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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF THE MASSACHUSETTS BAY TRANSPORTATION AUTHORITY JULY 1, 1996 TO MARCH 31, 1999

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Our review of the Massachusetts Bay Transportation Authority (MBTA) was conducted to determine the overall effectiveness and functions of the MBTA's real estate activities, which were assumed by a private company under a contract dated June 28, 1996. According to the submission made to the Office of the State Auditor (OSA) on April 24, 1996 and in accordance with Chapter 296 of the Acts of 1993, this action was undertaken to increase potential revenues, reduce expected costs, and improve the overall management and efficiency of the MBTA's real estate operations. As discussed below, our audit revealed that the proposed privatization contract that the MBTA submitted to the OSA for its review and approval was significantly different than the one the MBTA entered into for the management of its real estate activities. This contractual change, if known by the OSA at the time it reviewed the MBTA's privatization submittal, would have resulted in the OSA's denial of this proposed privatization contract. In addition, our review revealed over $239,000 in questionable commissions and fees, unwarranted fees and commissions of over $208,000, and a concessions license contract that was awarded noncompetitively.

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1. Signed Privatization Contract Terms Do Not Agree with Proposed Contract Terms as Submitted under Chapter 296 of the Acts of 1993: The proposed privatization contract submitted to the OSA by the MBTA provided for the payment of lease commissions to Transit Realty Associates, L.L.C. (TRA). The proposed contract showed that these commission payments would be limited to three years for the rental or renewal of existing concession space and also payable for an unlimited number of years for new leases and licenses for new properties brought on line by TRA (i.e., "growth"). However, the signed contract provides for the payment of these lease commissions for each year that a lease is in effect, with no distinction made between existing properties and concession renewals and true "growth." As a result, the effect of this change, if known to the OSA at the time we were reviewing the MBTA's privatization submittal, would have affected our determination and resulted in the denial of this proposed privatization contract. 4

2. The MBTA Paid over $239,000 in Commissions and Fees That Were Not Fully Earned by TRA: Our review of invoices for commissions and fees paid to TRA by the MBTA revealed that over $239,000 was claimed as fees earned by TRA for work that was substantially completed by the MBTA. 8

3. Complicated Contract Fees and Commission Schedules Led to Additional Unnecessary Contract Costs: The contract signed by the MBTA and TRA contains complicated and contradictory language regarding fees and commissions to be paid to TRA and, as a result, may cause the MBTA to be liable for unintended and unwarranted fees and commissions for long-term concession leases and licenses. Our audit identified over $127,853 in overcharges for new income production fees and $80,841 in advance commission payments that the MBTA may never recover. 11

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4. Improvement Needed in MBTA Oversight of TRA Activities: We noted a lack of MBTA oversight for certain TRA-initiated transactions, including accounts receivable adjustments, calculation errors for the billing of certain commissions, and a failure to award engineering, legal, and appraisal contracts in an open and competitive manner. 14

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INTRODUCTION

Background

Chapter 296 of the Acts of 1993, the Commonwealth's privatization law, outlines the process that must be followed by all agencies and applicable Authorities seeking to contract for a service that is presently performed by state or Authority employees. This law, which became effective on December 15, 1993, applies to all contracts with an aggregate value of $100,000 or more.

The process that an agency must follow includes preparing a detailed written statement of services, estimating the most cost-effective method of providing those services with agency employees, selecting a contractor through an open and competitive bid process, and comparing the true in-house costs to the costs that would be incurred by contracting out these services to a designated private contractor. The agency must also certify that the validity of the proposed service is at least equal to the present service and that the contractor's compliance record regarding relevant regulatory statutes is satisfactory. Furthermore, the agency must ensure that the signed contract, if ultimately awarded, contains certain provisions regarding wages; health insurance; and the hiring of qualified agency employees, nondiscrimination, and affirmative action.

On April 24, 1996, pursuant to Chapter 296, the MBTA notified the State Auditor of its intent to award a privatization contract for most of its real estate activities that, at the time, were being handled by its own employees. The functions proposed by the MBTA to be privatized included facilities management, disposition of property, and property development. Chapter 296 allows the State Auditor 30 days to either approve or reject the agency's contract. The specific activities for these functions encompassed:

- Tenant administration and leasing for concessions, land leases, utility easements, and master lease agreements;
- Disposition of surplus property;
- Granting licenses and permits for access and entry; and
- Joint development opportunities.

Accordingly, the Office of the State Auditor, after reviewing the MBTA's submission for compliance with certain statutory provisions, as well as the estimated costs to perform these services in-house versus the estimated costs to be incurred in the proposed privatization contract between the MBTA and Transit Realty Associates, L.L.C. (TRA), determined that the MBTA had complied with Chapter 296 of the Acts of 1993 in reaching its decision to privatize the management of its real estate activities.

Effective June 28, 1996, the MBTA and TRA executed a five-year-contract to manage the above-mentioned real estate activities. The signed contract, which expires on July 31, 2001, provides for the payment of the following fees and commissions:

Base Asset Management Fees:	$ 6,178,000 (5-year total)
Lease Commissions and Fees:	6% of year 1 rent and 3% for each year thereafter, including renewals
Licenses and Leases under One Year:	One month's rent
New Income Production Fee:	5% of additional rent and other income
Incentive Bonus Fee:	10% of the excess of total revenues collected over a predetermined annual calculation base
Surplus Property Sales:	10% of gross sale price
Joint Development Fees:	5% of gross revenues, 10% of excess total revenue, and 10% of "value creation"
Parking Garage Program:	5.5% master developer fee, 20% savings incentive fee, and management fee of $22.50/space/year

Audit Scope, Objectives, and Methodology

Our audit, which covered the period July 1, 1996 to March 31, 1999, was conducted in accordance with applicable generally accepted government auditing standards for performance audits. The objectives of this audit were to review:

(1) Compliance with contract provisions for asset management; development; and employee wages and health benefits,

(2) Sale of surplus properties,

(3) Fees and commissions paid to TRA, and

(4) MBTA monitoring and oversight of TRA activities.

Our methodology included reviewing (1) tenant files; (2) cash receipts and disbursements; (3) executed contracts and licenses; (4) MBTA and TRA correspondence; (5) approved budgets, monthly operating reports, and payroll records; and (6) approved policies and procedures for the reporting on and monitoring of contractor activities. In addition, we interviewed MBTA and TRA officials and personnel.

AUDIT RESULTS

1. Signed Privatization Contract Terms Do Not Agree with Proposed Contract Terms as Submitted under Chapter 296 of the Acts of 1993

The proposed privatization contract submitted to the Office of the State Auditor (OSA) by the Massachusetts Bay Transportation Authority (MBTA), as explained to us during our review of the proposed contract, provided for the payment of lease commissions to Transit Realty Associates, L.L.C. (TRA). The proposed contract showed that these commission payments would be limited to three years for the rental or renewal of existing concession space and would be payable for an unlimited number of years for new leases and licenses for new properties (i.e., "growth") brought on line by TRA. However, the signed contract provides for the payment of these lease commissions for each year that a lease is in effect, with no distinction made between existing properties and concession renewals and true "growth" properties added by TRA. As a result of this change in wording and implementation of the contract, the MBTA is now liable for increased commission costs over the life of this privatization contract. This contractual change, if known to the OSA at the time it reviewed the MBTA's privatization submittal, would have effected our determination and would have resulted in the denial of this proposed privatization contract.

Specifically, the "Summary Term Sheet-Table B-1" of the proposed contract that we reviewed, which summarized all the proposed fees, commissions, and other incentive payments to be paid to TRA under the contract, originally called for a commission payment of 6% based on the first year's rent and a 3% commission for each of the next two years for rental or renewal of existing concession space. However, the signed version of this same exhibit, dated June 28, 1996, was changed to provide for the payment of these commissions for as long as any lease is in effect, including any option periods for renewal agreed to in the original lease terms. During the privatization review process, we noted a discrepancy between this exhibit and the language contained in "Commission/Fee Schedule-Table B-2," which contained the phrase "for each year thereafter." MBTA representatives indicated to us, however, that most commissions were indeed limited to three years, and would be applied only to the renewal of existing

concessions leases. We factored that representation into our calculation of estimated costs to be incurred in the proposed privatization contract between MBTA and TRA.

The proposed privatization contract we reviewed indicated that the payment of commissions at the rate of 6% of the first year's rent and 3% of each year's rent thereafter, with no limitation, would apply only to leases and licenses for new properties developed by TRA (i.e., growth or expansion space that was not currently occupied and generating rental income at the time the contract began). Indeed, under the lease terms the renewal of leases and licenses for existing tenants for the same property would earn TRA no commission as such renewals are part of TRA's duties covered under its base asset management fee.

Accordingly, when we computed the additional costs to be incurred by the MBTA during this five-year management contract, the added commissions were computed based on the MBTA's five-year projections for concession revenue only, since these were the only known transactions for which the MBTA would incur additional costs by privatizing the rental of these spaces. However, based on this above-mentioned change to the contract, and the parties' subsequent interpretation of what leases and licenses are eligible for these expanded commissions, we found that the MBTA is paying TRA commissions based on a maximum of five years at the time that a concession lease is executed, and as much as 10 years' advance commissions for telecommunications and other licenses and leases. Finally, the MBTA has also agreed to make future payments to TRA for any additional commissions resulting from the exercise of any option periods to extend or renew a license or lease, also for as long as 10 years. Therefore, the MBTA would be liable for the payment of commissions to TRA for as long as 20 years. As a result of this contract change and the revised interpretation of eligible leases and licenses, we estimate that the MBTA may incur at least an additional $700,000 in commission expenses during the five-year privatization contract and perhaps significantly more, depending on the number of leases and the length of initial and option periods approved by the MBTA during TRA's term. If in 1996, we were informed and included these additional commissions in our computation of estimated costs to be incurred in the

privatization contract between MBTA and TRA, we would have had to reject the proposed contract being more costly than the then current in-house costs.

In light of this apparent contradiction in the contract's terms, we recommended that the MBTA refrain from approving any additional proposed leases or licenses that exceed five years for either an initial term or option for renewal. In addition, we urged the MBTA to begin negotiations with TRA to limit the number of years on which a commission would be paid to no more than three years for the initial lease term and also for any option or renewal terms.

The MBTA acknowledged that the draft contract and final executed contract contained confusing and perhaps contradictory provisions. However, MBTA officials indicated that, in the interests of maintaining a good working relationship with TRA, they felt legally obligated to pay the commissions as presently calculated for the duration of this privatization contract, which expires on July 31, 2001. In addition, they stated that they were unable to explain how or why the change in wording between the draft and final contracts occurred.

We believe that the MBTA's actions in amending the contract following our privatization review and determination and subsequently refusing to adopt the understood interpretation of the MBTA's proposed contract renders the current contract in violation of Chapter 296, Section 54(1), of Acts and Resolves of 1993, which states, in part:

> No amendment to a privatization contract shall be valid if it has the purpose or effect of avoiding any requirement of this section.

Since the financial effect of the language change, had it been known at the time of our review, would have been to negate the MBTA's purported cost savings, the MBTA's decision to adopt a contrary position subsequent to the OSA's completed review and determination renders the contract invalid. We are referring this matter to the Office of the Attorney General for its review.

Recommendation: We again recommend that MBTA to seek to renegotiate the terms of the contract to properly limit the amount and duration for which TRA would be entitled to receive commissions for both the initial and renewal terms of all leases and licenses. If the MBTA cannot reach a reasonable

settlement with TRA, it should consider a moratorium on approving any new leases and licenses until the expiration of TRA's agreement. Finally, the MBTA should ensure that all future proposed privatization contracts submitted to the OSA for its review and approval in fact represent the true and final version to be executed between the parties.

Auditee's Response: The MBTA stated, in part:

> The privatization contract submitted to the OSA, dated April 10, 1996, states at Exhibit B, pages B-1 and B-2, that lease commissions are payable at the rate of six percent (6%) of the first year's gross rent and three (3%) of the gross rent for each of the remaining years in the lease term (emphasis added). Attached to Exhibit B was Table B-1, which created an ambiguity in the contract because it stated that commissions would be paid out of income only for the first three years of the lease.
>
> The OSA pointed out this ambiguity to the MBTA. In response, the attorney representing the MBTA in the contract negotiations wrote to the attorney representing TRA, in a letter dated May 29, 1996 . . . that Table B-1 would be revised to make it conform to the language of the contract as set out in Exhibit B (pages B-1 to B-2). Thus, the contract terms were never changed. The MBTA officials involved in preparing the privatization contract have been interviewed on this question, and none of them recalled that any representation was ever made to the OSA that commissions were limited to three years. The MBTA believes that the McDermott, Will & Emery letter of May 29, 1996 is documentary support for the MBTA's position that the contract executed by and between the MBTA and TRA contains exactly the same payment provisions as were contained in the contract reviewed by the OSA.
>
> The payment provisions of the contract with TRA do not need to be revised because they represent good commercial practice in the real estate industry. The OSA, in fact, was provided with the final version of the privatization contract with TRA.

Auditor's Reply: The MBTA is correct in pointing out that the OSA detected the contradictory commission schedules contained in the proposed contract. After discussions with responsible MBTA officials regarding this contradiction, we expected that these contract provisions would be properly amended as described to us. Unfortunately, the final change that was made to the contract was not the change that we discussed.

Also, we noted that the letter from the MBTA's attorney to TRA regarding the proposed change to the contract was never forwarded to us prior to the contract's being executed. If it had been provided to us in 1996, we would have factored that information into our computation of estimated costs to be incurred in the privatization contract between the MBTA and TRA. During our review of the proposal to privatize the Property Management and Real Estate Development Activities, we computed an estimated

cost savings over the five years totaling $206,257. The added cost of these commission expenses would have forced us to reject the proposed contract.

Finally, the OSA's proposed change also included an amendment to the payout of commissions on an annual basis, as we requested at the time of our initial review. Unfortunately, this change to the contract was inexplicably not included in the final executed contract. If it had been included, the issue of advance payments of commissions would be moot.

In the future, we will be forced to interpret contradictory language in any proposed privatization contract to mean higher costs to the MBTA, therefore reducing the chance of approving that proposed contract. During future privatization reviews, we will consider all clarifications only if they are documented in writing.

2. The MBTA Paid over $239,000 in Commissions and Fees That Were Not Fully Earned by TRA

As part of our audit, we reviewed the fees and commissions claimed by TRA and paid by the MBTA to ensure that these amounts were proper and allowable under the terms of the management contract. We obtained and reviewed, where applicable, public advertisements seeking bids or proposals; MBTA board minutes and votes; MBTA staff summaries detailing property or license history; bids or proposals received; and executed leases, licenses, and sales agreements. Since TRA assumed the responsibilities of managing the MBTA's real estate on June 28, 1996, particular attention was given to those transactions that were pending prior to this date. Also, we identified which departments initiated all major transactions and the level of actual input or work contributed by TRA for each claimed commission.

As a result of this review, we have identified 10 transactions that were initiated and substantially completed by the MBTA prior to June 28, 1996 or were initiated, negotiated, and completed by MBTA departments after June 28, 1996 but were later improperly claimed as work done by TRA. In addition to these 10 transactions, we question one long-term lease transaction that was improperly billed and paid as a sale and thus carried a higher commission percentage, thereby overpaying TRA $30,644 ($44,000 commission for a sale as compared to $13,356 due as a long-term lease commission). Therefore, in total

MBTA has paid TRA over $239,000 in questionable commissions and fees. Some examples of these questioned transactions follow:

Transaction Type	Property Description	Initiating Department	Date of Bid Advertisement	Date of Bid Opening	Award Date	Commission Paid
Sale	Land-Dedham	MBTA Real Estate	N/A	5/23/96	6/27/96	$27,500
Sale	Land-Arlington	MBTA Real Estate	3/2/96	3/21/96	6/12/96	$82,177
Sale	Land-Marlborough	MBTA Real Estate	None	None	8/12/92	$23,500
Concession	Quincy Center	MBTA Real Estate	10/95	11/16/95	1/17/96	$18,900
License	Soft-Drink Pilot Program	MBTA Marketing	None	None	11/98	$ 9,226

N/A = Not Available

As indicated above, the MBTA paid TRA a full commission for work that was substantially done by the MBTA. In addition, although most of these transactions occurred during the period immediately prior to the implementation of the contract, some MBTA departments continued to negotiate lease, license, and promotional contracts without utilizing the services of TRA.

When asked why TRA was paid commissions for leases, licenses, or sales agreements that the MBTA was involved in prior to June 28, 1996, the MBTA's Director of Real Estate indicated that this was discussed with TRA during contract negotiations and the transition period. However, the signed contract does not exclude transactions that were ongoing on June 28, 1996. Also, the Director of Real Estate indicated that at the end of TRA's present contract "whatever is in the pipeline, the fee will go to the contractor who closes the transaction."

However, it is not reasonable to expect TRA to spend any time at the end of its contract processing and negotiating contracts that would earn a commission for another contractor. Conversely, it is imprudent to allow TRA to receive commissions on transactions that the MBTA substantially completed prior to June 28, 1996.

Recommendation: The MBTA and TRA should develop a schedule of reduced commissions for minimal TRA participation in MBTA-initiated transactions and ensure that no commission is paid for work not performed. Also, before it approves any requests for commission payments, the MBTA should require TRA to submit supporting documentation that clearly documents who actually initiated and managed the transaction. Moreover, the level of effort expended by TRA should be weighed against the effort provided by any MBTA departments to determine whether TRA is entitled to full, partial, or no commission. Finally, we urge the MBTA to begin negotiations with TRA to recover the overpayment of the $239,000 in unearned fees and commissions.

Auditee's Reponse:

> It was unavoidable that at the start of the TRA contract period that there would be real estate work in the pipeline that would need to be completed. A decision was made during contract negotiations to have TRA take whatever steps were necessary to close out those projects that had been initiated prior to the contract period and have TRA compensated as established in the contract. (See page B-1, Section B, eighth line "at commencement of the rent payments" and page B-2, Section G, second line "paid at closing.") The MBTA believed then, and believes now, that this compensation for work completed, but not initiated, will be offset at the end of the five-year term by work initiated, but not completed, by TRA for which they will receive no compensation.
>
> TRA was paid commissions on transactions which were initiated prior to the contract in accordance with contract terms. A memo provided to the Auditor at the June 3, 1999 meeting, clearly demonstrates the substantial work performed by TRA in order to conclude the transactions, including extensive in-house legal work which is otherwise uncompensated.
>
> The transaction characterized as a lease was in fact a sale-like lease (85 year lease) in that fair market value as a sale in fee was obtained, with the MBTA retaining reversion rights upon the termination of the contract. This lease is properly compensated as a sale.
>
> The main area of disagreement between the MBTA and the OSA regarding this point revolves around the OSA's contention that TRA will not work diligently at the end of the contract and, therefore, there will be no work in the pipeline. There are means available to the MBTA to penalize TRA during the life of this contract if the MBTA concludes that TRA is abandoning its best efforts.

Auditor's Reply: We reiterate that the MBTA should have either negotiated a schedule of reduced commissions with TRA for these cited transactions, or agreed to reimburse TRA for any out-of-pocket expenses incurred for TRA's minimal participation. Ultimately, the MBTA failed to seize the opportunity to save the taxpayers $239,000 for work that was substantially completed with MBTA funds. Finally, we

disagree with the MBTA's characterization that the questioned 85-year lease was properly compensated as a sale because it was a sale-like lease. Generally accepted accounting principles state:

> A lease involving real estate is not classified by the lessor as a sale-type lease unless title to the leased property is transferred to the lessee at or shortly after the end of the lease term.

As indicated in its response, the MBTA retains reversion rights to ownership and use of the property upon termination of the lease. Therefore, the MBTA should have paid TRA in accordance with the terms of its contract, which stipulated a lease commission of $13,356 and not a sales commission of $44,000.

3. Complicated Contract Fees and Commission Schedules Led to Additional Unnecessary Contract Costs

In reviewing the implementation and interpretation of the signed contract terms for TRA's fees and commissions, we have identified several instances in which contradictory and ambiguous contract terms and exhibits have led to additional and unwarranted costs to the MBTA. For example, the contract provides for the payment of:

> New Income Production Fee equal to five percent (5%) of the additional rent and other income [emphasis added] collected from the transactions described under the Third Category and Fourth Category of Table B-2 hereof...and paid on a monthly basis on New Income collected [emphasis added] during the Term of this Agreement with respect to an option period or renewal period under a lease.

This contract awards TRA a fee for increasing the rental income presently paid to the MBTA. For example, if the MBTA currently received an annual rent for a concession space of $50,000 and TRA secured a new lease for $60,000, then the contractor would be entitled to a new income production fee of 5% of the $10,000 in "new income" that it secured for the MBTA, or $500 in addition to its normal commission, which is based on the entire $60,000. However, we noted that the MBTA and TRA were improperly applying this new income production fee to the entire amount of the $60,000 in new rent. Therefore, in addition to normal commissions, the new income production fee, using this higher base, would be $3,000. As a result, the MBTA would be overpaying TRA by $2,500 per year for the life of the lease, including any option periods. We estimate that, as of March 31, 1999, the MBTA has been billed by TRA for over $127,853 in questionable and unnecessary new income production fees.

After determining that the MBTA was being overcharged for these fees, we notified the MBTA's Director of Real Estate in December 1998, and the contractor submitted corrected billings to the MBTA. However, we did not verify the accuracy of the stated prior tenant's scheduled rent charges used to compute the allowable new income.

In addition, the contract provides for the payment of leasing and licensing commissions in the following manner:

> All commissions, except for commissions related to any options or expansions which are exercisable by tenants, shall be paid in full to the Contractor by the Authority upon receipt of Contractor's invoice and commencement of rent payments under the new lease.

Based on this clause, it is the MBTA's practice to pay TRA in advance for all its possible commissions to be earned over the life of each new lease obtained. We have noted that in some instances TRA has received advance payments from the MBTA for as much as 10 years' worth of commissions at the time the leases have been signed. We have determined, through a survey of major commercial real estate brokers in the Boston area, that it is the industry's practice to require the full payment of all commissions due at the lease signing. However, we were informed that the timing of the commissions paid could be subject to negotiation. Accordingly, the MBTA should have negotiated a provision for the prorated refund of any commissions paid in the event that tenants' default on their lease payments. This is especially important when dealing with tenants whose financial and credit ratings are considered less than optimal. Therefore, the MBTA has paid commissions based on rental income that it may never receive and for which it may never recover. We estimate that the MBTA has made such advance commission payments to TRA of approximately $80,841.

Also, contract exhibit "Table B-1-Summary Term Sheet" provides for the payment of a commission "on new leases in existing facilities," while contract exhibit "Table B-2-Commission/Fee Schedule" states that no commission is due for new leases or licenses in existing facilities. Indeed, the confusion regarding what transactions are eligible for commissions, and for how much, forced the MBTA's Director of Real Estate in April 1997 to request from TRA a letter clarifying TRA's fees and commissions. However, TRA, in reviewing the circumstances under which it would be eligible for a commission, interpreted

"what the [contract] provisions contemplate[d]" and in so doing created a property transaction category of "new leases in existing facilities" that would now be eligible for a full commission, contrary to exhibit "Table B-2" of the contract.

The inability of the MBTA to properly review the draft proposed contract to ensure that all ambiguous or contradictory terms and provisions pertaining to fees and commissions, and how and when they are earned and properly payable to TRA, has exposed the MBTA to additional and unwarranted contract costs.

Recommendation: The MBTA should:

- Calculate all "new income production" fees only on the increased amount of revenue to be realized for all new leases and licenses over and above what it is presently receiving for these properties by the current tenants.
- Ensure that all new income production fees paid to TRA since the contract's inception were properly computed and verified to prior tenants' scheduled rent.
- Notify TRA that all future commissions will be prorated over the life of each lease and will be paid annually based on the rental payments actually received. In addition, TRA should be made to repay any future commissions that they have already received for any tenant who fails to fulfill his rental obligations.
- Amend the TRA contract to clarify the terms and conditions of all future fees and commissions.
- Ensure that all future contracts entered into for the management of its real estate department be absolutely clear as to how and under what circumstances a fee or commission is properly earned and paid.

Auditee's Response:

The MBTA agrees that "new income production" fees should be paid only on the difference between old lease payments and new payments. In addition, the MBTA has already recovered any money inadvertently paid to TRA on the entire lease payment.

The MBTA will follow OSA's recommendations for clarifying contract language where appropriate. However, the MBTA does not think that it can unilaterally change the lease payment provisions of the contract.

The OSA received information during its Audit demonstrating that the calculation of the new income production fees was disputed by the MBTA and was subsequently adjusted in statements in July and December of 1998. Further, all subsequent billings of the New Income Production Fees have been paid by the MBTA on the basis of the formula favored by the MBTA and the OSA.

The OSA's own survey of major commercial real estate brokers indicates that the contract's treatment of commissions on long term agreements is in keeping with usual business practices in the industry.

The "contradiction" between table B-1 and table B-2 was reconciled consistent with the intent of the contract and in accordance with standard business practices and did not "create a new class" as described by the OSA. The commissions are not unwarranted because the time and effort involved in publicly bidding and securing new tenants for existing facilities is commensurate with the commissions paid. A survey of Boston real estate brokers show that the process of securing new tenants in existing space is always accompanied by a payment of the full commission.

Auditor's Reply: As indicated in our report, MBTA officials were unaware that the MBTA was being overcharged for these new income production fees until the OSA informed them of this fact. We acknowledge that corrective action appears to have been taken by the MBTA, but we urge it to verify in each case the prior tenant rental income used by TRA in computing the fee.

Our survey results indicated that through prudent and aggressive negotiations all things are possible, including the timing of when commissions are earned and paid. Again, the MBTA failed to protect its own interests by requiring at least a prorated refund of prepaid commissions for any tenants that default on their lease payments. In its response, the MBTA does not address whether it ever attempted to negotiate in the contract a clause dealing with the timing of commissions paid for long-term leases. In addition, our survey indicated that the current private market rate for commissions on the sale of surplus property range from 3% to 6% of the sale price. However, the MBTA agreed via its "negotiations" to pay TRA a 10% sales commission, up to 200% more than what most major commercial real estate brokers charge their private customers.

4. Improvement Needed in MBTA Oversight of TRA Activities

During a site review at TRA's offices, we reviewed and tested certain TRA-initiated transactions to determine the level and effectiveness of MBTA oversight over TRA. We noted the need for improved MBTA oversight in several areas, including: accounts receivable adjustments initiated by TRA; calculation errors for the billing of certain commissions; and the failure by TRA to award engineering, legal, and appraisal contracts in an open and competitive manner. Specifically, we found the following:

- Ten out of 13 accounts receivable balance adjustments tested did not have evidence of MBTA review and prior approval as required by the services contract between the MBTA and TRA.

- Four out of four professional services contracts awarded for engineering, legal, and appraisal services were not publicly advertised, and competing bids were not formally obtained; instead competing bids were informally solicited.

- Three invoices out of 13 tested for fees and commissions billed by TRA and paid by the MBTA contained computational errors.

- Double payment of a legal services bill for $9,843 was made by the MBTA and TRA. This error was later corrected in subsequent billings to the law firm by the MBTA.

- TRA submitted in error five duplicate invoices for payment totaling approximately $771,000, which were subsequently cancelled and corrected.

- Also, in reviewing MBTA records we determined that the MBTA could not locate, in its files, 22 out of 84 (26% of invoices) submitted by TRA during the period of review.

The MBTA and TRA have developed a written set of "Operating Policies and Guidelines," the purpose of which is to ensure that TRA is providing its services in a manner that is consistent with MBTA policies. These guidelines establish the level of review and approval required by the MBTA before various kinds of property documents are executed. The MBTA's Director of Real Estate is responsible for reviewing and approving all of the above-mentioned transactions to ensure that they are in compliance with the MBTA's established operational rules and regulations, as well as the operating policies and guidelines adopted for this contract.

Recommendation: The MBTA's Director of Real Estate should ensure that TRA is complying with the "Operating Policies and Guidelines." In addition, prior signature authority by the Director should be obtained before any accounts receivable are written off as uncollectible. Finally, all invoices submitted by TRA for payment should be reviewed for mathematical accuracy.

Auditee's Response: The MBTA stated, in part:

- The [ten] cases cited were in fact mostly the correction of posting errors by the MBTA. The procedure followed by TRA is to obtain MBTA approval for the write-off of uncollectible accounts. For pre-contract period receivables, the practice has been interpreted to mean that if TRA found documentation in the file authorizing the write off, but no action had been taken by the previous MBTA accounts receivable clerk, TRA compiled the backup data and made the adjustment without further MBTA approval. . . .

- Appraisal Services are routinely hired through an RFP process. Competitive bids were obtained in two of the four cases cited. The MBTA Law Department advises TRA and approves the selection of outside counsel. Counsel for the MBTA telecommunications project was selected because the firm was considered the foremost expert in Boston in telecommunications law, having been the firm to draft the current legislation. Part of the purpose of the Services Contract was to streamline the process in order to effectively manage the assets. In keeping with the spirit of competitive bidding, TRA has developed competitive proposals prior to selecting subcontractors.

- The MBTA acknowledges there were errors early in contract performance which were identified by the MBTA. The cited errors in new income production fees were corrected in July and December Statements as stated above.

- As stated by the OSA, the double payment of a single legal services bill was later corrected.

- There do not appear to be duplicate billings made by TRA and the MBTA. Additional information provided OSA by the MBTA may account for the difference of opinion.

- "MBTA could not locate 22 out of 84 invoices." The MBTA did locate all of the invoices requested.

In regard to the recommendations provided by OSA on this section, the Director of Real Estate will continue to review invoices for mathematical errors, sign off on accounts receivable write-offs and insure that TRA complies with the "Operating Policies and Guidelines."

Auditor's Reply:

- Although only three of 10 adjustments were in fact accounts receivable write-offs, the fact remains that all 10 adjustments affected amounts owed to the MBTA for which prior approval should have been obtained. We urge the MBTA to "interpret" the process for all receivables adjustments over a set dollar amount to require prior MBTA authorization.

- We reiterate that these four professional services contracts were not awarded in an open and competitive manner. The informal process used by TRA to solicit bids from pre-selected vendors for two of these contracts fails to meet the open and competitive criteria advocated by sound business practices.

- Five duplicate billings were in fact submitted by TRA to the MBTA. Fortunately, these erroneous invoices were not paid and were subsequently cancelled. This situation highlights the need for the MBTA to closely monitor TRA's activities.

- Finally, we agree that the MBTA did locate all the invoices requested. However, 22 of these invoices could not be located in the MBTA's files. Instead, duplicates were requested from TRA's files, which indicates a lack of proper contract administration on the part of the MBTA.

5. Contract Award for License for Concessions Circumvented Open and Competitive Bid Process

Effective January 1, 1998, the MBTA granted an exclusive license to install and operate 120 soft-drink vending machines at 30 rapid transit stations located on the Red, Orange, Blue, and Green lines

(subsequently limited to the Red Line only) to a major bottling company without seeking competing bids from other companies. The term of this agreement was from January 1, 1998 to December 31, 1998, and the compensation to be received by MBTA was as follows:

Sales Commissions	35% of gross sales
Sponsorship Fee	$50,000 – paid to MBTA Marketing Department
Marketing Funds	$50,000 – paid to MBTA Marketing Department

Based on a review of Sales/Commission Reports supplied by the vendor to the MBTA, we estimate the sales value of this no-bid contract to be approximately $400,000 for the one-year term. When we asked MBTA officials why this concession license was not awarded on a competitively bid basis, they stated that they were authorized to do so under the MBTA's enabling legislation, Chapter 161A, Section 5(c), of the General Laws, which states, in part:

> Any concession or lease of property for a term of more than one year [emphasis added] or development agreement shall be awarded to the highest responsible and eligible bidder therefor unless the authority shall find that sound reasons in the public interest require otherwise.

MBTA officials reasoned that, since this lease term was for exactly one year, it did not violate the letter of the law and therefore did not have to be competitively bid. However, it is our contention that, although the awarding of this lease for exactly one year may not have violated Chapter 161A, it certainly avoided both the spirit and intent of the law, as well as prudent and sound business practice, since other potential bidders were denied the right to compete for this concession lease in an open and fair process. By failing to award this lease in an open and competitive manner, the MBTA may have deprived itself of increased commission and fee revenue. Furthermore, once the lease is properly offered via a competitive bid process, the current bottling company may have an unfair advantage over its competitors, since it will have already recovered a significant amount of its initial cost to install the vending machines during the term of this no-bid lease. Also included in the terms of this no-bid lease is a very favorable clause that benefits the bottling company, providing that the bottling company must be reimbursed for its unrecovered capital costs by any future successor lessee. This clause may very well reduce the maximum potential bids to be received from other bottling companies.

This no-bid lease expired on January 1, 1999, and the tenant currently remains on a monthly basis, pending the MBTA's issuance of a public request for competitive bids, which was projected by MBTA officials to occur in June 1999.

Recommendation: The MBTA should:

- Immediately solicit competitive bids in an open and public manner to ensure that the new concession lease for its soft-drink vending program is awarded to the highest eligible bidder.
- Stop the practice of awarding no-bid concession leases and avoiding the intent of its governing statute, and instead award all future leases based on an open public process.

Auditee's Response: In response, the MBTA stated, in part:

> When the OSA asked MBTA officials why this concession license was not awarded on the basis of a competitive bid, the MBTA replied that it is permissible to proceed with such a contract, but more importantly provided the OSA with sound business reasons for proceeding with a pilot project. Prior to committing the MBTA to an extensive program it was not sure it wanted to pursue over the long term, the MBTA wanted to study the effects of such a program on a small scale.
>
> Although the license agreement allowed for the possibility of installations on all of its subway lines, the implementation of the program was deliberately limited by the MBTA to the Red Line. Second, the pilot program was necessary to establish the operational impacts including the effect on free flow of MBTA patrons through the system during construction as well as during the on-going servicing of the vending units; the impact on other concession business in the affected stations; impact on MBTA facilities by the movement of product through the stations and on MBTA elevators and stairwells; and the security considerations in terms of vandalism to vending equipment and theft and the consequential impact on MBTA Police resources.
>
> The MBTA does not agree that one vendor has been given a competitive edge. Although that vendor can recover some of its capital costs, it had to put up this money first. In addition, the remaining capital costs are in effect a cost of doing business no matter who the vendor is and, therefore, these costs result in "less" money to the MBTA, then if the capital costs had been completely amortized. These costs will be completely amortized at the conclusion of the next long-term bid.
>
> The value of [the current vendor's] improvements within MBTA facilities is $120,000. If [the current vendor] is not the successful bidder for the Vending Request for Proposal, the successful bidder will benefit from the electrical installations. The new operator would pay approximately $72,000 to [the current vendor] for installations that cost [the current vendor] $120,000. The $72,000 would be paid directly to [the current vendor] and would not be calculated in the bid.
>
> The experiences of the pilot program have been well documented and were invaluable in making the decision to proceed with the expansion of the program over a longer term, and in producing an RFP [Request for Proposals] which takes into consideration all of the lessons learned. A review of other publicly bid vending contracts and adjustments for existing

> infrastructure and [the current vendor's] marketing payments (State Transportation Building 17% of Gross Revenues and Massport 42.5% of Gross Revenues) confirms that 35% of gross revenues plus $100,000 in payments to the MBTA was a fair market value. The reasoning of the OSA regarding the reimbursement of infrastructure costs to [the current vendor] is troublesome since it actually levels the playing field between [the current vendor] and other bidders and lets bidders know up front a significant portion of their capital costs.
>
> The MBTA strongly disagrees that the MBTA uses pilot programs to circumvent the intent of MGL chapter 161 Section 5(c). The MBTA uses the flexibility permitted by state laws to make sound business decisions for the benefit of the taxpayers of the Commonwealth. Moreover, the MBTA obviously embraces the inherent values of the competitive bidding process. The vending RFP is completed and will be publicly bid on June 8, 1999.

Auditor's Reply: We agree with the MBTA's decision to implement this vending program via a "pilot" or test basis on the Red Line only. The issue remains that the MBTA denied other vendors the opportunity to submit competing pilot proposals and competing commissions payments for this $400,000 contract. Without this open and competitive process, the MBTA cannot ensure that it received the maximum possible compensation. Also, it is indeed reasonable to assume that the current vendor recovered all its capital costs during the term of its one-year no-bid contract. This may allow the vendor to outbid its competitors once this contract is publicly bid. Finally, the assumption that the $72,000 in so-called "unrecovered" installation costs will be paid by the next successful bidder is unfounded. In reality, the MBTA will bear the actual cost of reimbursing the current vendor through reduced commissions that it will receive from the new operator.