

# **CITY OF SAN DIEGO'S REAL ESTATE ASSETS DEPARTMENT LEASEHOLD MANAGEMENT HAS WEAKNESSES**

## ***SUMMARY***

Over the past decade, San Diego's Real Estate Assets Department (READ) has been subject to intense scrutiny, beginning with a critical *San Diego Union-Tribune* article in 2006, which prompted the City to commission a Grubb & Ellis study of the department. The core issue of the newspaper article as well as the Grubb & Ellis report was that READ had been unable to accurately track and effectively manage the inventory of City-owned property. The 2006/2007 San Diego County Grand Jury also weighed in, recommending that READ fully implement the findings contained within the Grubb & Ellis study.

The 2016/2017 San Diego County Grand Jury (Grand Jury) evaluated the department to see how well READ is currently functioning and found that the department has made substantial improvement in its operations and tracking abilities. The Grand Jury commends READ for being responsive to the mandate for change.

However, the Grand Jury found that weaknesses persist in READ's ability to manage the City's leaseholds in a timely manner with maximum return. The Grand Jury recommends that READ develop a strategy for renewing its leases in a well-timed manner. The Grand Jury further recommends that READ adopt a policy to issue Requests for Proposals, when appropriate, in an adequate period of time in advance of a lease's expiration. Finally, the Grand Jury recommends that the San Diego City Council work together with READ to revise Council Policies 700-10 and 700-12, two of READ's governing documents, so that they are current and provide the guidance needed to effectively operate the department.

## ***INTRODUCTION***

At the request of the City, the real estate firm of Grubb & Ellis produced an in-depth report that addressed READ's need for a new business model. The Grand Jury became interested in evaluating how well READ has implemented the recommendations in the Grubb & Ellis report and if it is now operating in an efficient manner and can accurately account for and manage the City's real estate inventory.

## ***PROCEDURE***

The Grand Jury reviewed the following documents:

- The 2007 Grubb & Ellis report, "Best Practices Methodology for Real Estate Assets Department"
- The City Auditor's fiscal year 2012 READ Performance Audit #13-009
- Council policies 700-10 and 700-12
- READ's Portfolio Management Plan for fiscal year 2016

The Grand Jury also interviewed officials from the City's financial department, the City Auditor's office, and the Real Estate Assets Department.

## ***DISCUSSION***

In 2006, San Diego's Real Estate Assets Department was in disarray and lacked the ability to account for and properly manage City-owned property. The City of San Diego owns more than 4,000 properties, approximately 500 of which are leased to both for-profit and nonprofit entities. At that time, READ's software was antiquated and ineffective, and the department lacked strong leadership, resulting in an inability to produce an accurate inventory of its properties and to manage them effectively.

A 2006 *San Diego Union-Tribune* watchdog report<sup>1</sup> exposed these weaknesses within READ. In response, the City commissioned the real estate firm of Grubb & Ellis to conduct a study, "Best Practices Methodology for Real Estate Assets Department,"<sup>2</sup> to assess READ's weaknesses and suggest a restructuring of the department. A 2006/2007 Grand Jury report recommended that the City implement the Grubb & Ellis recommendations.

Since then, READ has undertaken a major reorganization, acquired new leadership, implemented modern software, and overcome most of the inadequacies outlined in the 2007 Grubb & Ellis report. The Grand Jury believes that READ deserves a commendation for its receptiveness to the mandate for change and for the fact that it is currently operating at a high level.

### ***Leaseholds***

Nevertheless, certain areas that READ oversees are still in need of attention, specifically, the management of its leaseholds. At the time of this report, approximately 125 out of more than 500 existing leases<sup>3</sup> had expired and were continuing on a month-to-month basis. Some of these leases have been in a state of nonrenewal for a decade or more. The Grand Jury acknowledges that some expired leases are for nonprofit entities, which typically lease for a nominal rate and may lack the urgency for lease renegotiation. Nonetheless, the Grand Jury believes that all leases should be kept current and that negotiations should commence at an appropriate time prior to any lease's expiration.

The Grand Jury recognizes that preparing and issuing a Request for Proposals (RFP) is an arduous task, and READ officials have indicated that they are working through held-over leases and issuing RFPs in an effort to bring them current. However, a proactive plan for doing so is not apparent, and the backlog is being addressed in a piecemeal and reactive manner. Because progress appears to be slow, the Grand Jury believes that READ may not have adequate resources to accomplish this task. The lack of resources and a strategy to bring leases current places lessees of held-over leases at a disadvantage because they do not know from one month to another if their lease will continue or if it will be summarily discontinued. The Grand Jury furthermore believes that held-over leases place the City at a disadvantage because, presumably,

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<sup>1</sup> Brooke Williams and Danielle Cervantes, "Land of Confusion," *San Diego Union-Tribune*, September 18, 2006, [http://legacy.sandiegouniontribune.com/uniontrib/20050918/news\\_1z1n18land.html](http://legacy.sandiegouniontribune.com/uniontrib/20050918/news_1z1n18land.html) (accessed 8/23/16).

<sup>2</sup> "Best Practices Methodology for Real Estate Assets Department," Grubb & Ellis, January 31, 2007, <https://www.sandiego.gov/sites/default/files/legacy/real-estate-assets/pdf/grubbellis070131.pdf> (accessed 8/24/16).

<sup>3</sup> <https://www.sandiego.gov/real-estate-assets/portfolio-management-plan> (accessed 11/2/16).

many held-over leases could continue at less than fair-market value, thereby reducing potential revenue for the City.

The City Auditor conducted a performance audit of READ in 2012. One of its recommendations was for READ to draft a policy for nonprofit leases that “recovers the City’s costs for facilities maintenance and upkeep of the subsidized space, as well as the costs of preparing, processing and monitoring leases.”<sup>4</sup> Although READ has begun assessing this fee in renewed nonprofit leases, the lag in renegotiating many expired leases is preventing the City from recouping actual costs associated with administering such leases.

READ’s Fiscal Year 2016 Portfolio Management Plan<sup>5</sup> includes a goal to “transition month-to-month agreements to long-term leases where appropriate.” This is a fitting philosophy, but it again lacks a strategic plan for accomplishing the goal.

### ***Governing Documents***

The primary governing documents for READ’s leased properties are Council Policies 700-10<sup>6</sup> and 700-12<sup>7</sup>. In discussion with City officials, the Grand Jury learned that Council Policy 700-10, in particular, needs added flexibility to allow READ to make leasing decisions that are in line with current economic conditions. Council Policy 700-12 dates back to 1985 and is sorely in need of revision to reflect current realities. READ officials have assured the Grand Jury that the department is spearheading an effort to revise both policies, and the jury encourages the completion of this task.

### ***FACTS AND FINDINGS***

***Fact:*** Approximately 125 of 500 READ leases are in held-over status.

***Fact:*** READ attests that the department is working on renewal of held-over leases, but progress in that regard is slow.

***Finding 01:*** The lag in renewing expired leases does not allow the City to maximize its revenue potential on leased properties and prevents lessees from developing secure, long-term plans.

***Finding 02:*** READ’s inability to bring the backlog of expired leases current demonstrates a lack of adequate resources.

***Fact:*** READ has no established standard time period for issuing RFPs prior to lease renewal.

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<sup>4</sup> “Performance Audit,” [https://www.sandiego.gov/sites/default/files/13-009\\_read.pdf](https://www.sandiego.gov/sites/default/files/13-009_read.pdf), p. 29 (accessed 11/3/16).

<sup>5</sup> “Portfolio Management Plan,” <https://www.sandiego.gov/sites/default/files/portfoliomanagementplan.pdf>, p. 23 (accessed 10/11/16).

<sup>6</sup> Council Policy 700-10, [http://docs.sandiego.gov/councilpolicies/cpd\\_700-10.pdf](http://docs.sandiego.gov/councilpolicies/cpd_700-10.pdf) (accessed 9/14/16).

<sup>7</sup> Council Policy 700-12, <https://www.sandiego.gov/sites/default/files/legacy/park-and-recreation/pdf/bptf/18.cp700-12dispositionofcityproperty.pdf> (accessed 9/14/16).

**Finding 03:** A policy for time-sensitive issuance of RFPs would promote fairness and accountability.

**Fact:** Council Policy 700-10 does not allow downward lease rate adjustments.

**Fact:** Council Policy 700-12 has not been updated since 1985.

**Finding 04:** Council Policy 700-10 is too rigid and needs revising, and Council Policy 700-12 is outdated, preventing READ officials from making sound leasing decisions that accurately reflect current economic conditions.

## ***RECOMMENDATIONS***

**The 2016/2017 San Diego County Grand Jury recommends that the San Diego City Council:**

- 17-01: Within fiscal year 2018, provide resources to the Real Estate Assets Department—either additional personnel or through outsourcing—to develop a proactive strategy for bringing held-over nonprofit and for-profit leases current.**
- 17-02: Direct the Real Estate Assets Department to establish, within fiscal year 2018, a standard time frame for issuing RFPs on expiring leases.**
- 17-03: Work with the Real Estate Assets Department to revise and update Council Policies 700-10 and 700-12 within fiscal year 2018.**

## ***REQUIREMENTS AND INSTRUCTIONS***

The California Penal Code §933(c) requires any public agency which the Grand Jury has reviewed, and about which it has issued a final report, to comment to the Presiding Judge of the Superior Court on the findings and recommendations pertaining to matters under the control of the agency. Such comment shall be made *no later than 90 days* after the Grand Jury publishes its report (filed with the Clerk of the Court); except that in the case of a report containing findings and recommendations pertaining to a department or agency headed by an elected County official (e.g. District Attorney, Sheriff, etc.), such comment shall be made *within 60 days* to the Presiding Judge with an information copy sent to the Board of Supervisors.

Furthermore, California Penal Code §933.05(a), (b), (c), details, as follows, the manner in which such comment(s) are to be made:

- (a) As to each grand jury finding, the responding person or entity shall indicate one of the following:
  - (1) The respondent agrees with the finding
  - (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.
- (b) As to each grand jury recommendation, the responding person or entity shall report one of the following actions:

- (1) The recommendation has been implemented, with a summary regarding the implemented action.
  - (2) The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
  - (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the grand jury report.
  - (4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.
- (c) If a finding or recommendation of the grand jury addresses budgetary or personnel matters of a county agency or department headed by an elected officer, both the agency or department head and the Board of Supervisors shall respond if requested by the grand jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision making authority. The response of the elected agency or department head shall address all aspects of the findings or recommendations affecting his or her agency or department.

Comments to the Presiding Judge of the Superior Court in compliance with the Penal Code §933.05 are required from the:

<b><u>Responding Agency</u></b>	<b><u>Recommendations</u></b>	<b><u>Date</u></b>
<b>San Diego City Council</b>	<b>17-01 through 17-03</b>	<b>03/02/17</b>