



# MIAMIBEACH

BUDGET AND PERFORMANCE IMPROVEMENT  
Internal Audit Division

## INTERNAL AUDIT REPORT

TO: Jorge M. Gonzalez, City Manager  
VIA: Kathie G. Brooks, Budget and Performance Improvement Director  
FROM: James J. Sutter, Internal Auditor

DATE: October 6, 2011  
AUDIT: City Operated Commercial Leases  
PERIOD: October 1, 2007, through March 31, 2010

This report is the result of an audit performed on the Leases of city-owned properties in accordance to our Audit Plan. Lease agreements to be reviewed in this audit are those where the City receives a "flat rent" payment and includes tenants in the 777 Building, Historic City Hall, and the facilities located at 8128 Collins Avenue.

### INTRODUCTION

Leasing responsibilities for the city-owned properties included in this audit are managed by the Real Estate, Housing & Community Development (REHCD) Department. At the time of this audit, the 777 Building has one vacant space of the four leasable units on the ground floor; Historic City Hall has three vacant spaces on the third, fourth and fifth floors; and the 8128 Collins Avenue facilities are being occupied jointly by Log Cabin Enterprises & Sunrise Community Services.

New tenant negotiations are also handled by REHCD; offers made by the tenants interested in leasing space from these locations are evaluated for reasonableness and presented to the City Commission for approval before the lease agreement can be executed.

Invoices for rent payments due are prepared by REHCD staff around the middle of the month preceding the due date. These invoices are reviewed/approved by the Redevelopment Specialist in the department for adequacy and approved for printing and mailing by a Revenue Supervisor in the Finance Department. When tenants' rent payments arrive in the Finance Department, payments are matched to the oldest invoice for that tenant. If payments are not current, they are taken to the Cashiers' Office for payment processing. These payments consist primarily of base rent and/or maintenance and operational charges (CAM), and sales tax, but they may also include real estate taxes, insurance charges, and parking charges. The Finance Department Revenue section is responsible for making the entries to the appropriate general ledger accounts based on these various components of the rental payment.

Rental revenues are recognized as invoices for rent payments are generated and posted to accounts receivable in the general ledger. When rent payments are received and processed they are credited to this account to reduce the accounts receivable balance.

The following table describes the current tenants and basic information about their leases:

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	Lease Term Years	Term Year	Square Footage	Annual Minimum Rent (1)
<b><u>Tenants of 777 Building</u></b>				
Vanexa Enterprises Corp. (Unit # 1) d/b/a Steve's Beauty Salon	5	4	1,326	\$ 39,528
Vacant (Unit #2)	n/a	n/a	1,803	\$ 0
SB Waxing/Roma Waxing (Unit # 3)	3	1	1,291	\$ 35,465
Damian J. Gallo & Assoc. (Unit # 4) d/b/a Permit Doctor	5	4	1,269	\$ 42,544
Klara Gershman, MD (Suite # 400)	3	1	1,926	\$ 54,121
<b><u>Tenants of Historic City Hall</u></b>				
Miami-Dade County Court & Clerk	n/a	19	6,285	\$ 1
MDGLCC Foundation	3	1	2,543	\$ 23,319
Miami Beach Film Society d/b/a Miami Beach Cinemateque	3	1	2,523	\$ 23,136
Paul A. Sack	3	1	660	\$ 7,121
Gemcor	3	1	1,518	\$ 16,076
Immunity	3	1	3,036	\$ 38,223
<b><u>8128 Collins Avenue</u></b>				
Log Cabin Enterprises/Sunrise Comm.	3	1	54,500	\$ 7,200
				\$ 286,734
<b>(1)</b> Annual rent amounts for contracts executed through 3/31/2010				

**OVERALL OPINION**

For the most part, current lease agreements between the City and tenants of city-owned properties are in compliance with the terms and key non-financial provisions of the leases. Most tenants have obtained their required annual business tax receipt and secured the required insurance coverage. However as a result of our testing, we identified some deficiencies in reference to the management and rental payment processes for the leasing of city-owned properties reviewed in this audit.

1. Vanexa Enterprises d/b/a Steve's Beauty Salon, a tenant of the 777 Building, consistently makes late rent payments and currently owes three months of rent totaling \$15,744.78, for March through May of 2010, however the City has not initiated any official collection efforts from this tenant. We also found that five months of billed rent were adjusted, but the Finance Department has not yet provided evidence that the adjustments were properly justified.
2. The upper floors of the 777 Building are not assessed ad valorem taxes because the space is supposedly used for City offices and other non-commercial purposes. However, a portion of the payment made by a former tenant of the 4<sup>th</sup> floor was allocated and posted to the property

- taxes general ledger account. Concurrently, office space leased to five new tenants for commercial purposes at the Historic City Hall building and one at the 777 building are not being assessed any allocation of ad valorem taxes as a result of this building being exempted.
3. The sales tax amount for the December 2009 rent payment of Roma Waxing was erroneously posted to the parking revenue general ledger account.
  4. The amounts currently used to allocate operational and maintenance expenses to tenants of the 777 Building and Historic City Hall are estimates without evidence of support. The Miami-Dade County Court and Clerk located at Historic City Hall only pays a charge for these expenses that represent approximately \$.21 per square foot, compared to other tenants of that building paying between \$9.20 and \$11.08 per square foot of space.
  5. The insurance allocation used for the 777 Building and Historic City Hall represents only a premium amount estimate provided by the City's Risk Manager. Also, the insurance premium estimate used to assess the square footage allocation for tenants of Historic City Hall is an incorrect amount.
  6. We found that a tenant of the 777 Building paid the Business Tax Receipt (BTR) renewal for the current year, but a late payment penalty was not collected along with the payment. There are also two tenants of Historic City Hall that have not obtained their current BTRs.
  7. Lease agreements for the 777 Building and Historic City Hall currently require some insurance coverage that is considered unnecessary by the City's Risk Manager.
  8. Written policies and procedures for the administration and monitoring of City leases need to be established.

Additional details regarding the above mentioned and other areas in need of correction are provided on the Findings, Recommendations, and Management Responses section of this report.

## **PURPOSE**

To ensure that the management and leasing processes for the tenants of the 777 Building, Historic City Hall, and the facility used by Log Cabin Enterprises are in compliance with the terms and provisions of their respective lease agreements and making their rent payments in a timely manner.

## **SCOPE**

1. Review all current lease agreements between the City and tenants of city-owned properties to confirm that they are in compliance with the terms and key provisions of the leases.
2. Confirm that all lessees have obtained their required annual business tax receipt (BTR).
3. Confirm that all lessees have secured the required insurance coverage and have been approved by the City's Risk Manager.
4. Confirm that the all lease monthly rent payments and common area maintenance (CAM) charges are billed in accordance with the lease, including all the consumer price index (CPI) increases as specified in the lease agreement.
5. Confirm that all monthly rent payments were timely received and correctly reported in the City's Financial System.
6. Review policies and procedures in place for the administration and monitoring of City leases and determine that these are being followed.

## FINDINGS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES

1. Finding – Late Charges on Rent Payments

We noted that one tenant, Vanexa Enterprises d/b/a Steve's Beauty Salon, consistently made late payments during the audit period reviewed. This tenant's lease agreement, assumed when the City purchased the 777 Building, contains a late payment charge clause (section 8) stating that the tenant shall immediately pay landlord each and every payment that is not paid within five days of the due date, a service charge equal to 10% of the past due sum plus an additional charge of \$25 for every day thereafter until all sums due are received by landlord. Our testing of this tenant's rent payments revealed the following:

- a. As of 5/10/10, the tenant has not made the rent payments for the months of March, April and May 2010 (invoices # 15606, 15808, 16233) totaling \$15,744.78.
- b. The rent due for September 2009 (invoice # 13346) was reduced by an invoice adjustment for \$5,389.79 on 1/12/10. There were four other invoice adjustments made on 6/5/09, totaling \$20,152.92, for the months of November and December 2008, and February and May 2009. These adjustments were discussed at a meeting with members of the Finance Department on 5/10/10. Proper support and clarification to determine the adequacy of these entries is pending their research.
- c. Section 8 of the agreement also allows the City to assess a fee for returned checks (the greater of \$40 or 5% of amount due). This was not done with the check returned for the December 2009 payment; the estimated fee not charged is \$262.40 or 5% of \$5,248.

Recommendation

The City should initiate past due rent collection efforts with this tenant for the three months of overdue rent payments totaling \$15,744.78. If the reasonableness of this process is not considered appropriate due to the current economic conditions, this matter should be presented to the City Commission for an acceptable solution for delinquency on rental payments. The Finance Department should complete their research of the five invoice adjustments reported above to determine if these were properly done or whether the five months of rent reduced by the adjustments needs to be added to the overdue rental payments. Additionally, the tenant should be billed for the allowed returned check fee.

Management's Response - REHCD

The Tenant vacated the leased premises over the 2010 Memorial Day weekend thus defaulting on the terms of its lease agreement. As required pursuant to the lease, on June 1, 2010, a Notice of Default was issued requesting payment of all past due monies (including rent payments due all corresponding penalties and interest). Additionally, a Notice of Termination was sent on June 4, 2010. Additional attempts to reach this Tenant have been unsuccessful.

Management's Response – Finance

The tenant's account has been reconciled and properly reflects amount due to the City.

2. Finding – Real Estate Taxes for City owned property.

Through November 2008, the City paid real estate taxes for the "777 Building" as a single property structure. After the building was turned into an office condominium starting with the tax year that commenced December 2008, ad valorem taxes are only being paid for the four commercial units on the ground floor. The upper floors are not assessed ad valorem taxes because the space is used for City offices, non-profit and community organizations. However,

our review of rent payments for 5 of 6 months tested revealed that a portion of the payment made by former tenant Raben, Feldman & Associates, M.D., P.A., was allocated and posted to the property taxes general ledger account (#601-7000-229218). Further testing showed that all payments made from December 2008 through September 2009 were also recorded in this manner, totaling \$5,130.16 for this period. Starting October 2009, this suite was leased to Klara Gershman, M.D., P.A., but no property tax allocation is included in the billing to this tenant.

In addition and subsequent to the renovation completion of Historic City Hall, office space in the building is currently being leased to five new tenants for commercial purposes. The new tenants are not being assessed a property tax allocation because the building has a tax exempt status.

Recommendation

Since an allocation of real estate property taxes due is not currently required for the upper floors of the 777 Building, an adjustment of \$5,130.16 should be made to the appropriate general ledger accounts for the ten-month period indicated above. In addition, the tax exempt status for the upper floors of this building, in particular the one currently leased in part to a commercial tenant, and leased spaces at Historic City Hall should be evaluated by the City's Administration to determine whether this may, in the future, affect the current tax exempt status of the properties.

Management's Response - REHCD

REHCD will coordinate the \$5,130.16 adjustment in the appropriate general ledger account regarding the payment made by the former tenant. The City Administration will evaluate the tax exempt status for the upper floors of 1701 Meridian Avenue (which is the office portion of the "777 building") as well as the tax exempt status for the leased spaces at Historic City Hall. It should be noted that the Lease Agreements between the City and Klara Gershman, M.D. PA, for use of space at 1701 Meridian Avenue, as well as the leases for use of space in Historic City Hall, contain language requiring tenants to pay property taxes, including real estate taxes, assessments, and special assessments of any kind which may be imposed upon the premises. Furthermore, the leases contain language which states that tenants shall also pay any expenses incurred by the City in obtaining a reduction of any such taxes or assessments

3. Finding – Incorrect Posting of Sales Taxes Paid

The amount of sales tax (\$300.23) included in the December 2009 rent payment for Roma Waxing was erroneously posted to the parking revenue general ledger account (#480-8000-344506) instead of the sales tax account (#601-7000-229047). This was brought to the attention of the Real Estate, Housing & Community Development Department.

Recommendation

An adjustment of \$300.23 should be made to the general ledger accounts affected by the erroneous entries.

Management's Response - REHCD

REHCD will follow-up and coordinate with the Finance Department.

Management's Response – Finance

An adjustment of \$300.23 will be made to the general ledger accounts affected by the data input error.

4. Finding – Allocation of Operational and Maintenance Expenses

The amounts currently used to allocate operational and maintenance (CAM) expenses to tenants of the 777 Building and Historic City Hall do not have a documented source to support them. We were informed that these were provided during 2009 by the former Asset Manager. Additionally, the source of CAM charges for the Miami-Dade County Court and Clerk located at Historic City Hall are not stated on the original contract or supported by any reasonable estimate. This tenant pays the fixed amount of \$1,301.83 per month for CAM, which represents approximately \$.21 per square foot based on the amount of space they occupy in the building (6,285 sq. ft.). In comparison, other tenants pay between \$9.20 and \$11.08 for operational expenses consisting of water utilities, maintenance, repairs, landscaping, and garbage service.

Recommendation

A report of current operational and maintenance charges should be requested periodically from the Property Management Division to ensure these expenses are being properly allocated and recovered from the tenants of these two buildings. Once a current expense report is obtained, the amount of CAM charges allocated for the space leased to the County should be renegotiated accordingly.

Management's Response (Property Management)

Property Management Division will comply with the audit recommendation, i.e., generate a current operational and maintenance report of charges to include utilities and contract services for the 777 Building and Historic City Hall. Report will be provided to both REHCD and Internal Audit prior to the end of this Fiscal Year.

Management's Response - REHCD

Upon the receipt of Property Management's report, the Administration and REHCD should discuss the impact, if any, said report may have on the City and its Tenants including the feasibility of implementing any changes during this depressed real estate market / economic environment.

5. Finding – Allocation of Insurance Expenses

The insurance allocation used for the 777 Building and Historic City Hall comes from a premium amount estimate provided to the Real Estate, Housing & Community Development Department by the City's Risk Manager. They informed us that there is no specific premium paid for insuring these buildings, so the estimate only represents a portion of the premium paid for an "umbrella policy" that covers all City buildings and structures. In addition, the insurance premium estimate used to assess the square footage allocation of tenants of Historic City Hall is incorrect since it does not correspond to the amounts provided by the Risk Manager.

Recommendation

We recommend that the adequacy of this insurance premium estimate be reviewed and approved by the City Administration to ensure the costs associated with insurance coverage are reasonably recovered from tenants of city-owned properties.

Management's Response - REHCD

REHCD will work with the Administration and Risk Management to ensure the costs

associated with insurance coverage are reasonably recovered from tenants of city-owned properties in all future agreements.

6. Finding – Business Tax Receipts (BTRs)

We reviewed the status of Business Tax Receipts (BTR) in the Eden system for tenants of the selected city-owned properties to confirm their licenses are current. This review revealed that Klara Gershman, M.D., P.A., a tenant at the 777 Building, paid BTR renewal fees on 2/17/10, but a late payment penalty of 25%, approximately \$57.75, was not assessed or collected when the payment was made. For Historic City Hall, we found that Paul A Sack, a tenant since 3/1/10 has not obtained the required BTR or completed an application for this; and the BTR for Gemcor, Inc. remains pending.

Recommendation

The Finance Department should bill the tenant for the late charge penalty not collected. In addition, follow up efforts should be initiated by the appropriate departments to ensure the other two tenants obtain their required BTR(s).

Management's Response- REHCD

REHCD will follow-up and coordinate with the Finance Department.

Management's Response – Finance

Lists of all unpaid Business Tax Receipt renewals are periodically sent by the Finance Department to the Code Compliance Division for enforcement.

7. Finding – Insurance Coverage Requirements

During our evaluation of the adequacy of insurance coverage for tenants of city-owned properties reviewed, we found that all tenants, except Immunity and Log Cabin Enterprises, did not show evidence of Workers Compensation and Employers Liability on their certificates of insurance. Also, none of the tenants had secured all-risk protection for leasehold improvements as required per their agreements. This was brought to the attention of the City's Risk Manager who indicated that the City has no responsibility or enforcement capability for Workers Compensation, and he added that the City purchases property insurance for these locations, which includes coverage for improvements. In summary he indicated that in his opinion there is no need to include these as insurance coverage requirements in the lease agreements for city-owned properties.

Recommendation

The City should initiate the necessary amendments to these lease agreements to remove unnecessary insurance coverage requirements, per the Risk Manager's recommendations.

Management's Response - REHCD

REHCD will work with the Administration, Legal, and Risk Management to ensure that all future agreements do to contain unnecessary insurance requirements.

8. Finding – Policies and Procedures

During the audit it was noted that there are no written procedures for the function, of administering and monitoring of City Leases. Policies and procedures serve both as a benchmark to measure individuals' performance and as an instruction manual in the event employees' change.

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Recommendation

Written policies and procedures for the administration and monitoring of City leases need to be established.

Management's Response – REHCD

REHCD agrees.

**EXIT CONFERENCE**

An exit meeting was held to discuss the audit report and to solicit management responses noted above. Attendees were Anna Parekh, Director, Real Estate, Housing & Community Development, Robert Rebozo, Redevelopment Specialist, Duane Knecht, Property Management Division Director, Georgie Echert, Assistant Finance Director, Manny Marquez, Finance Revenue Manager, James Sutter, Internal Auditor and Luis López, Internal Audit Contractor. All were in agreement with the contents of this report.

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Audit performed by Luis López, Internal Audit Contractor

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