



Audit of Land Lease Financial Provisions

Project # 13-19

Prepared by
Office of the Inspector General

J. Timothy Beirnes, CPA, Inspector General
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SOUTH FLORIDA WATER MANAGEMENT DISTRICT

April 10, 2014

Audit and Finance Committee Members:

Mr. Jim Moran, Chair
Mr. Tim Sargent, Vice Chair
Mr. Glenn Waldman, Member
Mr. Juan Portuondo, Member

Re: Audit of Land Lease Financial
Provisions - *Project No. 13-19*

This audit was performed pursuant to the Inspector General's authority set forth in Chapter 20.055, F.S. Our objectives focused primarily on determining whether lessees of District land complied with lease financial provisions. Dan Sooker and I prepared this report.

Sincerely,

A handwritten signature in blue ink that reads "J. Timothy Beirnes".

J. Timothy Beirnes, CPA
Inspector General

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BACKGROUND

In accordance with the approved 2013 Audit Plan, we conducted an Audit of Land Lease Financial Provisions. District leased land is used for sugar cane production, cattle grazing, citrus operations and other purposes. Generally, these leases require annual lessee payments and contain financial provisions that also require the lessee to maintain insurance and pay real estate taxes. The lessees may also be required to deposit with the District one year's lease payment and real estate taxes.

The District has 88 lease agreements that in most cases require lessees to maintain liability, automobile and other insurances and pay county real estate taxes. Upon execution of the lease, the property is placed on the tax rolls of the county, in which the property is located. The lessee agrees to pay all real property taxes, intangible property taxes and personal property taxes, as well as all local assessments.

In a coordinated effort, the District's Leasing Section and the Accounting and Procurement Bureaus monitor lessee compliance with various financial requirements. The Leasing Section is responsible for ensuring that lease and tax payments are accurate and timely. The Procurement Bureau monitors compliance with insurance requirements while the Accounting Bureau is responsible for depositing lessee payments in the District's bank account and ensuring that the payments are properly coded and recorded in the appropriate trust fund. In accordance with trust fund requirements, lease revenue is restricted and must be returned to the trust fund, in which, the leased land was purchased.

For FY 2013, income producing acreage is approximately 135,000 acres, which is projected to generate \$4.2 million annually. In comparison to the prior year, this represents a decrease in the number of land leases from 97 in FY 2012 to 88 in FY 2013 but an increase of 5% in acreage leased. Annual revenue remained approximately the same compared to the prior year. Cattle grazing continued to be the primary land lease use at 68,606 acres and sugar cane leases contributed the most revenue at \$2.4 million.

OBJECTIVE SCOPE AND METHODOLOGY

Our objective was to determine whether lease revenues are collected in accordance with lease agreements and whether lessees have complied with lease financial provisions such as procurement of contractually required insurance and remittance of required tax payments in a timely manner.

To accomplish our objectives, we performed the following:

- Documented the District's land lease monitoring process.
- Reviewed listing of District revenue generating land leases.
- Tested on a sample basis for lessee compliance with agreement terms and conditions.
- Agreed land lease payments to bank deposits.

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 RESULTS

Executive Summary

Overall, we found that the system of internal controls related to compliance with lease agreement financial provisions appeared sufficient. Lessee non-compliance was identified in a timely manner and follow-up action was taken to bring the lessee back into compliance. We also found that lease monitoring staff was diligent in overseeing the leasing process.

Currently lease agreements provisions vary widely depending on when the lease originated. Leasing Section staff is working with the Office of Counsel to improve the leasing process through updates and standardization to lease agreement financial provisions as leases expire or are renewed through new agreements or amendments.

We found that lessee compliance is monitored through a system of Excel spreadsheets, SAP table updates and updates to the Integrated Real Estate Information System (IRIS) database. The Leasing Section is also developing an Access database to manage certain aspects of compliance monitoring. In our opinion, it would prove beneficial to streamline the compliance monitoring process by updating IRIS database functionality to manage lessee compliance rather than developing an Access database. Management concurred with the recommendation. Information Technology and Leasing will work together to map the lessee compliance process to identify potential efficiencies gained by updating the IRIS application.

We found that District lease policy requires lessees to deposit one-year's estimated property and sales taxes in an escrow account held by the District until either lease expiration or termination. The lease policy restricts the use of the deposited funds to the lessee's non-payment of taxes. However, there may be other reasons that the District may want to collect additional lessee deposits. To mitigate risk of loss to the District, we recommend that the District amend the leasing policy to allow the District to use lessee deposited funds for property damage, land clean-up and other mitigation purposes. We also recommend that the policy be amended to authorize staff to increase lessee required deposits on a case by case basis to mitigate high risk land use. Management concurred and has begun incorporation of this recommendation into the new boilerplate lease agreement terms and conditions.

Lease Compliance Monitoring System Could be Streamlined

We found that financial provisions of lease agreements vary widely depending on when the lease originated. Older lease agreements or reservations often do not include many of the financial provisions that are now part of the current boilerplate lease agreement. Further, payments on older long term leases may not reflect current market rent conditions. Accordingly, the Leasing Section in collaboration with the Office of Counsel are working to update and standardize lease agreement financial provisions as leases expire or are renewed through new agreements or amendments. Through this process, recently renewed multi-year land leases now contain an escalation clause that is based on the Consumer Price Index or the Agricultural Commodity Index to secure a market rent over the life of the lease.

Lessee compliance with lease agreement financial provisions is currently monitored through a system of Excel spreadsheets, SAP table updates and updates to an Oracle database. The Leasing Section is currently in the process of adding to the monitoring system by developing an Access database to document lessee compliance. While this enhancement is an improvement over the current system, the Access database is not supported by the District's Information Technology Division and adds another system to the monitoring process. It should be noted that the Leasing Section already maintains lease information, which includes land compliance inspection records in an Integrated Real Estate Information System (IRIS) Oracle database. Thus, to simplify the compliance monitoring process, updating IRIS database functionality to add lessee compliance with financial provisions (including insurance monitoring) would establish a single point to record lessee compliance with all lease provisions. As such, we recommend that IRIS Oracle database functionality be enhanced to include all lessee compliance.

Recommendation

- 1. Update IRIS database functionality to include lessee compliance with financial provisions and establish a single point record of lessee compliance with all lease provisions.**

Management Response: Management concurs with the recommendation that using one software program to administer District leases is preferred as it would streamline the number of processes necessary to administer real estate lease agreements.

Acknowledging that the use of multiple software programs is less efficient in the management of the real estate leasing program, staff submitted to the Information Technology (IT) Bureau in August of 2012, a Project Charter for the inclusion of the leasing administration procedures into the IRIS (Integrated Real Estate Information Systems) database. The purpose was to enhance the application features or functions in IRIS to support the Section's additional tracking needs. However, the additional work by IT to modify the IRIS application fell below the current prioritized list of District software modifications that IT has the staffing capability to complete.

In concurrence with the audit recommendation Information Technology and Leasing will work together to map the lessee compliance process to identify potential efficiencies gained by updating the IRIS application. When completed, a new work request will be prepared and presented to management for approval. If funded, IT will schedule resources according to management guidance.

- Mapping Process - March 31, 2014
- New IT Work Request - April 30, 2014
- Management Decision - June 30, 2014

If the IRIS enhancements can be made by IT, staff will transition from using multiple software programs to the use of IRIS as a one-stop-shop for the administration of leases.

Responsible Division(s): Operations, Maintenance, and Construction; Administration Services Division's Information Technology Bureau

Estimated Completion: December 31, 2014

Accurate and Timely Lease Payments

The Leasing Section is responsible for invoicing lessees for lease payments due. To ensure that the lease billing cycle is complete and accurate resulting in timely invoicing, the Leasing Section developed and maintains a lease revenue spreadsheet which includes all active land leases, key dates and lease amounts to ensure that the invoiced payment request is sent to the lessee in a timely manner. Our review of the billing cycle indicated timely invoicing. In addition, our review of lease payments made in fiscal year 2013 revealed one past due lease payment that was received approximately 60 days late which required Leasing Section staff follow up.

We found that District lease policy requires lessees to deposit one-year's estimated property and sales taxes in an escrow account held by the District until lease expiration or termination. The lease policy restricts the use of the deposited funds to the lessee's non-payment of taxes. However, there may be other reasons that the District may want to use the deposited funds or collect additional lessee deposits resulting from the lessee's use of the land. Accordingly, the lease policy should be amended to allow the District to use deposited funds for purposes other than non-payment of taxes including property or environmental damage caused by the lessee or cleaning up debris left by the lessee. Further, the lease policy should be amended to mitigate land use risk and authorize the Real Estate staff to increase deposits depending on the proposed land use on a case by case basis.

Recommendation

- 2. Amend the District leasing policy to allow District staff to use lessee deposited funds for property damage, land clean-up and other mitigation purposes. Further, the policy should also be amended to authorize staff to increase lessee required deposits on a case by case basis to mitigate land use risk.**

Management Response: Management concurs with the audit recommendation and will direct staff to begin preparation of a Governing Board resolution to amend the leasing policy as proposed.

Responsible Division: Operations, Maintenance, and Construction

Estimated Completion: September 30, 2014

Accurate and Timely Payment of Real Property and Other Taxes

When the District acquires land for conservation, restoration or preservation, the property is designated as government use and exempt from paying county property taxes. However, often times prior to implementation of projects for ecosystem restoration or preservation, the District leases land temporarily to keep public lands in production, pay taxes and local assessments, control exotic vegetation and implement best management practices for nutrient management and other water quality improvements. Revenues generated by the leases are used to support land management activities throughout the District.

In accordance with the District's Policy on the Administration of Leases, dated April 2012, lessees are responsible for depositing funds in the amount of one year's estimated property and sales tax or an equivalent alternative into an escrow account. We found one instance where a recently signed lease did not require the lessee to leave a deposit for property taxes.

Lessees are also responsible for re-establishing the land leased from the District on the county tax rolls according to Leasing Section staff. Further, lessees are required to inform the District that the property taxes are paid and to provide proof of payment (i.e., a copy of the cancelled check).

Our review of Article 3 section 3.2 of the boilerplate lease agreement revealed that assignment for placing the property on the tax rolls is unclear. The District should consider strengthening this provision by assigning the responsibility for placing the leased property on the tax rolls to the lessee.

Leasing Section staff reported that they rarely receive confirmation from lessees documenting property taxes paid on the leased parcels although the lease agreement mandates that they provide such notice. Alternatively, in order to confirm that lessees have paid the property taxes due on a leased parcel and complied with the terms and conditions of the lease, Leasing Section staff conducts a search for the leased Parcel Identification number on County Appraiser websites and agrees the taxes calculated by the property appraiser to the electronic Tax Collector receipt. Monitoring lessee compliance with this provision is an arduous, time consuming process but without lessee provided documentation (i.e. cancelled check), indicating payment, Leasing Section staff can only confirm lessee real estate tax payment through the Property Appraiser and Tax Collector websites.

To strengthen internal controls over the leasing process and inform county Property Appraisers of District leases in their county, the Leasing Section implemented a procedure in FY 2012, whereby a listing of lessees, parcel ID numbers and other information is sent to the County Property Appraisers annually.

Recommendation

- 3. To strengthen the District's lease property tax provision, consider assigning the responsibility for placing the property on county tax rolls to the lessee in the boilerplate lease agreement terms and conditions.**

Management Response: Management concurs with the recommendation and has already begun incorporation of this recommendation into the new boilerplate lease agreement terms and conditions. A section in the lease contract titled, "Real Property Taxes" states:

Upon execution of this Lease, Lessee shall place the Property on the county property tax rolls and shall provide to the District documentation that it has done so. Lessee shall pay directly to the county tax collector all real property taxes, intangible property taxes, and personal property taxes levied against the Property, as well as all assessments, including but not limited to pending, certified, confirmed and ratified special assessment liens, accrued or levied with respect to the Property or this Lease during the Lease Term. The amount of taxes or assessments will be determined by the county property appraiser. Lessee may obtain an agricultural classification from the county property appraiser providing a reduction in property taxes. Lessee is solely responsible for obtaining the agricultural classification and must pay all taxes levied by the County."

In addition, the boilerplate template includes language that requires the Lessees to pay all property taxes and assessments promptly upon receipt of an assessment notice from the taxing authority but in no later than February 1st each year. The lessees are required to furnish proof of payment to the District within fifteen (15) days of the payment.

Responsible Division: Operations, Maintenance, and Construction

Estimated Completion: Complete