
Performance Audit of the Real Estate Assets Department – Residential Property Leases

CONTROLS AND COMPLIANCE
COULD BE STRENGTHENED

MAY 2014

Audit Report

Office of the City Auditor
City of San Diego



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THE CITY OF SAN DIEGO

May 7, 2014

Honorable Mayor, City Council, and Audit Committee Members

City of San Diego, California

Transmitted herewith is a performance audit report on the City of San Diego's Real Estate Assets Department – Residential Property Leases. This report was conducted in accordance with the City Auditor's Fiscal Year 2014 Audit Work Plan, and the report is presented in accordance with City Charter Section 39.2. The Results in Brief are presented on page 1. Audit Objectives, Scope, and Methodology are presented in Appendix B. Management's responses to our audit recommendations are presented after page 26 of this report.

We would like to thank staff from the Real Estate Assets Department for their assistance and cooperation during this audit as well as staff from the departments of Park and Recreation and Public Utilities. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff members responsible for this audit report are Shoshana Aguilar, Sara Collier, Danielle Knighten, and Kyle Elser.

Respectfully submitted,

Eduardo Luna
City Auditor

cc: Jan Goldsmith, City Attorney
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Jeff Sturak, Deputy Chief Operating Officer, Internal Operations
Kristi Geitz, Interim Real Estate Assets Director
Andrew Field, Interim Park & Recreation Director

OFFICE OF THE CITY AUDITOR
1010 SECOND AVENUE, SUITE 555, WEST TOWER • SAN DIEGO, CA 92101
PHONE (619) 533-3165 • FAX (619) 533-3036

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Results in Brief

The Real Estate Assets Department (READ) manages the City's real estate portfolio, including 13 residential, single-family houses on month-to-month leases. This audit focused on these 13 leases, which provide approximately \$121,000 in annual revenue to the City. The City's Municipal Code, City Charter, and California Civil Code all govern the City's leasing practices.

The Office of the City Auditor conducted this performance audit of READ's leasing of residential properties at the request of Mayor Faulconer during his tenure as Councilmember and Chair of the Audit Committee.

We found that the City has not acted to remove residential use from Sunset Cliffs Natural Park. A portion of dedicated park land in Sunset Cliffs is being used for residential purposes, which appears to be a violation of the City Charter. The Master Plan for the park, which City Council approved in 2005, indicates that the houses were to be demolished. However, READ continues to rent out the houses for reasons described within this report. We recommended the City develop a comprehensive plan, including a timeline and funding appropriation, to remove residential use from the Park to ensure compliance with the Master Plan and the City Charter.

We also found that controls for residential leases could be strengthened. Specifically, we found:

- Some City tenants with month-to-month residential leases may not be paying market rate rent;
- Some long-term residential tenants' rent rates and leases are not reviewed by City Council;
- READ's process to conduct interior inspections of its month-to-month residential properties could be improved.

For month-to-month residential leases lasting more than three years, we recommended that READ should conduct periodic market rate studies and adjust rent rates accordingly, and notify City Council. We also recommended that READ more fully develop protocols to inspect the interior of its residential properties. By doing so, the City will better manage its single-family residential properties.

We made a total of four recommendations to strengthen the controls and compliance for residential property leases, and management agrees with all of the recommendations.

Background

Real Estate Assets Department The City of San Diego Real Estate Assets Department (READ) manages the City's real estate portfolio and directs the operations of the City Concourse, the Parking Garages, QUALCOMM Stadium, PETCO Park, and the City's airports. The department's mission is to acquire and manage real estate for the highest public use and benefit, to generate maximum revenue through leasing and sales of surplus assets, and to maximize the overall financial return of the City's real estate portfolio. The department is comprised of four divisions:

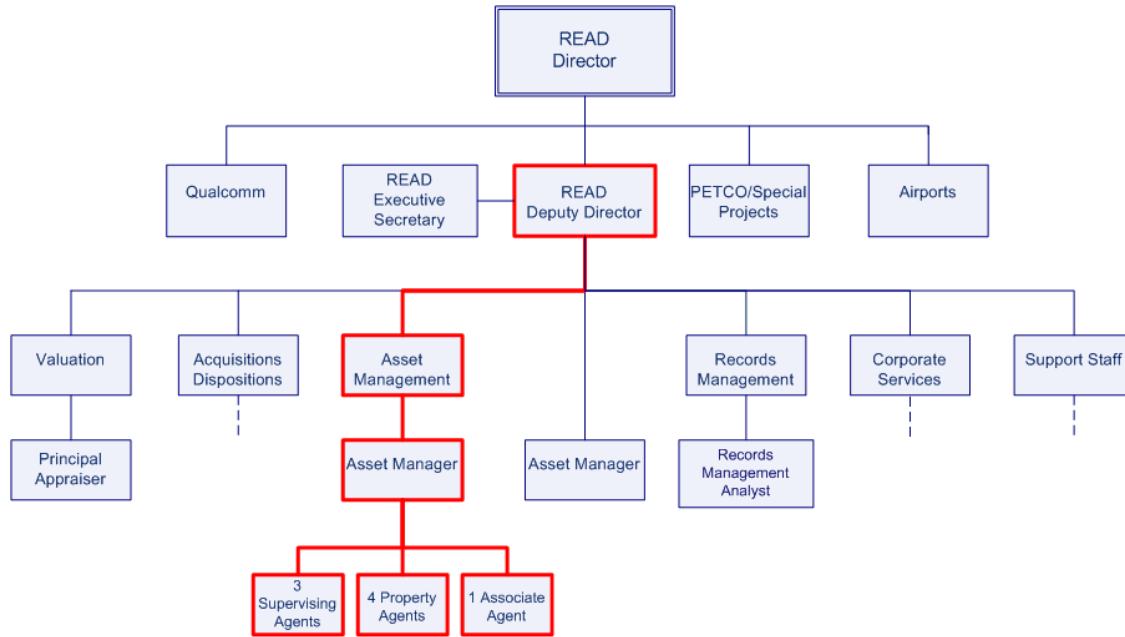
- Property Acquisition/Disposition
- Asset Management
- Valuation
- Corporate Services

This audit focused on the Asset Management Division, which is responsible for managing the City's diverse real estate portfolio. Specifically, we examined the Asset Management Division's handling of residential leases, focusing on single-family dwellings. While READ is responsible for maintaining an inventory of City-owned land, it is each department's responsibility to maintain an inventory of any buildings or other assets in their possession.¹ READ's organizational chart is shown in **Exhibit 1** with the Asset Management Division highlighted.

¹ Council Policy 800-16 provides Citywide asset management guidelines.

Exhibit 1

Real Estate Assets Department Organizational Chart



Source: OCA generated based on READ’s organizational chart.

Rent Revenue for the General Fund Exceeds \$44 million

Rent revenue exceeds \$44 million, with the Mission Bay Parks as the largest contributor. READ expects total revenues of \$46 million for FY 2014 and total expenditures of \$7.5 million. The budget has largely remained the same for the past few years. There are 30 budgeted FTE positions. Two of those positions are for property agents directly involved in managing the single-family residential leases, along with their other lease responsibilities. **Exhibit 2** summarizes the READ budget.

Exhibit 2

Real Estate Assets Department Budget Summary

	FY 2012 Actual	FY 2013 Budget	FY 2014 Adopted Budget	FY2013-2014 Change
FTE Positions (Budgeted)	29.0	30.0	30.0	0.0
Personnel Expenditures	\$3,219,066	\$3,333,797	\$3,635,563	\$301,766
Non-Personnel Expenditures	\$3,469,790	\$3,849,897	\$3,884,078	\$34,181
Total Department Expenditures	\$6,688,856	\$7,183,694	\$7,519,641	\$335,947
Total Department Revenue	\$45,544,972	\$43,732,638	\$46,049,141	\$2,316,503

Source: FY2014 READ Adopted Budget.

READ Manages 27 Residential Leases READ currently manages 27 residential property leases, and residential rent revenue collected for FY 2013 totaled \$1.3 million, as shown in **Exhibit 3**. Half of these leases are for single-family homes, and the remainder is composed of affordable housing apartments, transitional and temporary housing, and mobile home parks. While READ maintains the leases on the apartments and transitional housing, other entities manage the day-to-day operations and leases with the inhabitants as noted in the exhibit.

Exhibit 3

Fiscal Year 2013 Residential Leases

	Property Use	Managing Entity	Location	Lease Start	Lease Length	FY 2013 Total Rent
1	Apartments ²	Alexander Court Properties, LP	Pacific Beach	1971	55 years	\$127,320
2	Apartments	ST Associates	Point Loma Heights	1977	55 years	\$191,092
3	Apartments	SD Kind Corporation	Downtown	1979	50 years	\$1 ³
4	Apartments	SD Housing Commission	La Jolla	1977	50 years	\$0 ⁴
5	Apartments	Colonia Barrios Seniors Inc	San Ysidro	1981	50 years	\$0 ⁵
6	Apartments	Housing Development Partners of SD	Downtown	2014	65 years	\$0 ⁶
7	Apartments	Olivewood Housing Partners, LP	East San Diego	1981	55 years	\$0 ⁷
8	Apartments	MG Stonewood Garden Apts.	Point Loma Heights	1979	55 years	\$345,264
9	Apartments	Orchard II Associates	Point Loma Heights	1981	55 years	\$196,043
10	Apartments	La Casa Balboa, LLC	Clairemont Mesa East	1979	55 years	\$67,533
11	Mobile home park	Tecolote Investors, LLC	Linda Vista	1979	55 years	\$245,120
12	Mobile home park	SD Housing Authority	San Ysidro	1984	55 years	\$0 ⁸

² For the apartments where the City collects rent, rent payment is based on a percentage of gross revenue.

³ This is a nonrevenue lease that supports low cost housing in the City.

⁴ This lease is assigned to the San Diego Housing Commission.

⁵ This lease is assigned to the San Diego Housing Commission.

⁶ This lease is pending.

⁷ This lease supports low cost housing in the City.

⁸ This is a nonrevenue lease that supports low cost housing in the City.

Performance Audit of the Real Estate Assets Department

	Property Use	Managing Entity	Location	Lease Start	Lease Length	FY 2013 Total Rent
13	Temporary homeless housing	Southeast Counseling & Consulting	East San Diego	1999	Holdover	\$585
14	Transitional housing	YWCA of SD County	Mission Valley	2000	15 years	\$3,996
15	Single-family residential	READ ⁹	Sunset Cliffs Natural Park	1992	Month-to-Month	\$19,297
16	Single-family residential	READ	Sunset Cliffs Natural Park	1995	Month-to-Month	\$18,972
17	Single-family residential	READ	Sunset Cliffs Natural Park	1996	Month-to-Month	\$7,750
18	Single-family residential	READ	Sunset Cliffs Natural Park	1995	Month-to-Month	\$28,947
19	Single-family residential	READ	San Pasqual Valley	2013	Month-to-Month	\$0 ¹⁰
20	Single-family residential	READ	San Pasqual Valley	2010	Month-to-Month	\$3,900
21	Single-family residential	READ	San Pasqual Valley	2011	Month-to-Month	\$3,250
22	Single-family residential	READ	San Pasqual Valley	2011	Month-to-Month	\$13,200
23	Single-family residential	READ	San Pasqual Valley	2011	Month-to-Month	\$3,000
24	Single-family residential	READ	San Pasqual Valley	2011	Month-to-Month	\$3,595
25	Single-family residential	READ	San Pasqual Valley	2007	Month-to-Month	\$4,500
26	Single-family residential	READ	Del Cerro	2006	Month-to-Month	\$0 ¹¹
27	Single-family residential	READ	Dulzura ¹²	2007	Month-to-Month	\$9,503
Total:						\$1,292,868

Source: Real Estate Assets Department.

⁹ Real Estate Assets Department (READ).

¹⁰ The tenant is making repairs to the property. Rent collection starts in 2016.

¹¹ This property is part of a legal settlement for a City police officer who was paralyzed by gunfire.

¹² This property is reservoir keeper housing. The rent was adjusted down from market rate due to the work the tenant has done to maintain the property. The house is located next to the Barrett Reservoir dam.

Audit Results

Finding 1: The City Has Not Acted to Remove Residential Use from Sunset Cliffs Natural Park

We found that a portion of dedicated park land in Sunset Cliffs is being used for residential purposes, which appears to be a violation of City Charter Section 55, which requires such property to be used for park purposes. The Master Plan for the park, which City Council approved in 2005, indicates that the houses were to be demolished to make way for footpaths, ocean views, and native vegetation. The rental of four housing units, with annual City revenue of \$78,660, inhibits the use of the land for park purposes. Although the Real Estate Assets Department (READ) continues to rent the houses to prevent vandalism that would occur if these properties were otherwise vacant, the Mayor's Office should work with READ and the Park and Recreation Department to ensure full compliance with City Charter Section 55.

Sunset Cliffs Natural Park Residential Leases

READ currently manages four month-to-month residential leases in Sunset Cliffs Natural Park. The Park and Recreation Department manages the park itself. The leased homes were on the land when the City purchased it from a university in the 1970s. At the time of the purchase, two life estate owners were living on the property and renting out some of the units.¹³ Upon the death of the life estate holders, the City took over management of the properties and entered into lease agreements with the remaining tenants. The City continued to rent out the properties because the Master Plan for the park had not yet been implemented.

In 1983, City Council established Sunset Cliffs Natural Park as a dedicated park, so it can only be used for park purposes per San Diego City Charter Section 55. The City sent lease termination notices to the tenants of these residential properties in 2003. However, after a discussion during a City Council meeting, the City withdrew the termination notices for the following reasons:

- The Master Plan had not yet been finalized;
- A timeline to demolish the homes was not complete; and

¹³ A life estate is the ownership of land for the duration of a person's life. Upon death, ownership of the property may revert to the original owner, or it may pass to another person.

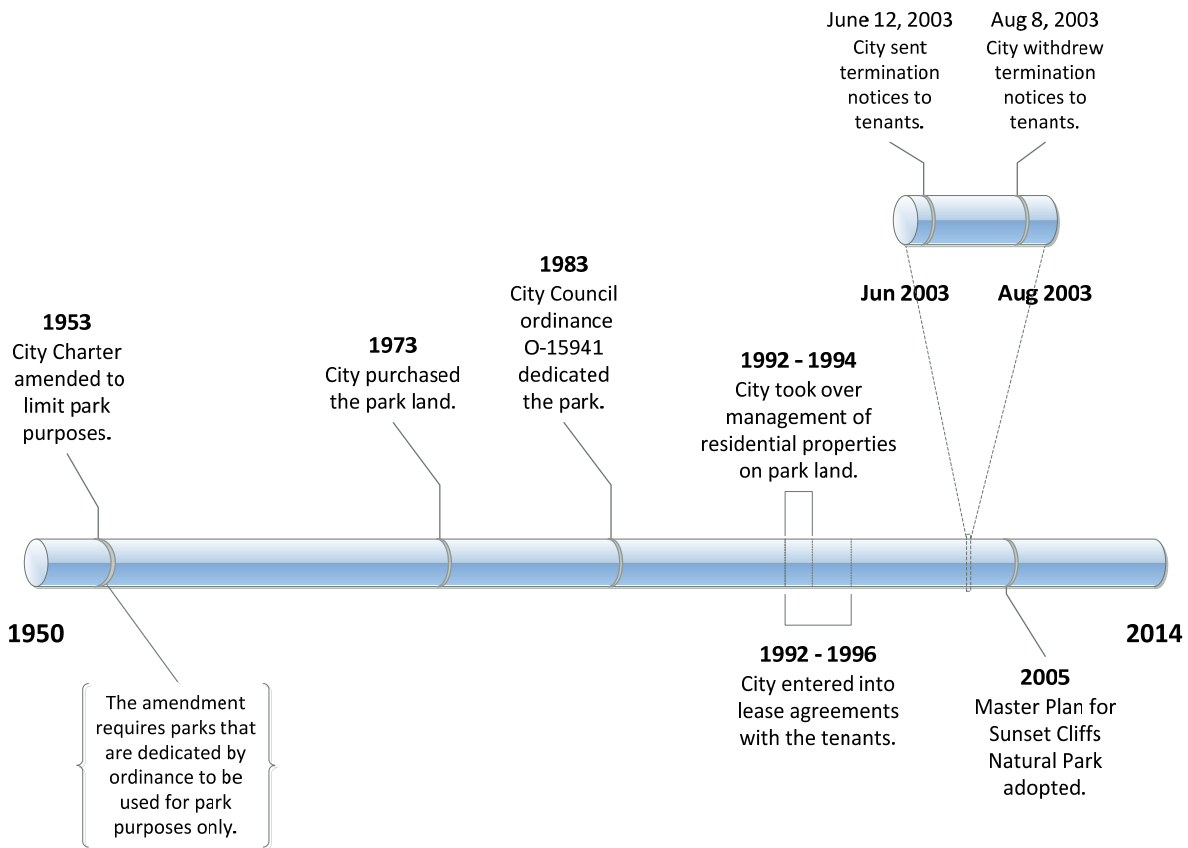
- To maintain the tenants' continued occupancy of the homes to discourage vagrancy and vandalism in the park.

The Master Plan was finalized in 2005 but there is still no demolition schedule for the properties, and the tenants remain in the homes.

Exhibit 4 provides a timeline of significant events for the Sunset Cliffs Natural Park houses.

Exhibit 4

Timeline of Events for Sunset Cliffs Natural Park



Source: OCA.

Dedicated Park Land Is Being Used for Residential Use

The City has not acted to remove residential use from Sunset Cliffs Natural Park since 2003. READ has been leasing single-family units on Sunset Cliffs dedicated park land since the early 1990s. Charter Section 55, last amended in 1975, sets forth that a dedicated park can only be used for park purposes. Section 55 places the responsibility on the Mayor to control and manage City parks, among other things.¹⁴ To permit a non-park use of a dedicated park, there would need to be an election where a two-thirds majority of the electorate voted to approve such a use.

The Sunset Cliffs Master Plan Has Not Been Fully Implemented

The Master Plan for Sunset Cliffs Natural Park, approved by City Council in 2005, indicates that the houses will be demolished and replaced with hiking paths and native vegetation. However, the full plan has not been implemented. After City Council approved the plan, READ did not attempt to remove the tenants from the park. According to the Park and Recreation Department, there is no timeline in place to execute the full Master Plan or to demolish the houses. Park and Recreation advised that they have made progress on the plan, specifically by completing a comprehensive drainage study and implementing hillside re-vegetation.

READ entered into leases with the existing tenants before the Sunset Cliffs Natural Park Master Plan was completed in 2005. Without a plan, READ could not be certain if the properties would need to be preserved for park use, such as a ranger station or nature center. City property in the park that was left vacant experienced vandalism and arson as evident in **Exhibit 5**. READ decided to rent out the properties to preserve the buildings for potential park use as well as for public health and safety purposes. Based on its experience, City management believes that the properties are more secure and better preserved occupied than vacant.

Park and Recreation Department officials reported that the Sunset Cliffs Natural Park residential properties have not been demolished because other items in the Master Plan and Capital Improvements Program took precedence. The first priority of the Master Plan is erosion control. Regarding demolition, the Department notes that the cost is difficult to estimate and may depend on the type of foundation under a house. The Department did have to demolish other properties in the park once they had suffered damage from a fire caused by arson. The properties were vacant and covered in

¹⁴ The City's shift to a Strong Mayor form of government transferred all responsibilities previously held by the City Manager to the Mayor.

graffiti at the time of the fire. That demolition cost over \$148,000. **Exhibit 5** shows photographs of the properties before demolition. The demolition left the concrete slab foundation in place, as it may have been preventing cliff erosion. The complete demolition of the remaining houses may have unanticipated costs related to erosion prevention.

Exhibit 5

Photographs of Demolished Sunset Cliffs Properties with Graffiti and Fire Damage



Source: Park and Recreation Memorandum regarding fire at Sunset Cliffs Natural Park.

There are various options available to implement the 2005 Master Plan and minimize the apparent conflict between the private tenancies at Sunset Cliffs Natural Park and the restriction of dedicated parks for public park use in Charter Section 55. READ could eliminate residential use from the park by terminating the four month-to-month leases. This would not require Council action. However, vacant

buildings may attract illegal activity. Given the vandalism that occurred at other vacant properties in Sunset Cliffs Natural Park, it may be in the City's interest to move ahead with demolition. The Mayor's Office could work with Park and Recreation to develop funding and a timeline for demolition. The demolition may require Capital Improvement Program funding, which the City Council would have to approve as part of the budgeting process. Given that the Mayor is responsible for controlling and managing City parks, and to ensure compliance with the Charter provisions, we recommend:

Recommendation #1 The Mayor's Office should work with the Park and Recreation Department and the Real Estate Assets Department to develop a comprehensive plan, including a timeline and funding appropriation, to remove residential use from Sunset Cliffs Natural Park, ensure compliance with the 2005 Master Plan, and to resolve the apparent conflict between the private tenancies at Sunset Cliffs and the restriction on dedicated parks for public park use in Charter Section 55. (Priority 2)

Finding 2: Controls Over Month-to-Month Residential Leases Could Be Strengthened

The Real Estate Assets Department (READ) manages 13 single-family residences, which provide rental income of \$121,000 per year, or less than one percent of total department revenue. Nevertheless, READ has a responsibility to the City and to the City's residential tenants.

We found:

- Some City tenants with month-to-month residential leases may not be paying market rate rent;
- Some long-term residential tenants' rent rates and leases are not reviewed by City Council;
- READ could strengthen the process to conduct interior inspections of its month-to-month residential properties to ensure habitability.

In order to strengthen controls over month-to-month residential leases, READ should conduct periodic market rate studies and adjust rent rates accordingly. Additionally, READ should report to Council with regard to residential month-to-month leases lasting more than three years. Finally, READ should more fully develop protocols to inspect the interior of its residential properties on a periodic basis. By doing so, the City will better manage its single-family residential properties.

Controls Over Month-to-Month Residential Leases Could Be Improved

Some tenants have lived on City property for more than three years on a month-to-month residential lease without a market rate rent study or Council review of any rate exceptions.¹⁵ For instance, the four month-to-month leases in Sunset Cliffs Natural Park date back to the 1990s. Without periodic reviews of market rates, the City cannot ensure that it receives full market value for its rental properties. Controls over month-to-month residential leases could be strengthened to address this issue.

The City of San Diego Municipal Code does not require a market rate rent study for month-to-month residential leases, regardless of their duration. Municipal Code Section 22.0901 is presented in **Appendix D**. For other leases lasting more than three years, the Municipal Code requires the City Council to approve such leases with a statement of

¹⁵ Council Policy 700-10 allows Council to pass a Resolution permitting a rent discount in the case of extraordinary circumstances.

market value of the real estate appraised by an independent fee appraiser or City staff as part of the presentation of the lease approval to the City Council. The administrative codes for other California cities provide examples of how the City of San Diego could strengthen controls over month-to-month leases as described later in this report.

READ manages 13 month-to-month single-family residential leases, 11 of which have tenants with occupancy lasting more than three years. As displayed in **Exhibit 6**, rents range from \$250 to \$2,500 per month. The estimated yearly rental revenue from the 13 agreements is \$121,000.

Exhibit 6

Fiscal Year 2014 Rent Amounts – Single-family Homes

	Location	Lease Start	Monthly Rent	Property Size in Square Feet
1	Sunset Cliffs Natural Park	1992	\$1,688	1,075
2	Sunset Cliffs Natural Park	1995	\$1,660	870
3	Sunset Cliffs Natural Park	1996	\$675	856
4	Sunset Cliffs Natural Park	1995	\$2,532	1,226
5	San Pasqual Valley	2013	\$325	700
6	San Pasqual Valley	2010	\$325	1,000
7	San Pasqual Valley	2011	\$250	1,000
8	San Pasqual Valley	2011	\$250	1,000
9	San Pasqual Valley	2011	\$250 ¹⁶	1,000
10	San Pasqual Valley	2011	\$1,100	3,400
11	San Pasqual Valley	2007	\$375	650
12	Del Cerro ¹⁷	2006	\$0	2,654
13	Dulzura ¹⁸	2007	\$650	864
Total monthly revenue for residential single-family homes: \$10,080				
Total yearly revenue for residential single-family homes: \$120,960				

Source: Real Estate Assets Department.

¹⁶ One of the tenants renting at \$250 also must pay 25 percent of avocado sales less operating costs. This is not included in the monthly total in this table.

¹⁷ This property is part of a legal settlement for a City police officer who was paralyzed by gunfire.

¹⁸ This property is reservoir keeper housing. The rent was adjusted down from market rate due to the work the tenant has done to maintain the property. The house is located next to the Barrett Reservoir dam.

READ Manages Seven Residential Leases in the San Pasqual Valley on Public Utilities Department Land

In addition to the residential properties in Sunset Cliffs Natural Park, READ manages residential and agricultural leases in the San Pasqual Valley for the Public Utilities Department, Water Enterprise Fund. The Water Enterprise Fund purchased land in San Pasqual just south of the City of Escondido over 50 years ago to preserve the valley for agricultural use and water-supply purposes. Water in San Pasqual flows into Lake Hodges, which serves as a drinking water reservoir for the City of San Diego. When the land was purchased, the City began to enter into lease agreements with the farmers in the area. READ continues to lease to farmers and others in the valley and currently has seven residential month-to-month leases. READ also manages a number of agricultural leases that include additional farm worker housing.¹⁹

The San Pasqual Valley Plan and Council Policy 700-14 preserve the valley for agricultural use and promote farm worker housing. To preserve agriculture in the San Pasqual Valley, the City offers several incentives to farmers living there, including low-income housing. Council Policy 700-14 requires the City to lease property in the valley for suitable agricultural uses at reasonable rates. In addition, Public Utilities also prefers to keep the properties occupied, as they have found that vacant properties invite illegal activity. Annual revenue collected on the residential leases on Public Utilities property totals over \$34,500. Many of these leases directly support a farm worker presence in San Pasqual. All the residential leases are month-to-month.

Some City Tenants May Not Pay Market Rate Rent

There are no market rate rent studies for 12 of the 13 residential month-to-month leases in the San Pasqual Valley and in Sunset Cliffs Natural Park. San Diego Municipal Code 22.0901 provides for City Council oversight of leases lasting more than three years. However, month-to-month residential leases do not require City Council review or a market rate study even if they last much longer. We observed that the properties were aging and in subprime condition. In San Pasqual, there may be additional reasons to rent below market rate, such as the imperative to maintain affordable farm worker housing. However, water utilities property must be leased at fair market value.²⁰ Council Policy 700-10 allows City Council to pass a Resolution permitting a rent discount in the case of extraordinary circumstances.

¹⁹ The agricultural leases in San Pasqual permit farmers to use the land and water for agricultural purposes such as a dairy, avocado orchard, or vineyard.

²⁰ The City Attorney interprets Charter Section 53 to require fair market value for the lease or sale of water utility property.

Nevertheless, the City would still need a market rate study to aid in determining the rent discount amount. Without market rate studies, tenants may not pay the City fair market value, and there could be a perceived gift of public funds.

**Other Cities Provide
Examples of How Council
Could Strengthen its
Oversight of Month-to-
Month Residential Leases**

Other cities have varying rules for managing month-to-month leases. For example, the City of Los Angeles requires documentation of fair market value for month-to-month leases and notification to the City Council if a month-to-month lease lasts more than one year. The City and County of San Francisco does not require the Director of Property to determine market value for month-to-month leases, regardless of their duration. However, the San Francisco Director of Property does have to provide an explanation of why rent was set below fair market value in each circumstance. This is not the case in San Diego.

The San Diego City Council amended the Municipal Code on January 5, 1977, to give the City Manager²¹ the authority to enter into month-to-month residential leases without City Council approval. There are no City Council records from that time that indicate the basis of the Municipal Code amendment. Although City Council has amended the Code since 1977, no significant changes to the month-to-month residential lease clause were made.

Recommendation #2 To strengthen controls over month-to-month residential leases, we recommend that the Real Estate Assets Department:

- **Conduct a market rate rent study on its single-family residential month-to-month leases;**
- **Adjust lease rates based on the market rate study; and**
- **Notify City Council of the rent rates for any single-family residential month-to-month leases lasting more than three years. READ should develop a policy to review rent rates and report to Council every three years. (Priority 3)**

**READ Could Strengthen its
Residential Inspection
Process to Ensure
Habitability**

The City is currently renting its residential single-family properties without a formalized process in place to ensure habitability. Although READ conducts property inspections for some of its single-family homes, it does not have a documented process to conduct internal inspections to ensure habitability requirements set forth in California Civil Code 1941.1 as it relates to residential leases.

²¹ The City's structure has changed since this amendment, and the authority to enter into month-to-month residential leases is now held by the Mayor. The mayor exercises all authority, power, and responsibilities formerly conferred upon the City Manager.

READ Has a Process for Repairs, but Does Not Have a Documented or Consistent Inspection Process to Ensure Habitability

READ has a process for conducting maintenance and repairs on its residential properties, which places a portion of the maintenance responsibility on the tenants. The leases we reviewed specify that the tenants are responsible for minor repairs and that the City is responsible for major repairs. Additionally, READ conducts inspections of some properties to identify potential health or safety issues. We found evidence that the City is conducting maintenance and repair work within the purview of their responsibility as noted in the lease agreements; however, there are no procedures in place to ensure habitability requirements are being met for all single-family month-to-month properties. READ did provide a checklist that property agents occasionally use when inspecting rental units. Yet, the checklist does not include the essential items for habitability, as described by California Civil Code Section 1941.1.

Under California law, all residential leases and rental agreements contain an implied warranty of habitability. Section 1941.1 of the California Civil Code lists the standard characteristics that deem a rental unit habitable. Specifically, it requires rental units to have certain features such as waterproofing, plumbing, hot water, heating, electricity, and garbage receptacles. Some of these requirements may change depending on the unit's year of construction. The warranty holds landlords responsible for repairing and maintaining a rental property in a habitable condition. Landlords must also ensure that the property complies with state and local building and health codes. This responsibility is concurrent with the tenant's duty to maintain the property.

As we conducted onsite observations of the properties during fieldwork, we noted an aged City property that was not recorded on our lease listing, because READ did not have a lease. However, it was inhabited by a retired farm worker in the San Pasqual Valley. READ reported that this individual is living in the property without a lease. Since READ does not conduct periodic indoor inspections of the dwelling, there is a risk that the property may not be habitable as defined by the California Civil Code. Furthermore, without a lease, the individual may not report any necessary repairs, and the City may still be held liable for any injuries resulting from hazards within the property.

READ Relies on Tenant Maintenance Requests to Ensure Upkeep, and the City May Be Held Liable for Uninhabitability

Currently READ is relying on tenant maintenance requests to ensure upkeep of some City-owned residential single-family properties. For example, tenants in the San Pasqual Valley have reported leaking pipes and broken electrical outlets that the City has since repaired. However, there is no evidence of the Sunset Cliffs tenants requesting any maintenance or of READ conducting indoor property inspections. Therefore, READ may be unaware of habitability issues for these properties. Over time, residential properties experience physical deterioration and will need repairs. Many of the properties that READ manages are forty to fifty years old. Without periodic indoor inspections of all properties, READ may not be aware of the extent of the properties' deterioration. The City may eventually demolish the Sunset Cliffs houses described in Finding 1, but as long as READ continues to rent them out, the City is responsible for maintaining habitability.

The City may be held legally liable if it is renting a substandard dwelling. Periodic internal inspections are necessary since the aging houses may need repairs that are not visible from external inspections. For example, the Public Utilities Department reported a case of lead poisoning in one of the homes in the San Pasqual Valley that is part of an agricultural lease. To prevent future problems, Public Utilities is in the process of developing a Healthy Homes inspection plan for all of the residential properties in the valley over the next several months. Public Utilities is aware that the inspections will yield items to repair.²² Although the San Pasqual leases notify the tenant of the presence of lead paint, further action should be taken to reduce the risk of liability to the City.

READ could adopt a documented annual inspection program to address these issues for all single-family residential properties. For example, READ could look to the Institute of Real Estate Management (IREM), which offers indoor and outdoor inspection checklists in addition to developing ethical business practices and promoting superior property management for the real estate manager community.

Recommendation #3 The Real Estate Assets Department should develop a process to ensure all residential leases are in compliance with the warranty of habitability for its single-family dwellings. (Priority 3)

²² Healthy Homes inspections employ a non-regulatory, non-binding set of assessment criteria used by public health professionals across the nation. The inspections review potential lead hazards in addition to other criteria for electrical safety, pests, and etcetera.

Recommendation #4 The Real Estate Assets Department should develop a process to ensure that all inhabited City-owned residential properties have a lease. (Priority 3)

Conclusion

The Real Estate Assets Department (READ) manages the City's real estate portfolio, including 13 single-family residential units on month-to-month leases. READ works with other departments to manage these properties, including the Park and Recreation and Public Utilities departments. While the lease revenue for the properties represents less than one percent of total rent revenue, READ has the responsibility to manage the properties effectively and to comply with all applicable laws and regulations. Additionally, READ's mission is to generate maximum revenue through leasing and to maximize the overall financial return of the City's real estate portfolio.

READ's management over month-to-month leases and the revenue generated from these leases could be improved. We found that the City has not acted to come into full compliance with the City Charter regarding dedicated park land in Sunset Cliffs Natural Park. We also found that some City tenants may not be paying market rate rent; some long-term tenants' rent rates and leases are not approved by City Council; and, READ could strengthen its process to conduct interior inspections of its month-to-month residential properties to ensure habitability. We made four recommendations to address these findings, and management agreed with all four recommendations.

Recommendations

- Recommendation #1** The Mayor’s Office should work with the Park and Recreation Department and the Real Estate Assets Department to develop a comprehensive plan, including a timeline and funding appropriation, to remove residential use from Sunset Cliffs Natural Park, ensure compliance with the 2005 Master Plan, and to resolve the apparent conflict between the private tenancies at Sunset Cliffs and the restriction on dedicated parks for public park use in Charter Section 55. (Priority 2)
- Recommendation #2** To strengthen controls over month-to-month residential leases, we recommend that the Real Estate Assets Department:
- Conduct a market rate rent study on its single-family residential month-to-month leases;
 - Adjust lease rates based on the market rate study; and
 - Notify City Council of the rent rates for any single-family residential month-to-month leases lasting more than three years. READ should develop a policy to review rent rates and report to Council every three years. (Priority 3)
- Recommendation #3** The Real Estate Assets Department should develop a process to ensure all residential leases are in compliance with the warranty of habitability for its single-family dwellings. (Priority 3)
- Recommendation #4** The Real Estate Assets Department should develop a process to ensure that all inhabited City-owned residential properties have a lease. (Priority 3)

Appendix A: Definition of Audit Recommendation Priorities

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The Office of the City Auditor maintains a classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class ²³	Description ²⁴	Implementation Action ²⁵
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.	Immediate
2	A potential for incurring significant or equivalent fiscal and/or non-fiscal losses exist.	Six months
3	Operation or administrative process will be improved.	Six months to one year

²³ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

²⁴ For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its residents.

²⁵ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.

Appendix B: Objectives, Scope, and Methodology

Objectives In accordance with the City Auditor's Fiscal Year 2014 Work Plan, we conducted a performance audit of the Real Estate Assets Department's (READ) leasing of residential properties. Specifically, our objectives were to:

- Assess the effectiveness of READ's leasing of residential properties; and
- Compare lease rates and terms to market conditions and industry practices.

Scope & Methodology To assess the effectiveness of the leasing of residential properties, we:

- Reviewed applicable City laws and regulations that govern the properties we examined as summarized below:
 - City Charter Section 55 which provides a process and authority for real property use as it pertains to park, recreation or cemetery purposes;
 - Municipal Code Section 22.0901 describes how the City should manage leased property and the authorities in establishing the leases;
 - Council Policy 700-10 discusses the disposition of City-owned real property;
 - Council Policies 600-45 and 700-14 provide guidance related to the properties in the San Pasqual Valley; and
 - Council Policy 700-17 explains the difference between dedicated and designated parks.
- Reviewed state law regarding the responsibilities of landlords and conducted benchmarking with other California cities;
- Conducted site visits for the single-family houses that the City leases and reviewed leases; and
- Interviewed READ management and staff as well as representatives from the departments of Public Utilities, Public Works, and Park and Recreation.

To compare lease rates and terms to market conditions and industry practices, we:

- Identified the Municipal Code paragraph that allows the City to rent residential housing on a month-to-month basis without developing a statement of market value; and
- Obtained price estimates to conduct a market rate appraisal for the month-to-month properties in our scope.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix C: Photographs of Single-Family Residential Properties

Select Properties in the San Pasqual Valley



Source: OCA.

Select Properties in Sunset Cliffs Natural Park



Source: OCA.

Appendix D: Municipal Code §22.0901

San Diego Municipal Code
(5-2005)

Chapter 2: Government

Article 2: Administrative Code

Division 9: Contracts — Leases — Sales

§22.0901 Leases of Real Property

Except as otherwise provided in the Charter, or by ordinance, the Council shall have the power to lease the real property of the City as follows:

- (a) No real property belonging to the City shall be leased except in pursuance of a resolution passed by a majority vote of all members of the Council, which shall contain the following:
 - (1) The reason for leasing such real estate;
 - (2) A description of the real estate to be leased;
 - (3) A statement of the market value of such real estate as appraised by an independent fee appraiser or City staff.
- (b) Nothing contained in this section shall be deemed to apply to any lease for a term of three years or less. The City Manager, at all times, shall have power, without advertising, notice, or competitive bidding, and upon such terms as he may deem proper, to lease any of the real property of the City of San Diego for a term of three years or less provided, however, that no such lease, so made, shall be renewed without the approval of the Council.
- (c) Nothing contained in this section shall be deemed to apply to any lease for a *wireless communications facility*, as defined in section 113.0103, for a term of ten years or less. The City Manager, at all times, shall have power, without advertising, notice, or competitive bidding, and upon such terms as he may deem proper, to lease any of the real property of the City of San Diego for a *wireless communications facility*, as defined in section 113.0103, for a term of ten years or less, provided however, that no such lease, so made, shall be renewed without approval of the Council.

Rental agreements may be executed by the City Manager covering month-to-month tenant occupancy of City-owned residential housing or Brown Field Airport Incubator Industries and shall not be subject to the provisions of subparagraphs (a)(1) through (3) of this section, and occupancy of the facilities under such agreements may exceed three years without the approval of the Council.
(Amended 4-11-1983 by O-15926 N.S.)
(Amended 5-3-2005 by O-19370 N.S.)

Ch.	Art.	Div.	
2	2	9	1



THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: May 7, 2014

TO: Eduardo Luna, City Auditor

FROM: Kristin Geitz, Interim Director, Real Estate Assets

SUBJECT: Management Response to Performance Audit of the Real Estate Assets Department – Residential Property Leases

The Real Estate Assets Department (READ) staff along with the Park and Recreation and Public Utilities departments have reviewed the City Auditor’s recommendations in the audit report examining residential property leases on City owned land. The response to each of the audit recommendations is documented below.

Recommendation #1: The Mayor’s Office should work with the Park and Recreation Department and the Real Estate Assets Department to develop a comprehensive plan, including a timeline and funding appropriation, to remove residential use from Sunset Cliffs Natural Park, ensure compliance with the 2005 Master Plan, and to resolve the apparent conflict between the private tenancies at Sunset Cliffs and the restriction on dedicated parks for public park use in Charter Section 55.

Recommendation #1 Management Response: Agree

As stated in the Sunset Cliffs Natural Park Master Plan adopted in 2005, “Erosion control is the first priority of the Master Plan.” The plan calls for initiation and implementation of a comprehensive drainage plan to arrest the ongoing and severe erosion problems in the park. Controlling and correcting the erosion problems in the park involves multiple strategies that the Park and Recreation Department has begun to implement, starting with the completion of a comprehensive drainage study completed in the fall of 2012 and continuing with the implementation of a Hillside Section trails and re-vegetation project that has recently been permitted and is ready for construction. The priorities of the Master Plan are reflected in the ongoing recommendations of the Sunset Cliffs Natural Park Council (the officially recognized advisory body for Sunset Cliffs) which have consistently focused on correcting the long standing erosion problems in the park.

The scope of work for the current trails project that began in 2010 originally included provisions for removal of the two residential structures nearest the coastal bluffs: the Dixon Estate and the Ladera Street house. The Dixon Estate, as noted, was destroyed by fire and will be completely removed and re-vegetated by the current project. The Ladera Street property was identified as potentially historic by the consultant; as a result, staff eliminated the removal of that property from the scope of work of this initial phase of work in order to meet grant funding deadlines.

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Eduardo Luna, City Auditor

May 7, 2014

The scope of work and funding from the Sunset Cliffs Natural Park Fund will be included in a new Capital Improvements Project (CIP) for the demolition of the remaining properties. The establishment of the CIP (Sunset Cliffs Natural Park Drainage Improvements) will be coming forward to the City Council in the next couple of months. Once the CIP is approved, it will be transferred to the Public Works Department for implementation. The tentative schedule for implementation includes two years for design and permitting, then demolition/construction contingent on additional funding being identified.

Recommendation #2: To strengthen controls over month-to-month residential leases, Real Estate Assets should:

- Conduct a market rate rent study on its single-family residential month-to-month leases;
- Adjust lease rates based on the market rate study; and
- Notify City Council of the rent rates for any single-family residential month-to-month leases lasting more than three years. READ should develop a policy to review rent rates and report to Council every three years.

Recommendation #2 Management Response: Agree

Within ninety days, READ will work to strengthen internal controls over month-to-month residential agreements as follows:

- *READ will conduct market rent studies on single-family residential month-to-month agreements. The scope of these studies will include any specialized requirements by the San Pasqual Vision Plan, such as providing farm worker housing, as is necessary in order to receive an accurate value. READ will endeavor to complete these studies over the next six months.*
- *Upon completion of the studies, lease rents will be adjusted accordingly. Any significant increases may be increased over a short period of time as appropriate. New agreements will be adjusted annually by the Consumer Price Index in order to maintain market consistency.*
- *Attached is a sample notification (Attachment A) that READ will send quarterly to the City Council to inform them of any month-to-month leases that will be exceeding a three year time period.*

Recommendation #3: The Real Estate Assets Department should develop a process to ensure all residential leases are in compliance with the warranty of habitability for its single-family dwellings.

Recommendation #3 Management Response: Agree

READ is working with the Public Utilities and Environmental Services Departments to finalize a schedule to conduct habitability inspections of homes owned by the City on Public Utilities property. It is anticipated that these inspections will be completed by the fall of 2014. Once the Public Utilities properties are complete, the inspections will occur at Sunset Cliffs shortly thereafter.

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Eduardo Luna, City Auditor

May 7, 2014

Recommendation #4: The Real Estate Assets Department should develop a process to ensure that all inhabited City-owned residential properties have a lease.

Recommendation #4 Management Response: Agree

All City-owned residential properties have current agreements with the exception of one small farm worker home in the San Pasqual Valley. Upon termination of a lease agreement, a dairy farm worker house was left inhabited by an elderly tenant. In an effort to be reasonable and compassionate, READ has been working with the occupant and his family while they find an appropriate alternative living arrangement for the gentleman. Written notice is being processed and will be served on or before May 30, 2014 in order to ensure that the building is vacated within ninety (90) days of the notice.

Kristin Geitz

Interim Real Estate Assets Director

cc: Stephen Puetz, Chief of Staff, Office of the Mayor
Brian Pepin, Director of Council Affairs, Office of the Mayor
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Jeff Sturak, Deputy Chief Operating Officer
Ron Villa, Deputy Chief Operating Officer
Mary Lewis, Chief Financial Officer
Halla Razak, Public Utilities Director
Andrew Field, Assistant Park and Recreation Director

**CITY OF SAN DIEGO
M E M O R A N D U M**

DATE: August 1, 2014

TO: Council President and City Council

FROM: Department Director, Real Estate Assets Department

SUBJECT: Notification of Month to Month Residential Lease Agreement for City Property

In accordance with San Diego Municipal Code §22.0901, month to month leases for City-owned residential property may be authorized by the Mayor without the approval of City Council. Due to the unique concerns involved in residential leases, READ is providing the information below as background information on an agreement that has been active for more than three years.

The residential month to month lease for City real property described below has been in effect since Month/Date/Year:

Location:

Council District:

Agreement Type:

Lessee:

Term:

Rent:

Most Recent Rent Adjustment:

Property Size:

Department Director,
Real Estate Assets Department