Chapter 3

Section

3.10 Ontario Realty Corporation—Real Estate and Accommodation Services

Background

The Ontario Realty Corporation (Corporation) was established in 1993 as a Crown corporation under the *Capital Investment Plan Act, 1993*. The Corporation provides real-estate, property-, and project-management services to most ministries and agencies of the province of Ontario. Since June 2005, it has reported to the Minister of Public Infrastructure Renewal.

Management of real property and accommodations is a responsibility shared by the Ministry of Public Infrastructure Renewal (Ministry), the Corporation, and its client ministries and agencies, which are all accountable for their respective decisions, strategic planning, and use of accommodations in an economical and efficient manner. As a service provider, the Corporation itself owns no real estate. The majority of the assets it manages are for the owner, represented by the Ministry, which provides it with direction, funding, and approvals for significant decisions regarding those assets.

The Corporation provides client ministries and agencies with the following services:

- development of policies, strategies, and implementation plans to maximize use of existing real-estate portfolios;
- sales and acquisitions of land and buildings;
- property leasing as needed to augment the inventory of owned space;
- property management, including day-to-day maintenance and repair of owned and leased facilities; and
- project management of large capital projects.

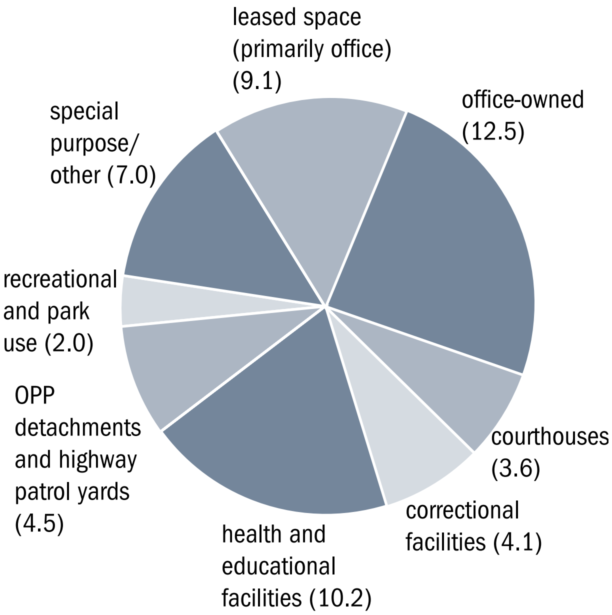
The Corporation manages one of Canada's largest real-estate portfolios, including more than 38,000 hectares (95,000 acres) of land and 6,000 buildings comprising more than 4.6 million square metres (50 million square feet) of space. (For consistency with industry standards, the remainder of this report will use imperial rather than metric measurements.) Eighty-one percent of the portfolio is owned by the government of Ontario, and the remainder is leased. The types of accommodations administered by the Corporation are shown in Figure 1.

The real-estate portfolio contains two broad categories of holdings:

- buildings used by ministries and/or agencies to deliver programs; and

Figure 1: In-use Government Real-Estate Portfolio Managed by the Ontario Realty Corporation, 2005/06 (rentable million square feet)

Source of data: Ontario Realty Corporation



- excess land, including greenbelts, land banks, farms, and other properties currently either being considered or offered for sale or being held by the province for possible future use.

In addition to acreage, the land holdings include about 1,300 residential, farm, and commercial buildings. Many are rented out to private-sector tenants, generating annual revenues of about $28 million.

The Corporation's head office is in Toronto and it operates four regional offices and three area offices across the province. In the 2005/06 fiscal year, it employed approximately 300 staff.

The Corporation requires revenues of nearly $600 million each year to offset expenses incurred to manage the portfolio and look after the accommodation needs of its clients. The vast majority of these revenues come from clients in the form of rent. In addition, the Ministry provides the Corporation with annual funding. The Corporation's real-estate portfolio revenues by source are shown in Figure 2. The Corporation uses the portfolio revenues to pay for leases, property taxes, repairs and maintenance, utilities, and other services, as illustrated in Figure 3.

Audit Objective and Scope

Our audit objective was to assess whether the Ontario Realty Corporation had in place adequate systems and procedures to ensure that:

- real-estate assets are acquired, managed, and disposed of with due regard for economy and the public interest;
- government accommodation requirements are met in a cost-effective manner; and
- the Corporation's performance is adequately measured and reported to allow for meaningful assessment of its activities and achievements.

Our scope did not include the Corporation's project management of large capital projects. We excluded this because we previously examined several large capital projects managed by the

Figure 2: Real-Estate Portfolio Revenues for Properties Managed by the Ontario Realty Corporation, 2005/06 ($ million)

Source of data: Ontario Realty Corporation

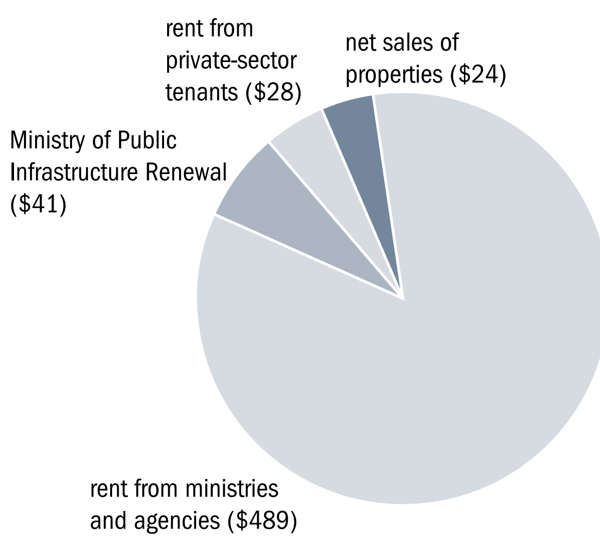
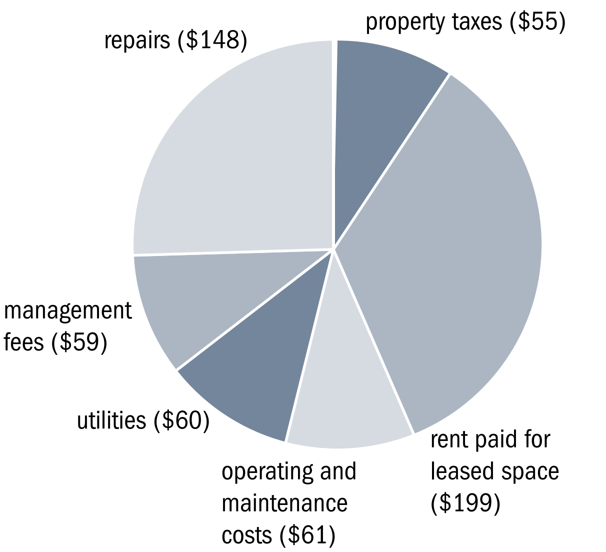


Figure 3: Operating Costs for Maintaining the Government's Real-Estate Portfolio Managed by the Ontario Realty Corporation, 2005/06 ($ million)
Source of data: Ontario Realty Corporation



Corporation for construction of new courthouses and repairs to existing ones, as detailed in our *2003 Annual Report*. As well, the Corporation's Internal Audit group had also recently completed audit work in this area.

Our audit fieldwork included a review of relevant files, payments, reports, administrative policies, and interviews of staff at the Corporation's head office and at two of its four regional offices. We also conducted site visits to properties, held discussions with representatives of the Ministry and several client ministries, and visited the offices of one major service provider for interviews and to review their files. In addition to our own work, our audit benefited from research by the Corporation and the Ministry into practices in other jurisdictions. The bulk of our fieldwork was completed by March 31, 2006.

Our audit was conducted in accordance with standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

We also reviewed the relevant work done by the Corporation's Internal Audit group, established three years ago. Internal Audit completed a number of audits, including leasing activities and use of service providers and contractors, that allowed us to reduce the extent of our own work in several areas.

Summary

The Ontario Realty Corporation has recently made a number of improvements with regard to its systems and procedures over leasing activities, property sales and acquisitions, and its hiring and monitoring of building management service providers. However, it must continue to work with the Ministry of Public Infrastructure Renewal (Ministry) and its client ministries and agencies to ensure that:

- all managed space is being efficiently used;
- properties are being maintained through appropriate investments in building life-cycle repair and maintenance; and
- its management information systems provide relevant and reliable information for decision-makers.

The Ministry recently identified several factors that had inhibited effective management and rationalization of the province's real-estate portfolio—for instance, the processes used to deal with surplus and underutilized property. Our review of the Corporation's real-estate portfolio and property sales in recent years confirmed this concern. For example, the province gave its approval in 1999 for the Corporation to sell 330 properties but, as of 2006, the Corporation had disposed of fewer than half of them. The Corporation also needs to improve its systems and procedures for identifying properties that could be rationalized or sold. Solutions include improving information systems and establishing strategic plans on the future uses of individual properties.

We also made observations in a number of other areas as follows:

- Controls were inadequate to record and track potential recoveries from property sales. Following our inquiries, the Corporation recovered approximately $265,000 that was still owing to it from a property sale and that had been available to it since April 2004.
- We discovered one property sold by the Corporation for $2.6 million in March 2002 that was resold by the purchaser seven months later for $4.2 million, or 60% more. As a result, the Corporation's internal auditors will now be monitoring subsequent sales of government properties, which should help to identify any similar situations and to assess the circumstances that could result in such large resale profits.
- In handling requests for new accommodations that could not be met by the existing inventory of owned space, the Corporation generally leases space without always assessing the cost effectiveness of alternatives such as construction, lease-buy, outright purchase, or relocation.
- The Corporation did not have adequate assurance that space was being used by its clients in an efficient manner. The Ministry's recent review also raised the issue of the relationship between the Corporation and its clients—in particular the control some clients exercised over real-estate decisions—as being contributing factors.
- The Corporation imposed best practices and high standards on its two major providers of building-management services, including remuneration tied to performance standards. However, it set less stringent expectations for its own staff regarding property they manage directly.
- The Corporation estimated that deferred costs for repairing, renewing, and modernizing provincially owned buildings stood at $382 million as of March 31, 2006. More than 40% of the buildings it manages are at least 40 years old and its assessment of 582 in-use buildings rated 148 of them—one-quarter of the total—as being in poor to defective condition.
- The Corporation's real-estate database contained extensive errors regarding the current status of properties. In addition, it requires greater co-operation from other ministries and agencies to permit the development and sharing of a complete electronic inventory of all government-owned and controlled real estate.
- The Corporation's public reporting of its performance measures did not include comprehensive and reliable performance indicators required to properly assess its effectiveness in managing the province's real-estate portfolio and meeting its accommodation needs.
- The introduction three years ago of an internal audit function that reports to an independent Audit Committee has improved the overall governance and oversight process and has contributed to more rigorous, ongoing reviews of systems and procedures.
- In our *2003 Annual Report*, we noted that the Corporation's project-management practices for large capital projects, such as new courthouses, failed to use fixed-price contracts or proper competitive-acquisition processes and approvals for projects of this size. While our current audit did not include work in this area, based on recent work by the Corporation's internal auditors in December 2005, our previous concerns have still not been satisfactorily addressed.

Detailed Audit Observations

The Management Board of Cabinet Directive on Real Property and Accommodations (Directive) provides a framework to support the government's efforts to acquire, manage, and dispose of real property and accommodations effectively and efficiently. The Directive designates the Ontario Realty Corporation (Corporation) as the mandatory fee-for-service real-estate organization for most ministries and certain agencies, and it requires that value for money be achieved by:

- using a competitive process to acquire real property and accommodations;
- optimizing use of the government's real property and accommodation assets; and
- maximizing the return to the Crown when disposing of surplus assets.

Clients must submit annual accommodation plans to the Corporation as part of their yearly planning process, and the Corporation assists clients in identifying potentially surplus properties through its annual portfolio-planning and asset-review process.

Real estate or accommodations deemed surplus to ministry or agency needs can be:

- transferred to the Corporation for reassignment to another ministry or agency;
- terminated, in the case of a lease; or
- managed by the Corporation as part of its surplus property holdings, which include consideration for sale to other government organizations in the broader public sector, or to the public.

The Corporation prepares annual sales plans for surplus or underutilized properties. These plans must be approved by its Board of Directors and the Ministry of Public Infrastructure Renewal (Ministry), and each proposed property sale must be formally authorized by an Order-in-Council.

Over the last 10 years, the Corporation has been selling surplus properties, as illustrated in Figure 4.

Figure 4: Ten-year Trend of Sales of Properties

Source of data: Ontario Realty Corporation

Fiscal Year	Gross Value of Sales ($ million)	# of Properties Sold
1996/97	59.3	193
1997/98	79.5	175
1998/99	109.5	146
1999/2000	111.3	153
2000/01	103.6	80
2001/02	46.8	78
2002/03	112.0	84
2003/04	29.5	44
2004/05	17.6	40
2005/06	47.7	20

The few properties acquired over the same period were primarily land purchases for expected highway expansions.

REVIEW BY THE MINISTRY OF PUBLIC INFRASTRUCTURE RENEWAL

In 2005, the Ministry examined processes relating to the government's real-property management system and realized that there were a number of significant barriers that needed to be removed. The issues raised included the following:

- A significant proportion of the province's portfolio, including some properties with high development potential, was surplus and underutilized.
- There were no formal plans for, or assessments of what should be done with, many of the province's surplus and underutilized properties, for which the province continued to incur ongoing costs.
- It was unclear who was responsible for what, particularly with respect to strategic decisions such as keeping, selling, or redeveloping a property.
- The province entered into complex negotiations with municipalities and other government

organizations in the broader public sector over disposal or reuse of a property often without any clear sense of its own interests.

- There was no centralized, comprehensive understanding of the province's overall real-estate holdings, and no easy way to get at this information quickly.
- There were few incentives—and too many disincentives—for clients to optimize their use of real estate. For example, clients must bear decommissioning costs but do not share in proceeds from sales.
- The province sold property "as is" without examining all opportunities to make improvements or seek partnerships that could add substantial value and increase proceeds to the government.

Our review of the Corporation's real-estate portfolio and property sales over the last several years identified similar concerns.

For more than 10 years, successive governments in search of new revenues have instructed the Corporation to sell real estate. Sales during that time included primarily those properties that were the easiest to market. Surplus or underutilized properties remaining today may have conditions that could make them more difficult to sell. Examples include the need to relocate existing government tenants, soil contamination, heritage restrictions that limit use, aboriginal land claims, municipal interests, and restricted access to some properties. These conditions can all require a significant financial investment to make a property saleable, and extensive negotiations with stakeholders prior to any sale.

The difficulty in selling certain surplus or underutilized properties is evident from one past sales exercise. In 1999, the province gave its approval for the Corporation to sell a portfolio of 330 properties. In the seven years that followed, the Corporation was able to sell just 140 of them—fewer than half.

We also noted that the Corporation could improve its systems and procedures for identifying properties that could be rationalized or sold by implementing better information systems and by establishing strategic plans on the future uses of individual properties. The current information systems categorize properties as active or inactive, vacant or occupied, surplus, or sold. However, there were no categories to identify properties as targeted for sale, or as underutilized and thus eligible for rationalization. In addition, the Corporation's information systems did not adequately capture information on future plans for individual properties.

When the Corporation did prepare strategic plans for certain properties, these were often not acted upon. Frequently, there were no timetables for implementation of the plans, and the current status of properties was unclear. Our efforts to identify properties being considered for rationalization or sale required us to compile lists from several sources, including the Corporation's annual sales and rationalization plans, and property reports drafted by its external property managers.

For instance, we identified several residential properties in the portfolio that have not been scheduled for sale even though no plans exist for future government use. Many other properties have been demolished or are vacant and cannot be rented out to generate revenues due to their poor condition. Corporation staff indicated that many of these properties might not have been acted upon due to their relatively low value and to limited Corporation staff resources to initiate the sale process.

The government approved five initiatives in January 2006 that required the Ministry, the Corporation, and its clients to improve the strategic management of real estate. These were:

- development of a new framework to guide decisions on acquiring, using, improving, redeploying, and disposing of properties held or controlled by the government;

- examination of a number of complex and more valuable government properties to determine if they can either be used to better support programs and the public interest, or be redeveloped and sold to maximize proceeds;
- review and improvement of the business practices of the Corporation and its clients to ensure real-estate strategies and transactions support government policies. This will involve reviews of heritage-protection protocols, the process by which property is declared surplus, and the methods used to offer surplus government property to broader public-sector organizations;
- completion of an inventory of all government-owned and -controlled real estate to improve the quality of asset information and better support decision-making by providing complete, strategic, and accessible information about the portfolio; and
- changes to the way the government reviews and approves the Corporation's annual rationalization and sales plans, improving the analysis that supports decision-making, and improving the Corporation's ability to execute transactions once approval has been granted.

As part of the Ministry's new direction to the Corporation, the government rescinded outstanding Orders-in-Council for the remaining 190 unsold properties in April 2006 and established a revised, more streamlined, procedure for obtaining Order-in-Council approvals for future property sales.

The Ministry has also assumed responsibility for the rationalization and potential sale of 11 major properties, many of which had previously been earmarked for sale through the Corporation. The Ministry will facilitate inter-ministry co-operation to advance their disposition, but the Corporation will continue to play an active role in the sale of these properties.

RECOMMENDATION 1

The Ontario Realty Corporation should establish timetables for implementing any changes necessary to its operations to support recent government initiatives aimed at improving the strategic management and rationalization of real-estate assets, including developing plans for the future uses and dispositions of individual properties and implementing those plans.

CONTROLS OVER PROPERTY SALES AND ACQUISITIONS

For the most part, we found that controls over property sales and acquisitions were generally satisfactory. Properties are first offered for sale to government organizations in the broader public sector at full market value and then, if there are no takers, to the public. Key controls over the sale of properties included requirements that:

- properties be appraised using a qualified external valuation process before going on the market;
- the asking and sale price properly reflect the amounts in the appraisal report;
- sales to the public be conducted using a competitive selection process to select a listing broker, and a competitive bidding process to openly sell the property to the highest bidder; and
- an Order-in-Council be issued to pre-authorize each property sale by the Corporation.

The establishment of, and adherence to, these controls by Corporation staff follows a period of extensive audit, investigation, and ongoing litigation relating to problems with a number of earlier property sales by the Corporation. The litigation, which was initiated in 2000 by the Corporation against a number of parties and four of its own employees, was still ongoing at the time we completed our fieldwork.

An internal audit report completed in August 2004 identified the need for stronger controls over the use of appraisers, and over selection practices for brokers and environmental consultants. While our more recent testing and Internal Audit's follow-up in 2005 both noted improvements had been made, we identified two areas where controls required strengthening:

- In June 2000, the Corporation sold a property for $15 million and agreed to a condition that it pay $500,000 into an interest-bearing escrow account to cover 25% of the purchaser's costs to remove asbestos from the building. The amount was a maximum, and the work was required to be completed by April 2004, after which the Corporation was entitled to any remaining funds in the escrow account. As of April 2006, we found that the Corporation was unaware of the funds remaining in the account. As a result of our inquiries, it has since recovered about $265,000.
- We tested a sample of properties sold by the Corporation to determine if any were resold soon afterwards for higher amounts. Such transactions could indicate either that the Corporation's sales procedures failed to get the highest price possible, or that there was something questionable about the transaction. We noted one instance in which a property sold in March 2002 for $2.6 million was resold by the purchaser in October 2002 for $4.2 million—an increase of $1.6 million, or more than 60%, in just seven months. At our request, the Corporation's internal auditors reviewed this transaction and, while they noted that the appropriate process was followed for this sale, they also questioned whether a conservative appraisal of the potential land use was made. We were informed that Corporation internal auditors plan to conduct more such tests on property sales in future.

RECOMMENDATION 2

In order to help ensure that amounts owing from property sales are properly accounted for and obtained, and to help ensure ongoing monitoring for effectiveness of its sales procedures, the Ontario Realty Corporation should:

- establish controls to ensure that receivables are recorded and tracked for any potential recoveries from conditions of property sales; and
- track and identify any resale of properties sold for significantly higher amounts shortly after their sale and investigate how such situations could have occurred.

In addition, the Corporation should consider the feasibility of requiring safeguards in its sales agreements that would permit it to share in any large profits from subsequent sales of properties.

ACCOMMODATION PLANNING AND UTILIZATION

Many government initiatives over the last 10 years have resulted in changes to both the size and mix of the province's real-estate portfolio. Government decisions to transfer responsibility for some provincial services to local governments, and changes to the role of the Ontario Public Service, led to a decrease in space requirements compared to 10 years ago.

Significant changes in the government's property inventory over the past 10 years included the sale and lease-back of several large office buildings previously owned by the province, and the sale of institutional properties no longer required, such as health-care facilities. Several major properties—new and bigger courthouses and jails—were added during initiatives to rationalize and modernize the justice sector.

An Accommodation Program Review (APR) was undertaken during 1996/97 and 1997/98 aimed at

Figure 5: Ten-year Trend of Government-owned and -leased Real-Estate Portfolio

Source of data: Ontario Realty Corporation

	Owned	Leased
Fiscal Year	(rentable million sq. ft.)	
1996/97	43.7	10.0
1997/98	43.6	8.9
1998/99	43.0	8.3
1999/2000	42.2	7.8
2000/01	41.1	7.6
2001/02	40.4	8.1
2002/03	40.6	8.2
2003/04	41.0	8.3
2004/05	40.0	8.6
2005/06	39.4	9.1

reducing leased space and maximizing the use of owned space. In addition, all ministries and agencies were required to pay rent, called "charge for accommodations" (CFA), for the space they occupied. CFA assigned accountability for accommodation costs to the user ministry or agency. Together, APR and CFA helped at the time to reduce accommodation costs by more than $100 million.

As a result, there has been a reduction in both owned and leased space over the past 10 years, as shown in Figure 5. However, the table also shows that in the last five years there has been a 20% increase in the use of leased space due to the unavailability and reduction of owned space over the same period.

Recently, an Accommodation Savings Review (ASR) was initiated as a result of the May 2005 Ontario Budget. The ASR requires the Corporation and its clients to achieve accommodation savings of $50 million by 2007/08. Two strategies have been identified to help achieve this goal:

- reducing the amount of space required, including cuts to office-space standards, reductions in underutilized space, and increased use of shared space (such as boardrooms and offices); and
- reducing the cost of space by relocating to less expensive leased premises, negotiating lower-cost leases through longer terms and earlier renewals, and electricity conservation projects.

The Corporation advised us that savings attributable to the ASR were almost $23 million as of March 31, 2006.

Long-term Plans for Meeting Accommodation Requirements

According to the Corporation, and as was evident from our review of new accommodation requests, there were generally two options available to satisfy new client requests, particularly for office space:

- use existing owned space, which is in short supply; or
- enter into new leasing arrangements.

This increased reliance on leased space over the last five years was required because of a 7% increase in the size of the Ontario Public Service—from 60,300 full-time-equivalent staff in 2000/01 to 64,500 in 2005/06—as well as a reduction in owned space. The Corporation indicated it would need specific direction from the Ministry to pursue new capital investments and the use of other alternative financing options.

As a result of leasing being the only feasible option for satisfying client requests for more space, the Corporation concluded that it was not necessary to prepare formal financial assessments of alternatives to leasing, such as construction, lease-buy, outright purchase, or relocation, that might provide both cost-effective accommodations and long-term savings in each case. The focus on cost reductions and leasing in the past has resulted in minimal long-term planning for meeting accommodation requirements. For instance, our review of new accommodation requests from clients identified only limited circumstances when the Corporation prepared financial assessments of alternatives to leasing (such as ownership) to satisfy clients' requests for more space. For office space, no such assessments were made of alternatives. We were informed that over the last two years, the Corporation did complete approximately 22 financial assessments for mostly smaller special-purpose space requests, such as for Ontario Provincial Police detachments in smaller communities.

Ministries were generally required to look ahead only 18 to 36 months for their anticipated space needs, and this was primarily to meet the Corporation's requirements for lease negotiations. Investment in real estate typically requires longer time frames and/or large sums of capital from the province in order to develop property or enter into significant lease or alternative financing arrangements with the private sector. We noted that the last major expansion of government-owned office space came in 1995 and 1996. At that time, government direction resulted in the relocation of several office headquarters from the Greater Toronto Area to new, owned office accommodations in four other cities.

Assessments of Existing Space Utilization

We observed some recent initiatives, still in the early stages, that should help to promote strategic longer-term accommodation planning in the future. In the short term, these initiatives should result in a continued focus on further maximizing the use and efficiency of existing owned and leased space.

In September 2004, the Corporation completed a Provincial Accommodation Plan that provides a workplan for managing the province's real-estate assets more strategically and for achieving the savings in the ASR initiative. A key component of the plan calls for reviews of existing assets at the community and client level, and of short- and long-term use of real-estate and accommodation needs.

The Corporation has reorganized its staff, creating Key Account Teams to work with individual clients towards implementing the Provincial Accommodation Plan initiative. The teams work with clients to develop annual portfolio plans for their real-estate and accommodation needs, to identify opportunities for cost efficiencies, and to provide input into the development of community accommodation plans.

Annual ministry portfolio plans were initiated in 2004/05 and were again completed for all ministries in 2005/06. Our review of these plans noted that, in their current form, the activities have been largely focused on each ministry achieving short-term savings to meet its targets under the ASR. In general, we noted that the plans provide an inventory of each ministry's existing owned and leased space, and identify opportunities to reduce space, usually at the time of lease renewals. However, the portfolio plans had several shortcomings, including:

- a lack of longer-term analysis of ministry requirements;
- an absence of discussions regarding co-location and sharing opportunities with other ministries; and
- no quantitative analysis of the ministries' utilization of existing space.

With respect to the last point above, we would have expected ministries to assess their use of existing space based on the number of staff occupying the premises. There are at present no mandatory requirements for clients to report on their space usage to the Corporation. We noted that a space standard of 200 square feet per person is being applied to new accommodation requests. But we also noted that this standard is not being applied retroactively to all existing space. Ministry staffing requirements could change over time, so periodic assessment of existing-space utilization would be useful for identifying new opportunities to make better use of existing space or for justifying ministries' use of the space assigned to them. Our discussions with Corporation staff noted that such analysis would have to be done manually because central human-resource departments do not adequately track staffing by location. In addition, we were informed that some clients periodically need to accommodate large numbers of temporary staff, such as consultants, and this limits the extent to which space can be cut or requirements determined with certainty.

Savings from existing-space utilization assessments can be significant. The Corporation and ministries on occasion agree to conduct such studies. In November 2004, for example, the Corporation completed a leasing plan for ministry and agency programs in six downtown Toronto buildings that occupied about 866,000 square feet and whose lease was up for renewal within two years. The plan identified through assessments of existing-space utilization that the clients could reduce their space by more than 65,000 square feet, or 8% of the total. Annual savings from this measure alone were expected to be almost $2 million.

Another initiative under way at the Corporation during our audit was a Queen's Park Accommodation Plan for 10 owned office buildings in the vicinity of the Legislature in Toronto. We were informed that criteria have been established for the types of programs, activities, and uses suitable for these buildings and locations. However, the Corporation's efforts over the last two years to conduct a space-utilization assessment for these buildings have been on hold pending the provision of more complete and reliable data from existing tenants.

RECOMMENDATION 3

To enable it to help the government achieve additional accommodation expenditure savings in the real-estate portfolio, the Ontario Realty Corporation should work with the Ministry of Public Infrastructure Renewal and client ministries and agencies to establish requirements for:

- carrying out long-term accommodation planning to allow for exploration of options beyond leasing, such as construction, lease-buy, outright purchasing, and relocation, to meet space needs at lower costs;
- exploring co-location and sharing opportunities with other ministries; and
- having ministries periodically report their present and future expected staff size, as well as their existing space utilization, to the Corporation to enable a more informed assessment of the use of existing space.

LEASING

Leased space is acquired to satisfy client needs that cannot be met through existing owned space. The Corporation's Key Account Team representatives work with clients to identify accommodation requirements at least 18 to 36 months in advance of the need in order to renew leases or sign new ones. The Corporation's leasing department identifies available space for lease to satisfy client needs and, following client approval, negotiates lease rates and conditions.

As of March 31, 2006, there were almost 700 leases in place for approximately 9.1 million square feet of rentable space, 78% of which was for office space and 17% for law courts. Annual net rent expenditures were approximately $110 million.

Lease Administration for Government-occupied and -owned Space

In February 2004, the Corporation's internal auditors identified a significant backlog of expired government leases with private-sector landlords. They found that 151 of 876 leases, or 17% of the total, had expired and, therefore, were "in overhold" since ministries and agencies continued to occupy the space. The risk in failing to renew leases in a timely manner is that some programs could be forced either to vacate space on short notice or the Corporation would be put at a disadvantage in negotiations for a new lease because of time pressures to vacate the space.

We noted that the Corporation made changes to address the backlog and prevent a recurrence. Follow-up internal audits found that the backlog had been significantly reduced, to 38 by March 2005 and down to 10 as of December 2005. Leases still in overhold were either in negotiations or had issues requiring further attention by the Corporation.

For example, the lease for Toronto's Old City Hall, used for law courts, has been in overhold since 1999. The Corporation continues to pay the 1999 rate of $35 per rentable square foot but estimates the current market rate for this property is substantially lower, in the range of $15. However, we were not aware of any ongoing discussions or activities to renegotiate this lease, and we estimate the Corporation and its client are paying at least $3.3 million in excess rent each year for this property.

In addition, the Corporation administers approximately 250 leases, worth about $10.5 million a year, for non-Ontario-government tenants occupying space in government buildings. These tenants may be from the private sector, municipalities, the broader public sector, or non-profit organizations. We noted that approximately 100 of these leases were also in overhold—many for over 10 years—including about 60 that were paying only a nominal rent of $1 a month. About 40 others, required to pay market rates, continued to pay rent based on leases that expired several years ago. In the case of the tenants paying nominal rent, the Corporation requires direction from the Ministry clarifying whether the policy established in 1994 to permit such leases requires updating with respect to the need to pursue market rates. The Corporation estimates that charging market rates for these properties would yield an additional $2 million a year.

RECOMMENDATION 4

To help ensure that leases negotiated by the Ontario Realty Corporation, both for government-occupied space and for government-owned space leased to others, reflects the best rates, the Corporation should:

- resolve in a timely manner all remaining leases in overhold; and
- obtain the necessary policy direction from the Ministry of Public Infrastructure Renewal to allow it to negotiate appropriate rents—at market rates where possible—for non-Ontario-government tenants in government buildings.

BUILDINGS AND LAND MANAGEMENT

The Corporation's Property Management and Client Services Division is responsible for managing operations, maintenance, and repairs for all owned and leased space, plus the land portfolio. It spends nearly $400 million a year to ensure, on a daily basis, that the properties are clean and that the lights, heating, air conditioning, elevators, and other services are in good working order.

The Corporation contracts with various service providers in each of four regions in the province to manage buildings and lands. In 1999, it awarded two major contracts covering the two biggest regions, the Greater Toronto Area (GTA) and the Southwest. In the first contract, the Corporation outsourced the overall management and operations of more than 2,200 owned and leased buildings in the GTA and Southwest regions to one service provider for about $4 million a year. In the second, the Corporation retained another service provider to look after the land portfolio in the same two regions for about $2 million a year. Each contract was for five years and each had two renewal options, at the Corporation's sole discretion, for the same rates and conditions.

In the East and North regions, Corporation staff provide overall property management services for buildings and land, using many smaller local service providers.

Overall we concluded that acquisition and management of service providers was done using proper procedures and controls, and with due regard for economy. For instance, we were satisfied that the Corporation had properly:

- exercised due diligence in awarding the two large contracts;
- followed the appropriate competitive-selection processes; and
- obtained the required approvals from Management Board of Cabinet, then responsible for the Corporation, for both the original contracts and their renewals.

The Corporation also established a number of controls for the ongoing management and monitoring of the two large contracts, including regular verification of invoices submitted by the service providers and inspections of supporting documents for those invoices.

A key clause in the two large contracts stipulates that a portion of the remuneration is held back and dependent on whether service providers meet performance standards. For example, the building- maintenance contract in the GTA and Southwest regions requires the service provider to report on 45 key performance indicators in the areas of management, financial performance, asset integrity, and customer service. The service provider must attain an overall rating of more than 80% before the Corporation pays out a portion of the holdback funds, and over 90% in order to get all of the holdback money.

The Corporation's internal auditors also act as a key control over the use of service providers, conducting regular audits of building-management contracts in all regions. These audits have led to several recommendations for improving controls over service providers.

However, there was a need for improvement to ensure that best practices and high standards were applied consistently throughout the province. We noted that the reporting and performance requirements imposed on the two major service providers in the GTA and the Southwest were more stringent than those imposed in the North and East, for properties managed by Corporation staff.

For example, building-service providers are used in the North and East on a smaller contractual basis, managing anywhere from one to several buildings. These contractors are paid fixed amounts with no holdbacks dependent on their meeting key performance indicators. Nor were Corporation staff under any formal requirement to schedule reports and inspections for unused buildings and surplus properties, as is the case for the Corporation's major land-management service provider. We noted instances where annual inspections were not carried out, and where there were no requirements to prepare annual asset-management plans for each property detailing its condition, maintenance plan, potential for rental revenues, and recommended course of action for the short and long term.

RECOMMENDATION 5

In order to help ensure that all Ontario Realty Corporation staff and service providers managing buildings perform their management and reporting duties appropriately, consistently, and at a high level, the Corporation should review building-management practices in all regions and ensure that best practices are being consistently adopted.

DEFERRED MAINTENANCE ON GOVERNMENT-OWNED AND -OCCUPIED BUILDINGS

The Corporation estimates that, optimally, it needs about $160 million a year to fund its repair, renewal, and modernization program for owned buildings. However, the Corporation has not had such funding, and it estimated that, as of March 31, 2006, deferred maintenance costs for its buildings totalled approximately $382 million.

The need for major repairs is usually identified through the Corporation's annual building inspections, and these capital repairs are deferred to future years if funding is not immediately available. The Corporation classifies repairs under several categories, such as those needed for compliance with health and safety requirements, to achieve building code compliance, for energy management, and to replace aging building systems that are at risk of imminent breakdown. While deferring capital repairs can help solve short-term funding shortfalls, it can lead to costlier problems over the long run if the necessary work is not done in a timely way. Repairs deferred to future years will also decrease the funding available for repairs already scheduled for those years.

In addition, most of the Corporation's owned buildings are relatively old, putting further pressure on funding requirements for keeping the properties in a good state of repair. As shown in Figure 6, more than 80% of its key buildings are over 20 years old, and almost one-half are more than 40 years old.

The Corporation's Strategic Capital Management Unit (Unit) manages the development of implementation plans for capital repairs based on available funding. Prior to the 2004/05 fiscal year, capital repairs were prioritized on an annual basis, depending on the urgency of the requirement. In 2004/05, the Unit introduced an annual life-cycle-costing process that includes a 10-year rolling capital repair program and a comprehensive repair planning and capital investment evaluation

Figure 6: Average Age of Government-owned Buildings as of March 31, 2006

Source of data: Ontario Realty Corporation

	# of Buildings	# as % of Portfolio	Area (rentable million sq. ft.)	Area as % of Portfolio
< 11 years	39	2	2.5	8
11–20 years	205	12	3.7	13
21–30 years	171	10	3.1	11
31–40 years	295	18	6.8	23
> 40 years	825	49	11.9	40
age unknown	148	9	1.4	5
Total	**1,683**	**100**	**29.4**	**100**

process. In some cases, program use permitting, the Corporation can consider disposing of a building rather than repairing it. Repairs are then prioritized based on a business case prepared for each project that examines the options for performing the work, the scope of the work, and the levels of review performed to date in support of the recommended repairs. Projects planned for major repairs within two to 10 years are re-evaluated annually against new project initiatives, updated assessments of the planned repair, and ongoing program needs of the building occupants.

The Corporation also determines the condition of its buildings by assigning a Facility Condition Index (FCI) for each building, which compares the property's total deferred maintenance cost to its replacement cost. The Corporation conducted its assessment for 2005/06 using the FCI for the 582 in-use buildings that required repairs, as shown in Figure 7. The figure indicates that, while the majority of buildings were in good to fair condition, about 148 of them, or 26%, were classified as poor to defective.

Senior corporation management noted that its total life-cycle funding requirements were not being met by current revenues from the real-estate portfolio, most notably because of outdated rent rates paid by ministries and agencies occupying government-

Figure 7: Facility Condition Index (FCI) for Selected Government-owned Buildings Managed by the Ontario Realty Corporation, 2006

Source of data: Ontario Realty Corporation

	# of Buildings Assessed					
FCI Classification	**GTA**	**East**	**Southwest**	**North**	**Total**	**% of Total**
good condition	29	83	121	104	337	58
fair condition	10	25	24	38	97	16
poor condition	23	14	18	25	80	14
critical condition	7	3	12	6	28	5
defective condition	13	12	7	8	40	7
Total	**82**	**137**	**182**	**181**	**582**	**100**

owned space. Commencing in 1998/99, all ministries and agencies were required to pay the charge for accommodations (CFA) for the space they occupy in government-owned buildings. The rates were originally based on market-rent information collected in 1996/97—and they have not changed in the past nine years. However, ministries or agencies that occupy space leased from the private sector have always paid the actual rents. The Corporation estimates that CFA for government-owned buildings would increase by $89 million a year if current market rates were imposed on tenants of government-owned space.

We asked the Chief Administrative Officers (CAOs) of several ministries if they believed that increasing CFA to current market rates would encourage further efficiencies in the use of government-owned space. In general, the CAOs said that after several years of funding constraints, they believed existing cost-saving measures on ministries were sufficient to motivate them to maximize the use of existing space. Concerns were raised that if CFA were raised to current market rates, additional funding would also have to be provided from the province to compensate ministries and agencies. However, many recalled that when CFA was introduced in 1997/98, ministries and agencies were only given 85% of the funding required to pay for CFA, with the balance coming out of existing program expenditures. CAOs were thus concerned that any increase in CFA at this time, after several years of constraints, could again require offsetting program expenditure cuts.

The Corporation was also concerned that its total funding is subject to fiscal pressures and competing priorities from other government programs, and not based on the operating and capital needs of the portfolio. As a result, when capital repairs are not sufficiently funded in one year, the backlog of deferred maintenance impacts the capital repair budgets of future years until funding levels can no longer cover both in-year capital requirements and the backlog of deferred maintenance.

RECOMMENDATION 6

To enable the Ontario Realty Corporation to properly maintain government-owned buildings in accordance with life-cycle costing for capital repair requirements and to avoid any longer-term impact resulting from deferring needed preventative or preservation repairs, the Corporation should work with its clients and the Ministry of Public Infrastructure Renewal to establish stable and appropriate levels of funding for maintaining government-owned buildings.

REAL-ESTATE INFORMATION SYSTEMS

The Corporation uses a variety of computerized information systems to manage its real-estate portfolio and financial transactions. Two of its major systems are:

- RealSuite, an integrated real-estate management system that tracks leases, space, and facilities management. RealSuite was implemented in October 2003 and tracks all property for which the Corporation is responsible; and
- Geographical Information System (GIS), a computerized system recently developed by the Corporation in conjunction with a software development company, provides geographic views of the Corporation's properties and portfolio. It can display legal and mapping information about properties, along with government uses of real estate, for specified areas. A key feature is its ability to integrate information from a variety of sources, including RealSuite, the provincial land registry system, and databases maintained by other ministries.

RealSuite is used extensively by Corporation staff for making decisions on meeting accommodation needs and for tracking the use of properties. Despite the Corporation's recent efforts to improve data quality, there were extensive errors with respect to the current status of properties in the database, such as the following:

- Approximately 1,200 buildings were listed in the system as being both occupied and inactive. For example, a large office building in downtown Toronto, vacated and declared surplus in 1995, was listed as occupied.
- A large property valued at over $10 million that was listed as active had in fact been sold almost two years earlier.
- More than 300 acres of Hydro One corridor lands managed by the Corporation were declared surplus according to RealSuite, although they were active and in use.
- RealSuite lists the land portfolio in the Greater Toronto Area and Southwest regions managed by the Corporation's major service provider as including about 57,000 acres, whereas the service provider's records indicated that it managed only about 48,000 acres. Our inquiries with the service provider determined that approximately 7,500 acres had never been included in the contract, and approximately 500 acres originally managed by the service provider had been either transferred or sold and were no longer part of the contract. In addition, the service provider's records listed 40 fewer buildings than the 1,087 contained in RealSuite. RealSuite also listed more than 110 of these buildings as occupied when they were in fact vacant, or listed as vacant when they were occupied.

The Corporation's internal auditors noted similar concerns with RealSuite data integrity in a report issued in September 2005, based on testing of the accuracy of information on 45 high-priority buildings.

Data integrity errors also produce unreliable results for searches of vacant space in owned buildings. We noted a number of instances where premises listed as vacant in RealSuite were actually in use, usually for the temporary accommodation of clients during renovations to their permanent quarters.

As the Ministry identified in its recent review of real-estate management, there exists no complete inventory of all government-owned and -controlled real estate. Such an inventory could be used to improve the quality of asset information and support decisions by offering complete, strategic, and accessible information about the portfolio. The situation arises because some ministries and government agencies, such as the ministries of Transportation and Natural Resources, and GO Transit, are not required to use the Corporation's services, and they own and manage real property across the province. Information about those assets, including location, size, value, and use, is known only to the ministry or agency. This makes it difficult for government to get the overall picture needed to make strategic decisions about its very large and valuable portfolio.

The Corporation has made efforts over the last two years to obtain a more complete listing of real-estate assets using several sources, most notably by linking GIS to RealSuite and Ontario's land registry system. However, RealSuite only includes records on properties managed by the Corporation, while electronic land registry information is not complete as it is available only from 39 of the province's 54 land registry offices. A more complete inventory will require the co-operation of all ministries and agencies with the Corporation to share information. At the time of our audit, these partnerships had not been established, although we understand that the Corporation had been working with the Ministry in its efforts to establish better linkages with other ministries and agencies. The Corporation also informed us that it has offered GIS to other ministries, including some that have already invested in their own systems, in order to avoid duplication of effort and costs, and to have only one comprehensive system on which the government could base decisions.

RECOMMENDATION 7

In order to help ensure that the Ontario Realty Corporation is capable of providing reliable and complete information on the province's real-estate holdings and activities, and to support strategic decision-making on real-estate and accommodation decisions, the Corporation should:

- investigate the causes of data integrity errors on its RealSuite information system and implement quality control procedures to correct existing errors, and prevent and detect any recurrence in future; and
- continue its efforts to secure the co-operation of other ministries and agencies with real-estate holdings to permit the development and sharing of a complete inventory of all government-owned and -controlled real estate.

PERFORMANCE MEASURES

The Corporation is required to provide a results-based plan and annual report that sets out the performance targets it has achieved and the actions it plans to take, along with an analysis of its operational and financial performance. In addition, the Memorandum of Understanding between the Corporation's Board of Directors and the Minister of Public Infrastructure Renewal makes the Board responsible to ensure the development of an effective performance measurement and management system for assessing the Corporation's performance. It also requires the Corporation to provide the Ministry with mid-year and year-end performance reports. Such reports are also intended to inform legislators and the public about the extent to which programs and services meet program objectives and provide value to the public.

In our discussion with senior Corporation management, there was general acknowledgement of the need to establish more appropriate measures to report on the Corporation's performance, including:

- customer satisfaction;
- its management of the real-estate portfolio;
- its efforts to satisfy accommodation requirements economically and efficiently; and
- a benchmark comparison of its costs with industry and with other jurisdictions.

Performance measures for these areas have not been established or publicly reported in its annual report. We noted that the only key performance measurement reported in the Corporation's most recent annual report, for 2003/04, (no report was issued for either the 2004/05 or the 2005/06 fiscal year) was the overall vacancy rate, which we have already found to be unreliable.

We did note, however, that there was significant information produced by the Corporation for internal management purposes that may have the potential to be used to improve external reporting. For instance, it conducts periodic surveys of ministry staff and Chief Administrative Officers to assess their satisfaction with its services. The Corporation's annual approved corporate objectives also detail a number of key strategic goals for the year, including tracking the achievement of government-mandated initiatives such as accommodation savings and energy efficiencies.

The Corporation's recent efforts to track the Facility Condition Index (FCI) of buildings, along with deferred maintenance liabilities, could also be used to report on the condition of buildings in the portfolio. There were many jurisdictions in the United States and Canada that reported an FCI as a measure of their performance and status of their buildings' state of repair. However, senior Corporation management noted that there was no universally accepted method of calculating and reporting on FCI that would allow for benchmark comparisons between the Corporation's portfolio and those of other jurisdictions.

The Corporation had established an initiative to develop improved performance measures and targets during the current fiscal year. In this regard, a consultant engaged by the Corporation to complete a workplan to implement corporate real-estate performance indicators and benchmarking reported in April 2006 on issues relating to human resources, data, information technology, and the selection of key performance indicators. The consultant also included a survey of, and research into, public- and private-sector organizations. The report identified more than 225 potential key performance indicators in such areas as leases, facilities and project management, and occupancy costs. While external reporting should focus on a few key indicators, this does give a good overview of the potential for enhanced performance reporting.

In addition, our discussions with senior representatives of clients revealed that the Corporation provided them only with information on budgetary and actual expenditures charged to the ministry, primarily relating to rent and project costs. Clients said they would have liked to receive information about a building's state of repair, and about the energy efficiency of their building relative to industry standards.

RECOMMENDATION 8

The Ontario Realty Corporation should develop and report comprehensive and reliable performance indicators that would enable legislators, clients, and the public to properly assess its effectiveness in managing the province's real-estate portfolio and meeting accommodation requirements and objectives in an economical and efficient manner. Where possible, the Corporation's performance should be benchmarked to comparable private-sector and government property-management organizations in other jurisdictions.

OTHER MATTER

Procurement Practices for Capital Projects

The scope of our audit did not include an examination of the Corporation's project-management activities for large capital projects—those where, for example, a ministry pays for renovations to its accommodations. However, we were concerned about the December 2005 observations by the Corporation's internal auditors that were critical of procurement practices for large capital projects, because they reflected similar concerns raised by us in 2003 about project-management and procurement practices.

In our 2003 value-for-money audit of Court Services at the Ministry of the Attorney General, we observed that capital projects managed by the Corporation used unit-price contracts (UPCs) for construction work without proper competitive acquisition processes and approvals for projects of this size. We noted that a project costing approximately $8 million was awarded to unit-price contractors who provided their services at rates that were agreed to beforehand but intended for assignments costing less than $100,000.

The Corporation's internal auditors noted in their 2005 review of UPCs that:

- the Corporation's rotational process for awarding UPC work to a roster of pre-qualified contractors did not follow established procurement policies and procedures for projects of this size;
- there was a bypassing of controls intended to ensure that established project costs, proper Corporation approvals, and performance bonds were in place before work began; and
- a significant percentage of the total cost of projects assigned under a UPC were not in fact unit-price work, and as such were not competitively procured.

These concerns were identified for work performed from January 2004 to May 2005, when eight contracts ranging in size from $1.1 million to $3.6 million were inappropriately handled as UPC work. We were informed by the Corporation's internal auditors that they were to follow up on procurement practices for large projects by June 30, 2006.

RECOMMENDATION 9

In view of the concerns we raised in 2003, and of those raised by the Ontario Realty Corporation's internal auditors in 2005, regarding the use of unit-price contractors in place of established procurement procedures and competitive selection processes in hiring contractors for large construction projects, the Corporation should conduct a comprehensive review of its use of unit-price contractors, as well as of the policy framework that permits their use, to ensure the required open competitive procurement practices are not being circumvented.

ONTARIO REALTY CORPORATION RESPONSE

The Auditor General has made useful recommendations, and those that are operational in nature will be acted upon by the Ontario Realty Corporation as indicated below. For those recommendations that require policy approval from the government, the Corporation will continue to advise the Ministry of Public Infrastructure Renewal (Ministry) on all aspects of policy options and implementation.

Recommendation 1

The Corporation is pleased that the Ministry's examination of processes acknowledged many of the issues the Corporation has raised and suggestions it has made over the years for improvements to the real property management system. The Corporation will work with the Ministry to support policy changes and make improvements.

Consistent with the Auditor's recommendation, business plans and workplans now include timetables for those changes that are the responsibility of the Corporation.

A further comment on the difficulty in selling surplus and underutilized properties: The former government gave the Corporation approval to sell a variety of properties to meet established sales targets if the business cases for sales made economic sense. Many of the 330 properties noted in the audit are "in use" for delivery of government programs, and the business cases for many of these potential sales were subsequently determined not to be sound.

Recommendation 2

We are pleased that the Auditor General found the controls over property sales and acquisitions to be satisfactory. This recommendation should help to further strengthen controls.

Safeguards in sale agreements, which the Auditor recommended be considered to prevent higher resales, are currently applied to properties sold to municipalities. These safeguards, however, would significantly limit prices for sales to the public. Where significant potential for future value enhancement may exist, other means to ensure full value to the government, such as participating with the private sector in joint ventures, will be pursued.

Recommendation 3

The Corporation agrees with the recommendation. As observed in the audit, more long-term planning has been occurring, and the Corporation will continue to work towards improved long-term planning with the Ministry and tenant ministries. The government has entered into different arrangements for some accommodation requirements (for example, Durham Consolidated Courthouse, which will consolidate seven existing leases for courts into one new location). Also, the Corporation is in the process of relocating 11 ministries in Ottawa into one location to share space and services—reducing the space requirements by 22,000 square feet and saving operating costs.

The Corporation has been working and will continue to work with the Ministry of Government Services to obtain reports on the staff size of ministries by location to assist in the proper assessment of space use.

Recommendation 4

The Corporation agrees with the recommendation. As noted in the audit, the Corporation implemented a successful strategy to reduce the number of outstanding leases for space leased from third parties from 151 to 10 by December 2005. Success in this area has resulted in a high satisfaction rating by ministries for leasing services at the Corporation. The Corporation's 2006/07 business plan includes an initiative to apply a similar strategy to reduce the number of outstanding leases for space rented to third parties.

The Corporation plans to provide the Ministry with an overview, an analysis, and recommendations to help develop policy for leasing to not-for-profit community groups that are paying nominal rents.

Recommendation 5

We are pleased that the Auditor found that the acquisition process and management procedures in place for securing building- and land-management services used the proper procedures and controls while having due regard for economy.

As the Auditor noted, the Corporation monitors the performance of the large service providers in detail. We will examine how these enhanced monitoring practices can be economically applied to smaller service-provider contracts. In addition, commencing April 1, 2006, these smaller contracts are subject to the Corporation's formal contractor-evaluation process. This new process should help ensure appropriate service-provider performance through ongoing monitoring of contractor performance that can lead to termination of the contract for poor performance.

Recommendation 6

The Corporation concurs that there should be a stable and appropriate level of funding for maintaining government-owned buildings and will continue to work with the Ministry and tenant ministries to establish that level of funding.

In recognition of the deferred maintenance situation identified by the Corporation, the Ministry has provided additional capital funding for repairs over the past three years and is continuing to provide that financial support, and the Corporation has applied funding to the most appropriate building repairs.

The current deferred maintenance assessment is based on the Corporation's strategic review of key government assets using the Facilities Condition Index. As the Corporation's review of all other assets in the portfolio is completed, it is contemplated that a continuing emphasis on deferred maintenance will be required.

Recommendation 7

The Corporation concurs with the recommendation. The Corporation is re-establishing its data-quality initiative to improve information on the assets of the portfolio. This effort has been initiated, and a strategy is in place to deal with the data issues, starting with the most significant buildings in the portfolio.

A project to develop a complete inventory of government-owned and -controlled assets has commenced. Also, the Corporation is continuing its efforts to secure co-operation from ministries and agencies, in general and for this project, through its newly established Account Teams that have significantly improved communications with ministries.

Recommendation 8

The Corporation concurs with the recommendation. Our now completed 2004/05 and 2005/06 annual reports contain more specific performance information than did previous annual reports. Included in these reports are performance measures based on pre-established corporate objectives, presented in a "report-card" fashion. Starting in 2006, additional performance information, particularly customer satisfaction levels, is being provided in quarterly reports to stakeholders. The Corporation's objectives for 2006/07 include the development of improved performance indicators benchmarked against private-sector and government property-management organizations in other jurisdictions.

Recommendation 9

The Corporation is currently implementing an alternative procurement option to address the concern regarding the use of unit-price contractors. From now on, repair and alteration projects will be awarded using established procurement procedures and a competitive selection process based on securing bids from contractors on pre-established source lists utilizing stipulated sum contracts.