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Report of the Independent Fairness Commissioner

City of Winnipeg

Report on Compliance – Amendment to lease of Unit 5 - 1450 Mountain Avenue

June 13, 2018

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Auditors' Report on Compliance with Framework
City of Winnipeg
Amendment to lease of Unit 5 - 1450 Mountain Avenue

To: City Council

We performed an audit of the proposed real estate transaction described in Section 1 of this report (the "Transaction") to determine whether the Transaction was undertaken by the City of Winnipeg's Planning, Property and Development Department ("PP&D") in compliance with version 1.01 of the framework referenced in Section 1 of this report (hereinafter referred to as the "Compliance Framework"). The Compliance Framework as well as compliance of the Transaction with the Compliance Framework are the responsibility of PP&D. Our responsibility is to express an opinion on the City of Winnipeg's compliance with the Compliance Framework based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether PP&D complied with the applicable criteria of the Compliance Framework described in Section 1. An audit includes examining, on a test basis, evidence supporting compliance with the applicable criteria of the Compliance Framework and included: 1) performing corroborative interviews with City of Winnipeg employees and representatives who were responsible for conducting the Transaction; 2) examining documentation provided by City of Winnipeg employees; and 3) reperforming transaction specific calculations, where applicable. We performed our audit procedures based on discussions with PP&D Management and information available as at June 12, 2018.

In our opinion, except for the compliance exceptions noted in Section 2, PP&D is in compliance, in all material respects, with the individual criteria of the Compliance Framework (version 1.01) for the Transaction noted above.

This report was prepared for City Council for the purpose of City Council's ultimate determinations related to the above noted transaction, and although it may be made publically available, readers are cautioned that this report is not suitable for any other purpose.

Deloitte LLP

Chartered Professional Accountants
Winnipeg, Manitoba
June 13, 2018

Section 1 – Compliance Framework, the Transaction, and Management's responsibility

Compliance Framework
City Council ("Council") created the role of the Independent Fairness Commissioner ("IFC") for the purpose of ensuring that real estate transactions and management services ("Transactions") are performed in a fair, transparent and open manner. Under the direction of Council, the City Auditor has engaged Deloitte LLP ("Deloitte") to provide certain services as part of the IFC role through the performance of compliance audits in accordance with the assurance standards of the Chartered Professional Accountants of Canada ("CPA Canada"). To ensure Council's objectives for the IFC are addressed, a Compliance Framework was developed under the oversight of PP&D (also referred to as "Management") through consideration of applicable City of Winnipeg by-laws, policies and procedures including PP&D's internal Real Estate Transaction Management Framework ("RETMF"). The Compliance Framework is to be used as the basis for the performance of compliance audits of selected Transactions, and can be subject to revision by PP&D based on evolving requirements. Further background information regarding the Compliance Framework is in Appendix 1.

The Transaction
The proposed transaction is the amendment to the City's previously approved lease agreement for Unit 5-1450 Mountain Avenue, in order to provide for the cost of additional tenant improvement requirements at the location. The property is to be used for the relocation of the City's Corporate Records Centre, and the existing three-year lease agreement is with Mountain Avenue Holdings Ltd. The scope of the Compliance Audit includes only the compliance aspects of the proposed lease amendment outlined in the associated Administrative Report, and excludes any prior or ongoing Transaction related activities where applicable, including the previously approved lease agreement. Management represents that the complexity of this transaction has been deemed to be "low" for the purposes of this compliance audit.

Management responsibility and assertion
Transaction documentation has been prepared by PP&D based on information available at June 12, 2018. The Compliance Framework and applicable criteria is the responsibility of PP&D and has formed the basis of the compliance audit conducted by Deloitte on the Transaction. PP&D is responsible for ensuring the fairness, transparency, and openness of any proposed or completed transactions and the compliance of transactions with the Compliance Framework. Further, as discussed in Appendix 2 of this report, PP&D has made certain representations regarding the information provided to Deloitte to support the performance of the independent compliance audit. Deloitte's responsibility is to express an opinion on PP&D's compliance with the Compliance Framework based on the results of their independent audit procedures performed as outlined in Appendix 1 to the report.

Yours truly,

J. Hauer

Planning, Property and Development Department
City of Winnipeg

Section 2 – Exceptions noted and Management's unaudited response

Exceptions noted

The criteria within the Compliance Framework was subject to audit procedures performed by Deloitte for the purposes of determining compliance to support our independent auditors' report, as discussed in Appendix 2. Included in the table below is a summary of the exceptions noted in testing the compliance of the Transaction with the Compliance Framework, the associated criteria, and the unaudited responses to these exceptions prepared by Management. The City Auditor has requested responses from PP&D for each exception noted and provided the responses to Deloitte for inclusion in the report. Management's responses are unaudited, and have been included to provide commentary by the City of Winnipeg, to the SPCPDHDD and/or Council.

A complete listing has been included in Appendix 2 of those criteria for which exceptions were noted, criteria that were deemed to not be subject to audit, and criteria deemed by Management to not be applicable to the Transaction.

Summary of exceptions noted		Related criteria
Reporting documentation incomplete	Aspects of the Administrative Report were not completed as required by Appendix B of the RETMF, such as (but not limited to) financial, regulatory, environmental, human resources, or other implications of Management's recommendations were not addressed; and evidence of review by the Supervisor/Superintendent/Manager of PP&D was not included. Further details regarding the exceptions noted are included in Appendix 2 of this report.	1.01
File documentation incomplete	The file documentation was not in compliance with several aspects of the Compliance Framework, such as (but not limited to): • The Complete Reporting Checklist relating to the Transaction has not been fully completed and evidence of review of the Complete Reporting Checklist by the author of the Administrative Report, as required by Appendix C of the RETMF, was not present in the file; • There was no evidence in the transaction documentation that PP&D issued a circulation to the applicable City departments, utility and service provider entities, or the Ward Councilor; • File documentation included consideration of alternative locations, but review and communication of this analysis with the requesting department was not evidenced in the file; and • There was no documentation provided to indicate that the Transaction has been included in the Tracking Database.	1.03, 1.04, 3.01, 10.01, 20.01

Market analysis not completed as required	Appendix D of the RETMF prescribes that a market analysis should be completed, given that an appraisal was not required. File documentation included an analysis, however this analysis did not include the factors required of a market analysis as per Appendix D of the RETMF, including: • Operating costs; • Capital improvement obligations; • Rent free periods; • Tenant improvement allowances; and • For similar assets, consideration of total occupancy costs of each property. The market analysis relied on for the City's tenancy of the subject property contemplated tenant improvement costs estimated by the City's consultant to be in the range of $175,000 to $200,000. Subsequent to the original lease agreement being approved and executed, the landlord provided a higher estimated cost of tenant improvements of approximately $600,000 due to additional scope of work required. The market analysis was not updated or reconsidered in light of the increased tenant improvement costs related to the subject property.	2.03

Unaudited Management response to exceptions noted

Management does not consider any of the IFC's findings of non-compliance to have materially impacted the transaction.

In several instances, the RETMF has not been fully implemented by Management due to the complexity of the undertaking or the lack of applicability of requirements in this specific situation. In other instances, the timing of the IFC review did not allow Management to adequately prepare file documentation.

Much of the non-compliance was related to file documentation. Appropriate procedures were followed throughout the transaction, including approvals by supervisors/managers at every level, however records of this lies in internal systems, (RIS system). Other documentation is not immediately applicable to the template of the RETMF, which is somewhat of a one-size fits all for all real estate transactions. In this instance, the proposed location was found by the Client Department via consultant who undertook their own due diligence. Finally, the additional scope of work and cost related to Tenant Improvements would have similarly applied to all other sites considered, in addition to addressing the shortcomings of each respective site.

Management accepts the findings of the IFC but takes the position that if full compliance were achieved, the final outcome of the transaction would remain unchanged.

Appendix 1 – Scope of services requested

Introduction

As outlined in Section 1 of the report, and to address Council's objectives for the IFC, a Compliance Framework was developed under the oversight of PP&D. The Compliance Framework development process also included assistance from Deloitte and the City Auditor in the form of consultation as to the sufficiency and appropriateness of the Compliance Framework for PP&D's ultimate determinations. The version of the Compliance Framework utilized for the purposes of this compliance audit is Version 1.01 dated March 27, 2018 as made available by Management. The Transaction is to be presented to the Standing Policy Committee on Property and Development, Heritage and Downtown Development ("SPCPDHDD") and/or Council for approval. Council has adopted the Executive Policy Committee's recommendation that the compliance audit of Transactions will occur prior to presentation to SPCPDHHD and/or Council. Accordingly, Deloitte has been engaged to perform the compliance audit of Transactions while in progress, the results of which will be reported directly to SPCPDHHD through the City Auditor and Deloitte.

Scope of services requested of Deloitte by the City of Winnipeg

Deloitte has been engaged to perform an independent audit of the Transaction's compliance with the Compliance Framework noted above as follows:

a. Produce an independent auditor's report on whether the Transaction is in compliance with the relevant criteria outlined within the Compliance Framework;
b. Submit the results of the compliance audit and specific Auditor's Report to the City Auditor.
c. Report specific findings and compliance exceptions within the Auditor's Report based on the Compliance Framework where applicable.
d. Prior to performance of a specific compliance audit of a Transaction,
    i. declare any conflict of interest in connection with the specific Transaction; and
    ii. obtain management's representation of the complexity rating of the Transaction, based on specific guidance retained by the City and in consultation with the Contract Administrator.
e. Attend the SPCPDHDD's regular meeting and/or any agreed upon special meetings in person where the independently prepared auditor's report will be tabled so as to answer questions regarding the report.

Deloitte's audit procedures to determine compliance with the stated criteria within the Compliance Framework included testing on a sample basis of the evidence supporting compliance with the applicable criteria of the Compliance Framework and included: 1) examining documentation provided by City of Winnipeg employees; 2) reperforming transaction specific calculations, where applicable; and 3) performing corroborative interviews with City of Winnipeg employees and representatives who were responsible for carrying out the Transaction.

For criteria identified to not be in compliance and related exceptions noted, the report provides these findings and, where applicable, management comments related to the compliance exceptions. Any identified instances of non-compliance in relation to the Transaction are detailed in Appendix 2 of this report. Management's unaudited responses to the compliance exceptions, if any, are included in Section 2 of the report. Responses regarding the cause of non-compliance, where provided, are prepared by PP&D. Observations regarding the impact on the fairness, transparency, and openness of the Transaction, where provided, would be prepared by PP&D and/or the City Auditor.

Appendix 2 – Findings and compliance exceptions noted

Background information provided by the Independent Auditor

The Compliance Framework referenced in Appendix 1 above forms the basis of the criteria for Deloitte's independent audit of the Transaction. The Compliance Framework is presented in two components as follows:

Objectives	Summarized objectives of the IFC and RETMF as considered and defined in the applicable by-laws, policies, procedures, and the RETMF.
Criteria	Specific requirements that a real estate transaction is expected to comply with in order to be considered fair, transparent and open. Criteria were developed in consideration of specific statements or requirements within by-laws, policies, procedures, and the RETMF. Management's ultimate determination of applicable criteria is based on the nature of the transaction, property type, and transacting party.

Our audit procedures to determine compliance with the stated Criteria within the Compliance Framework included testing on a sample basis of the evidence supporting compliance with the applicable Criteria of the Compliance Framework and included: 1) examining documentation provided by City of Winnipeg employees; 2) reperforming transaction specific calculations, where applicable; and 3) performing corroborative interviews with City of Winnipeg employees and representatives who were responsible for carrying out the Transaction. We performed our procedures based on discussions with Management and information available as at June 12, 2018. Any compliance exceptions pertaining to individual Criteria noted by Deloitte during the performance of our audit procedures are identified below.

Management's representations provided to the Independent Auditor
As discussed in Section 1 of this report, Management has represented that to the best of their knowledge and belief, the following:

- All information presented to Deloitte has been presented fairly and accurately, and in a manner that would not create judgements requiring interpretation that could result in a change in conclusion as to the compliance of the Transaction with the Compliance Framework;
- All documents prepared and provided to Deloitte for review were prepared in the course of conducting the Transaction;
- Deloitte has been provided access to all relevant documents, information, and City employees or representatives who possess information related to the Transaction, and within the stated period to meet the City's requirements to determine compliance;
- Criteria deemed as not applicable to the Transaction are identified in sub-section C of this appendix; and
- The complexity rating of the transaction based on the review completed by PP&D is low.

Findings and compliance exceptions noted

The findings and compliance exceptions noted through the performance of Deloitte's audit procedures have been presented in the following categories:

A. Exceptions noted	The table outlines only those Criteria defined in the Compliance Framework that are applicable to the Transaction and for which we have noted exceptions in compliance. The exceptions have been organized in the table by the Objective reference number, and included in the second column those Criteria where instances of non-compliance have been identified. The third column contains a description of the exception noted.
A. Criteria not subjected to audit	The table outlines those Criteria that could not be subjected to audit on the basis of Management's representation that the related activities have not been performed based on the rationale provided.
B. Criteria not applicable to the Transaction	During the course of our test procedures performed, Management has represented and confirmed that the Criteria referenced in this table are not applicable to the Transaction, and have therefore not been included in the scope of our audit.

It should be noted that Criteria for which no compliance exceptions were noted are not included in the tables below. The Compliance Framework should be referenced for a complete listing and description of all applicable Criteria included within the Compliance Framework as at the date specified above.

A. Exceptions noted

1. Information reported to Council or delegate with respect to the transaction was complete

	Criteria	Exceptions noted
1.01	Reporting to Council has been prepared in the form of an Administrative Report that includes a recommendation(s); reason for the Administrative Report; implications of the recommendations; history of the Administrative Report; financial impact of the transaction; summary of consultations; and identification of the preparer, reviewer, and review date, in accordance with Appendix B of the RETMF.	The following aspects of the Administrative Report were not included as outlined in Appendix B of the RETMF: • Financial, regulatory, environmental, human resources, or other implications of Management's recommendations, if any, were not addressed; and • Evidence of review by the Supervisor/Superintendent/Manager of PP&D was not included.
1.03	The complete reporting checklist (as outlined in Appendix C of the RETMF) which corresponds to the transaction type has been fully completed, including all attachments noted to be evidenced in file. Rationale for the notation of any particular item within the checklist as "N/A" has been included.	The following sections of the Leasing Approvals Checklist per Appendix C of the RETMF were not completed at the date of Transaction review: • Background Information (partially completed); • Program of Requirements (partially completed); • Leasing (partially completed); • Reporting (partially completed); • Final negotiated position (partially completed); and • Admin Report or Briefing Note Approval. The Market Analysis, Summary of Offers, Short List/Counter Offer, and Term Sheet sections were not included in the checklist as documented in the file.

1.04	The complete reporting checklist relating to the transaction has been reviewed by the author of the associated Administrative Report or Briefing Note, as evidenced by date and sign-off on the checklist.	Evidence of review of the Complete Reporting Checklist by the author of the Administrative Report, as required by Appendix C of the RETMF, was not present in the file.

2. An appraisal of the property has been performed by a qualified individual, in an acceptable format, as needed

	Criteria	Exceptions noted
2.03	For transactions involving the Property Management Branch for which an appraisal was deemed not to be required, a market analysis reflecting consideration of all factors outlined in Appendix D of the RETMF has been prepared by the Leasing Officer or Appraisal Branch and included in the file. In addition, the Property Management Branch has determined the appropriate form of market analysis by completing the Risk and Complexity Tool for Market Analysis and including this documentation in the file.	Appendix D of the RETMF prescribes that a market analysis should be completed, given that an appraisal was not required. File documentation included an analysis, however this analysis did not include the factors required of a market analysis as per Appendix D of the RETMF, including: • Operating costs; • Capital improvement obligations; • Rent free periods; • Tenant improvement allowances; and • For similar assets, consideration of total occupancy costs of each property. The market analysis relied on for the City's tenancy of the subject property contemplated tenant improvement costs estimated by the City's consultant to be in the range of $175,000 to $200,000. Subsequent to the original lease agreement being approved and executed, the landlord provided a higher estimated cost of tenant improvements of approximately $600,000 due to additional scope of work required. The market analysis was not updated or reconsidered in light of the increased tenant improvement costs related to the subject property.

3. Consultation and communication with internal City stakeholders such as City departments, the Ward Councilor, and utility agencies has been solicited prior to the execution of the transaction

	Criteria	Exceptions noted
3.01	PP&D issued a circulation to applicable City departments, the Ward Councilor, and utility agencies to identify any requirement(s) for the real property with a 14 working day deadline for response in accordance with the requirements stipulated in Appendix H of the RETMF. All correspondence has been retained within the transaction file. Departments that are required to be contacted include: Assessment and Taxation, Community Services, Fire Paramedic Service, Local improvements, Planning, Property and Development Department, Public Works Department, Transit Department, Water and Waste department. Winnipeg Parking Authority, and Winnipeg Police Service. Utility and service provider entities that are required to be contacted include: BellMTS, Manitoba Hydro, and Shaw.	There was no evidence in the transaction file that PP&D issued a circulation to the applicable City departments, utility and service provider entities, or the Ward Councilor.

10. Alternative properties and procurement methods were considered in selecting the property

	Criteria	Exceptions noted
10.01	A search was undertaken to identify alternative property locations and purchase/lease opportunities available. In cases where multiple opportunities were identified by this search, a comparative analysis was undertaken to evaluate the most economical option. This analysis was reviewed and communicated with the requesting department.	File documentation included consideration of alternative locations, but review and communication of this analysis with the requesting department was not evidenced in the file. As noted in the finding related to Criteria 2.03, the market analysis was not updated or reconsidered in light of the increases to the tenant improvement costs contemplated by the Lease Amendment.

20. The transaction has been included in the Tracking Database

	Criteria	Exception noted
20.01	The transaction has been included in the Tracking Database in accordance with Appendix L of the RETMF.	There was no documentation provided to indicate that the Transaction has been included in the Tracking Database, as required by Appendix L of the RETMF.

B. Criteria not subjected to audit

4. Transaction approval has been granted by an appropriate individual based on the delegations of authority outlined in the Delegation of Authority - January 28, 2009 Council minutes

	Criteria	Representations or rationale provided
4.01	Transaction approval has been granted by an appropriate individual based on the delegations of authority outlined in Delegation of Authority - January 28, 2009 Council minutes.	The Transaction has not yet been provided to Council for approval.

C. Criteria not applicable to the Transaction

Objective	Criteria not applicable
1. Information reported to Council or delegate with respect to the Transaction was complete.	1.02
2. An appraisal of the property has been performed by a qualified individual, in an acceptable format, as needed.	2.01, 2.02, 2.04, 2.05, 2.06, 2.07, 2.08, 2.09, 2.10, 2.11, 2.12, 2.13, 2.14
3. Consultation and communication with internal City stakeholders such as City departments, the Ward Councilor, and utility agencies has been solicited prior to the execution of the transaction.	3.02
5. All land has either been declared surplus or is planned to be declared surplus concurrently with the approval of sale by the Chief Administrative Officer and/or Council, based on the applicable Delegation of Authority.	5.01
6. PP&D has been authorized to commence negotiations for the acquisition or disposal of land, and completed site inspections as appropriate.	6.01, 6.02, 6.03
7. An Environmental Site Assessment ("ESA") was completed as required.	7.01, 7.02, 7.03, 7.04, 7.06
8. A competitive procurement process was conducted when prescribed by the RETMF.	8.03, 8.04, 8.05
11. Where land is to be expropriated, compliance with the Expropriation Act has been considered and verified by City Legal Services.	11.01, 11.02, 11.03, 11.04, 11.05, 11.06, 11.07, 11.08
12. Unsolicited offers for the purchase of City owned property have been pursued only when the conditions established by Council have been met.	12.01
13. Any offer for the purchase of City-owned property was only acted on by PP&D if it was provided in the form of a formal written offer.	13.01
14. Acquisitions of privately owned property containing dilapidated structures are accompanied by a program of rehabilitation, redevelopment, or improvement.	14.01, 14.02
15. Specific policies relating to transactions involving property under the purview of the Parks & Recreation division have been observed.	15.01, 15.02
16. Where land declared surplus had previously been transferred by a Developer to the City, that land has first been offered back to that Developer.	16.01
17. Other policies related to the general process for the sale of land have been adhered to.	17.01, 17.02
18. The policies pertaining to acquisitions and dispositions of specific types of property have been adhered to.	18.01, 18.02, 18.03, 18.04, 18.05, 18.06, 18.07, 18.08, 18.09, 18.10
19. The policies pertaining to specific types of transaction have been adhered to.	19.01, 19.02, 19.03, 19.04