



METRO

Office of the Auditor

TRANSIT-ORIENTED DEVELOPMENT PROGRAM AUDIT FOLLOW-UP

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November 17, 2010

SUMMARY

The Metro Auditor's Office assessed the Transit-Oriented Development (TOD) Program's implementation of recommendations from the 2008 audit "**Transit-Oriented Development Program: Improve transparency and oversight.**" We found the TOD Program implemented three of the twelve recommendations contained in the original audit report. Nine recommendations remain in process or not implemented. The TOD Program needs to fully implement recommendations related to oversight, transparency of funding sources, cost-effectiveness analyses and a policy to reduce the risk of repeat investments with the same developer.

BACKGROUND

Metro's Transit-Oriented Development (TOD) Program provides incentives to developers to build mixed-use, higher density projects near public transit. It was transferred from TriMet to Metro in 1996. In August 2008, Metro's Office of the Auditor released an audit report of the TOD Program. The report contained twelve recommendations focused on improving transparency and oversight. The purpose of this report is to follow-up on each of the recommendations to determine what progress has been made to implement them.

SCOPE AND METHODOLOGY

To determine what progress was made, we conducted interviews with management, staff and members of the Program's Steering Committee. We reviewed reports, meeting minutes, contracts and other documentation related to each of the recommendations.

We conducted our follow-up audit work 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.

RESULTS

We found the TOD Program implemented three of the twelve recommendations. Six recommendations were in process and three were not implemented. The TOD Program was in the middle of a strategic planning process that included work elements related to four of the six recommendations that are in process. We determined that little progress had been made on the remaining three recommendations.

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RECOMMENDATIONS IMPLEMENTED

The TOD Program implemented the following three recommendations:

- Develop a consistent and publicized process for selecting projects (Recommendation A1);
- Advertise the TOD Program's criteria and selection process periodically (Recommendation A2); and
- Improve administrative procedures for file management (Recommendation C1).

The TOD Program developed and posted on its web site a brochure, presentation and other information about the project selection process and criteria. Our review of project and contract files found administrative procedures had improved, resulting in better file management and supporting documentation. Contract and project files were well organized and contained appropriate documentation.

RECOMMENDATIONS IN PROCESS

Progress was made on the following six recommendations, but they were not fully implemented:

- Re-examine selection criteria (Recommendation A3);
- Develop a policy to address the risk of repeat investment in projects with the same developer (Recommendation A4);
- Document key assumptions used in cost effectiveness analyses (Recommendation A5);
- Standardize the template used for cost effectiveness analyses (Recommendation A6);
- Report the actual source of program funding (Recommendation B1); and
- Clarify the role of the TOD Steering Committee in oversight and selection of projects (Recommendation D1).

Some of these recommendations were intended to be addressed through a strategic planning process that began at the beginning of 2010. Other recommendations were partially addressed in the last two years, but remain incomplete.

The TOD Program hired a consultant to help develop its strategic plan. The consultants are due to make recommendations by the end of the year. Their recommendations will be used to make revisions to the TOD Program Work Plan in 2011. The Work Plan was last updated in 2007. The results of the strategic planning process are likely to impact four of the six recommendations listed above related to the project selection criteria, cost-effectiveness analyses and Steering Committee oversight.

In addition to the potential changes associated with the strategic plan, some work was done on these recommendations. The TOD Program made some progress on developing a policy to address the risk of repeat investments in projects with the same developer. A draft Recurring Investment Policy was discussed with the Steering Committee. The policy was never formally approved or included as part of the TOD Program Work Plan. It is unclear if the policy is currently in effect.

Besides the question of whether the policy was in effect, additional questions about which projects it applies to came up during our work. Management stated that the Recurring Investment Policy does not apply to Urban Living Infrastructure projects because these types of projects are for a different purpose than other TOD grants. Most TOD grants are intended to help a project get built. Urban Living Infrastructure grants are for improvements to the retail space in buildings to help attract businesses to occupy the space. As a result of this distinction, management does not view grants for Urban Living Infrastructure as repeat investments even if they are in buildings that received a TOD grant in the past.

If the policy does not apply to some grant types, it's not clear if the TOD Program is addressing the risk identified in the 2008 audit report. That report noted "...that project failure can have a negative impact on efforts to demonstrate market viability. As a result, the TOD Program is willing to continue to support a troubled project. Explicitly stating a policy regarding this practice would increase program transparency."

Our review of projects approved in the last two years found an example of a grant for Urban Living Infrastructure that raised the same type of risk that was identified in the 2008 audit report. In February 2010, the TOD Program approved a grant for improvements to the retail space of the 3rd Central TOD project in Gresham to attract a specialty grocery store to occupy the space. That project received an original TOD grant in May 2007. Total funding for the two awards was \$430,000. The second grant award increased the risk that the TOD Program will become overly reliant on the success of certain developers or projects. The grocery store that leased the space is 90% owned by the company that developed and owns the 3rd Central building. If either project, residential or retail, is unsuccessful, it could cause problems for the other.

If the Recurring Investment Policy covers Urban Living Infrastructure grants, this project would not have met the conditions for "repeat investments." The Policy states that when the TOD Program elects to provide additional funds to a project that has already received funding, the total investment amount must not exceed the lesser of the cost-effectiveness analysis or cost premiums.

Project	Project Type	TOD Grant Award
3rd Central (May 2007)	TOD/Center Easement	\$345,000
3rd Central (Feb 2010)	Urban Living Infrastructure	\$ 85,000
Total		* \$430,000

** Aggregate investment amount \$430,000 exceeded the cost-effectiveness calculation of \$343,000 (the lesser of the original cost-effectiveness calculation and cost premiums).*

The TOD Program needs to clarify:

- whether the Recurring Investment Policy is in effect;
- what types of projects it applies to; and
- whether the current draft of the policy is sufficient to address the risks identified in the 2008 audit and this follow-up audit.

The assumptions and templates used for cost-effectiveness analyses are another area where some progress was made, but the recommendations have not been fully implemented. Cost-effectiveness analyses are an important tool in the project selection process. They are used to estimate the additional public transit revenues that are anticipated to result from the project over a thirty-year period. The TOD Program uses the results of cost effectiveness analyses to make recommendations to the Steering Committee about the amount of public funds that should be invested in a TOD project.

Project cost-effectiveness analyses were not standardized or used consistently. The assumptions used in the analyses varied between projects. Some of the variation in assumptions may be appropriate, but there was no supporting documentation to explain how and why different assumptions were made. The discount rates used in the calculations were inconsistent with those listed in the key assumptions section of the analysis template. There was variation in the assumptions used for the percentage of the building's residents who would use public transportation and the percentage of the project's costs not directly related to construction. Small changes to assumptions can have a large impact on the amount of funding a project is eligible to receive. Clear documentation and explanations for each of the assumptions used is needed to ensure transparency about how funding amounts were derived. Without them, the decision-making rationale could be called into question.

In its 2010 Annual Report, the TOD Program increased transparency by stating that it exchanges funds. Management stated it will add a note to future annual reports to identify TriMet as Metro's partner in this exchange. Funding for the TOD Program involves an exchange of funds between TriMet and Metro. A portion of federal Metropolitan Transportation Improvement Program (MTIP) funds are allocated to the TOD Program. Metro then exchanges these funds for an equal amount of TriMet general funds. Internal budget reports increased transparency by listing "Localized MTIP (TriMet exchanged funds)" as the TOD Program's main funding source. Adding this information to public documents would increase transparency about program funding.

RECOMMENDATIONS NOT IMPLEMENTED

Three recommendations were not implemented:

- Develop a regular report that shows a comparison of projects in terms of the results they achieve (Recommendation D2);
- Develop a method for tracking and reporting complete project costs by project (Recommendation D3); and
- Develop procedures to monitor projects after they are completed (Recommendation D4).

The TOD Program did not develop reports or procedures to monitor completed projects. These recommendations are important for a number of reasons including:

- To ensure the Steering Committee and Metro Council have complete information during the project selection process;
- To verify that project funding agreements are met; and
- To evaluate the effectiveness of investments relative to outcomes they achieve.

Funding agreements for TOD projects often contain provisions to ensure that the projects comply with the TOD Program's funding conditions and policies. These agreements form the basis for project monitoring. Procedures to monitor completed projects would help ensure that the TOD Program received what it paid for. In addition, procedures can help ensure that the TOD Program is consistent when monitoring projects.

Monitoring and reporting about completed projects helps evaluate the impacts of TOD projects. The over arching goal of the TOD Program is creating higher density, mixed use improvements near public transit stations to reduce dependence on the automobile. Surveys of TOD project users and/or other comparisons of projects could help assess the assumptions used by the TOD Program. Moreover, it would help evaluate the impact of TOD projects on the regionally desired outcomes in the 2040 Growth Plan.

The TOD Program recently signed an agreement with Portland State University for surveys of travel behavior at some TOD projects. We determined that this effort did not meet the intent of the original audit recommendation because it is not a regular report and it only includes surveys of four of the fifteen projects completed in the last five years. Management stated that an additional three projects will be added to the analysis which would bring the total to seven projects.

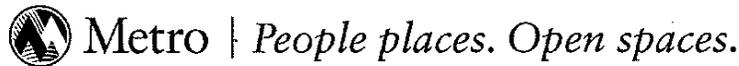
AREAS NEEDING FURTHER ATTENTION

While the TOD Program implemented some recommendations, the majority of recommendations were not fully implemented. Key issues related to oversight and transparency remain:

- 1) TOD Program oversight needs to be clarified and formalized in the TOD Program Work Plan to provide guidance about what aspects of the TOD Program's administration, policies and project selection require formal action by the Steering Committee or Metro Council.
- 2) The Recurring Investment Policy should be reevaluated to determine if it is sufficient to address the risks associated with recurring investments. Next, it should be formally approved by the Steering Committee or Metro Council and be included in the TOD Program Work Plan.
- 3) The assumptions and templates used for cost effectiveness analyses need to be standardized to reduce inconsistencies and improve transparency.
 - a. Ensure assumptions listed in the "Key Assumptions" section are used in the analysis
 - b. Provide an explanation and documentation to justify the assumptions used in the analysis
 - c. Ensure analyses use the most recent template and assumptions
- 4) The TOD Program should develop a consistent methodology to determine the level of investment for Urban Living Infrastructure projects.

STATUS OF METRO AUDITOR RECOMMENDATIONS

2008 Recommendations	Status
A. To improve project selection, the Transit-oriented Development Program should:	
1. Develop a consistent and publicized process for selecting projects for TOD funding.	<i>IMPLEMENTED</i>
2. Advertise the Program's selection process and criteria periodically.	<i>IMPLEMENTED</i>
3. Re-examine selection criteria.	<i>IN PROCESS</i>
4. Develop a policy to address the risk of repeat investments in projects with the same developer.	<i>IN PROCESS</i>
5. Document key assumptions used in cost-effectiveness analyses, including transit mode share, discount rates and how loans are treated.	<i>IN PROCESS</i>
6. Standardize the template used for cost-effectiveness analyses.	<i>IN PROCESS</i>
B. To improve transparency, the Program should:	
1. Report the actual source of program funding.	<i>IN PROCESS</i>
C. To improve administrative procedures, the Program should:	
1. Work with the Procurement Office to ensure that documentation required by Metro is maintained.	<i>IMPLEMENTED</i>
D. To improve project oversight, the Program should:	
1. Clarify the role of the TOD Steering Committee in oversight and selection of projects.	<i>IN PROCESS</i>
2. Develop a regular report that shows a comparison of projects in terms of the results they achieve.	<i>NOT IMPLEMENTED</i>
3. Develop a method for tracking and reporting complete project costs by project.	<i>NOT IMPLEMENTED</i>
4. Develop procedures to monitor projects after they are completed.	<i>NOT IMPLEMENTED</i>



Date: November 15, 2010

To: Suzanne Flynn, Metro Auditor

From: Michael Jordan, Chief Operating Officer
Robin McArthur, Director, Planning and Development Department

Re.: Transit Oriented Development Program Audit Follow-up dated October 2010

We have reviewed the Transit Oriented Development Program Audit Follow-up report. Thank you for the opportunity to review the status of our work to address the 2008 Audit Recommendations. We are pleased to report that we have made significant progress on the previous audit recommendations and that the majority of the recommendations identified have been implemented or are in the process of being implemented.

As you are aware, the TOD Program undertook a Strategic Planning process in early 2009. This effort is intended to allow the program to be more focused with its program resources as well as more clearly define program activities. The Strategic Plan is anticipated to be completed by the end of the year, after which the TOD Program Work Plan will be overhauled to not only incorporate the new direction of the Strategic Plan, but also to address many of the audit recommendations.

The attached table presents our responses to the follow-up audit findings regarding progress in implementing the twelve original recommendations and one new recommendation. Each recommendation is restated and referenced by the original audit report numbering system (A1, A2, etc.) That status of the audit recommendations is as follows:

Recommendations implemented	3	(A1, A2, C1)
Recommendation implemented per 2007 mgt. response	1	(D3)
Recommendations being implemented immediately	2	(A5, A6)
Recommendations in the process of being implemented	<u>6</u>	(A4, B1, D1, D2, D4, new)
	12	

We appreciate the work of you and your staff to review our progress and anticipate the TOD Program will continue to improve as audit recommendations continue to be implemented.

Best regards,

Robin McArthur,
AICP, Director, Land Use and Transportation Planning

cc: Michael Jordan, Chief Operating Officer
Scott Robinson, Deputy Chief Operating Officer
John Williams, Deputy Director, Planning and Development Department
Megan Gibb, Manager, Development Center

Attachment to Transit Oriented Development Program Audit Follow-up Response

Recommendation A1	Develop a consistent and publicized process for selecting projects for TOD funding.
Follow-up audit finding	Implemented

Recommendation A2	Advertise the Program's selection process and criteria periodically.
Follow-up audit finding	Implemented

Recommendation A3	Re-examine selection criteria.
Follow-up audit finding	In process
Management response	Implementation is in process and will be addressed in the revised TOD Program Work Plan.

Recommendation A4	The Recurring Investment Policy should be reevaluated to determine if it is sufficient to address the risks associated with recurring investments. Next, it should be formally approved by the Steering Committee or Metro Council and be included in the TOD Program Work Plan.
Follow-up audit finding	In process
Management response	Implementation is in process and will be addressed in the revised TOD Program Work Plan. -In response to the original audit, the Recurring Investment Policy was drafted by the Office of the Metro Attorney and then formally presented for review by the TOD Steering Committee. The policy will be reevaluated, formally approved and included in the TOD Program Work Plan when it is revised in 2011.

Recommendations A5 & A6	The assumptions and templates used for cost effectiveness analyses need to be standardized to reduce inconsistencies and improve transparency: a. Ensure assumptions listed in the “Key Assumptions” section are used in the Analysis. b. Provide an explanation and documentation to justify the assumptions used in the analysis. c. Ensure analyses use the most recent template and assumptions.
Follow-up audit finding	In process
Management response	This will be implemented immediately. When this finding was identified in the original audit, staff instituted a practice of annual updates to each of the financial and travel behavior assumptions used in cost-effectiveness calculations. Work procedures will be adjusted to provide additional documentation of assumptions and to verify the consistent use of the most recent templates.

Recommendation B1	Report the actual source of program funding.
Follow-up audit finding	In process
Management response	Implementation is in process. Staff attempted to address this finding immediately during the initial audit in 2008 by adding language regarding the source of program funding and the fund exchange with Trimet to the Metro website, in the TOD annual report, and on financial reports to the TOD Steering Committee. However, staff will work to develop language that is satisfactory to the Auditor’s office.

Recommendation C1	Work with the Procurement Office to ensure that documentation required by Metro is maintained.
Follow-up audit finding	Implemented

Recommendation D1	TOD Program oversight needs to be clarified and formalized in the TOD Program Work Plan to provide guidance about what aspects of the TOD Program's administration, policies and project selection require formal action by the Steering Committee or Metro Council.
Follow-up audit finding	In process
Management response	Implementation is in process and will be addressed in the revised TOD Program Work Plan. Implementation of this recommendation is part of a strategic planning process currently underway, which benefits from consultation provided by the Center for Transit Oriented Development, Strategic Economics, and Nelson Nygaard. The consultants' are nationally recognized experts in transit oriented development and public-private partnerships; their recommendations will be used to make revisions to the TOD Program Work Plan in 2011.

Recommendation D2	Develop a regular report that shows a comparison of projects in terms of the results they achieve.
Follow-up audit finding	Not implemented
Management response	Implementation is in process and will be addressed in the upcoming effort to revise the TOD Program Work Plan. This recommendation was implemented as stated in the original response by providing the TOD Steering Committee with staff reports that present data in tables to facilitate project comparisons when new projects are recommended for funding. In addition, program results are reported in the TOD Program annual report and Metro's annual program-performance budget. Portland State University also conducts travel behavior studies specific to completed TOD Projects in order to isolate the travel behavior changes that result from our TOD investments. However, Audit staff have specifically suggested providing the Steering Committee with a listing of cost per induced rider statistics for all projects approved over the life of the program. This recommendation will be reconsidered as part of the Work Plan rewrite to be undertaken following completion of the Strategic Plan.

Recommendation D3	Develop a method for tracking and reporting complete project costs by project.
Follow-up audit finding	Not implemented
Management response	Program staff took steps to implement this item according to the management response in 2008. The TOD Steering Committee is provided with regular budget updates that detail program revenues and expenditures by project, by source of funds. However, audit staff expressed a preference for combining both the ULI and TOD project investments on the one page budget reports. We will continue to refine and enhance information provided to Steering Committee members, the Metro Council and the public in order to address the auditor's concern.

Recommendation D4	Develop procedures to monitor projects after they are completed.
Follow-up audit finding	Not implemented
Management response	Implementation is in process and will be addressed in the upcoming effort to revise the TOD Program Work Plan. It should be noted that procedures are in place to "verify that project funding agreements are met" and to "ensure that the TOD program received what it paid for." Onsite inspections are conducted before funds are released to ensure that projects have been built as approved. The TOD Program has been contracting with Portland State University since 2005 for travel behavior studies of TOD projects near MAX stations, after the residential portion of the projects become fully occupied. The residential portions of all TOD Projects on light rail have been or currently are under study. It was not considered cost-effective to survey residents of projects located on frequent bus lines. Similarly, it was not considered cost-effective to pay for the in-person survey methods required to document the travel behavior of all the employees and customers using commercial space. However, this recommendation will be reconsidered and a systematic monitoring system will be put in place as part of the Work Plan revision effort to be undertaken following completion of the Strategic Plan.

New recommendation	Develop a consistent methodology to determine the level of investment for Urban Living Infrastructure (ULI) projects.
Management response	Implementation is in process and will be addressed in the upcoming effort to revise the TOD Program Work Plan. The ULI program is a pilot program designed to improve the economic feasibility of compact, mixed use development by creating a more amenity-rich locale. TOD staff have consistently addressed the eligibility criteria set forth in the TOD Work Plan in staff reports submitted for TOD Steering Committee consideration, which includes an analysis regarding the project's cost-effectiveness. The method for determining cost-effectiveness of a ULI project is different from a TOD project due to differing program objectives. The cost-effectiveness of a ULI project is calculated based upon the impact the Metro investment will have on the value of a near-term, future TOD residential development. The cost-effectiveness of a TOD project is calculated based upon the impact the Metro investment will have on the value of transit ridership over the next 30 years. The Work Plan overhaul can clarify the methodology for ULI project investments to enhance transparency and address this new recommendation.