



City of Phoenix

Mission Statement

To improve the quality of life in Phoenix through efficient delivery of outstanding public services.

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Project Number

1240042

This report can be made available in alternate format upon request.

Citywide Real Estate Acquisitions

June 24, 2024

Report Highlights

Finance Department

The Department complied with federal regulations and City policies in its real estate acquisitions.

Neighborhood Services Department

The Department complied with federal regulations and City policies in its acquisitions of real property using federal grant funds.

Community and Economic Development Department

The Department largely complied with federal regulations and policies, except that 2 of 6 properties closed more than 180 days after the required environmental inspection period.

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Executive Summary

Purpose

Our purpose was to review the City's acquisitions and due diligence process for procuring new real estate assets.

Background

The City's *Administration Regulation (AR) 1.51 – Delegation of Authority*, delegates authority to key departments, including the Finance Department (Finance), the Community and Economic Development Department (CED), the Housing Department (Housing), and the Neighborhood Services Department (NSD), enabling them to actively participate in real property acquisitions. These departments are empowered to endorse real estate contracts and related documents on behalf of the City Manager's Office. The Finance's Real Estate Division acquires property by donation, voluntarily, and under the threat of eminent domain, which follows the *Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970* (Uniform Act).

Administrative settlements only apply to those properties acquired under the threat of eminent domain as permitted by the Uniform Act. Administrative settlements are not permitted for voluntary acquisition because of a potential violation of the Gift Clause under the Arizona Constitution. Over the past several years, most acquisitions have been closely tied to the Light Rail expansion project.

AR 3.95-Environmental Due Diligence for Real Estate Acquisitions and the federal All-Appropriate Inquiry Rule (AAI), requires that an Environmental Site Assessment (ESA) is performed for acquired properties. In addition, the City adheres to the federal Uniform Act which ensures fair and equitable treatment for individuals whose properties are acquired for public use.

Between July 2021 and April 2024, the City allocated \$127.5M for acquiring easements, land, rights-of-way, buildings, and land improvement costs. Funding for these acquisitions mainly comes from federal sources, including the Federal Highway Administration (FHWA) and the Federal Transit Administration (FTA). Additionally, the Community Development Block Grant Program (CDBG), American Recovery and Reinvestment Act (ARRA), American Rescue Plan Act (ARPA), and HUD Neighborhood Stabilization Program 3 Formula (NSP3) funds are frequently used by CED, NSD, and Housing for their acquisitions.

Results in Brief

Finance complied with federal regulations and City policies in its real estate acquisitions.

We reviewed a sample of 49 files from the Real Estate Division. We confirmed that all required documents and records of correspondence were maintained. We examined 29

ESA summary reports from the 49 test files to ensure that the escrow closing date fell within 180 days or had an updated ESA.

In addition, we verified that Finance complied with the federal Uniform Act which requires that sellers receive fair and just compensation for their properties. The collective appraised value of the 49 properties totaled \$26.2M and the City paid \$26.5M for the properties. Administrative settlements, as permitted under the Uniform Act, accounts for the difference in the appraised value and purchase price of the properties when acquired under the threat of condemnation.

NSD complied with federal regulations and City policies in its acquisition of real property using federal grant funds.

NSD acquired one property as part of its Strategic Acquisitions Program using CDBG funds. We examined the eligibility requirements outlined by the U.S. Department of Housing and Urban Development and confirmed that the acquisition followed the guidelines. Additionally, we verified that the ESA was completed, including a Phase II assessment. Furthermore, NSD demonstrated compliance with the Uniform Act by acquiring the property equal to the appraised value.

CED largely complied with federal regulations and City policies, except that 2 of the 6 properties closed more than 180 days after the required environmental inspection period.

We tested one property that CED acquired using ARPA funds and five Government Property Lease Excise Tax (GPLET) development agreements. GPLET serves as an economic tool to promote revitalization by reducing or waiving the excise tax for development projects in designated redevelopment areas. We found that two properties closed more than 180 days after the AAI date: one property funded by ARPA funds closed 192 days after the 180-day window and one of the GPLET properties closed 97 days after the 180-day window. CED acknowledged that the ESA had expired and did not seek an updated assessment.

Department Responses to Recommendations

Rec. #2.1: Community & Economic Development - Develop a file management process and checklist for all real estate acquisitions and Government Property Lease Excise Tax (GPLET) agreements. The checklist should identify the All-Appropriate Inquiry (AAI) expiration date and if a new Environmental Site Assessment (ESA) would be required.

Response: CED will create and adopt both a file management policy and a property acquisition checklist, including AAI and ESA requirements.

Target Date:
9/25/2024

1 – Finance - Real Estate Division

Background

Departments authorized to purchase buildings or land must ensure that all necessary documents are promptly submitted to a title company and the City Clerk for proper recording. Finance’s Real Estate Division has developed comprehensive checklists tailored to several types of acquisitions, including Permanent Easements, Temporary Easements, and Fee Acquisitions. These checklists verify that each acquisition file contains all relevant documents and a thorough record of correspondence. Failure to maintain complete records could jeopardize future federal funding for projects.

AR 3.95 – Environmental Due Diligence for Real Estate Acquisitions, requires that an Environmental Site Assessment (ESA) is performed for all acquired properties except temporary easements. The All-Appropriate Inquiry Rule (AAI), as defined in Chapter 40 of the Code of Federal Regulations (CFR) 312, establishes performance criteria and objectives aimed at safeguarding the City from assuming liability related to environmental contamination. There are two types of ESAs: Phase I and Phase II. A Phase I is sufficient for most properties; however, when contaminants are present, a more comprehensive Phase II assessment is required. Regardless of what phase is required on the property, close of escrow must occur within 180 days of the AAI date. If there is speculation that the close will occur outside the 180 days, an updated ESA is required to establish a new AAI date.

The Uniform Act (Title 49 Subtitle A: Part 24), amended by Congress in 1987, establishes consistent and equitable treatment for individuals whose property is acquired for public use. Key provisions include, 1) fair market value and displacement assistance, 2) transparent negotiation process, and 3) waiver valuation for low-value properties. Under the Uniform Act, administrative settlements are only permitted for properties acquired under the threat of eminent domain. Administrative settlements for voluntary acquisitions would potentially violate the Gift Clause under the Arizona Constitution.

The Real Estate Division provided a report detailing 390 acquisitions in which they actively participated between December 1, 2020, and December 12, 2023. We conducted a judgmental review of 49 files to ensure compliance and accuracy. Our objective was to verify the presence of all required documents, confirm completion of ESAs in accordance with federal and City policies and assess adherence to the Uniform Act regarding purchase prices and equitable treatment.

Results

The Real Estate Division followed federal guidelines; all required documents and records of correspondence were present in each of the tested acquisition files.

The Real Estate Division follows the FHWA guidelines for all acquisitions. This ensures that every acquisition, regardless of funding source, follows the same criteria of Uniform

Act compliance, environmental regulations, and appraisals. Both the FHWA and the Federal Transit Authority have established guidelines requiring agencies to maintain records of each acquisition for a minimum of three years. All files are subject to audits or review by FHWA or other government officials.

We reviewed a sample of 49 files. We tested the following acquisition types:

- 12 Permanent Easements
- 19 Temporary Easements
- 18 Fee Acquisitions

We confirmed that all required documents and records of correspondence were maintained. Each file contained the appropriate checklist, duly signed by a Real Estate Division employee. Our assessment revealed no errors or omissions; all necessary documents were present and accounted for.

The Real Estate Division complied with federal and City requirements for Environmental Site Assessments in the tested acquisitions.

The federal requirements outlined in 40 CFR 312 are also included in *AR 3.95 – Environmental Due Diligence for Real Estate Acquisitions*. Both policies detail when a Phase I, Phase II, or an ESA waiver is appropriate. Both federal and city requirements follow the All-Appropriate Inquiries (AAI) rule which is the process of evaluating a property’s environmental conditions, which may be relevant to assessing potential liability for any contamination. Upon initiating an ESA, the AAI date is established. To be compliant with the AAI rule, the City has 180 days from the AAI date to close escrow. If there is speculation that the closing will occur outside the 180 days, the City is required to complete an updated ESA.

We examined 29 ESA summary reports from the 49 test files to ensure that the escrow closing date fell within the 180-day AAI deadline. During our review, we observed that 20 properties needed an updated assessment because the original AAI was set to expire before the closing date. All properties successfully completed escrow within the required timeframe and averaged 103 days from the original or updated AAI date.

The Real Estate Division followed the Uniform Act in the tested acquisitions.

The FHWA requires all acquisition projects that use federal funds to comply with the Uniform Act, which ensures fair and equitable treatment to all individuals whose property is acquired for public use. Title 49 Part 24.4 requires that agencies provide appropriate assurances that it complied with the Uniform Act. The Real Estate Division adopted the Uniform Act for all acquisitions regardless of funding source. Doing so provides consistency and ensures future projects using federal fund are eligible.

In the same 49 files, we compared the appraisal reports or value waivers, the offer letters, and any counter offers to the final purchase price. We also examined the correspondence in the files to confirm that there was no indication of coercion during the negotiation process that would indicate non-compliance with the regulations. Although

there were no instances of owners being displaced, we verified that they received fair and just compensation for their properties.

The collective appraised value of the 49 properties totaled \$26.2M and the City paid \$26.5M for the properties. Additionally, eight owners negotiated counteroffers with the City, and two sellers donated their properties to the City, which had a combined appraised value of \$46,500. Administrative settlements, as permitted under the Uniform Act, accounts for the difference in the appraised value and purchase price of the properties when acquired under the threat of condemnation.

Recommendations

None

2 – Neighborhood Services, Community & Economic Development, and Housing Departments

Background

While Finance's Real Estate Division oversees most of the City's acquisitions; the Neighborhood Services Department (NSD), the Community and Economic Development Department (CED), and the Housing Department (Housing) also possess the authority to procure real estate. Environmental assessment requirements and compliance with the Uniform Act remain applicable, regardless of the funding source. *AR 3.95 – Environmental Due Diligence for Real Estate Acquisitions*, requires that an Environmental Site Assessment (ESA) is performed for all acquired properties except temporary easements. The All-Appropriate Inquiry Rule (AAI), as defined in Chapter 40 of the Code of Federal Regulations (CFR) 312, establishes performance criteria and objectives aimed at safeguarding the City from assuming liability related to environmental contamination. The close of escrow must occur within 180 days of the AAI date and if there is speculation that the close will occur outside the 180 days, an updated ESA is required to establish a new AAI date.

NSD frequently uses Community Development Block Grant (CDBG) funds for acquisitions, which have additional guidelines enforced by the U.S. Department of Housing and Urban Development (HUD). Eligible CDBG real property acquisition activities include but are not limited to:

- Land
- Air rights
- Easements
- Water rights
- Rights-of-way
- Buildings and other real property improvements

CED engages in temporary land acquisitions in conjunction with the Government Property Lease Excise Tax (GPLET) development agreement. Although these projects do not involve outright land purchases, they technically qualify as land acquisitions because fee-title ownership of the land and improvements are transferred to the City for a specified period. Lease agreements between the City and the developer are recorded with the County Recorder's Office.

We obtained reports of all acquisitions made between December 1, 2020 and December 12, 2023 from NSD, CED, and Housing. Housing did not have any acquisitions during the scope of the audit. We tested acquisitions from each department to verify compliance with City policies and federal funding requirements.

Results

NSD complied with federal and City policies for its real estate acquisitions using CDBG funds.

The acquisition of one property by NSD was part of its Strategic Acquisitions Program using CDBG funds. HUD's guidance qualifies these properties for use of CDBG funds because the property will be used for housing Low to Moderate Income individuals.

However, before disbursing funds for a project, HUD conducts a comprehensive review of the acquisition file to verify all objectives have been met. We examined the eligibility requirements outlined by HUD and confirmed that the acquisition adhered to the prescribed guidelines. Additionally, we verified that the ESA was completed, including a Phase II assessment. Furthermore, NSD demonstrated compliance with the Uniform Act by acquiring the property equal to the appraised value.

CED had two real estate acquisitions that closed after the required environmental inspection period had ended.

The American Rescue Plan Act (ARPA), enacted in March 2021, allocated \$350 billion in relief funds to states and local governments to address the ongoing impact of the COVID-19 pandemic. During our assessment period, CED procured one property using ARPA funds. To use these resources, the City had to demonstrate that the acquisition met the program's criteria. The property acquisition aimed to create a workforce facility for the community. In response, the City Council approved the allocation of \$12 million in ARPA funds for this acquisition. We ensured that CED complied with the Uniform Act by reviewing correspondence between the City and the seller. Furthermore, the City purchased the property at a price \$3.2 million higher than its appraised value. In the justification memo to City Council, CED explained that the inflated purchase price was due to location, the market value, and resources the facility will provide to the community.

In the assessment of the fee acquisition, we found that the close of escrow date exceeded the mandatory AAI date by 192 days. We observed that CED did not have a formal process or checklist to ensure timely adherence to deadlines. In addition, we found that escrow documents were not organized making it difficult for staff to locate requested items. Implementing a real estate acquisition file management process which includes a checklist to track key due dates and documents could enhance compliance with City policies and federal regulations.

Additionally, CED engaged in five Government Property Lease Excise Tax (GPLET) development agreements. GPLET serves as an economic tool to promote revitalization by reducing or waiving the excise tax for development projects in designated redevelopment areas. To qualify, property owners must transfer ownership of the land to a government entity, which then leases it back for private use.

The five GPLET agreements are associated with three City contracts (146128, 135145, and 140687). We reviewed agreement documents, City ordinances, and ESA reports.

We noted one of the properties had a close of escrow 97 days beyond the AAI window. CED acknowledged that the ESA had expired and did not seek an updated assessment. AR 3.95 and 40 CFR 312 both require that acquisitions occur within 180-days of the AAI date.

Recommendation

- 2.1 Community & Economic Development - Develop a file management process and checklist for all real estate acquisitions and Government Property Lease Excise Tax (GPLET) agreements. The checklist should identify the All-Appropriate Inquiry (AAI) expiration date and if a new Environmental Site Assessment (ESA) would be required.

Scope, Methods, and Standards

Scope

We reviewed real estate acquisitions conducted between December 1, 2020 and December 12, 2023.

The internal control components and underlying principles that are significant to the audit objectives are:

- Control Activities
 - Management should design control activities to achieve objectives and respond to risks.
 - Management should implement control activities through policies.
- Control Environment
 - The oversight body and management should demonstrate a commitment to integrity and ethical values.
 - The oversight body should oversee the entity's internal control system.

Methods

We used the following methods to complete this audit:

- We interviewed staff from Finance, Housing, NSD, and CED.
- We reviewed federal standards (FHWA, FTA, AAI, CDBG)
- We reviewed SAP expenditure reports for GL accounts associated with acquisitions.
- We tested acquisition files in NSD and Finance, and documented findings.

Unless otherwise stated in the report, all sampling in this audit was conducted using a judgmental methodology to maximize efficiency based on auditor knowledge of the population being tested. As such, sample results cannot be extrapolated to the entire population and are limited to a discussion of only those items reviewed.

Data Reliability

The SAP data used in testing for this audit was previously determined to be reliable through an independent audit review. We assessed the reliability of the data received from Finance, CED, and NSD by performing testing to compare the information provided to the reports in SAP. We determined that this data was sufficiently reliable for the purpose of this audit.

Standards

We conducted this performance audit 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. Any deficiencies in internal controls deemed to be insignificant to the audit objectives but that warranted the attention of those charged with governance were delivered in a separate memo. We are independent per the generally accepted government auditing requirements for internal auditors.