CITY OF SAN DIEGO LEASEHOLD MANAGEMENT STILL HAS WEAKNESSES

SUMMARY

The 2021/2022 San Diego County Grand Jury (Grand Jury) studied concerns regarding the lease and operations of the City of San Diego-owned property at 2800 Torrey Pines Scenic Drive, La Jolla, CA, also known as the Torrey Pines City Park and the Torrey Pines Gliderport (TPG).

As a result of the investigation into the TPG, the Grand Jury found that the City of San Diego (City) continues to have a large portfolio of holdover leases – leases that have never been officially renewed (some are decades old) and continue in perpetuity under the original terms. This topic has been officially addressed in a prior Grand Jury report[1] and two separate reports by the City Auditor.[2] [3] These leases are managed by San Diego's Department of Real Estate and Airport Management (formerly known as Real Estate Assets Department and referred to in this report as DREAM).

Many of the lease issues are the result of persistent understaffing at DREAM. As noted in the 2022 City Auditor report entitled, "Performance Audit of the City's Lease Management and Renewal Process," understaffing causes the department to be reactive, rather than proactive.[4] Leases are frequently reviewed because of political will or administrative choice, rather than through a documented process.

The Grand Jury recommends that the City of San Diego Department of Real Estate and Airport Management: consider outsourcing or short-term hiring to immediately evaluate all leases on holdover status; consider developing a process of the return of good faith deposits in cases where the resulting lease is not able to be executed; review insurance requirements on holdover properties; create a consistent and thorough process for inspections of all properties; update Council Policy 700-10; and conduct a comprehensive staffing analysis to ensure leases are managed proactively.

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[1] 2016/2017 Grand Jury Report: City of San Diego's Real Estate Assets Department Leasehold Management Has Weaknesses, https://www.sandiegocounty.gov/content/dam/sdc/grandjury/reports/2016-2017/RealEstateAssetsDepartmentReport.pdf.
[2] Office of the City Auditor, City of San Diego, "Performance Audit of the Real Estate Assets Department," December 2012, https://www.sandiego.gov/sites/default/files/13-009_read.pdf
[3] Office of the City Auditor, City of San Diego, "Performance Audit of The City's Lease Management And Renewal Process," February 2022 https://www.sandiego.gov/sites/default/files/22-007_lease_mgmt_renewal_process.pdf.
[4] Ibid.

INTRODUCTION

In 2016/2017 the Grand Jury issued a report entitled, "City of San Diego's Real Estate Assets Department: Leasehold Management Has Weaknesses." The Grand Jury had three recommendations:

- 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.
- Direct the Real Estate Assets Department to establish, within fiscal year 2018, a standard time frame for issuing RFPs on expiring leases.
- Work with the Real Estate Assets Department to revise and update Council Policies 700-10 (*Disposition of City-Owned Property*) and 700-12 (*Disposition of City Property to Nonprofit Organizations*) within fiscal year 2018.

The 2021/2022 Grand Jury's investigation focused only on the TPG lease. However, since the issues found mirror those of the prior reports mentioned, there is a concern that this lease is emblematic of similar issues that may exist for many of the 120 properties on holdover as of February 2022.

METHODOLOGY

The Grand Jury researched relevant policies, documents, and websites, and interviewed representatives from DREAM, the City of San Diego Department of Parks and Recreation, and the TPG, to evaluate the status of the lease of the TPG property as well as other related operational issues.

The Grand Jury also reviewed the following reports and audits in the leasing of City properties:

- December 2012 Audit Report from the City of San Diego Office of the City Auditor, "Performance Audit of the Real Estate Assets Department"
- 2016/2017 San Diego Grand Jury report titled, "City of San Diego's Real Estate Assets Department: Leasehold Management Has Weaknesses"
- February 2022 Audit Report from the City of San Diego Office of the City Auditor, "Performance Audit of the City's Lease Management and Renewal Process"

DISCUSSION

In 1998, a lease was initiated between a former lessee and the City of San Diego. The terms were for a five-year no-rent lease to operate the TPG. There was an option for a five-year extension with no change in terms, which would have extended the active lease through 2003 (this process was not formalized; the lease continues in holdover status). The lease was transferred to the current owner in 2009.

In 2007, a settlement agreement was signed between Coastal Law Enforcement Action Network (CLEAN) and the City.[5] As part of the settlement, the City agreed to prepare a General Development Plan (GDP) for the development and management of Torrey Pines City Park, as well as the establishment of a Torrey Pines City Park Advisory Board. The final GDP was approved by the Advisory Board in 2010 and by the City Parks and Recreation Board in 2012. This was a comprehensive plan that addressed not only areas of the TPG, but also improvement of two miles of beach trails; the addition of new native vegetation to restore eroded bluffs; 19.6 acres to the Multi-Habitat Planning Area; 565 public parking spaces, and improved restroom facilities.[6] Despite the years of work that went into the GDP, there was never any funding to implement the proposal; it was “wishful thinking”— what could be done if funds were available. Indeed, unfunded proposals are quite common.

In 2016, a Request for Proposal (RFP) was issued by the City for the lease and operation of the TPG. There were two respondents, but neither satisfied the terms of the RFP. The following year, an RFP was once again initiated. At that time, the current lessee made the required $5,000 faithful performance (or good faith) deposit and met the requirements of the RFP. The RFP required extensive property improvements at the expense of the lessee. The projected cost for these improvements was estimated by the lessee at nearly $5 million over six years.[7] Not only would these costs have made the enterprise unprofitable for the lessee, but since the project was dependent on the implementation of the unfunded GDP, it did not go forward. The RFP was put on hold and a new lease was never issued. Instead, the City is currently negotiating a three-year lease with the existing lessee, which should be finalized and executed no later than the end of May 2022.

The 2017 RFP stated that faithful performance deposits would be returned to unsuccessful proposers within 30 days of approval of the lease for a selected proposer and applied to the lease deposit upon the completion and execution of the lease for the selected proposer. However, the 2017 lease never went into effect and the City retained TGP’s $5,000 deposit for six years, instead using it toward costs to be incurred in the new three-year lease that is now being negotiated (even though the deposit for a short-term agreement of three years or less is $960, not $5,000).[8] There is a process in place for handling deposits for RFPs successfully executed or retaining deposits from proposers who withdraw from negotiations after selection. However, the Grand Jury found no process for the possible retention or return of a faithful performance deposit in cases where the lease resulting from a successful RFP is not executed or is placed on indefinite hold, through no fault of the successful proposer.

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[5] City of San Diego, Request for Council Action, May 29, 2007, https://docs.sandiego.gov/councildockets_attach/2007/June/06-19-2007%20Item%20106.pdf.

[6] City of San Diego, Torrey Pines City Park General Development Plan, June 21, 2012, https://www.sandiego.gov/sites/default/files/tpgdp120621.pdf.

[7] City of San Diego Purchasing and Contracting Department, RFP No. 2800-B Response, August 24, 2016, March 24, 2022.

[8] City of San Diego Department of Finance, *City of San Diego Fiscal Year 2021 User Fee Schedule*, March 24, 2022.

Holdover Leases

In its review, the Grand Jury examined prior reports on DREAM and the City's leasing processes. The 2016/2017 Grand Jury report found that DREAM had persistent challenges in being able to manage the City's leaseholds in a timely manner with maximum return.[9]

In February 2022, the City Auditor chose a sample of 32 lease agreements (from the 421 active leases that were a part of DREAM's portfolio at that time) for testing. They, too, found little progress had been made on reducing the number of holdover leases and in fact, the percentage has increased.[10] In February 2022, there were 401 lease properties, with 120 (or 29.9%) currently in holdover. Also, 32 (or 26.6%) of those in holdover were dated 2012 or earlier, with several going back to the 1990s. The data shows that instead of reducing the number of leases in holdover since the Grand Jury's 2016/2017 report, the percentage has increased.

The Effects of an Extended Holdover Lease

A holdover lease has some benefits for certain lessees. If the lease requires rent, the lessee may not want to actively pursue a new lease to avoid the increased cost of rent, insurance coverage, or even improvements. Conversely, the uncertainty of running a business on a holdover lease disincentivizes innovation and investment on the part of the lessee and can negatively impact the value of the business. Potential lessees may also have concerns about investing in a business with no long-term right to remain in business, as is the case with the current lease of the TPG.

The City may be losing out on potential revenue that could be generated from appraising a property and renewing or entering into a new lease with the current tenant at current market value.[11]

Insurance

The coverage required by the 1998 lease is public liability and property damage insurance in the amount of not less than $1 million Combined Single Limit Liability and not less than $1 million in third person liability covering flight operations. Although the City has the right to require the revision of amounts and coverages at any time, the coverages and amounts have remained the same since the 1998 approval of the original lease. The lease requires all insurable property on the premises to be covered for 100% of the replacement cost. There is no evidence that this coverage has been updated.

Since the TPG has been in holdover status since 2003, with no updated lease, there had been no increase in the required coverage limits to indemnify the City against any damages or injuries to persons or property directly or indirectly connected with the leasehold in 24 years. The 2017 RFP states, "The insurance requirements were reviewed by the City's insurance broker and determined the appropriate limits for the proposed authorized uses of the

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[9] 2016/2017 San Diego Grand Jury, op. cit.

[10] Office of the City Auditor, City of San Diego, February 2022, op. cit.

[11] "Performance Audit of the City's Lease Management and Renewal Process," op. cit.

property"[12] and specified a requirement for insurance coverage in the amount of $5 million. The three-year lease currently being negotiated does not require the execution of the GDP or the extensive property improvements by the lessee that were a part of the 2017 RFP; the proposed authorized uses will be the same as the original 1998 lease. However, insurance requirements are substantially increased in the new lease, with required coverage in the amount of $5 million for any one occurrence and $10 million aggregate, with the City as an additional insured.

Property Inspections

Current leases require annual inspections. Since the TPG lease dates back to 1998 and does not contain a provision specifically requiring an annual property inspection, there is no legal requirement to do so.

The Grand Jury reviewed copies of TPG property inspection reports covering the years 2015, 2016, 2017, and 2019 (2018 was not available). Each report contained a deficiency comment (such as large potholes in parking lot, tenant watering turf, and a pig that had to be removed from the property). There was no documentation on the form to show that the deficiencies noted had been reviewed or resolved. It was also unclear whose responsibility it was to address deficiencies found during these inspections.

Operating Procedures

There are two primary governing documents that guide operations for DREAM: Council Policies 700-10 (last updated December 18, 2012) and 700-12 (last updated April 8, 1985). Both were cited in the 2016/2017 Grand Jury Report as out of date and in need of revision to reflect the current market realities and operational needs of the office more effectively. In its April 2017 response, DREAM stated it was in the process of updating both policies and planned to present them to City Council for consideration and adoption by June 30, 2017.[13] In the February 2022 City of San Diego audit, the same issue was cited, and the report noted the agency's noncompliance with the prior Grand Jury audit. As of April 2022, neither of these policies has been updated.

In its 2016/2017 report, the Grand Jury found that DREAM did not have sufficient resources to accomplish necessary tasks and recommended that funding be provided for enough personnel (or outsourcing) to bring held-over leases current. In its April 2017 response, DREAM stated that two positions had been added for FY2017 and that after a period of training and education, they should have had adequate resources to meet the department's needs.
In the February 2022 City of San Diego audit, the same issue was cited, stating that the department "appears to be significantly understaffed, limiting its ability to effectively oversee lease management and renewal."[14] Although DREAM responded to the 2016/2017 Grand Jury

[12] Addendum B to 2016 TPG RFP, https://www.sandiego.gov/sites/default/files/rfptpg_b.pdf.
[13] "City of San Diego's Real Estate Assets Department: Leasehold Management Has Weaknesses," op. cit.
[14] "Performance Audit of the City's Lease Management and Renewal Process," op. cit.

report that adequate staffing changes had been implemented, the 2022 audit found staffing levels had decreased since that time. The current budget calls for 28 positions in FY2022, versus the 34 positions budgeted for FY2017.[15] Again in this investigation, inadequate staffing was a reason for the continuing large number of holdover leases, the inconsistent documentation of insurance records, and inconsistent property inspections.

FACTS AND FINDINGS

Fact: The Department of Real Estate and Airport Management (DREAM) manages the lease portfolio for City-owned properties.

Fact: The 2016/2017 San Diego Grand Jury report titled "City of San Diego's Real Estate Assets Department: Leasehold Management Has Weaknesses," cited a concern regarding the large percentage of existing leases that had expired and were continuing a holdover basis, some being in a nonrenewal status for more than a decade.

Fact: The February 2022 Audit Report from the City of San Diego Office of the City Auditor, "Performance Audit of the City's Lease Management and Renewal Process" made numerous recommendations regarding the detriments of holdover leases.

Finding 1: The City has received multiple notifications that holdover leases are a concern, yet the percentage of leases in holdover status has continued to increase.

Fact: The Torrey Pines Gliderport lessee paid a required $5,000 deposit when it submitted a proposal for the 2016 RFP.

Fact*:* The $5,000 fee was applied to the 2017 RFP, when no proposals from the 2016 RFP were deemed to be responsive.

Fact: The current Torrey Pines Gliderport lessee was the successful bidder for the 2017 RFP, but the lease was not implemented due to the lessee's required improvements being dependent on the unfunded Torrey Pines General Development Plan.

Fact: DREAM retained the $5,000 fee, even though the 2017 RFP was not executed

Fact: DREAM continues to hold the $5,000 agreement fee from 2016 and plans to use it to offset costs incurred in the three-year lease currently being negotiated.

Finding 2: There are processes in place for handling the faithful performance deposits for RFPs successfully executed, but no process found for handling deposits for successful RFPs that cannot be executed due to no fault of the proposer, resulting in extended retention of funds.

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[15] Ibid.

Fact: The 1998 lease for Torrey Pines Gliderport required public liability and property damage insurance in the amount of not less than $1 million Combined Single Limit Liability and not less than $1 million in third person liability covering flight operations.

Fact: Since the 1998 lease is still in effect, required insurance coverage has not increased in 24 years.

Fact: The 2016 and 2017 RFPs specified increased insurance coverage for public liability and property damage insurance in the amount of not less than $5 million Combined Single Limit Liability and not less than $5 million in third person liability covering flight operations.

Fact: The three-year lease that will be finalized and executed in 2022 includes insurance requirements for $5 million for any one occurrence and $10 million aggregate, with the City as an additional insured

Finding 3: The increased insurance requirements in the pending 2022 three -year lease indicate a need for a substantial increase in coverage for the TPG, which could also be a concern for other properties in long-term holdover.

Fact: There is no requirement in older, holdover current leases for annual property inspections at the Torrey Pines Gliderport.

Finding 4: DREAM does not have a consistent process for inspecting Torrey Pines Gliderport; property report forms do not include detail on resolution of deficiencies noted, nor responsible party.

Fact: City Council Policies 700-10 (Disposition of City-Owned Real Property was last revised in 2012.

Fact: The 2016/2017 Grand Jury recommended updating these documents and DREAM replied that this would be done by June 30, 2017.

Fact: The February 2022 City Auditor report noted that these policies had not been updated.

Finding 5: DREAM had previously agreed to updating Council Policies 700-10 in 2017; five years later, this has not been done.

Fact: The 2016/2017 Grand Jury found DREAM did not have adequate staffing to accomplish necessary tasks.

Fact: Despite DREAM's response to the 2016-2017 Grand Jury report indicating it would have adequate resources by 2017, inadequate staffing levels persist until this day.

Fact: The February 2022 City of San Diego audit found that the department was significantly understaffed, and that budgeted positions have decreased instead of increased, since 2017.

Finding 6: Inadequate staffing is the reason for ongoing operational shortcomings, such as continuing large numbers of holdover leases, inconsistent documentation of insurance records, and irregular property inspections.

RECOMMENDATIONS

The 2021/2022 San Diego County Grand Jury recommends that the City of San Diego's Department of Real Estate and Airport Management:

22-25: **Consider outsourcing or short-term hiring to facilitate the evaluation of all leases on holdover status.**

22-26: **Consider developing a process for the return of good faith deposits to successful RFP proposers, when the lease resulting from the process is not able to be executed.**

22-27: **Create a process to review insurance requirements on holdover properties to ensure properties are adequately insured to meet current potential for liability and the City is properly indemnified against potential loss.**

22-28: **Create a consistent and thorough process for inspecting leased properties in holdover, including a revised document for documenting the resolution of any property deficiencies that are noted.**

22-29: **Update Council Policy 700-10, to better reflect current market realities and operational needs.**

22-30: **Conduct a comprehensive staffing analysis to ensure a plan and funding is in place to guarantee adequate staffing for long term operational effectiveness.**

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:

Responding Agency	Recommendations	tba
City of San Diego Department of Real Estate and Airport Management	**22-25 through 22-30**	**9/21/22**