



**CITY OF COLORADO SPRINGS
OFFICE OF THE CITY AUDITOR**

**06-280-a JIMMY CAMP CREEK PROPERTY
PURCHASES**

AUGUST 11, 2006

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Office of the City Auditor

Date: August 11, 2006
To: Honorable Mayor and Members of City Council
Re: 06-280-a Jimmy Camp Creek Property Purchases

We have completed a review of property purchases made in conjunction with the proposed Jimmy Camp Creek Reservoir.

As background information, we began a performance audit of the City of Colorado Springs Real Estate Services operation in January 2006. This audit was on the 2006 Audit Plan submitted to you in November 2005. In July 2006, local media began publishing reports on property transactions involving the future Jimmy Camp Creek Reservoir. Because of the public interest, I elected to issue this report on the above mentioned property transactions in advance of the performance audit of Real Estate Services, which is expected to be released in September.

The purpose of this audit was to evaluate whether property purchases designated to be used for the Jimmy Camp Creek Reservoir, a component of the Southern Delivery System, were executed in accordance with established City procedures and in an efficient, effective and economical manner. We also evaluated whether reliable information was being maintained. The audit included a review and evaluation of procedures, practices and controls related to property purchases for the Jimmy Camp Creek project.

As always, please let me know if you have any questions.

Sincerely,

A handwritten signature in purple ink that reads "Jeff Litchfield".

Jeff Litchfield
City Auditor

Cc: Jerry Forte, Utilities Executive Director
Edward Easterlin, Chief Planning & Finance Officer
Jeanne Brown, Utilities Continuous Improvement Manager
Sandi Yukman, Integrated Resources Division Officer
John Fredell, Deputy City Attorney, Utilities
Lorne Kramer, City Manager
Ron Cousar, Director, Internal Support Services
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Introduction

AUTHORIZATION

We performed an audit of property purchases designated to be used for the Jimmy Camp Creek Reservoir, a component of the Southern Delivery System. We conducted this audit under the authority of Chapter 1, Article 2, Part 7 of the Colorado Springs City Code, and more specifically parts 703, 705 and 706, which state:

1.2.703: ENSURE PUBLIC ACCOUNTABILITY:

The City Auditor shall ensure that administrative officials are held publicly accountable for their use of public funds and the other resources at their disposal. The City Auditor shall investigate whether or not laws are being administered in the public interest, determine if there have been abuses of discretion, arbitrary actions or errors of judgment, and shall encourage diligence on the part of administrative officials. (1968 Code §1-10.3; Ord. 76-54; 1980 Code; Ord. 01-42)

1.2.705: DETERMINE EFFECTIVENESS AND EFFICIENCY OF PROGRAMS:

The City Auditor shall determine the extent to which legislative policies are being efficiently and effectively implemented by administrative officials. The City Auditor shall determine whether City programs are achieving desired objectives. The City Auditor shall review the administrative control systems established by the enterprises, department or group managers and by the City Manager, Utilities Executive Director and Memorial Hospital Executive Director and determine whether these control systems are adequate and effective in accomplishing their objectives. (1968 Code §1-10.3; Ord. 76-54; Ord. 01-42)

1.2.706: EXAMINE BOOKS, RECORDS:

The City Auditor shall examine and inspect all books, records, files, papers, documents and information stored on computer records or in other files or records relating to all financial affairs of every office, department, group, enterprise, political subdivision and organization which receives funds from the City or under the direct or indirect control of the City Council. The Auditor may require any person to appear at any time upon proper notice and to produce any accounts, books, records, files and other papers pertaining to the receipt or expenditure of City funds, whether general or special. If that person fails to produce the papers, then the Auditor may request Council approval to search for and take any book, paper or record in the custody of that person or public official. (1968 Code §1-10.3; Ord. 76-54; Ord. 01-42)

ORGANIZATION PLACEMENT

The City Auditor's Office of the City of Colorado Springs is structured in a manner to provide organizational independence from the entities it audits. This is accomplished by the City Auditor being appointed by and reporting directly to the City Council. The audited entities in this audit were the City of Colorado Springs Real Estate Services, which is under the direction of the City Manager, and Colorado Springs Utilities (Utilities), under the direction of their Chief Executive Officer. Both the City Manager and the Chief Executive Officer are City Council Appointees.

Introduction

SCOPE AND METHODOLOGY

We conducted our audit in a manner that meets or exceeds the Standards for the Professional Practice of Internal Auditing, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. Our audit included such tests of records and other supporting documentation as we deemed necessary in the circumstances. We reviewed the internal control structure and compliance tests were performed. Sufficient competent evidential matter was gathered to support our conclusions.

The purpose of this audit was to evaluate whether property purchases designated to be used for the Jimmy Camp Creek Reservoir, a component of the Southern Delivery System, were executed in accordance with established City procedures and in an efficient, effective and economical manner. We also evaluated whether reliable information was being maintained. The audit included a review and evaluation of procedures, practices and controls related to property purchases for the Jimmy Camp Creek project. Our fieldwork covered the period ending July 20, 2006.

BACKGROUND

The Southern Delivery System is a water project designed to bring water owned by the City of Colorado Springs and other local entities from Pueblo Reservoir to the Pikes Peak Region. The Jimmy Camp Creek Reservoir is planned to be located east of U.S. Highway 24 and north of Colorado State Highway 94 in El Paso County. It is envisioned as a 30,500 acre feet reservoir used as localized storage in the Southern Delivery System. Beginning in February 2003 and ending in January 2005, the City purchased 14 properties that are designated to be used for the Jimmy Camp Creek Reservoir.

In January 2006, we began a performance audit of the City of Colorado Springs Real Estate Services. Real Estate Services provides services to Colorado Springs Utilities. In May 2006, a newly formed section of the City Auditor's Office, the Construction Monitoring section, began reviewing activity associated with the Southern Delivery System, of which Jimmy Camp Creek Reservoir is an integral component.

In July 2006, local media began publishing reports on property transactions involving the future Jimmy Camp Creek Reservoir. Because of the public interest, the City Auditor elected to issue this report on the above mentioned property transactions in advance of the performance audit of Real Estate Services, which is expected to be released in September.

Introduction

THE PROPERTIES

The properties that were reviewed for this audit report are as follows:

Parcel ID*	Number of Acres	House or Other Structures	Price Paid for Base Property	Relocation, Investment or Replacement Cost Paid	Total Paid	Appraised	Ratio
53-037	40	No	\$150,000	\$0	\$150,000	\$130,000	1.15
53-124	40	Yes	380,000	340,000	720,000	400,000	1.80
53-127	10	Yes	255,000	65,000	320,000	255,000	1.25
53-133	10	No	100,000	20,000	120,000	90,000	1.33
53-141	40	Yes	550,000	340,000	890,000	525,000	1.70
53-169	25	Yes	485,000	300,000	785,000	# 405,000	1.94
53-170	40	Yes	500,000	340,000	840,000	500,000	1.68
53-171	35	Yes	550,000	297,500	847,500	# 475,000	1.78
53-178	10	No	140,000	0	140,000	105,000	1.33
53-200	5	Yes	200,000	0	200,000	185,000	1.08
53-315	40	No	140,000	0	140,000	130,000	1.08
53-322	40	Yes	210,000	130,000	340,000	210,000	1.62
53-349	25	Yes	450,000	320,000	770,000	450,000	1.71
54-045	40	No	152,000	0	152,000	130,000	1.17
Totals			4,262,000	2,152,500	6,414,500	3,990,00	1.61

* Auditor truncated the middle five 0's of the Parcel ID, i.e. 53-037 is actually 5300000037.

Auditor adjusted appraisal since amount of acreage was less than acreage appraised.

The above table displays base prices paid plus amounts identified as Relocation, Investment Appreciation or Replacement Costs. It does not include other incidentals, which totaled \$11,397 for all 14 properties. The total paid is then compared to the appraised value to arrive at a ratio of total paid vs appraised value.

Introduction

OVERALL CONCLUSIONS

We conclude the property purchases by Utilities for the future Jimmy Camp Creek Reservoir were not executed in an efficient, effective and economical manner. The factors contributing to this conclusion are:

- the procedures established to provide internal controls over the acquisition of property were incomplete, ambiguous and often in conflict with each other,
- the haphazard manner in which the purchases were made resulted in payments far exceeding normal market values,
- the newly acquired assets were leased back to the sellers at below market rates, and
- if the Reservoir is not built, Utilities would probably not be able to recoup their investment in the properties.

FUTURE AUDITS

As mentioned earlier, we expect to release a performance audit report on the City's Real Estate Services in September. Additionally, one of the primary purposes of the Construction Monitoring section of our office is the continuous monitoring of projects such as the Southern Delivery System so periodic reports on that project will be released over the life of the project.

For the findings that follow, we have made no determination as to which findings are more important than others. Therefore, the findings are not listed in order of importance.

Findings, Recommendations and Responses

POLICY RELATED CONCERNS:

1. The Handbook for Acquisition of Real Property needed to be updated and strengthened.

Preface - In January 2006, we began a performance audit of the City of Colorado Springs Real Estate Services. Real Estate Services provides services to Colorado Springs Utilities. Real Estate Services is aware of the substance of the items mentioned in this finding and have taken steps to improve the real estate acquisition process. Our audit report on Real Estate Services should be released in September. However, because of its impact on the Jimmy Camp Creek property purchases, we are providing an overview of our concerns with the Handbook governing property purchases with this audit. This overview is divided into several areas.

Applicability of the Handbook

The City Council, through their *Rules and Procedures of City Council*, had recognized the need to follow specific steps when purchasing property. In Part 6 of that document, they adopted the Handbook for Land Acquisition (the Handbook, also referred to as the Handbook for the Acquisition of Real Property) and also indicated that matters involving Utilities' land acquisitions are subject to Utility Board policies or by-laws.

In our review of the Handbook and its use, we found several references to its use as a "guideline."

Colorado Springs Utilities, through its Utilities Administrative Regulations, had stated the real property acquisition process shall follow the provisions of the "Handbook." The Utilities Administrative Regulations also stated "the policies and requirements of this Handbook are intended only as general guidelines for the internal use of the Real Estate Services Office."

The theme of using the Handbook as a guideline is further emphasized in the Handbook itself, where in section 1-4 we find the following:

The policies and requirements of this Handbook are **general guidelines**. As used in the Handbook, the terms "may" and "should" denote **optional and advisory provisions**. For the purposes of determining whether negotiations have been conducted in good faith in the event of court action, it shall be necessary only to show **substantial compliance** with the procedures set forth in this Handbook. (emphasis added)

The first two sentences hinder our ability to determine compliance with the Handbook for any deviation would fall under the "**guidelines**" and "**optional and advisory provisions**." However, the third sentence, by containing the words "**substantial compliance**," does provide an indication that the essence of the Handbook should be followed.

Additionally, in reviewing the contents of the Handbook, we interpret it to read that property appraisals are only necessary for purchases made through a "Taking" (eminent domain) and are optional for all other purchases.

The use of the Handbook for Real Estate Acquisitions should be strengthened by defining which areas are absolutes and which are optional.

Findings, Recommendations and Responses

Ambiguity and/or Internal Conflicts within the Handbook

In our review, we found several areas where the Handbook was unclear on items we felt should be very specific. An example of an ambiguity and/or an internal conflict within the document is as follows.

The Handbook contains the following wording in Chapter 3 – Determining Fair Market Value:

- 3.8 ESTABLISHMENT OF JUST COMPENSATION
- a. The Real Estate Services Manager shall certify documentation which:
 1. Establishes just compensation (fair market value) for each property.
 2. Identifies each property by name of owner, parcel number, or other identification.
 3. Describes and delimits the property and the interest to be acquired therein.
 4. Certifies that the establishment of fair market value with respect to each property has been performed in a competent manner.
 - b. In cases where fair market value is determined to be \$100,000 or more, just compensation shall be established by the City Council.
 - c. In cases where fair market value is determined to be less than \$100,000, just compensation shall be established by the Real Estate Manager, in coordination with the requesting department.

In reading this section, it leaves us with the impression the City Council should be involved in cases where the fair market value is greater than \$100,000. However, in the definition section of the Handbook, we find the following:

Just Compensation – The amount established by City Council or by the Real Estate Services Office in cooperation with the requesting department, to justly compensate the owner considering fair market value of the property. (City Council establishes just compensation for properties to be taken with a fair market value over \$100,000. The Real Estate Services Office in cooperation with the requesting department establishes just compensation for properties to be taken with a fair market value under \$100,000.)

In reading the definition of Just Compensation, we find a reference in parentheses that indicates Council is only involved for properties “to be taken” with a value greater than \$100,000. Property to be “taken,” while not defined in the Handbook, is generally believed to mean property obtained through an eminent domain proceeding.

The Handbook should be clearer concerning when City Council would be involved in establishing or affirming fair market values.

Findings, Recommendations and Responses

Documentation Retention needs to be clarified in the Handbook

Chapter 6 of the Handbook covers Documents to be retained in the parcel files. It reads:

6-1. MAINTENANCE OF RECORDS.

The Real Estate Services Manager shall maintain all records, reports, ordinances and resolutions concerning the City's OR UTILITIES' land acquisition activities after the project is completed. A record in summary form shall be kept showing major actions and items of information on each parcel as follows:

- a. Date of notice of intent to acquire.
- b. Appraisal report value and applicable dates.
- c. Amount approved as just compensation and date of approval.
- d. Date of initiation of negotiations.
- e. Date of final acceptance of offer.
- f. Date the condemnation proceeding was authorized by City Council.
- g. Date that condemnation proceeding was instituted.
- h. Date that title vests in City or Utilities.
- i. Acquisition price, if by purchase or stipulation.
- j. Acquisition price, if by court award after trial of the issue of value.

During our review, we were interested in reviewing items such as the Records of Negotiations as described in section 4-27 of the Handbook, but found that the Records of Negotiations were not available since they were not required to be kept.

Items such as documentation of negotiations are important and should be maintained in the acquisition file.

Incomplete areas of the Handbook

We found the Handbook does not address Relocation Expenses.

Relocation Expenses are usually associated with property acquisitions and, therefore, should be addressed in the Handbook.

Auditor's Recommendation:

We recommend the Handbook be updated for these and any other deficiencies. We recognize staff is currently embarked on a project to achieve this recommendation and our audit report on the performance of Real Estate Services will provide additional recommendations.

Findings, Recommendations and Responses

City Response:

Real Estate Services (RES) in conjunction with the City Attorney's office is currently working on a complete revision and rewrite of the Handbook for the Acquisition of Real Property ("Handbook"). RES and City Attorney's Office have been working on necessary comprehensive revisions to the Handbook since early 2006. The project is to be completed in the third quarter of 2007. RES acknowledges that the Handbook is vague, outdated, and incomplete. The outline for the revised Handbook is extensive; the following are some of the areas that are being addressed:

- Relocation
- Acquisition
 - fair market value
 - just compensation
 - arms length transactions
 - eminent domain
 - possession and use agreements
 - federally-funded projects
 - donations
 - required City Council action
 - Environmental Audits
- Swaps/Land Exchanges
- Disposition (property surplus)
 - required City Council action
 - Deed Disclaimers
- Appraisers/Appraisals
- Property Leases
- Easement Vacations
- Easement Encroachments
- Revocable Licenses/Leases
- Dedication/Acceptance by Plat
- Intra-City property transfers
- Appeal Process
- File maintenance and archiving
- Real property interest inventory system
- Definitions

The verbiage in the Handbook will be revised to eliminate vague terms such as "guidelines" "may" and "should" when not applicable. The revised Handbook will clearly address actions which may be optional and actions which should be definite.

The major areas of concern, relocation, acquisition, and disposal will be addressed this year. RES and the City Attorney's office estimate that the revised Handbook will be completed in 2007.

Findings, Recommendations and Responses

Colorado Springs Utilities Response:

Colorado Springs Utilities agrees that Real Estate Services' Handbook is inadequate and should be rewritten to eliminate deficiencies. We have recently been informed by Real Estate Services that it is working with the City Attorney's Office on a comprehensive revision of the Handbook. Colorado Springs Utilities agrees that the Auditor's recommendations and other improvements identified during the revision effort must be appropriately addressed. We would appreciate the opportunity to work together with Real Estate Services and the City Attorney's Office on this important project.

Findings, Recommendations and Responses

2. Utilities did not follow established guidelines for Relocation Expenses.

Colorado Springs Utilities Board Policy EL-4 – Asset Protection - contains the following:

The Chief Executive Officer shall not allow corporate assets, tangible and intangible, to be unprotected, inadequately maintained, or unnecessarily risked. Accordingly, the CEO shall not: ... Operate without written land acquisition regulations, assuring legal and fiscal compliance, that address fair and consistent appraisal and negotiation practices, and compliance with applicable relocation benefit requirements.

We found where Utilities had adopted a Colorado Springs Utilities Administrative Regulation requiring use of the Handbook for the Acquisition of Real Property developed by the City's Real Estate Services to guide all land acquisitions. However, we could not find where they had adopted any relocation benefit requirements. In the absence of any specific relocation benefit requirements, we understand the City Code applies to relocation efforts of Springs Utilities.

The City Code for the City of Colorado Springs contains guidance on how to compensate persons displaced by a City project. The follow is an excerpt from the Code.

Chapter 6 – Neighborhood Vitality/Community Health
Article 13 – Relocation Policy and Program
Part 2 – City Program or Project
Section 204 – Expenses for Displaced Persons and Displaced Businesses:

- A. Moving And Related Expenses: When displacing any displaced person or displaced business or tenants from real property due to acquisition of that property for public purpose or use, the City shall make fair and reasonable relocation payments to those persons for:
1. Actual reasonable expenses incurred in moving the household, business, farm operation or other personal property;
 2. Any actual direct personal property loss caused by being displaced;
 3. Actual expenses involved in searching for a replacement relocation; or
 4. A fixed settlement in lieu of subsections A1, A2, and A3 of this section, determined according to a schedule pre-established by the City, which shall not exceed that amount established in the City relocation policy for residential units, and for displaced businesses, a payment equal to the average annual net earnings of the business for the two (2) years prior to displacement, but not to exceed that amount established in the City relocation policy. If, however, the business has not been in operation for a full two (2) years prior to displacement, then the average annual net earnings will be projected by the City based upon the amount of actual earnings of the business. (Ord. 85-240; Ord. 01-42)

In our review of transactions, we found instances where relocation expenses were based on an inflated value for the purchase of raw land.

Findings, Recommendations and Responses

Auditor's Recommendation:

We recommend Utilities follow the Relocation Policy and Program as found in the City Code. We also recommend that Real Estate Services assist the Council in establishing a schedule for allowable relocation expenditures and a maximum amount which can be paid to displaced home owners.

City Response:

The revised Handbook will address relocation expenses and the process of determining what is to be included in the payments. The City Code:

6.13.107

A. Persons or businesses displaced from real property as a result of a City funded program or project shall be entitled to relocation assistance which complies with the provisions of the Uniform Relocation and Assistance Policies, 42 USC section 4261 et seq.

The revised Handbook will require that all relocation assistance comply with Federal Regulations. The Handbook will also set clear guidelines as to how the City is to comply with the Federal Regulations, allowable relocation expenditures and maximum amounts to be paid.

Colorado Springs Utilities Response:

Colorado Springs Utilities will ensure that all applicable provisions of the Relocation Policy and Program contained in Article 13 of Chapter 6 of the City Code (Current Relocation Policy) are followed for its real property acquisitions until such time as another relocation policy is formally adopted. Colorado Springs Utilities believes that the Current Relocation Policy is confusing and should be revised. Colorado Springs Utilities would appreciate the opportunity to assist Real Estate Services to develop those revisions.

Findings, Recommendations and Responses

PROPERTY RELATED CONCERNS:

3. Acquisition price was not adjusted for properties where Utilities did not purchase the entire tract.

Section 4-24 d. – Reservation of Rights in Owner - of the Handbook states:

The Real Estate Services Manager, with concurrence of the requesting department, may permit an owner to reserve an interest or right, including the right to remove fixtures, buildings or other improvements, **provided the acquisition price is adjusted accordingly**. Such action is to be coordinated with relocation provisions to avoid duplicate compensation. (emphasis added)

We found two properties where the appraised amount included more property than Utilities purchased yet the price paid did not appear to be adjusted for the property retained by the owner. Specifically:

- a. Parcel 5300000169 was appraised at \$435,000. The appraisal included 40 acres of land and a 4,000 sq ft residence. The actual purchase by Utilities was for 25 acres and the residence, for which Utilities paid \$485,000. The owner was allowed to keep the residence and move it to the 15 acres he retained. Additionally, Utilities paid \$300,000 in relocation costs to the Owner.
- b. Parcel 5300000171 was appraised at \$500,000. The appraisal included 45 acres of land and a 3,920 sq ft residence. The actual purchase by Utilities was for 35 acres of land and the residence, for which Utilities paid \$550,000. Additionally, Utilities paid \$297,500, which was noted in the file as “replacement land costs.”

We conclude the appraisals were not adjusted for the amount of property the owners retained and in the case of Parcel 5300000169; Utilities paid the owner for the residence and then paid them an additional \$300,000 for them to move it.

Auditor’s Recommendation:

We recommend all future real estate purchases include documentation of how the acquisition price was determined. Real Estate Services should abide by the policy of adjusting the acquisition price when an owner is allowed to reserve an interest or right.

City Response:

A new standard operating procedure (SOP) entitled “Records Maintenance 14.1” is now in place and being followed by all RES staff. The SOP lists what documents are to be kept in the file when it is closed and archived. Documents that show how an acquisition price was determined are among those required to be kept in the file.

In the future RES will abide by the Handbook policy 4-24 (d) which requires that an acquisition price be adjusted when an interest or right is reserved by an owner.

Findings, Recommendations and Responses

Colorado Springs Utilities Response:

Colorado Springs Utilities agrees with both recommendations and will ensure that future Utilities' real estate purchases will comply with them.

Findings, Recommendations and Responses

4. A reimbursement to a property owner for a second appraisal exceeded the amount defined in the Handbook.

Section 3-1 a. of the Fair market Value section of the Handbook states:

A formal independent appraisal by a qualified appraiser in private practice shall be required for takings where the fair market value is estimated by the Real Estate Services Manager to exceed \$5,000 (38-1-121, CRS) or in circumstances deemed appropriate by the Real Estate Services Manager in coordination with the requesting department. In these cases, a second appraisal may be obtained by the owner with reasonable costs paid by the City or Utilities. "Reasonable costs" are considered to be within 10 percent of the cost of the original appraisal paid by the City or Utilities.

Parcel 5300000315 was a 40 acre tract of land. Utilities paid their appraiser \$300 to appraise the site. Utilities also paid \$3,000 as a reimbursement to the property owner for a second appraisal on the site. According to the Handbook, reasonable costs would have been \$330.00 for the second appraisal.

Auditor's Recommendation:

We recommend Utilities follow the guidelines for determining reasonable costs for a second appraisal and document reasons when the amount exceeds the 10% threshold.

Colorado Springs Utilities Response:

Colorado Springs Utilities agrees that there was a large disparity between the costs of the two appraisals that is not explained by available documentation. In the future, Colorado Springs Utilities will ensure that appropriate documentation is maintained, and additionally that management approval is required for a disparity of this magnitude.

Findings, Recommendations and Responses

5. Properties were purchased at prices well above Market Value.

Section 1-2 of the Handbook states:

1-2. OBJECTIVES OF REAL PROPERTY ACQUISITION PRACTICES:

In the administration of its real property acquisition program, the City and Utilities shall:

- a. Make every reasonable effort to acquire real property expeditiously through negotiated agreements.
- b. Pay fair market value for all property interest acquired and conduct its acquisition activities in a manner that minimized hardships to owners and tenants and promotes public confidence in the City's and Utilities' land acquisition practices.
- c. Assure consistent treatment to all owners and tenants.
- d. Minimize litigation in the acquisition of real property.

The Handbook has the following definition of Fair Market Value:

The fair, actual, cash market value of the property. It is the price the property could have been sold for on the open market under the usual and ordinary circumstances, that is, under those circumstances where the owner was willing to sell and the purchaser was willing to buy, but neither was under an obligation to do so.

The property must be valued with reference to all the uses and purposes for which it is adaptable and available, including its highest and best use. This definition of fair market value presupposes that both parties are familiar with the property and all of its present adaptability and uses and those uses which would be reasonable and probable in the near future.

Using this as a measurement, we found several of the properties were purchased at amounts that far exceeded our understanding of Fair Market Value.

Example 1

In reviewing the appraisal for Parcel 530000322, we noted it was marketed for \$225,000 for the period May 1, 2002 to January 1, 2003. The appraised value of the property was \$210,000. Utilities purchased the property for \$340,000 in May 2003. This property was purchased for 61% more than the appraisal and 51% more than the owner had listed it just five months earlier.

Example 2

In reviewing the appraisal for Parcel 5300000133, we noted the property was appraised at \$90,000. Utilities paid \$100,000 for the property plus an additional \$20,000 was provided to the property owner as "Investment Appreciation." This means Utilities paid \$120,000 for property appraised at \$90,000, or a premium of 33.3%.

Findings, Recommendations and Responses

Example 3

In reviewing the file for Parcel 5300000124, we noted the appraised value of the dwelling was \$230,000. Utilities paid the \$230,000 for the dwelling. However, Utilities also paid an additional \$340,000 for “Replacement Housing.”

Example 4

In reviewing the file for Parcel 5300000349, we noted the appraised value for the raw land was \$6,000 per acre for a 20 acre tract. Utilities paid the owners the appraised value for the land plus an additional \$12,800 per acre as “Relocation Fee,” thereby bringing the price paid for the land to \$18,800 per acre, which is 213% greater than the appraised value of the land.

These are examples of the various methods of payments made to purchase the properties.

Based on these examples, we conclude the payment for items termed Investment Appreciation, Replacement Housing and Relocation Fee, are premiums paid for the property and are in direct conflict with the concept of Fair Market Value as published in the handbook.

In addition, if the Reservoir is not built, Utilities is at risk of losing their investment in the properties because they probably would not be able to sell them for the amounts they have paid.

Auditor’s Recommendation:

We recommend the use of items termed as Investment Appreciation, Replacement Housing, Relocation Fees or other similar terms not be used as a mechanism to get around the concept of paying Fair Market Value for purchased properties.

City Response:

RES agrees that the process that was used for determining the Fair Market Value of the properties is not in keeping with the understanding of Fair Market Value that is found in the Handbook. The process of determining Fair Market Value as well as the documentation for such determination will be addressed in the revision of the Handbook. RES agrees with the Auditor’s recommendation and verifies that it is not the current practice of RES to use such terms as “investment appreciation,” “replace housing” and “relocation fees” to skirt the intent of Fair Market Value as stated in the handbook.

Findings, Recommendations and Responses

Colorado Springs Utilities Response:

Colorado Springs Utilities has determined that neither its land acquisition files nor those of Real Estate Services contain a formula for, or an explanation of, the amount paid in excess of the appraised value for these four properties. Additionally, personnel changes subsequent to the acquisitions have made it difficult for Utilities staff to piece together details of the transactions. Colorado Springs Utilities is finalizing improvements to its real property acquisition processes that will be put in place during the week of August 14th. For real property acquisitions exceeding \$50,000, interim improvements will require that Colorado Springs Utilities provide City Council with detailed information about the acquisition and the proposed purchase price (including a written justification for any amount paid in excess of the appraised value) and gain City Council's approval prior to proceeding with those acquisitions.

Findings, Recommendations and Responses

6. Properties were leased back to previous owners at terms below Market Value.

Several of the properties were leased back to the previous owners at terms that appear unfavorable to Utilities.

As an example, Parcel 5300000171, a 35 acre site with a 3,920 sq ft house was appraised at about \$475,000. Utilities paid the owners \$847,500 for the property and relocation. A residence lease was entered between Utilities and the previous owner where they could lease back the 35 acres and the 3,920 sq ft dwelling for \$300 a month plus upkeep of the property. This lease has no escalation clause, is binding on the parties, their personal representatives, successors and assigns, has no termination date, but continues from year to year until the property is needed by Landlord.

While we did not perform a detailed analysis of the lease value of property in the area, we believe it is probable the property could be leased for a considerable higher value on the open market, and even at a rate that would far exceed the costs to manage the property. Therefore, we conclude the lease agreement was not in the best interest of Utilities nor its customers.

In addition, the lease continues until the City needs the property for the Jimmy Camp Creek Reservoir. If the property is determined to not be needed for the Reservoir, then the previous owner has the right to repurchase the property at the then appraised value.

Auditor's Recommendation:

We recommend Utilities not enter into lease agreements which do not provide a reasonable market rate of return for the assets being leased.

City Response:

One of the issues that will be addressed in the revised Handbook will be the process and procedures for leasing City owned property. The new policy and procedures will be written to assure that the best interests of the property owner (the City) are protected.

The Real Estate Office in conjunction with the City Attorney's office is in the process of completing a lease template. This template will be used when leasing City owned property. By using the lease template RES will be able to assure consistency of lease documents, the establishment of a fair market rental rate and also will be able to identify any problems or issues before execution of any lease agreements. The lease template will be completed and in use September 2006.

Findings, Recommendations and Responses

Colorado Springs Utilities Response:

Colorado Springs Utilities agrees with the City Auditor's recommendation.

Colorado Springs Utilities has benefited from the original owners leasing back the property and retaining residency as a means to discourage vandalism or other damage that could occur to vacant property located in an isolated part of the City. Additionally, pursuant to the leases, the lessees are responsible for the general maintenance and upkeep of the property. Furthermore, the City may terminate any lease if the lessee violates the terms of that lease.

With that said, in the future, Colorado Springs Utilities will require written justification, legal review and management approval before entering into a lease arrangement of this type.

Findings, Recommendations and Responses

INTERNAL CONTROL RELATED CONCERNS:

7. Reporting of Property Transactions to the Utility Board needs to be improved.

a. Colorado Springs Utilities Board Policy EL-8 contains the following:

The Chief Executive Officer shall not permit the Board to be uninformed or unsupported in its work. Accordingly, the CEO shall not: ... Let the Board be unaware of major and unusual land acquisition, contracts issued (after the fact) over \$50,000, unusual or exceptional purchases,

and the City Code, in Chapter 12 – Utilities, contains the following definition:

12.1.101 BUSINESS CONTRACTS: All contracts or agreements by Utilities for purchase or sale of goods and services except contracts or agreements involving purchase or sale of any interest in real estate.

The Utility Board should be made aware of major and unusual land purchases. After reviewing the details surrounding the land acquisitions, our opinion is the majority of the purchases were major and unusual purchases. The purchases should have been reported to the Utility Board as they occurred. If the definition of “contract” in EL-8 was expanded to include real estate transactions, it would lessen the subjectivity as to whether a land purchase was major.

b. Colorado Springs Utilities Board Policy EL-7 contains the following:

With respect to the actual, ongoing financial condition and activities, the Chief Executive Officer shall not cause or allow the development of fiscal jeopardy or a material deviation of actual expenditures from Board priorities established in Ends policies. Accordingly, the CEO shall not: ... Acquire real property at more than fair market value without justifiable reason.

Using this as a guideline, three of the Jimmy Creek land purchases were reported to the Board. When you include the amounts paid for relocation fees, replacement costs or investment appreciation, all 14 properties were acquired at an amount greater than the fair market value appraisal. The overall average was 61% greater than the appraisal.

Auditor’s Recommendation

We recommend that Utilities enhance their communication with the Utilities Board to include details of all real estate purchases exceeding \$50,000. We recommend the definition of “contracts” as used in EL-8 be expanded to include real estate acquisitions. We also recommend that all costs be included when determining if a transaction exceeds Fair Market Value.

Findings, Recommendations and Responses

Colorado Springs Utilities Response:

As mentioned in the response to finding #5 above, Colorado Springs Utilities will implement improvements to its real property acquisition processes during the week of August 14th. For real property acquisitions exceeding \$50,000, interim improvements will require that Colorado Springs Utilities provide City Council with detailed information about the acquisition and the proposed purchase price (including a written justification for any amount paid in excess of the appraised value) and gain City Council's approval prior to proceeding with those acquisitions.

Findings, Recommendations and Responses

8. City Auditor should review source documents when verifying compliance with Executive Limitations.

In our annual review of transactions that might impact Utilities EL 7 – Financial Condition and Activities and EL-4 – Asset Protection, we perform certain tests of compliance. One of those tests is to obtain a list from Real Estate Services of all transactions involving real estate purchased by Utilities. The list contains appraised values and the amount Utilities paid for the property. The list does not include other amounts paid such as those for relocation fees, replacement costs or investment appreciation.

If each real estate file had been reviewed, the properties with the amounts paid outside of the appraisal process would have been recognized by the auditor as an anomaly and would have been reported as such. Since all of the transactions with the “extra” fees were completed in 2003, reviewing the source documentation would not have prevented the transactions from occurring. However, it would have brought them to light much sooner.

Auditor’s Recommendation:

We recommend the Auditor review all real estate purchases made on behalf of the City of Colorado Springs, including its enterprise operations, to identify not only the amount paid for the property, but also any other amounts associated with the acquisition, which should be disclosed to the City Council.

Auditor’s Response:

One of the underlying concepts of the reliability of evidence is that documents and information obtained from third parties provides a greater level of confidence than those obtained from the parties involved in the transaction.

In the past, we have treated information on Utilities real estate purchases we received from Real Estate Services to be outside or third party confirmation. We now recognize that was an erroneous assumption. For the future, we will review the file for every real estate purchase made by the City or its enterprises with the purpose of identifying and reporting on any transaction that appears unusual.