THE CITY OF SAN DIEGO

DATE: September 23, 2021

TO: Honorable Members of the Audit Committee

FROM: Andy Hanau, City Auditor

SUBJECT: City Auditor's Comments on the City Attorney's Rebuttal Response to the Performance Audit of the City's Major Building Acquisition Process

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On August 31, 2021, the City Attorney provided a memorandum titled 'Rebuttal Response to the Performance Audit of the City's Major Building Acquisition Process' (attached). We appreciate the Office of the City Attorney's stated commitment to understanding why City processes failed and what corrective actions are needed to best protect taxpayers in the future. Additionally, we appreciate that in the first response to the audit the City Attorney committed to implementing some of the recommendations to ensure legal risks of each transaction are written and communicated to the City Administration and City Council.

However, we are commenting on the City Attorney's second response to our audit to provide additional clarity to the City Attorney and the public on our audit process and compliance with Government Auditing Standards. Again, rather than comment on all areas of the response that we found to be misleading or inaccurate, we have summarized our comments below.

The City Attorney incorrectly asserts that our audit was an "incomplete investigation."

As stated in our report, including our comments on the City Attorney's first response to the audit,[1] the objectives of our performance audit were to determine (1) if the City followed policies and best practices when purchasing buildings or entering into lease agreements worth more than $5 million from FY 2015 to FY 2019 and (2) if the City has sufficient governance mechanisms for oversight of purchases and lease agreements worth more than $5 million from FY 2015 to FY 2019. We completed our audit objectives in accordance with Government Auditing Standards and identified numerous policies and oversight mechanisms that the City should establish to ensure failed major building acquisitions do not occur again in the future.

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[1] See Page 108 of our Performance Audit of the City's Major Building Acquisition Process: https://www.sandiego.gov/sites/default/files/22-002_building_acquisition_process.pdf

While the City Attorney is correct that Government Auditing Standards require us to revise and re-issue an audit report if we later discover that we did not have sufficient or appropriate evidence for the audit, none of the information the City Attorney raises in the August 31, 2021 memorandum changes our audit's findings or recommendations. Simply put, the City did not have adequate policies and procedures in place to ensure the City followed real estate best practices and did not ensure staff presented complete and accurate information to City Council for these major real estate transactions. Although the City Attorney's Office asked our office to change our report to indicate that the entire 101 Ash transaction took place under the prior City Attorney, we did not do so because it would not be accurate because the current City Attorney's name is on the signed contract acquiring 101 Ash. We find it concerning that the current City Attorney's name was put on the contract signed in 2016 without her knowledge until 2020. However, it does not change the fact that at least some of the transaction occurred during both City Attorney administrations.

The City Attorney also incorrectly suggests that our audit is incomplete because we did not interview the City Attorney directly.

We met with representatives from the City Attorney's Office on at least seven separate occasions throughout the course of the audit. Further, the City Attorney's Office is invited to each audit's entrance and exit conference, and we provided the City Attorney's Office with drafts of the audit on multiple occasions for their review and comment before we published the audit.

At the outset of the audit, we asked the City Attorney's Office for the best contacts to interview regarding the transactions in our audit scope, including 101 Ash. No one from the City Attorney's Office indicated we had reason to interview the City Attorney, or that the City Attorney desired to be interviewed. The City Attorney's Office directed us to an Assistant City Attorney and attorneys in the Real Property and Public Finance Section, all of whom we met with multiple times.

The City Attorney incorrectly asserts that we concluded the City Attorney has the power to veto legislative and administrative actions.

Contrary to the City Attorney's assertion, at no point does our audit contend that the City Attorney is empowered to or should veto legislative and administrative actions. We found that per Charter Section 40, the City Attorney is the City's chief legal advisor and should provide legal advice to City Council on major building acquisitions. Our report merely states that the City Attorney's Office should advise the City Council on the legal risks associated with the building acquisition contract, and that we did not find any evidence that this occurred on the 101 Ash Street transaction.

The City Attorney incorrectly states that the Office of the City Auditor went outside the parameters of the audit.

As detailed above, our audit had two objectives. In line with those objectives, we determined that the City did not follow applicable policies and best practices when purchasing major buildings. As part of Government Auditing Standards, we also identified what real estate best practices are, what practices were not followed, and why those practices were not followed. Identifying this information ensures our recommendations address the root cause of the audit findings and is required by Government Auditing Standards – it is not straying from objectives.

The City Attorney incorrectly asserts the audit did not comply with Government Auditing Standards related to ongoing investigations and legal proceedings.

In accordance with Government Auditing Standards, we discussed ongoing civil litigation and investigations with management and the City Attorney's Office representatives multiple times throughout the audit. We also met with a representative from the U.S. Government Accountability Office (GAO), the organization that creates Government Auditing Standards, and determined that our audit would not interfere with any criminal investigations as required by the standards. The GAO advised that this section of the standards is referring to criminal investigations and legal proceedings, and not civil litigation. Further, during our citywide risk assessment and the risk assessment stages of the audit, it was clear the risks evident in the City's building acquisition process merited independent and timely review.

Additionally, the City Attorney implies that our work was incomplete because we did not center our report on the risk presented by the City having used an uncontracted real estate advisor that was paid by the seller of 101 Ash and Civic Center Plaza. In Finding 1 of the report, we discuss the risk the advisor posed to the City and we identify the controls that should have been in place to ensure the risk was mitigated. However, the overall findings of our audit go beyond the ways the City should have protected itself from the alleged fraud perpetrated by the City's real estate advisor. The City did not follow applicable policies and real estate best practices in each of the five buildings in our scope. The City did not inform City Council of all material information related to these transactions. The City did not have adequate oversight mechanisms in place for these transactions. The uncontracted real estate advisor likely had significant influence in the 101 Ash and Civic Center Plaza transactions, but the City did not have oversight and policies in place to ensure the City conducted adequate due diligence on any of the buildings acquired.

Finally, the City Attorney requested that their August 31, 2021 memo also be included in the final audit report. Government Auditing Standards do not require reports to be amended for response memos provided after a report is issued. However, we will post the City Attorney's memo along with this memo on our website adjacent to the link to the original audit report.

Conclusion

Our audit makes recommendations that will ensure the City Administration, City Attorney's Office, and City Council know the real estate best practices that should be followed on major building acquisitions. If best practices and policies are not followed in the future, our recommendations are designed to help ensure City decisionmakers know why. Our recommendations will help ensure future real estate advisors have contracts with the City and disclose their economic interests. We look forward to working with City decisionmakers in the future to ensure these recommendations are implemented.

Respectfully submitted,

Andy Hanau, MPP, CIA, CFE
City Auditor

cc: Honorable Mayor Todd R. Gloria
Honorable Members of the City Council
Honorable City Attorney Mara Elliott
Jay Goldstone, Chief Operating Officer
Paola Avila, Chief of Staff, Mayor's Office
Jessica Lawrence, Director of Policy, Mayor's Office
Andrea Tevlin, Independent Budget Analyst
Christiana Gauger, Chief Compliance Officer
Penny Maus, Director, Department of Real Estate and Airport Management
Jim McNeil, Assistant City Attorney
Heather Ferbert, Chief Deputy City Attorney

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 533-5800

DATE: August 31, 2021

TO: Andy Hanau, City Auditor, Office of the City Auditor

FROM: Mara W. Elliott, City Attorney

SUBJECT: Rebuttal Response to Performance Audit of Major Building Acquisition Process

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On July 22, 2021, the City Auditor issued a Performance Audit of the City's Major Building Acquisition Process (Audit Report) to "determine if the City followed policies and best practices when purchasing buildings or entering into lease agreements worth more than $5 million from FY2015 to FY2019; and to determine if the City has sufficient governance mechanisms for oversight of purchases and lease agreements worth more than $5 million from FY2015 to FY2019." Audit Report, OCA-22-002 at 107-110. Prior to publication, the Auditor solicited responses to the draft Audit from the Mayor and my Office. Those responses appeared in the published Audit along with previously unseen rebuttals by the Auditor. *Id.* The Audit Committee voted on July 28, 2021, to have the Auditor update his Audit to include additional responses from the Mayor's Office. We request that this memo also be included in the final Audit, consistent with Generally Accepted Government Auditing Standards (GAS). U.S. Government Accountability Office, (April 2021). Government Auditing Standards: 2018 Revision, Technical Update April 2021, ¶9.54, at 207 (Publication GAO-21-368G), https://www.gao.gov/assets/gao-21-368g.pdf.

I have spent nearly two decades of my legal career advising government auditors and audit committees on their roles and responsibilities at the County of San Diego and the City of San Diego. And as Deputy General Counsel to the San Diego Metropolitan Transit Development Board, now MTS, I worked closely with its outside auditors. As such, I am very familiar with GAS, San Diego Charter (Charter) sections 39.1 and 39.2, and the Kroll and Charter Review Committee reports that led to the creation of the Auditor position and the Audit Committee. I believe performance audits that comply with GAS can assist management and those charged with governance and oversight with better program performance and operations, reduced costs, and improved public accountability. However, the work product must be accurate, objective, complete, based on fact, non-partisan, and nonideological. *See* GAO-21-368G, ¶¶3.09, 3.10, 9.17, at 26-27, 197. For that reason, we bring forward the following clarifications.

Incomplete Investigation

The City Auditor's Office asserts their investigation was complete despite being unable to compel interviews with former key City officials involved in the transactions under review.

However, the City Auditor did not attempt to speak with me, with the attorneys who had worked directly on the transactions, or, apparently, with the former City Attorney, about the 101 Ash Street and Civic Center Plaza (CCP) lease-to-own agreements, which the City Auditor contends "transcended two City Attorney administrations." This failure to seek complete information led to inaccuracies in the Audit Report. Had I been interviewed, I would have offered the following:

According to publicly available lobbying reports, 101 Ash Street and CCP discussions resulting in the lease-to-own agreements commenced in early 2014.

On January 26, 2015, and again on February 10, 2015, Mayor Faulconer asked the City Council (Council) to approve an ordinance authorizing the City to enter into a 20-year lease-to-own agreement with CCP 1200, LLC, a Cisterra-owned company, for the real property and improvements located at 1200 Third Avenue (Civic Center Plaza) and 201 A Street (the King-Chavez High School building), collectively "CCP." According to Report to Council No. 14-073 (Jan. 20, 2015) (Staff Report 14-073), the Real Estate Assets Department (READ) skipped Council Committee and directly docketed the item at Council to expedite the transaction and prevent the City's landlord from selling CCP and displacing hundreds of City employees. The Council was briefed on this item in closed session on November 17, 2014, and at individual briefings conducted by READ staff. IBA Report No. 15-03 (Jan. 23, 2015). As explained in Staff Report 14-073, when the City was unable to secure funding in time to meet the current owner's escrow closing mandate, "the City, working with Jason Hughes (President/CEO of Hughes Marino and unpaid City consultant) was approached by CCP, LLC who proposed to purchase the buildings and underlying real property from the current owner within the mandated deadline of March 15, 2015, and enter into a lease-to-own agreement with the City." Report to Council No.14-073 at 3 (Jan. 20, 2015). Cisterra purchased CCP from the City's landlord for $44M, and then entered into a lease/purchase agreement with the City effective March 13, 2015. *Id.*

Mayor Faulconer used a nearly identical lease-to-own agreement with a Cisterra-owned company to purchase 101 Ash Street, only this transaction was not direct-docketed. On September 21, 2016, the Smart Growth and Land Use (SGLU) Committee considered and unanimously approved the acquisition request. The Independent Budget Analyst (IBA) included the item at her Council docket briefing on October 13, 2016. The request was then heard in open session by Council on October 17, 2016, and on November 15, 2016. The acquisition was approved unanimously by Council and then signed by Mayor Faulconer on November 17, 2016.

Despite the Auditor's assertion, I had no role in the acquisition of 101 Ash Street or CCP. I was not briefed by the prior City Attorney administration on either deal before or after taking office on December 12, 2016, nor did I know that Debra Bevier, the Deputy City Attorney (DCA) who reviewed the 101 Ash Street and CCP transactions, had not signed the 101 Ash Street agreement before former City Attorney Jan Goldsmith left office. On December 19, 2016, and without briefing or notifying me, DCA Bevier used a pen to cross out former City Attorney Jan Goldsmith's name from the 101 Ash Street agreement approved by the Council and Mayor Faulconer, and replaced Mr. Goldsmith's name with my name. I did not become aware of this circumstance until 2020.

With regard to the purchase of the Palm Avenue (Super 8 Hotel) for our successful "San Diego Misdemeanants At-Risk Track" (SMART) Program, the Auditor omitted relevant information to support his assertion that most of the buildings purchased by the City are not used for their primary intended purpose. While the Palm Avenue motel was acquired in 2017 and renovations were underway, attorney Cory Briggs filed a lawsuit against the City challenging the acquisition. Although the lawsuit was meritless, a local judge ordered the City to stop all renovation work pending its resolution. After a delay of more than two years, the City was vindicated on appeal, and the last phase of the renovation was completed just as the Covid-19 pandemic arrived. In response to the pandemic, the City determined that using the hotel to provide temporary refuge for unsheltered families during the pandemic took precedence. The hotel's temporary use during the pandemic was memorialized in a Memorandum of Understanding (MOU), with the understanding that the hotel would be used for SMART after the pandemic emergency ended. My Office provided the Auditor with a copy of the MOU before he released the final Audit. As explained in the response memo we provided to the Auditor before the Audit was issued, the acquisition process had no bearing on the City's decision to temporarily repurpose this asset. Rather than acknowledging the omission in his rebuttal, the Auditor argued that the real issue was that Smart on Palm was slow to come on-line. Audit Report, OCA-22-002 at 115.

The Auditor Reaches Incorrect Legal Conclusion

The Auditor states, "[w]hile it appears to be true that the vast majority of the legal work on the 101 Ash transaction was completed under the prior City Attorney, it is not factually accurate to refer only to the prior City Attorney, because the final signoff occurred after their term." Audit Report, OCA-22-002 at 108. The Auditor's legal conclusion is wrong. All the legal work occurred before the Council approved the transaction on November 15, 2016. To suggest otherwise ("the vast majority") is disingenuous for the following reasons:

- Legal review for a property acquisition concludes before the transaction is brought to a City Council Committee or, if direct-docketed, to Council, for a vote. As described above, the 101 Ash Street lease-to-own agreement was preceded by a meeting of the SGLU Committee on September 7, 2016, in which Committee members asked legal questions and then unanimously approved the proposed acquisition. The item was then heard at the IBA's docket briefing on October 13, 2016, and then by the Council on October 17, 2016, and again on November 15, 2016. The suggestion that a legislative body would approve a lease-to-own agreement for a skyscraper worth tens of millions of dollars before legal review of the acquisition concludes defies logic. If it were true, it would have been an egregious failure by the City and a principal finding of the Audit.

- The Auditor does not understand the City Attorney's obligations under San Diego City Charter (Charter). Charter section 40 requires the City Attorney and her deputies to prepare in writing "all ordinances, resolutions, contracts, bonds or other instruments in which the City is concerned, and to endorse on each approval of the form or correctness thereof." As the California Supreme Court has explained, an attorney's approval as to

form and content is an affirmation that "counsel has read the document, it embodies the parties' agreement, and counsel perceives no impediment to his client signing it." *Monster Energy Co. v. Schechter*, 7 Cal. 5th 781, 792 (2019) (citing *Freedman v. Brutzkus*, 182 Cal. App. 4th 1065, 1070 (2010)). By law and by practice, all ordinances, resolutions, contracts, bonds, or other instruments signed by the City Attorney's deputies are approved as to form for purposes of verifying that they capture the intent of the action taken by the legislative and administrative branches. This is an approval of the form of the document, not the substance of the document. As such, the signature of a DCA affirms that the lease-to-purchase agreements captured the terms approved by Council and the Mayor. The distinction between a legal review of an acquisition and approval of a document as to form is monumental.

- "Most of the powers exercised by a municipal corporation require either an ordinance or a resolution… Where the charter requires the passage, of an ordinance – a legislative act – by the council, to accomplish the object desired, an ordinance is indispensable; the power cannot be delegated to others. 5 McQuillin Mun. Corp. § 15:3 (3d ed. 1990) (citing *Barnes v. Merritt*, 428 F.2d 284 (5th Cir. 1970)). An ordinance "imports a local rule of general and permanent character, enacted to regulate continuing conditions, and it has the force of law over the community in which it is adopted." 5 McQuillin Mun. Corp. § 15:12 (3d ed. 1990) (citing *McCoy v. Providence Journal Co.*, 190 F2d 760 (1st Cir. 1951)). Ordinances have been said to amount to laws. 5 McQuillin Mun. Corp. § 15:12 (3d ed. 1990) (citing *Little v. City of North Miami*, 624 F. Supp. 768 (S.D. Fla 1985) (decision aff'd in part, rev'd in part on other grounds, *Little v. City of North Miami*, 805 F.2d 962 (11th Cir. 1986)). "So, where the charter provides that a particular power shall be exercised by ordinance, its exercise in any other manner, as by contract or resolution, would not be legal." 5 McQuillin Mun. Corp. § 15:3 (3d ed. 1990). Accordingly, the Council's adoption of an ordinance has the force of law, and this power cannot be delegated to another branch of the City's government.

- The Auditor contends that Charter section 40 empowers the City Attorney to veto the legislative and administrative actions taken under the City's Charter, even if the action taken is legal. As explained in the paragraph above, this contention contradicts established law. It also defies logic. If the Auditor was right, the City Attorney could refuse to sign an ordinance, resolution, contract, bond, or other instruments she does not like or support even if duly elected administrative and legislative officials properly exercise their responsibilities. This position, if taken, would undermine the authority vested in the Mayor and the Council and disenfranchise members of the public who express opinions on proposed actions and policies to their elected representatives. The Auditor's contention would elevate the City Attorney to the most powerful public official in City governance, a result that is not contemplated in our Charter or our City's legislative history.

"Red Flags"

The Auditor claims that the City Attorney's Office should have seen "red flags" at the time of approval of the 101 Ash transaction because it "should have had access to all the information and reports used by City Management to support their statement related to the condition of the building." Audit Report, OCA-22-002 at 108. Further, "[a] review of that information would have shown that City Management was relying on the seller's building assessment information and City Management did not conduct their own building condition assessments." *Id.* The Auditor's conclusions are problematic for numerous reasons:

- Attorneys must rely on those with expertise to perform their work consistent with industry standards. With a Capital Improvement Project, for example, we would not question the materials used by the City's selected contractor or whether the contractor's work meets applicable standards. We must rely on those with expertise. And those with expertise report to another branch of government - the executive branch.

- The attorneys must rely on facts presented by City staff. As we pointed out in our initial response, the City Attorney's Office does not control staff employed by other branches of the City government. This is the case for the entire legal profession, not only for government attorneys. You will often see language in our memoranda to this effect: "Based on the facts as presented…" Moreover, when we draft factual recitals in a resolution or an ordinance for Council consideration, we necessarily rely on facts from the staff report or other materials provided by City staff.

- The Auditor places no responsibility on the City's decision-makers to review their materials, ask questions, or request briefings. Instead, all responsibility is placed on other branches of government to predetermine what a councilmember needs to know to make a well-reasoned decision. That same abjuration of responsibility resulted in the pension crisis in the early 2000s. See Kroll Report at 129. With 101 Ash, all branches of government had access to the same information, yet the Auditor, who was appointed by the City Council, releases from any accountability the actual decision-makers and suggests they were confused by terms like "as-is" and "all risk"- a suggestion for which neither he nor the public record offers any evidence. In other cities, independent auditors hold *all* branches of government accountable. See, for instance, the City of Oakland, which elects an auditor who is accountable to the voters and not to an audit committee.

- The Auditor similarly assigns no responsibility to the IBA, even though the Audit identifies flaws in the financial analysis on 101 Ash that City staff presented to the Council. The position of the IBA was created to be a corrective to staff bias and error through its analysis of City finances and is appointed by the Council to maintain the position's independence.

- Finally, the Auditor's assessment is based on speculation rather than fact. For instance, he states, "[t]he City Attorney's Office *could* have requested to review the due diligence documents …," and "*could* have raised this issue as an item of note to City Council …," ((Audit Report at 114) (emphasis added)).These suggestions do not account for the facts as presented at that time (i.e., the Report to Council stated that Jason Hughes was an "unpaid consultant." Staff Report 14-073 (Jan. 20, 2015)) and instead are informed by facts that only came to light after the City initiated litigation and subpoenaed records. Lawyers are well aware of the laws concerning dual agency, as well as myriad other possibilities not suggested by the facts presented by staff. The Audit recommendation then is to have the City Attorney attach a boilerplate list of all possible risks of any real estate transaction, whether implicated by known facts and circumstances or not.

The Auditor Went Outside the Parameters of the Audit

The Auditor asserts that the Audit is intended to "help ensure the City follows best practices when acquiring major buildings and informs the City Council and the public of all material facts, including significant legal risks." Audit Report at 108. The Auditor strayed far afield from this stated objective by assessing blame for various transactions based, again, on a flawed understanding of the facts and a wholly inaccurate understanding of the law.

Ongoing Investigations and Legal Proceedings

As explained in GAS (GAS or GAO-21-368G), auditors should inquire of management of the audited entity whether any investigations or legal proceedings have been initiated or are in process with respect to the period under audit, and should evaluate the effect of initiated or in-process investigations or legal proceedings on the current audit. See GAO-21-368G, ¶6.12 at 112. The City is engaged in high-stakes litigation involving 101 Ash and CCP, and the City Attorney's Office has referred these matters to outside law enforcement agencies for investigation. As these activities were underway, the Auditor published an audit that steps outside his work plan to reach unsupported conclusions. This occurred without consultation with the City Attorney's Office regarding in-progress investigations or legal proceedings. As explained in GAS, avoiding interference with investigations or legal proceedings is essential in pursuing indications of fraud and noncompliance with provisions of laws, regulations, and contracts. GAO-21-368G, ¶6.14 at 112. In some cases, it may be appropriate for the auditors to work with investigators or legal authorities or to withdraw from or defer further work on the engagement or a portion of the engagement to avoid interfering with an ongoing investigation or legal proceeding. *Id.* As communication did not occur, the Auditor has now been subpoenaed as a key witness in the 101 Ash and CCP litigation.

Additionally, the ongoing litigation should have raised a "red flag" for the Auditor that his work product was incomplete. On the morning of June 29, 2021, the City Attorney announced a lawsuit against the 101 Ash seller and the real estate broker who advised the City on the acquisition. The lawsuit revealed an undisclosed $4.4 million commission that the seller paid the

broker, in violation of California's conflict disclosure and anti-corruption laws, and contrary to the broker's representation that he was not being paid by any party. The Auditor circulated a draft Audit on the afternoon of that same day, June 29, 2021, and a "final draft" on July 13, 2021. The final Audit was published on July 22, 2021. During those 24 days, the Audit findings and recommendations were not updated to incorporate the implications of the City being misled by its own real estate broker, even as the Audit cited representations that were made to the City by that broker and which factored heavily in the Audit's findings on due diligence. Instead, the Auditor inserted a last-minute and objectively absurd statement that the City Attorney (and no one else) should have intuited that this illegal activity was occurring behind closed doors.

A reasonable interpretation of GAS would require that, following the revelation in the litigation, the Auditor would reassess his belief that the evidence gathered for the Audit was adequate to serve the Audit's purposes. He did not, it appears, and as a consequence, the Auditor sheds no light on the massive betrayal of the public trust that is the heart of the issue with 101 Ash.

Conclusion

The City Attorney's Office supports measures that will ensure that staff truthfully and timely report information that is important to those charged with decision-making. Litigation of the 101 Ash acquisition will provide City decision-makers with additional information that will likely be instructive in understanding why City processes failed and what corrective actions are needed to best protect taxpayers from future malfeasance by public officials.

MARA W. ELLIOTT, CITY ATTORNEY

By 

MWE:sne
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cc: Jay Goldstone, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst