

DISTRICT OF COLUMBIA OFFICE OF THE INSPECTOR GENERAL

OIG Project No. 16-1-12AM

August 2017



DEPARTMENT OF GENERAL SERVICES:

MANAGEMENT OF THE DISTRICT'S REAL PROPERTY ASSETS AND LEASING PROCESSES NEEDS SIGNIFICANT IMPROVEMENT, WHICH COULD LEAD TO SUBSTANTIAL COST SAVINGS



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Why the OIG Did This Audit

Managing leased spaces is a high-risk issue, according to the U.S. Government Accountability Office (GAO).¹ Like the federal government, the District of Columbia (District) leases space and may be exposed to the same types of risks.

The District established the Department of General Services (DGS) to promote efficient and effective management of the District's real estate investments, which includes "maintaining inventory records for tracking and controlling District-owned, controlled, and leased space."²

The Office of the Inspector General (OIG) reviewed DGS' Portfolio Management Division to: (1) assess processes for maintaining real property assets inventory; and (2) determine whether the leasing strategies yield the intended benefits for the District.

What the OIG Recommends

The OIG provided DGS with 14 recommendations to improve the development and implementation of policies and procedures to ensure effective management of the District's real property assets and leased space.

DEPARTMENT OF GENERAL SERVICES:

Management of the District's Real Property Assets and Leasing Processes Needs Significant Improvement, Which Could Lead to Substantial Cost Savings

What the OIG Found

DGS neither maintained a complete and accurate inventory of District-owned property, nor submitted annual reports detailing changes in this inventory to the D.C. Council as required by law. DGS lacked effective policies and procedures for maintaining inventory records; collecting and recording required data; and creating the necessary data fields in its database to record and update the inventory of District real property assets. A complete and accurate inventory is necessary to make decisions regarding whether to lease space from a third party or use existing, District-owned space to meet agency needs. With DGS budgeting \$177.7 million in FY 2018 to lease space, it is imperative that it has an accurate and complete list to ensure sound decisions are made to either lease or use District-owned space. Furthermore, DGS officials were unaware of the annual reporting requirements and, therefore, did not submit the reports to the Council. As a result, the Council was not fully informed about changes in the District's real property assets.

DGS lacked mechanisms to ensure its lease management practices yielded maximum benefits for the District. For example, DGS did not always seek competitive bids for leases and brokerage services, or maintain complete documentation for all lease transactions. DGS also did not establish adequate controls over rent collection or proper administration of the broker's contract. Without effective policies and procedures governing lease management, DGS will not consistently maintain appropriate supporting documentation to demonstrate all lease agreements are in the best interest of the District, and ensure that millions of dollars in rent and rebates due to the District are collected.

If DGS addresses the findings contained in this report, the District could collect \$4.85 million in unpaid rent, and recoup \$633 thousand in rebates in the broker's possession.

¹ GAO, FEDERAL REAL PROPERTY, GSA COULD REDUCE LEASING COSTS BY ENCOURAGING COMPETITION AND REDUCING UNNEEDED FEES, GAO-16-188 (Jan. 2016) at 1, available at <http://www.gao.gov/assets/680/674631.pdf>.

² Responsibilities for DGS are specified under D.C. Code §10-551.01(b)(6) (Lexis through June 15, 2017).

GOVERNMENT OF THE DISTRICT OF COLUMBIA

Office of the Inspector General

Inspector General



August 17, 2017

Greer Johnson Gillis
Director
Department of General Services
2000 14th Street, N.W., 8th Floor
Washington, D.C. 20009

Dear Director Gillis:

Enclosed is our final report, *DGS: Management of the District's Real Property Assets and Leasing Processes Needs Significant Improvement, Which Could Lead to Substantial Cost Savings* (OIG Project No. 16-1-12AM). Our audit objectives were to review DGS' Portfolio Management Division to: (1) assess processes for maintaining real property assets inventory; and (2) determine whether the leasing strategies yield the intended benefits for the District. We conducted this audit in accordance with generally accepted government auditing standards.

We provided DGS our draft report on July 14, 2017, and received its response on August 2, 2017, which is included as Appendix C to this report. We appreciate that DGS officials began to address some of the findings immediately upon notification during the audit. DGS concurred with 8 of our 14 recommendations and outlined actions and target completion timeframes for recommendations 1, 2, 3, 5, 6, 7, 9, and 11. Therefore, we consider the recommendations resolved, but open pending completion of planned actions or evidence of stated actions.

DGS did not fully concur with 5 of our 14 recommendations. Therefore, we consider recommendations 4, 8, 10, 12 and 13 open and unresolved. We request that within 30 days of the date of this final report, DGS reconsider and respond to recommendations 4, 12 and 13. For recommendations 8 and 10, we request that DGS provide us a response after the first quarter of FY 2018, with actions taken or target dates for completion of planned actions. For recommendation 14, DGS did not concur, but proposed actions are sufficient to meet the intent of our recommendation. Therefore, we consider this recommendation resolved but open pending evidence of stated actions. Our comments to DGS's response to the draft report are included on page 12 of this report.

Director Gillis

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We appreciate the cooperation and courtesies extended to our staff during this audit. If you have any questions concerning this report, please contact me or Benjamin Huddle, Acting Assistant Inspector General for Audits, at (202) 727-7721.

Sincerely,



Daniel W. Lucas
Inspector General

DWL/mo

Enclosure

cc: See Distribution List

Director Gillis

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BACKGROUND

The D.C. government created the Department of General Services (DGS) in September 2011 to promote the efficient and effective management of the District's real estate investments. Pursuant to D.C. Code § 10-551.01(b)(6), DGS' responsibilities include "managing data and information needs pertaining to real property, including maintaining inventory records for tracking and controlling District-owned, controlled, and leased space."

To manage the District's real estate investments, DGS oversees approximately 12 million square feet of District-owned property³ where the District is the landlord and collects rent from tenants. In addition, DGS oversees 3.9 million square feet of leased space for District agencies that cannot be accommodated with a District-owned property. In the latter situations, DGS locates private space such as offices, warehouses, parking, clinics/housing, and land for agencies and pays rent on their behalf. As of May 2017, DGS paid approximately \$12.9 million in monthly rent for leases it manages for District agencies. For FY 2018, DGS has budgeted \$177.7 million to lease space. This represents an increase of \$14.4 million over the approved FY 2017 budget.

Prior to 2014, DGS used its real estate portfolio management staff to locate and negotiate all leases on behalf of the District. In July 2014, DGS issued a request for quotation seeking a contractor to provide tenant representation services that include site location, market analysis, and lease acquisition pursuant to D.C. Code § 10-551.07. In August 2014, DGS contracted with Savills Studley Inc. (hereinafter, "the broker") to provide tenant representation services. As of May 2017 the broker only provided tenant representation services for in-leases (where the District is tenant) and did not provide leasing services for out-leases (where the District is the landlord).

For each successfully negotiated lease on behalf of the District, the broker receives a commission from the property's landlord based on the gross lease value, which includes real estate taxes, operating costs, and money that the District borrows from the landlord to make tenant improvements to the space. Table 1, on the following page, shows the cost components of one of the leases we reviewed, including the gross lease value used to calculate the broker's commission.

³ This number excludes occupied schools in the District because the District of Columbia Public Schools, not DGS, manages those schools.

Table 1. Example of Broker Commission Calculation

	Lease Cost Components	Square Feet. Rate Per Year (A)	Rentable Square Feet (B)	Total Annual Amount (A x B)
1	Operating Costs	\$8.99	199,822	\$1,796,399.78
2	Real Estate Taxes	\$9.86	199,822	\$1,970,244.92
3	Amortization of Tenant Improvements <i>(money borrowed⁴ from landlord)</i>	\$3.02	199,822	\$603,462.44
4	Shell Rental <i>(Base rent amount net of items 1, 2 &3)</i>	\$27.72	199,822	\$5,539,065.84
	Gross Annual Rental Cost <i>(per RSF)</i>	\$49.59	199,822	\$9,909,172.98
	Total cost over 10 Year Lease Term <i>(Gross Annual Rental x 10 years plus 2% annual escalation)</i>			\$108,171,900
	Broker's Commission <i>(3.0% of the gross total value)</i>			\$3,245,157

Source: OIG analysis

Our audit objectives were to review DGS' Portfolio Management Division to: (1) assess processes for maintaining real property assets inventory; and (2) determine whether the leasing strategies yield the intended benefits for the District.

We conducted this performance audit from June 2016 to July 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We reviewed and assessed DGS's compliance with its policies and procedures, as well as applicable District laws and regulations. We also interviewed DGS officials, contractors, and Office of the Chief Financial Officer (OCFO) officials; reviewed compliance with the leasing process of select leases when the District was the tenant and landlord; and confirmed commission amounts paid or to be paid to the broker. Our audit period covered fiscal years (FY) 2012 through 2015. We also reviewed leases and related transactions initially assigned to the broker in FY 2015 but not executed until FYs 2016 and 2017.

⁴ District borrowed \$41.75 per square foot (total of \$8.34 million) for tenant improvements on this lease restructure to be paid back in monthly installments (\$53,478 over 157 months).

FINDINGS

DECISIONS USING INACCURATE INFORMATION CONTAINED IN THE DISTRICT'S REAL PROPERTY INVENTORY COULD RESULT IN WASTED RESOURCES

DGS neither maintained a complete inventory of real property assets in its centralized automated database, nor submitted annual reports of changes in the real property assets inventory to the D.C. Council as required by law. Without an accurate and complete inventory, DGS officials could be making decisions to enter into a lease when a District real property asset could be used. As a result, the District could be spending unnecessary resources to both lease third-party space and maintain unutilized District real property assets.

DGS Did Not Maintain a Comprehensive and Accurate Inventory of Real Property Assets

D.C. Code § 10-551.05(a) requires DGS to “maintain an inventory of all real property assets, based upon information provided by each District department, agency, and instrumentality under the executive control of the Mayor.” Based on our review, DGS did not maintain a complete inventory of the District’s real property assets in its centralized automated database.

To verify the completeness of DGS’ inventory, we selected known District-owned properties from the Office of Tax and Revenue’s (OTR) database to determine whether they were included in DGS’ database. We electronically compared OTR’s database to DGS’ database and found 1,540⁵ more properties listed as District-owned in the OTR database than included in the DGS database. We judgmentally selected a sample of 32 from the 1,540 real property assets missing from the DGS database, and cross-referenced them with ownership title records maintained by the District’s Recorder of Deeds. Of the 32 real property assets, 30 (93.8 percent) were District-owned, and the remaining 2 were owned jointly by the federal and District governments.

In addition, DGS did not maintain all required information for each property. D.C. Code § 10-551.05(a) requires DGS to maintain the following identifying information on each property in its database:

- (1) A detailed description of each real property asset;
- (2) Facility condition assessments, which shall contain a proposed or actual annual budget for maintenance and deferred maintenance, and a detailed description and estimate of any needed repairs;
- (3) The street address of the property;
- (4) The property’s square and lot number;
- (5) The current and prospective future use of the property;

⁵ This figure did not include properties belonging to District agencies that maintain their own real property databases, namely the Department of Parks and Recreation, District of Columbia Public Schools, Fire and Emergency Medical Services, and the Office of the Deputy Mayor for Planning and Economic Development.

- (6) The area of the property in square feet and, if improved, the gross floor area, including the subsurface area and the number of stories of any building on the property;
- (7) The current assessed value of the property and any improvements;
- (8) The Ward and Advisory Neighborhood Commission boundary within which the property is located; and
- (9) Whether the real property is located within a historic district or is designed as a registered historic landmark under District or federal laws and, if so, the designation.

To determine whether DGS recorded all required real property information, we selected and reviewed a random sample of 30 real property assets from DGS' database and found that:

- 24 properties did not have detailed descriptions;
- 8 properties did not have square and lot numbers;
- 24 properties did not contain the property square footage;
- 10 properties did not have the current assessed value;⁶ and
- none of the 30 properties had a facility condition assessment or historic district identification.

DGS has yet to establish policies and procedures for maintaining its real property asset inventory, collecting the necessary data, and creating the necessary data fields in its database to record and update the inventory. A complete and accurate inventory is necessary for DGS to: make decisions on whether to lease space from a third party or use District-owned space to meet agency needs; and track leases and tenants in District-owned buildings. For FY 2018, DGS has budgeted \$177.7 million, which is an increase of \$14.4 million over the FY 2017 budget, to rent non-District buildings. Having an accurate and complete inventory of District-owned buildings would better inform DGS officials and could substantially reduce the amount of money the District pays in rent, resulting in better use of the District's real property.

To improve performance in this area, we recommend that the DGS Director establish policies and procedures for maintaining the inventory of real property assets and modify the centralized database to include required data fields.

DGS Did Not Submit to the D.C. Council Annual Reports of Changes in Real Property Assets Inventory

Although D.C. Code § 10-551.05(e) states that the DGS "Director shall submit to the Council an annual report indicating the changes in inventory no later than 30 days after the beginning of the fiscal year," we found that DGS officials were unaware of the annual report requirements and,

⁶ For the real property assets that did contain the current assessed value, the book value was listed as of December 1, 2010.

therefore, did not submit the reports. DGS was unable to provide us copies of annual reports for FYs 2012 through 2015. Instead, DGS provided us with a Master Property List for FYs 2013 and 2014, which is a list of properties from DGS' database that it provided to the Council as part of DGS' annual oversight hearing. This list does not indicate changes in inventory as required by law.

As a result, the Council was not fully informed about changes in the District's real property assets, and its ability to provide performance and budget oversight of DGS was minimized. This information would be helpful to the Council, especially during the budget season, as DGS' FY 2018 budget for renting non-District owned buildings increased \$14 million over the FY 2017 budget.

To improve performance in this area, we recommend that the DGS Director prepare and submit annual reports of changes in real property assets to the Council as required by law.

MANAGEMENT OF LEASING PROCESSES NEEDS IMPROVEMENT

DGS lacked mechanisms to ensure its leasing strategies yielded maximum benefits for the District and the best use of District resources. We found DGS did not always: seek competitive bids for leases and contracted lease services; have complete documentation for all lease transactions; establish controls over rent collection; and properly administer and monitor the broker's contract.

DGS Did Not Always Seek Competitive Bids for Leases and Contracted Lease Services, and Monitor the Broker's Contract.

DGS did not competitively bid 2 of 26⁷ executed leases with a dollar value of \$18 million, but instead sole sourced the leases without documenting justification for those decisions. DGS did not competitively bid the leases for two District agencies in accordance with its practice⁸ to issue a request for space on its website to ensure competition. According to DGS staff, one of the two leases was unsolicited and negotiated with the landlord by a former senior DGS official. The file for the first lease did not contain a justification to support the award decision or any comparative financial and market analysis to justify that the lease was in the best interest of the District. DGS executed the second lease without documenting its decision for non-competitive negotiation.

DGS did not competitively bid the subsequent renewal of the broker's contract, which expired in August 2015, for tenant representation services as required by law. D.C. Code § 10-551.07(b) states that "[e]ach contract for the services of a representative shall be awarded on a competitive basis to a qualified real estate professional in accordance with applicable procurement regulations." We found that DGS entered into a Purchase Order Agreement (PO) with the broker

⁷ We sampled a total of 33 lease files where the District was the tenant, but DGS only provided supporting documentation for 26 of the leases. See additional discussions of the sample we reviewed under the finding *DGS Did Not Have Complete Documentation for All Lease Transactions*.

⁸ DGS' leasing process was verbally described to us by the Management of the Portfolio Division. DGS also provided a 2009 flowchart as evidence of its leasing process, but it is outdated because it does not reflect current leasing practices.

for 1 year. The broker's contract expired in August 2015 and DGS continued to use its services without an underlying contract until February 2016, which was when DGS issued a new agreement to the same broker without seeking competition.

DGS did not always competitively bid leases and contracted lease services for several reasons:

- DGS' current leasing practices are not memorialized, and the agency has yet to establish policies and procedures for competitively bidding contracted lease services.
- DGS did not provide relevant training to its portfolio management staff responsible for locating and negotiating leases. Although the introductory section to DGS' Portfolio Division *Operational Policies & Procedures* FY 2016 manual mentions ongoing training for the management of DGS real estate, it does not address training requirements for the portfolio management staff. We reviewed the General Services Administration (GSA) training requirements and standards as a benchmark for DGS and noted that GSA has a leasing certification program with various training levels that its staff must meet. The training courses include contract negotiation techniques, market research, cost and price analysis, and real estate appraisal principles.

As a result, DGS cannot be assured that the District is getting the best price for leases and contracted lease services. Further, competitive solicitation and bidding requirements help ensure the District does not overpay for leases and related services, while allowing businesses to compete for District government business fairly. The risk of potential fraud, waste, and abuse by vendors and District personnel increases when vendors are selected without adhering to competitive solicitation or bidding requirements.

To improve performance in this area, we recommend that the DGS Director:

- Update policies and procedures to emphasize the requirement to competitively source all leases.
- Develop policies that include procedures to competitively bid contracted lease services; and requirements to provide relevant training to portfolio management staff.
- Report potential Anti-Deficiency Act violations to the Board of Review for Anti-Deficiency Violations.⁹
- Consult with the Office of Contracts and Procurement to determine if the leasing contracts executed without a valid PO between August 2015 and February 2016 require ratification.

⁹ The Board of Review for Anti-Deficiency Violations is an independent agency within the District of Columbia government to advise and make recommendations on anti-deficiency law violations.

DGS Did Not Have Complete Documentation for All Lease Transactions

Title 1 of the District of Columbia Municipal Regulations § 1502.1 states: “Agency heads shall establish controls over the creation of records to ensure that adequate and proper records are made and preserved in the District government.” We found that DGS did not document decisions and analysis to support all lease transactions, and did not maintain complete files for all leases. DGS was unable to provide us complete documentation for:

- 8 of 22 (36.4 percent) leases requested for review where the District was the landlord. The 8 files contained only executed leases, but the remaining 14 contained executed leases and other documentation to support the lease transaction.
- 16 of 33 (48.5 percent) leases requested for review where the District was the tenant. Nine of the 16 files contained some documentation, but not for key decisions or rationale to support the final selection of the awardees. The remaining seven files contained only executed leases.

DGS has yet to establish procedures on what type of documentation realty specialists should maintain for each lease. As a result, DGS lacks appropriate supporting documentation to demonstrate that all leases were executed in the best interest of the District, and that adequate controls exist to detect and address irregularities in the District’s lease transactions.

To improve performance in this area, we recommend that the DGS Director establish policies and procedures specifying the lease file documents leasing specialists must maintain in support of the decision/rationale for each real estate transaction, and ensure ongoing reviews of lease file documents for compliance with established control guidelines.

DGS Did Not Establish Adequate Policies and Procedures Governing Rent Collections from District Tenants

DGS did not establish policies and procedures governing the rent collection process to include monitoring lease agreements; coordinating between the Portfolio Management Division and Finance Department to verify collected rents against a list of all existing leases; and ensuring all rent due to the District was collected. As a result, DGS did not collect at least \$4.85 million in rent from tenants identified in our sample.

DGS did not collect rent in accordance with D.C. Code § 10-551.02(3)(D), which requires DGS to coordinate “[r]ent collection from entities leasing District-owned or leased properties.” We reviewed 14 lease files where the District was the landlord to assess whether DGS monitored and provided effective lease administration, including rent collection. We found that DGS did not collect approximately \$1.9 million in rent from two charter schools as required by the terms of the lease agreements, and another \$2.95 million in potential uncollected rent from other tenants (\$4.85 million in total). Although the lease agreement for one of the schools required DGS to

start collecting rent in November 2015, more than a year has passed without a rent abatement¹⁰ request and DGS still has not collected rent or otherwise enforced the terms of the lease agreement. Additionally, the lease agreement for the other school required DGS to start collecting rent in June 2016, but the tenant did not submit a request for a rent abatement credit until October 21, 2016. Approximately 4 months passed between the rent-collection start date and the request for rent abatement credit, and DGS had not collected rent or otherwise enforced the terms of the lease agreement.

In addition to the 14 lease files, we reviewed DGS' rent receivable schedule as of September 30, 2016, and noted several additional tenant accounts with a combined \$2.95 million in potential uncollected rent. Subsequent to our audit fieldwork, DGS officials informed us that they performed a reconciliation of the rent receivable schedule and found that approximately \$1.93 million of the \$2.95 million was either received or recorded in error and should have been removed from the rent receivable schedule. According to DGS officials, the total amount of unpaid rent due to the District for these properties is approximately \$1.02 million as of June 2017. DGS officials provided several explanations for the decrease in unpaid rent: 1) payment was received; 2) the tenant vacated the space and does not owe rent; 3) the lease was terminated; or 4) payment was erroneously recorded. Nonetheless, DGS officials have not provided adequate documentation to validate that the \$1.93 million in payments were actually received, erroneously recorded, or that leases were terminated.

To improve performance in this area, we recommend that the DGS Director establish rent collection policies and procedures that specify how to maintain a complete inventory of District-owned properties, monitor lease agreements, and collect rent, including procedures to alert leasing personnel when rent payments begin.

The Broker's Contract Was Not Properly Administered

DGS did not properly administer the broker's contract. DGS issued two contractual documents to the broker with conflicting terms and commission rates; did not establish a process for determining what deals are assigned to the broker; and did not structure the broker's commission to align with the rentable square footage consistent with GSA best practices.

We found that DGS executed a PO agreement with the broker that established a 2 percent rate for the broker's commission and the District's rebate, respectively. Subsequently, DGS amended the PO agreement, which increased the broker's commission to 2.75 percent and issued task orders with terms that were not consistent with the PO agreement. The task orders adopted the 2 percent commission rate for both the broker and District rebate from the original PO and also stated that the order of "precedence [is]: (1) This Task Order; (2) Purchase Order Agreement dated August 14, 2014, as amended; and (3) Standard Contract Provisions for use with District of Columbia Government Supplies and Services Contracts dated March 2007." Had DGS used the rebate rate on the task order, the District would have received approximately \$2.22 million in

¹⁰ The District's leasing agreement with charter schools requires the tenant to incur at least \$10 million in capital alterations (renovation and improvements) and allows the tenant to recover the construction cost within a specified period through rent abatement.

rebates. Instead, the District used the original PO rate, and received \$1.32 million in rebates from 7 lease transactions.¹¹

DGS management informed us that the PO agreement dated August 14, 2014, was the controlling document for payment of commission and determining rebate amounts to the District. DGS also told us that the task orders with terms contradictory to the PO agreement were issued in error by its Portfolio Division program managers who did not have delegated contracting authority. Nonetheless, we also discovered an uncollected rebate of \$633,709, held by the broker, from a lease executed in 2015. Until DGS collects the \$633,709 from the broker, the rebate cannot benefit District taxpayers.

Furthermore, DGS told us that the reason for amending the PO to increase the broker's commission from 2 percent to 2.75 percent in 2014 and 3 percent in 2016 was to compensate for additional lease administration and auditing services. Based on our review, the broker received 0.75 percent (later increased to 1 percent in PO amendment #6, dated April 13, 2016,) for each lease executed to provide lease administration and auditing services. For example, in a lease transaction where the broker earned \$2 million in commission, over \$500 thousand of that amount would represent the fee for providing lease administration and auditing services. During our fieldwork, the broker informed us that it has yet to provide any auditing services under the agreement. In effect, this arrangement has further reduced the amount of money rebated to the District and increased the amount paid to the broker, all without significant benefit to the District.

D.C. Code § 10-551.07 (d) allows DGS to pay for the services of a representative "either as a percentage of the total contract value or a fixed dollar amount." It is our opinion that contracting and paying for lease administration and auditing services as a percentage of the total lease value is unfavorable to the District because DGS prepays for these services but the broker has no legal requirement to provide them beyond expiration of the 1-year contract.

We also found that DGS did not establish a process for determining what lease deals are assigned to the broker and which could be done by in-house staff. Based on our review of leases where the District was the tenant, we found that DGS used the broker instead of in-house staff to negotiate lease renewals and restructures. Lease restructuring occurs when the terms of the lease are renegotiated and the agency remains in the same building. Tenants usually restructure leases for the following reasons: lower the rent on the space occupied; reduce or increase the amount of space occupied; extend the lease terms to more favorable conditions; and induce the landlord to make additional improvements. For example, in January 2017, the broker restructured an existing lease that was originally due to expire in February 2020 and extended the term to 2030. The annual rent amount increased from \$9.4 million to \$9.9 million even though the rentable square footage remained the same. The broker received a commission of \$3.2 million on this deal, which includes audit fees and lease administration services that the broker has no legal requirement to provide beyond expiration of the 1-year contract.

¹¹ As of November 2015, DGS had assigned 13 task orders with 22 potential leases to its broker, 7 of which had been completed as of July 2017.

In another example, DGS issued a task order to its broker on June 8, 2015, to restructure an existing lease¹² for two agencies (at 2100 Martin Luther King, Jr. Avenue, S.E.) that was due to expire in January 2020. The term of the lease would be extended by 18 months to reconstruct and renovate the property, followed by a 14-year term with the rentable square footage remaining the same. The cost per rentable square foot would increase from \$32.65 to \$46.95 per year and the annual rent amount would increase from approximately \$2.4 million to \$3.1 million,¹³ even though the rentable square footage remained the same. The broker would receive a total commission of approximately \$1.35 million on this deal. This is another lease restructure that we believe could have been done by DGS staff instead of the broker. We noted that the broker was assigned and engaged in ongoing lease renewal/restructure negotiations for three other District agencies; however, these negotiations had not been completed as of the end of our fieldwork.

We also found that DGS did not structure the broker's commission to align with the rentable square footage. For benchmarking purposes, we reviewed GSA's real estate broker services contract and commission structures and noted that the GSA commission schedule used a three-tiered rate structure based on the square footage, with commission percentage rates decreasing as building size increases. The DGS' agreement with the broker was not tied to square footage and DGS did not provide a rationale on how its commission rate was set. For example, the commission rate paid to the broker was 3 percent for one lease with 11,014 square feet compared to 3 percent commission for another lease with 199,822 square feet. Given that the same amount of work is required of the broker regardless of the size of the building, paying flat commissions based on the dollar value of the lease may not be in the best interest of the District. These conditions occurred because DGS did not provide adequate oversight of the Portfolio Management Division and did not establish guidelines for setting and structuring broker commissions. As a result, the District may be overpaying for tenant representation services.

To improve performance in this area, we recommend that the DGS Director:

- Coordinate between the Portfolio Management Division and the Finance Department to reconcile rent collected against the tenant listing and follow-up in a timely manner with tenants who miss rent payments.
- Separate lease administration and auditing services from future tenant representation contracts and award a separate contract with a fixed annual fee for these services.
- Establish guidelines for assigning lease tasks to the broker; consider limiting the use of broker services to new lease acquisitions; and use DGS in-house realty specialists to negotiate leases involving renewals and restructures.
- Establish a standard commission rate schedule for future broker contracts similar to the GSA model, which considers the project's rentable square footage in the compensation structure by decreasing the commission percentage as the project size range increases.

¹² As of the end of our fieldwork, negotiation to restructure this lease was ongoing. The Council approved the lease subsequent to the conclusion of our fieldwork, but prior to our issuing a draft report.

¹³ This will be the annual amount paid after the construction term.

- Collect and recoup all rebates due to the District, including \$633,709 in the broker's possession.
- Determine if DGS Portfolio Division program managers are accountable for making an unauthorized commitment to the broker on behalf of the District.

CONCLUSION

DGS has not established effective internal control mechanisms for maintaining inventory of real property assets and for ensuring that District real estate transactions are well managed. DGS has budgeted \$177.7 million to lease space in FY 2018, which is an increase of \$14.4 million over the approved FY 2017 budget. Without addressing internal control and management issues, such as inadequate information on current inventory, poor contracting practices, and multi-million dollar fees paid to vendors without adequate justification or documentation, DGS cannot ensure that its leasing processes and strategies yield intended benefits for the District. A continued lack of internal control will result in further waste if new processes are not developed, and millions of dollars in rent and rebates will continue to be uncollected.

LIST OF RECOMMENDATIONS

We recommend that the DGS Director:

1. Establish policies and procedures for maintaining inventory of real property assets and modify the centralized database to include required data fields.
2. Prepare and submit annual reports of changes in real property assets to the Council.
3. Update policies and procedures to emphasize the requirement to competitively source all leases.
4. Develop policies that include procedures to competitively bid contracted lease services; and requirements to provide relevant training to portfolio management staff.
5. Establish policies and procedures that specify the lease file documents leasing specialists must maintain in support of the decision/rationale for each real estate transaction.
6. Establish rent collection policies and procedures that specify how to maintain a complete inventory of District-owned properties, monitor lease agreements, and collect rent, including procedures to alert leasing personnel when rent payments begin.
7. Coordinate between the Portfolio Management Division and the Finance Department to reconcile rent collected against the tenant listing and follow-up in a timely manner with tenants who miss rent payments.

8. Consider separating the lease administration and auditing services from future tenant representation contracts and award a separate contract with a fixed annual fee for these services.
9. Establish guidelines for assigning lease tasks to the broker; consider limiting the use of broker services to new lease acquisitions; and use DGS in-house realty specialists to negotiate leases involving renewals and restructures.
10. Establish a standard commission rate schedule for future broker contracts similar to the GSA model, which considers the project's rentable square footage in the compensation structure by decreasing the commission percentage as the project size range increases.
11. Recoup all rebates due to the District, including \$633,709 in the broker's possession.
12. Report potential Anti-Deficiency Act violations to the Board of Review for Anti-Deficiency Violations.
13. Consult with the Office of Contracts and Procurement to determine if the leasing contracts executed without a valid PO between August 2015 and February 2016 require ratification.
14. Determine if DGS Portfolio Division program managers are accountable for making an unauthorized commitment to the broker on behalf of the District.

AGENCY RESPONSE AND OFFICE OF THE INSPECTOR GENERAL COMMENTS

We provided DGS our draft report on July 14, 2017, and received its response on August 2, 2017, which is included as Appendix C to this report. We appreciate that DGS officials began to address some of the findings immediately upon notification during the audit. DGS concurred with 8 of our 14 recommendations and outlined actions and target completion timeframes for recommendations 1, 2, 3, 5, 6, 7, 9, and 11. Therefore, we consider the actions taken or planned to be responsive and meet the intent of the recommendations, but open pending completion of planned actions or evidence of stated actions.

For recommendation 4, DGS indicated that it was allowed to procure brokerage services through a competitively sourced General Services Administration (GSA) schedule. However, the terms and conditions of the current DGS brokerage contract are significantly different from the terms on the GSA schedule. We consider this recommendation open and unresolved, and request that DGS reconsider its position on this and provide corrective actions within 30 days of the date of this final report.

Although DGS fully concurred with recommendation 6, it stated in its response that the "factual basis upon which this recommendation relies is incorrect and misleading. DGS reviewed the delinquent receivables list ... and eliminated the majority of delinquent items from the delinquent list." During the course of this audit, we provided the list to DGS officials and they

were apparently able to collect outstanding rent and reconcile most of the delinquent items, but did not provide supporting documentation. We believe these actions would not have occurred without this audit. As DGS indicated, its inaccurate inventory and rent-roll for District-owned assets, coupled with a lack of rent collection and lease administration policies and procedures, allowed the condition to occur. We consider this recommendation resolved but open pending completion of planned actions.

For recommendations 8 and 10, DGS stated in its response that it would evaluate and determine if these recommendations are in the District's best interest in FY2018. For recommendation 8, DGS stated in its response that it would need to evaluate the value of the services as part of the brokerage contract, as opposed to having a contract that would require additional dedicated funds. Considering DGS increased the broker's commission from 2 percent to 3 percent to provide both lease administration and audit services, but has yet to receive any audit services, the contractual separation of these services would ensure DGS is receiving an adequate level of contracted services. For recommendation 10, DGS stated it "does recognize the potential benefits and financial implications of varying commission rates based upon the particular project," but would need to evaluate whether this recommendation was in the best interest of the District and whether the recommendation reflects the best practice in the real estate industry. We consider these recommendations open and unresolved pending completion of DGS' evaluation and request that DGS provide us with a response no later than January 31, 2018.

For recommendation 12, DGS did not provide a response; therefore, we consider this recommendation to be open and unresolved pending a response from DGS. The Anti-deficiency Act prohibits agencies from making obligations or expending funds in advance or in excess of an appropriation, and from accepting voluntary services. Since DGS obligated the District government to pay for brokerage services without a valid contract, we recommended that DGS consult with the Board of Review for Anti-Deficiency Violations and determine if this is in fact a violation. We request that DGS review the recommendation and provide a response within 30 days of the date of this final report.

For recommendation 13, based on DGS' response, we consider recommendation 13 unresolved and open. We agree that DGS has authority to acquire real property for the District through purchase or lease, but question if DGS has the authority to acquire property and services without a ratified contract. We request that DGS reconsider the recommendation and provide a response within 30 days of the date of this final report. DGS did not concur with recommendation 14, but proposed actions are sufficient to meet the intent of our recommendation. Therefore, we consider this recommendation resolved and open pending evidence of stated actions.

We request that within 30 days of the date of this final report DGS reconsider and respond to recommendations 4, 12, and 13. For recommendations 8 and 10, we request that DGS provide us a response no later than January 31, 2018, with actions taken or target dates for completion of planned actions.

ACTIONS REQUIRED

We request that within 30 days of the date of this final report, DGS reconsider and respond to recommendations 4, 12 and 13. For recommendations 8 and 10, we request that DGS provide us a response after the first quarter of FY 2018, with actions taken or target dates for completion of planned actions.

APPENDIX A. OBJECTIVES, SCOPE, AND METHODOLOGY

We conducted our audit work from June 2016 through July 2017 in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit objectives were to review DGS' Portfolio Management Division to: (1) assess processes for maintaining real property assets inventory; and (2) determine whether the leasing strategies yield the intended benefits for the District.

To assess processes for maintaining real property assets inventory, we reviewed and assessed compliance with DGS' policies, procedures, and applicable District laws and regulations. We also interviewed DGS officials to gain an understanding of its processes for maintaining the inventory database for real property assets. Additionally, we interviewed contractors that DGS hired to provide property database consulting services. To verify the completeness of DGS' real property assets inventory, we obtained a property listing from OTR, electronically compared it to the listing that DGS maintained in its database, and cross-referenced the information with that held by the District's Recorder of Deeds where property titles are issued.

To determine whether leasing strategies yielded the intended benefits for the District, we interviewed officials from DGS and the OCFO, as well as the broker, to gain an understanding of their roles and responsibilities. We also reviewed lease files requested from the Portfolio Management Division for compliance with the leasing process by assessing whether DGS monitored leases both when the District is the tenant and landlord. However, we experienced significant delays in obtaining the requested lease files. We requested a total of 55 lease files both when the District is the tenant and landlord for review as of October 20, 2016. The Portfolio Management Division periodically provided us with lease files beginning November 8, 2016 through January 24, 2017 and granted us access to its database where its lease documentation is maintained. It took DGS over 2 months to provide us with the requested lease files and for 15¹⁴ out of the 55 files requested, DGS did not have complete documentation for the lease transactions. To verify commission rates and rebates, we reviewed PO agreements (the District's contract with the broker) and related amendments, as well as task orders that assigned projects to the broker and set the broker's commission rate and rebates due to the District.

Although we did not perform a formal reliability assessment of computer-processed data, we validated the data by reviewing supporting source documentation and interviewing knowledgeable agency officials about the data. We determined that the data obtained were sufficiently reliable for the purposes of this report.

¹⁴ See Report Section "DGS Did Not Have Complete Documentation for All Lease Transactions" for a breakdown of the 15 lease files.

APPENDIX A. OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit period covered fiscal years (FY) 2012 through 2015. We also reviewed leases and related transactions initially assigned to the broker in FY 2015 but not executed until FYs 2016 and 2017.

APPENDIX B. ACRONYMS AND ABBREVIATIONS

D.C.	District of Columbia
DGS	Department of General Services
FY	Fiscal Year
GAO	Government Accountability Office
GSA	General Services Administration
OCFO	Office of the Chief Financial Officer
OIG	Office of the Inspector General
OTR	Office of Tax and Revenue
PO	Purchase Order

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF GENERAL SERVICES



August 1, 2017

(VIA E-MAIL)

Daniel W. Lucas
Inspector General
Office of the Inspector General
717 14th Street, N.W.
Washington, D.C. 20005

Re: Response to Draft Report entitled *DGS: Management of the District's Real Property Assets and Leasing Processes Needs Significant Improvements, Which Could Lead to Significant Cost Savings* (OIG Project No. 16-1-12AM), dated July 14, 2017 (the "Report")

The Department of General Services (DGS) is in receipt of the above-referenced Report. Thank you for the opportunity to provide responses to the Report. We welcome the opportunity to constructively review these critical District functions and to implement initiatives to improve and enhance agency activities. DGS recognizes the need for improvement in its leasing processes and we are pleased to report that the agency had already identified several of the findings and recommendations in the Report as areas of improvement and DGS' efforts to address many issues discussed in the Report were well underway prior to receipt of the Report. DGS' specific responses to the recommendations are as follows:

Recommendation 1	Timeline
Establish policies and procedures for maintaining inventory of real property assets and modify the centralized database to include required data fields.	
<p>DGS Response:</p> <p>DGS agrees with this recommendation. DGS has initiated an agency-wide policy and procedure development initiative, which included procuring the services of a vendor to inventory all existing policies and procedures and to provide a needs assessment for each division, including the Portfolio Division. The agency has already identified as a priority policies and procedures for portfolio asset management activities and inventory. Additionally, DGS has procured and is currently working with a vendor to collect requisite information related to the real property inventory. Our</p>	<p>Underway and will be completed during FY 2018</p>

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APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

information technology team is working closely with the Portfolio team to improve the agency database of real property assets. These actions will ensure that all required fields are included in the database and will improve reporting capabilities. In addition to the above, DGS will also procure a vendor to inventory the District's antenna assets during FY2018.	
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Recommendation 2	Timeline
Prepare and submit annual reports of changes in real property assets to the Council.	
DGS Response: DGS agrees with this recommendation and will begin submitting the required report annually within 30 days of the close of each fiscal year.	Will commence during FY 2018

Recommendation 3	Timeline
Update policies and procedures to emphasize the requirement to competitively source all leases.	
DGS Response: DGS agrees with this recommendation to the extent that it calls for updated policies and procedures, but not to the extent that it calls for a blanket requirement to competitively source all leases. DGS has initiated an agency-wide policy and procedure development initiative, which included procuring the services of a vendor to inventory all existing policies and procedures and to provide a needs assessment for each division, including the Portfolio Division. The agency has already identified as a priority policies and procedures for portfolio leasing activities, including appropriate criteria for both competitive and non-competitive leases.	Underway and will be completed during FY 2018

Recommendation 4	Timeline
Develop policies and procedures that include procedures to competitively bid contracted lease services and requirements to provide relevant training to Portfolio Management staff.	

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

<p>DGS Response:</p> <p>DGS does not agree with this recommendation to the extent that it calls for new procedures to competitively bid contracted lease services. Extensive procurement policies and procedures currently exist to procure lease support services, such as brokerage services. Although the Report correctly provides that DGS is required by D.C. Official Code §10-551.07(b) to award such contracts on a competitive basis in accordance with applicable procurement regulations, the Report incorrectly fails to recognize that DGS awarded the second broker's contract from the GSA supply schedule pursuant to §2-354.10 which provides that the contracting officer may procure goods or services through a General Services Administration (GSA) schedule pursuant to <u>40 U.S.C. § 502(a)(3)</u> and <u>40 U.S.C. § 602(c)</u>. Therefore, the GSA has competitively selected and awarded the contract to the broker and the District, in accordance with applicable procurement regulations, has utilized the competitive contract awarded by the GSA.</p> <p>DGS agrees with this recommendation to the extent that it calls for additional training opportunities for Portfolio Division staff. Although there is no required mandatory training for Realty Specialists, as their roles are not subject to licensure, DGS has recently hired a training coordinator to develop training programs and opportunities for all DGS divisions, including Portfolio. Our Portfolio Division is developing a training plan that includes a focus on lease administration and financial analysis. Additionally, DGS has facilitated a number of internal and subject matter expert training sessions that highlight trends in the leasing industry. Lastly, all Portfolio staff have recently (July 2017) undergone training comparable to training offered to federal real estate professionals, including lease acquisition training and a federal real property lease refresher course.</p>	<p>Underway and ongoing.</p>
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Recommendation 5	Timeline
Establish policies and procedures that specify the lease file documents leasing specialists must maintain in support of the decision/rationale for each real estate transaction.	

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

<p>DGS Response:</p> <p>DGS agrees with this recommendation. DGS has initiated an agency-wide policy and procedure development initiative, which included procuring the services of a vendor to inventory all existing policies and procedures and to provide a needs assessment for each division, including the Portfolio Division. The agency has already identified as a priority policies and procedures for portfolio leasing activities, including appropriate record management and documentation of leasing decisions and activities.</p>	<p>Underway and will be completed during FY 2018</p>
<p>Recommendation 6</p> <p>Establish rent collection policies and procedures that specify how to maintain a complete inventory of District-owned properties, monitor lease agreements and collect rent, including procedures to alert leasing personnel when rent payments are due.</p>	<p>Timeline</p>
<p>DGS Response:</p> <p>DGS agrees with this recommendation. DGS has initiated an agency-wide policy and procedure development initiative, which included procuring the services of a vendor to inventory all existing policies and procedures and to provide a needs assessment for each division, including the Portfolio Division. The agency has already identified as a priority policies and procedures for portfolio leasing activities, including collection and lease administration activities.</p> <p>Additionally, DGS has recently procured the services of a vendor to assist in the development of a more accurate and complete inventory and rent-roll for all District-owned assets. This effort will provide the baseline information for improved rent collection and lease administration activities.</p> <p>Although DGS agrees with this recommendation and acknowledges the need for improvement in collection activities/financial reconciliation, the factual basis upon which this recommendation relies is incorrect and misleading. DGS reviewed the delinquent receivables list provided to DGS by the OIG and eliminated the majority of delinquent items from the delinquent list. DGS did offer to provide the OIG with documentation to support this reconciliation, but the OIG did not accept such offer. We remain prepared to offer information as needed to support this reconciliation.</p>	<p>Underway and will be completed during FY 2018</p>

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

Recommendation 7	Timeline
Coordinate between Portfolio Management Division and the Finance Department to reconcile rent collected against the tenant listing and follow-up in a timely manner with tenants who miss rent payments.	
<p>DGS Response:</p> <p>DGS agrees with this recommendation. DGS has recently procured the services of a vendor to assist in the development of a more accurate and complete inventory and rent-roll for all District-owned assets. This effort will provide the baseline information for improved rent collection, lease administration activities and reconciliation of delinquent receivables with the Office of the Chief Financial Officer (OCFO).</p> <p>Additionally, DGS is working collaboratively with the OCFO to establish appropriate systems and processes to ensure financial reconciliation between the two Departments, including updated tenant listings, information technology as needed to support these functions and appropriate follow-up to ensure tenant payment or other appropriate collection action.</p>	Underway and will be completed during FY 2018

Recommendation 8	Timeline
Consider separating the lease administrative and auditing services from future tenant representation contracts and award a separate contract with a fixed annual fee for these services.	
<p>DGS Response:</p> <p>DGS is evaluating this recommendation and will determine if this recommendation is in the District's best interest. The District's current broker has performed and continues to perform significant lease administration activities, including review and abstracting of all leases under which the District is a tenant, including key dates and rent escalation information, and database creation and management. DGS will need to evaluate the cost/benefit and value of including auditing services as part of the brokerage contract, as opposed to a stand-alone contract which would require additional dedicated funds.</p>	DGS will evaluate this recommendation during the first quarter of FY 2018

Recommendation 9	Timeline
Establish guidelines for assigning lease tasks to the broker; consider limiting the use of broker services to new lease acquisitions; and use	

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

DGS in-house realty specialists to negotiate leases involving renewals or restructures.	
<p>DGS Response:</p> <p>Although DGS agrees with the recommendation to establish guidelines and criteria for the assignment of tasks to the broker, the guidelines will include criteria based upon the individual needs and complexity of a particular transaction (as opposed to the static categories proposed within the Report). These guidelines will be established as part of the agency-wide policy/procedures development initiative.</p>	<p>Underway and will be completed during FY 2018</p>

<p>Recommendation 10</p> <p>Establish a standard commission rate schedule for future broker contracts similar to the GSA model, which considers the project's rentable square footage in the compensation structure by decreasing the commission percentage as the project size range increases.</p>	<p>Timeline</p>
<p>DGS Response:</p> <p>DGS agrees to consider: 1) whether this recommendation is in the best interest of the District and 2) whether this recommendation reflects the best practice in the real estate industry. DGS does recognize the potential benefits and financial implications of varying commission rates based upon the particular project.</p>	<p>DGS will evaluate this recommendation during the first quarter of FY 2018</p>

<p>Recommendation 11</p> <p>Recoup all rebates due to the District, including \$633,709 in the broker's commission.</p>	<p>Timeline</p>
<p>DGS Response:</p> <p>DGS agrees with this recommendation. DGS agrees that funds are being held by the broker in the approximate amount of \$633,000 (the "DDS Funds") in connection with a lease at 250 E Street SW. No rebate is due to the District in connection with any other lease. DGS has confirmed that the DDS Funds were collected by the broker in error because the Purchase Order Agreement in effect at the time of the lease execution did not provide for any share of the commission with the District. Therefore, DGS has instructed the</p>	<p>Underway and will be completed before the end of FY 2017</p>

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

broker to return the DDS Funds to the landlord as an abatement of rent or directly to the District for deposit into the General Fund.	
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Recommendation 12	Timeline
Report potential Ant-Deficiency Act violations to the Board of Review for Anti-Deficiency Violations.	
DGS Response:	
DGS requires further explanation regarding this recommendation and can neither agree nor disagree until the OIG provides additional clarification.	

Recommendation 13	Timeline
Consult with the Office of Contracting and Procurement to determine if the leasing contracts executed without a valid PO between August 2015 and February 2016 require ratification.	
DGS Response:	
DGS does not agree with this recommendation for the following reasons:	
<ol style="list-style-type: none"> 1. The Office of Contracting and Procurement does not have oversight or responsibility for lease agreements because lease agreements are not subject to the Procurement Practices Reform Act. 2. DGS has legal authority to acquire leasehold interests pursuant to 10-551.01(b)(2). DGS does not derive its authority to acquire real property interests from the brokerage contract. Therefore, the expiration of the brokerage contract would neither eliminate DGS' separate statutory authority to enter into leases nor invalidate those lease agreements. The only question is whether the broker has the authority to provide services upon the expiration of the brokerage contract. 3. The specific project Work Orders and the broker's entitlement to compensation, validly existing and issued under the contract with the broker, survive expiration of the broker contract because the broker has already earned the commission by finding the property and brokering the transaction. 	

APPENDIX C. DGS' RESPONSE TO THE DRAFT REPORT

<p>Therefore, the agency is comfortable the lease agreements executed between August 2015 and February 2016 do not require ratification.</p>	
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Recommendation 14	Timeline
<p>Determine if DGS Portfolio Division program managers are accountable for making an unauthorized commitment to the broker on behalf of the District.</p>	
<p>DGS Response:</p> <p>DGS does not agree with this recommendation. Although Work Orders issued by the DGS Portfolio Division may have in some instances been inconsistent with the underlying purchase order contract, the actual commission paid under the executed lease agreements was in all events equivalent to or less than the commission provided in the purchase order contract. In order to avoid such inconsistencies going forward, Task Orders and Work Orders shall be reviewed and executed by the Contracting Officer to confirm consistency with the underlying and controlling purchase order contract.</p>	

Again, DGS appreciates the opportunity to provide input and to identify opportunities for improvement. We also recognize that there is need for improvement to various aspects of the leasing process and we are committed to implementing efforts to address areas identified in the Report.

Sincerely,



Greer Johnson Gillis, P.E.
Director

Cc: [REDACTED] EOM
 [REDACTED] DGS
 [REDACTED] DGS
 [REDACTED] DGS
 [REDACTED] DGS