthorized uses. Inspections should be documented. Management agreed and will identify tenants that require inspection each January and will perform and document the inspections.

Late payment fees, outlined in lease agreements, are not applied. Internal Audit recommends management develop and implement procedures to ensure late payment provisions are enforced. Management agreed and will calculate and document the value of late fees based on the licensee's individual agreement with OCTA and communicate this rate with the tenant and Accounts Receivable.

Summary

Internal Audit has completed an audit of real estate administration and has offered five recommendations for improvement.

Attachment

A. Real Estate Administration, Internal Audit Report No. 25-506

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ATTACHMENT A

ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT

OCTA

Real Estate Administration

Internal Audit Report No. 25-506

Revised - April 28, 2025

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Conclusion

The Internal Audit Department (Internal Audit) of the Orange County Transportation Authority (OCTA) has completed an audit of real estate administration. Based on the audit, controls over real estate administration could be improved. Five recommendations have been made to develop procedures for implementing fair market adjustments, improve documentation of approval for negotiated lease rates, document reviews of insurance requirements, develop procedures for periodic inspection of leased properties, and to implement procedures for collection of late payment fees.

Background

The Real Property Department (Real Property), within the Capital Programs Division, has management responsibilities for properties acquired and owned by OCTA. The Real Property Policies and Procedures Manual (Policy) outlines responsibilities including managing leases, licenses, and rights-of-entry, conducting fair market analyses of revenue generating real estate interests, monitoring tenant insurance, periodic inspection of leased properties, and coordination with the Accounting Department for revenue collection.

OCTA permanently owns and manages 695.8 acres of rail right-of-way (ROW) property and acquires additional properties as part of its responsibilities in delivering highway and rail projects. As of September 2024, OCTA owned 803.58 acres of capitalized real property, including bus bases and transit centers. As of October 2024, Real Property manages 165 revenue-generating leases, licenses, and rights-of-entry, with annual collections of $1.69 million and $1.55 million for fiscal years 2023 and 2024, respectively.

Real Property is staffed with one manager and five real property agents (RPA). Real Property also utilizes two consultant firms, CBRE Group, Inc. (CBRE) under Agreement No. C-0-2160, and Cal Pacific Land Services, Inc. (Cal Pacific) under Agreement No. C-3-2807, to perform various activities, including development of initial fair market valuations, assistance with lease negotiations, monitoring of tenant insurance coverage, and development of recommendations for periodic fair market and Consumer Price Index (CPI) adjustments.

Lease, license, and right-of-entry agreements are negotiated by staff and approved by the Executive Director of Capital Programs. The Policy states that insurance requirements should be implemented as determined by OCTA's Risk Management Department (Risk Management). The Policy requires regular review of the terms and conditions of existing agreements and consistent implementation (at least every five years) of fair market adjustments and annual CPI adjustments. Individual agreements also may include terms for the frequency of fair market adjustment, CPI adjustment, and for fees to be assessed for late payments. Recommended lease rate adjustments that are not applied due to negotiations or other considerations are required to be documented and approved by the executive director.

On a monthly basis, Accounts Receivable staff prepare a billing list for the RPAs' review and approval prior to mailing invoices. For any invoices outstanding 90 days or more, Accounts Receivable will send duplicate invoices and notify the RPA of the delinquency.

In accordance with California Revenue and Taxation Code, Real Property prepares and files an annual Possessory Interest Report (PIR) with the County of Orange. The PIR notifies the county assessor's office of revenue-generating agreements allowing others to use publicly owned property. The leaseholder is responsible for paying taxes on the interest in the property created by the agreement.

Objectives, Scope, and Methodology

The objectives were to assess and test controls over real estate administration.

The methodology consisted of testing compliance with key Policy and agreement requirements, testing compliance with the Capital Asset Management Manual for recording of real property in the accounting system, testing controls for valuation, approval, and new account set-up, testing controls for monitoring of insurance requirements, testing compliance with the Policy and agreement terms for application of fair market and CPI adjustments, testing of invoice controls and application of late payment fees, and testing compliance with requirements for filing annual PIRs.

The scope period was from July 1, 2022 through September 30, 2024, the Active Customer Account Listing from the accounting system as of October 24, 2024, and PIR filings for 2023 and 2024. Judgmental samples were selected with a bias for different types of agreements and to provide coverage throughout the scope period. Testing for application of market and CPI adjustments included a sample of active agreements over five years old as of October 24, 2024, and invoice testing included two invoices per agreement. Since the samples were non-statistical, any conclusions are limited to the sample items tested.

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.

Audit Comments, Recommendations, and Management Responses

Fair Market Valuation

Results of initial fair market valuations performed by consultant firms are accepted through informal means, including email and sticky notes, rather than requiring formal reports describing methodology and support for the rate used to determine value. In addition, management has not developed procedures to ensure that periodic fair market value adjustments are implemented in accordance with agreement terms and the Policy.

Consultant-prepared fair market value opinions for four out of five agreements executed since July 2022, were supported only by calculations sent by email or written on sticky notes without support.

In addition, the Policy requires management consistently implement fair market adjustments; specifically, the Policy states that "…at least every five years, through an independent consultant, conduct a fair market analysis of the revenue-generating real estate interest owned by OCTA." Agreements also include language addressing fair market adjustments to be performed not less than every three or five years from the anniversary date. Despite this, there was no evidence of fair market analyses being performed for 11 out of 15 agreements tested, and the last analyses performed on the remaining four agreements were dated between June 2016 through May 2018, beyond the three-to-five-year requirement per agreement terms and the Policy. The fair market analyses on file for these four utilized a rate of $28 per square foot, without discussion or support as to how the rate was derived.

Recommendation 1:

Internal Audit recommends management develop and implement standards for the conduct and documentation of fair market valuations and assessments and require consultant firms to provide opinions of value in writing, including descriptions of the methodology and support for the rates used. Management should also develop and implement procedures to ensure fair market analyses and related adjustments are conducted and applied in accordance with agreement terms and Policy requirements.

Management Response:

Management agrees with the recommendation. OCTA staff are obtaining an updated rail corridor appraisal, which will be used as the basis for calculating future fair market valuation (FMV) increases. The Real Property Manager will use the appraisal and FMV recommendations from staff and consultants to negotiate FMV increases.

Staff will develop a process requiring a justification memorandum to be sent each January from the Real Property Manager to the Capital Programs Executive Director, recommending either an FMV increase or justifying why an FMV was not imposed on licenses eligible for an increase. The memorandum will document the methodology used to calculate the rate including reference to any source material such as appraisals used.

Approval of Rate Adjustments

Rate adjustments not applied or modified due to negotiation and/or other considerations are not documented and approved as required by the Policy.

The Policy requires that the decision not to apply a rate adjustment be documented, validated by the Real Property Manager, and approved by the Capital Programs Executive Director.

Testing identified three instances whereby a lease rate was reduced from the FMV derived through analysis without documentation describing the negotiated rate and without evidence of approval by the Capital Programs Executive Director. In addition, the two existing lease agreements were not amended to reflect the negotiated rate.

Recommendation 2:

Internal Audit recommends management comply with the Policy requiring documentation and approval of lease rate adjustments modified or not applied and implement procedures to ensure lease amendments are processed to reflect negotiated rate adjustments.

Management Response:

Management agrees with the recommendation. On a monthly basis, staff and/or consultants will calculate Consumer Price Index (CPI) increases and present them to the Real Property Manager for approval and provide Accounts Receivable the approved CPI increases. Rate adjustments will be documented in a memorandum from the Real Property Manager to the Capital Programs Executive Director recommending the agreed-upon rate is considered prudent and in the best interest of OCTA. Lease rate changes resulting from CPI adjustments will not require license agreement amendments. Negotiated adjustments to lease rates will be included in an amendment to the license agreement.

Insurance Requirements

There is no evidence that insurance requirements included in lessee agreements are reviewed by Risk Management for sufficiency, as required by the Policy.

The Policy requires Real Property to implement insurance requirements as determined by Risk Management and consult Risk Management for approval of changes to standard insurance requirements. Discussion with management indicates that Risk Management is consulted; however, this is not documented.

In addition, testing identified two license agreements dated 1957 and 1963, that do not contain any insurance requirements. These licenses were executed by the prior owner of the ROW and have not been updated to include OCTA standard terms and conditions, such as insurance requirements.

Recommendation 3:

Internal Audit recommends Real Property obtain documentation of Risk Management's review and direction as to insurance requirements. In addition, management should consider reviewing and updating license agreements that do not contain insurance requirements or other standard terms and conditions.

Management Response:

Management agrees with the recommendation. Real Property will request a memorandum from Risk Management each January to confirm minimum requirements for insurance for above-ground uses and underground utility company facilities on OCTA property. This will include:

1) Commercial General Liability
2) Automobile Liability
3) Umbrella Liability
4) Workers Compensation and Employers Liability
5) Excess Liability
    a) 2nd and 3rd Layers

If a potential licensee is requesting a unique or unusual use, the Risk Manager will be consulted so that they can determine if the insurance requirements are sufficient. Insurance requirements for improved properties will be discussed and addressed separately by Risk Management. If the insurance requirements change within the calendar year, the Risk Manager will send an updated memorandum.

Real Property reviews tenant insurance certificates to ensure compliance with the insurance terms and conditions in their respective agreements. Staff will initiate discussion with licensees on any changes needed for insurance and other terms and conditions of their license and document the discussions in tenant files.

Periodic Field Inspections

There is currently no documented, systematic process to periodically inspect leased properties to ensure compliance with agreement terms and to prevent unauthorized uses.

The Policy requires Real Property to manage leases, licenses, and rights-of-entry through periodic field inspections to ensure compliance with the terms and conditions of the respective agreements and to manage properties to minimize maintenance and prevent unauthorized uses. Discussion with management confirmed there is currently no systematic process in place; rather, inspections occur when leases are being negotiated or amended, or when inquiries are received.

Recommendation 4:

Internal Audit recommends management develop and implement procedures for periodic inspection of properties to ensure compliance with agreement terms and identify unauthorized uses. Inspections should be documented.

Management Response:

Management agrees with the recommendation. OCTA inspects active tenant leases and licenses intermittently and on an ‘as needed’ basis, as reflected in the Policy and updates approved by the Board of Directors since 2013.

Each January, Real Property will review and identify tenants that would likely require a more recurrent inspection based on the specific site and the tenants’ use of the property. Properties requiring more recurrent inspection will be documented in the tenant file and OCTA’s Real Property and Rail Maintenance-of-Way staff will log inspections performed. Other ‘as needed’ or case-by-case inspections will be performed and documented in the tenant file.

Late Fees

Late payment fees, outlined in lease agreements, are not applied.

Some lease agreements include late payment provisions; however, Real Property has not developed and implemented procedures to apply these fees. Internal Audit noted that late fees were not collected in accordance with the underlying agreement terms for any of the late payments observed during testing.

Recommendation 5:

Internal Audit recommends management develop and implement procedures to ensure late payment provisions are enforced.

Management Response:

Management agrees with the recommendation. Most licenses that incur late fees are from utility companies with facilities transversely crossing OCTA rail and Pacific Electric ROW. Promptly recovering late fees from utility companies has proved challenging.

Real Property will receive a report on all tenants whose payments are 30 days late. Real Property staff will calculate and document the value of late fees based on the license agreement and communicate this rate with the tenant and Accounts Receivable. Staff will ensure that tenants that are 30-day delinquent receive a phone call or e-mail to inform them of late fees and urge prompt payment. At 90 days OCTA will consult with OCTA's Legal Counsel to determine whether to pursue a lease or license violation. This process will be documented in each tenant file that appears on a late fee report.