



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of Proposed Changes to Council Policies 700-10, 700-12, and 700-32

OVERVIEW

On October 19, 2023, the Land Use and Housing (LU&H) Committee discussed the proposed revisions to the following three Council Policies brought forward by the Department of Real Estate and Airport Management (DREAM):

- Council Policy 700-10: Disposition of City-Owned Real Property
- Council Policy 700-12: Leasing City Property to Nonprofit Organizations
- Council Policy 700-32: Acquisition of Real Property

The Committee recommended Council approve proposed revisions to Council Policy 700-12 and Council Policy 700-32. Amendments to Council Policy 700-10 were suggested by the Committee, and instead of proceeding to Council like the other two policies, DREAM was requested to work with Council District 1 and the LU&H Committee Consultant to bring back a draft of Council Policy 700-10, reflecting those amendments, to LU&H Committee as an action item.¹ The Committee also requested that the Independent Budget Analyst (IBA) provide an analysis of proposed changes to all three Council Policies before they are docketed at City Council. This report responds to that request.

This report provides background on the revised Council Policies, analyzes the proposed changes, clarifies the associated impact on the disposition and acquisition processes, and offers policy considerations. For each Council Policy, we also identify whether the proposed changes are driven

¹ The Committee requested two amendments to CP 700-10: 1) Add to Section II, E(2) governing the sale approval process, an option for City Council to retain the property; and 2) revise one of the criteria for leasing as referenced in Section III, B(1)(f) to read “The property can be leased to provide a public benefit, including, but not limited to, constructing or preserving affordable housing units, operating a homeless shelter, or pursuing a significant economic development opportunity.”

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by any audit recommendations made by the Office of the City Auditor (OCA), as well as changes that are beyond audit recommendations.

As the proposed changes to Council Policy 700-10 will be brought back to the LU&H Committee, we include an analysis of this Council Policy in **Attachment 1** of this report. As DREAM works with Council District 1 and the Committee Consultant to revise Council Policy 700-10, we recommend considering the areas discussed in **Attachment 1**.

BACKGROUND

The City's authority to acquire, sell, and lease properties is rooted in the City Charter. The Department of Real Estate and Airport Management (DREAM), which is currently being merged with the Economic Development Department (EDD), oversees the City's real estate portfolio comprised of over 1,600 properties. In 1975, the City enacted Council Policy 700-32: Acquisition of Real Property Interests. It has not been updated since its adoption 49 years ago. Similarly, Council Policy 700-12: Disposition of City Property to Nonprofit Organizations dates back to 1985 and has not been updated since.

In 2006, the City engaged real estate consultant Grubb & Ellis Corporate Services to provide a study on best practices for the management of the City's real properties based on both private sector and governmental real estate industry standards.² Following the consultant study, in 2008 the City Council incorporated several associated best practices into Council Policy 700-10, which governs the lease and sale of City property. Notable changes then included the institution of a Portfolio Management Plan, the requirement of an appraisal that is less than six months old for properties to be leased or sold, and requirements for notification of the availability of government property pursuant to the California Government Code. Since 2008, no substantive updates to the Council Policy 700-10 have been made.

Over the past several years, the City's management of its real estate portfolio has been the subject of several performance audits conducted by OCA. A number of recommendations from those audits called for updates to the three Council Policies referenced above:

[Performance Audit of the Real Estate Assets Department](#), dated December 2012, highlighted the need to update Council Policy 700-12 to establish eligibility criteria for rent subsidies to nonprofit organizations and a fee to help recover the City's administrative costs. (Recommendation 4)

[Performance Audit of the Real Estate Assets Department's Portfolio Management Practices](#) (Portfolio Management Audit), dated July 2018, recommended updating Council Policy 700-10 to reflect the most appropriate channel of publicly presenting the Portfolio Management Plan, as determined by DREAM, in consultation with the City Attorney's Office and Council. This is so that the Council and public can weigh in on the City's real estate portfolio. (Recommendation 4)

² Grubb & Ellis, [Best Practices Methodology for Real Estate Assets Department](#), 2007

[Performance Audit of the City’s Major Building Acquisitions Process](#) (Building Acquisition Audit), dated July 2021, recommended creating a new or amended Council Policy that requires a best practices checklist and a due diligence checklist for building acquisitions; IBA review of the best practice checklist for future acquisitions; and additional requirements for contractors, consultants, or advisors, among other recommendations. (Recommendations 1- 6, 8, 10)

[Performance Audit of the City’s Lease Management and Renewal Process](#) (Lease Management Audit), dated February 2022, recommended updates to Council Policy 700-10 to improve oversight of non-competitively priced leases and clarify valuation methods. (Recommendations 9, 10)

Additionally, a 2016 Grand Jury Report entitled [City of San Diego’s Real Estate Assets Department Leasehold Management Has Weaknesses](#), recommended updates to Council Policies 700-10 and 700-12 to allow the City to make leasing decisions that reflect current economic conditions. (Recommendations 17-03)

FISCAL AND POLICY DISCUSSION

This section provides fiscal and policy considerations for major changes proposed for Council Policies 700-12 and 700-32. Proposed changes are categorized into “Changes in Response to Audit Recommendations” and “Additional Changes Beyond Audit Recommendations.”

CP 700-12: Leasing City Property to Non-profit Organizations

Changes in Response to Audit Recommendations

The most notable changes in the proposed policy are the establishment of eligibility criteria and the administrative cost recovery for non-profit leases. These revisions implement Audit Recommendation 4 of the 2012 Real Estate Assets Department Audit. Under the proposed policy, the City may charge a non-profit lessee a rent that is less than market value if the City Council determines that a proposed lease transaction will confer public benefits. In such a case, the rent could be either 1) a nominal fee for City property acquired or improved with CDBG funds³, or 2) an administrative cost recovery fee, to be adjusted annually based on the Consumer Price Index. Under the proposed changes, Council would have the authority to determine whether a lower-than-market-rate rent is justifiable. In situations where Council could not make a finding that the proposed lease transactions provide one or more public benefits, a market rate rent should be pursued.

Additional Changes Beyond Audit Recommendations

The proposed policy includes the addition of a definition section that defines terms such as “CDBG-restricted properties,” “nonprofit organization,” and “public services.” The proposed policy provides a broad definition of ‘nonprofit organization’ to cover any organization that meets one or more of the following criteria:

³ Community Development Block Grant funds are federal funds that primarily serve low-income persons.

- (a) designated, or *in the process of* seeking designation, as a nonprofit entity by the California State Board of Equalization
- (b) holds tax-exempt status from the Internal Revenue Service
- (c) is a public or quasi-public agency

This definition of ‘nonprofit organization’ is broader than that of other City programs, which do not include organizations in the process of seeking designation. Any below-market-rate rent amount paid by non-profit organizations is essentially subsidized by the City. **To prevent potential abuse of the program, we recommend requiring nonprofit organizations in the process of seeking designation to provide proof of designation to the City before the start date of the lease term.**

The proposed policy requires DREAM to present proposed non-profit leases of City property to the Land Use & Housing Committee before presenting them to the full Council. Although not specifically recommended in any audit, this revision is consistent with the intent of Audit Recommendation 1 of the Building Acquisition Audit to ensure staff consistently present land use proposals to a Council Committee with expertise in the City’s real estate needs and practices to allow for proper Council oversight.

The proposed policy also addresses subleasing or licensing the use of leased City property and provides a revenue-sharing mechanism resulting from subleasing or licensing. Nonprofit organizations are required to obtain written permission from the City in advance of subletting, and to pay the City at least 50% of revenue from subleasing or licensing, consistent with the subleasing revenue-sharing structure for nonprofit entities, as established in the City’s current Council Policy 700-10. This amendment is reasonable given that subleasing or licensing may not serve a public purpose. Finally, the proposed policy expands the types of property that could be leased to nonprofit organizations by removing the prohibition to lease properties with significant potential for commercial, industrial, or scientific research uses to nonprofits.

CP 700-32: Acquisition of Real Property

Changes in Response to Audit Recommendations

Roles and Responsibilities

In response to Audit Recommendation 2 from the 2021 Building Acquisition Audit, the proposed policy outlines the roles and responsibilities of various departments in the acquisition process, as reflected in the table below. We note that instead of setting out the roles and responsibilities in an Administrative Regulation as recommended in the Audit Recommendation, these elements are incorporated into the proposed policy and the Acquisition Due Diligence Checklist, which still meets the intent of the Audit Recommendation.

Department	Roles and Responsibilities
DREAM	<ul style="list-style-type: none"> - Responsible for all acquisitions by the City - Coordinate with the Office of the City Attorney on any acquisitions involving the City’s exercise of its power of eminent domain - Present proposed acquisition to LU&H prior to full City Council when Council approval is required - Evaluate the benefit derived from the City’s use of the property proposed to be acquired - Complete all due diligence steps identified in the due diligence checklist before recommending City Council approval - Periodically revisit and revise, if appropriate, the due diligence checklist - Complete staff report including meeting all disclosure requirements
Office of the City Attorney	<ul style="list-style-type: none"> - Work with DREAM on any acquisitions involving the City’s exercise of its power of eminent domain - Provide written legal analyses for any major building acquisition; may provide legal analysis identifying any known significant legal risks in the transaction
Office of the IBA	<ul style="list-style-type: none"> - Review all due diligence steps completed by DREAM as identified in the due diligence checklist
Department of Finance	<ul style="list-style-type: none"> - Confirm adequate funds are available for the proposed building acquisition
Acquiring Department	<ul style="list-style-type: none"> - Provide proposed use for the building to be acquired and to what extent it fits the business case - Provide proposed tenant improvements and associated costs, if any - Complete financial/economic analysis, which considers potential alternatives to acquisition or acquisition site

Most of the roles and responsibilities included in the table above are driven by other recommendations from the Building Acquisition Audit. For instance, Audit Recommendation 1 calls for a business case analysis, an economic analysis, a tenant improvement proposal if applicable, City Attorney’s Office’s written analysis of the significant legal risks, and a designated Council Committee to review acquisition and lease proposals. Additionally, Audit Recommendation 8 calls for the IBA’s review of the due diligence checklist and to determine if the staff has completed the associated steps. These elements are delineated in the proposed policy and the Acquisition Due Diligence Checklist which are discussed further below.

We note that Audit Recommendation 1 also calls for an analysis of how a building acquisition fits into the City’s strategic real estate plan (the Real Property Management Plan), which is not explicitly required in the proposed policy. However, staff from DREAM indicated that this analysis will be covered in the business case analysis to be completed by acquiring departments. **To prevent this element from being overlooked during the implementation of the Council Policy, we recommend either specifying in the proposed policy: 1) the requirement that acquisition decisions be made in consideration of the strategic real estate plan (Real Property**

Management Plan), or 2) defining the scope of a business case to include an analysis of how a building acquisition fits into the City's strategic real estate plan.

Disclosure Requirements

In response to Audit Recommendation 4 from the 2021 Building Acquisition Audit, the proposed policy requires DREAM to disclose in staff reports associated with property acquisitions if it has retained a broker, and if so, the broker's compensation structure and amount payable to the broker. Furthermore, DREAM is required to ensure that any consultants or advisors who provide significant input on a proposed acquisition have a signed contract with the City, submit a Disclosure Determination for Consultant form, and, if applicable, file a Statement of Economic Interest (Form 700) with the Office of the City Clerk. Although not specified in the proposed policy, per DREAM “significant input” means an ongoing role of a third party contributing to a transaction that will influence the City’s direction. In some cases, high-level information regarding market conditions provided by a third party may not constitute “significant input”.

The filing of Form 700 is managed by the Office of City Clerk, following statutory procedures. Consultants are required to file a Form 700 within 30 days of assuming office, each year thereafter, and within 30 days after they have completed their City service. Although not specifically required in the proposed policy, DREAM staff said that the department will disclose in its staff report the date on which the consultant determination form and Form 700 were filed with the Office of the City Clerk as well as any economic interests subject to Charter 225 - Mandatory Disclosure of Business Interests.

As there are no requirements to update Form 700 should new conflicts of interest arise, it will be incumbent upon the consultant to disclose any new potential conflicts of interest. We note that to address this concern, the San Diego Housing Commission requires updated conflict attestations from brokers and agents prior to entering into any agreement or closing escrow to purchase real estate. In situations where the broker/agent obtains compensation of any type from a seller or cooperating brokers, the broker/agent is required to disclose and detail all such compensation prior to the execution of the purchase and sale agreement for each transaction. **Council may wish to consider adding similar language in the proposed policy to ensure any newly arisen conflicts of interest are disclosed by consultants/brokers. Alternatively, as suggested by the Office of the City Attorney, the City could include a provision in purchase or lease agreements requiring the other contracting party (e.g., seller, buyer, landlord, tenant) to make a factual representation as to whether a broker or consultant has been retained and is owed any commission or fee with respect to the sale/lease transaction.**

Due Diligence Checklist

In response to Audit Recommendation 5 of the 2021 Building Acquisition Audit, a due diligence checklist covering activities and investigations necessary for property acquisition was developed by DREAM. The proposed policy amendments reflect the required use of the checklist. The due diligence checklist covers various items recommended in the Audit for building acquisitions such as:

- the use of a current appraisal provided by an appraiser retained by the City
- an independent building assessment

- an environmental site assessment
- a test fit⁴

Additionally, in response to Audit Recommendation 1 from the Building Acquisition Audit, the checklist requires DREAM to request a written legal analysis from the Office of the City Attorney for any major building acquisition where the property or rent to be paid over the lease period of the property has a current market value of at least five million dollars. The Office of the City Attorney may provide a written legal analysis identifying the known significant legal risks in the transaction.

To ensure the proposed due diligence checklist aligns with the industry's best practices, our Office engaged real estate consultant firm Kosmont to review the checklist, and Kosmont determined that the checklist aligns with best practices and did not suggest major changes.

Designation of Council Committee to Oversee Acquisition

In response to Audit Recommendations 1 and 10 from the 2021 Building Acquisition Audit, the proposed policy requires DREAM to present acquisition proposals to the LU&H Committee if the acquisition requires City Council approval.⁵ If a presentation at another Council Committee is required, DREAM shall clearly identify the reasons for this in the written staff report.

Additional Changes Beyond Audit Recommendation

Appraisal Validity Period Extension

The proposed policy extends the validity length of a real estate appraisal from six months to 12 months. This appraisal extension is also proposed in Council Policy 700-10. According to staff, once a real estate appraisal is completed, negotiations often require multiple business and legal reviews that take several months. After all necessary legal approvals and approvals from client departments are obtained, it could take another 90 days to draft, route, and docket an item for Committee and Council approval. By the time the proposal is ready to be presented to the Committee and Council for approval, the Department is often faced with having to update the appraisal due to its expiration.

Appraisal costs range from \$3,000 to \$16,000; in FY 2023, the City spent \$30,600 to update nine expired appraisals. The table below reflects the number of appraisals requiring updates in the past three fiscal years and associated costs. Since the number of appraisals conducted in FY 2021 is significantly less than that of the ensuing years likely due to the pandemic, the proposed extension of appraisal validity time is expected to result in an annual savings of approximately \$31,000 based on the last two years actual expenditures.

⁴ A test fit is a floor planning exercise to confirm that the space needs and the requirements of the tenant can be met within the specific space.

⁵ According to San Diego Municipal Code Section 22.3110 Council approval is not required to acquire property necessary for the construction, reconstruction, repair, operation, or maintenance of City facilities so long as certain criteria are met.

Fiscal Year	Appraisals Completed	Total Cost of Appraisals	Average Cost per Appraisal	Appraisals Requiring Updates	Total Appraisal Update Cost	Average Cost per Appraisal Update
2023	74	\$ 310,800	\$ 4,200	9	\$ 30,600	\$ 3,400
2022	64	\$ 332,800	\$ 5,200	8	\$ 31,200	\$ 3,900
2021	7	\$ 33,600	\$ 4,800	3	\$ 9,000	\$ 3,000

The proposed Council Policies do include requirements for DREAM to continue to monitor market conditions between the appraisal date and when the transaction is docketed for Council or Committee, and to identify any pertinent changes in market conditions in staff reports. For leasehold appraisals, Council Policy 700-10 requires DREAM to consider whether an appraisal update is needed if there have been significant changes in lease market conditions. Similar requirements should also be added to Council Policy 700-10 regarding for-sale properties and Council Policy 700-32 regarding acquisitions.

To ensure appraisals conducted within 12 months continue to reflect the market value of the property, **we recommend establishing criteria for assessing whether an appraisal conducted more than six months before an item is docketed continues to reflect the market value of the property.** Any corresponding process should be constructed to provide due diligence without overburdening staff; criteria to be considered may include an analysis of changes in market and economic conditions, changes in zoning regulations, an analysis of competing properties and the improvements to or lack of maintenance of the subject property, and natural disasters. **Council may wish to request DREAM to provide information in staff reports that confirm the Department’s conclusion that an appraisal remains valid for real estate transactions under consideration, for transactions subject to Council Policy 700-10 or 700-32.**

Furthermore, an Appraisal Review is a formal evaluation of the quality of an appraisal and is recognized as a sound practice in the real estate industry to determine whether an appraisal is complete, clearly reasoned, and has adequate support for the conclusion of the appraisal value. It serves as a second opinion to help ensure the appraisal’s accuracy and thoroughness in valuing the property by identifying any errors, omissions, or inconsistencies. An Appraisal Review is required by some other agencies in California for certain types of real estate transactions. For instance, San Francisco requires an Appraisal Review if an appraisal determines the fair market value of the real property the City intends to acquire or convey exceeds \$200,000, or if the market rent of the lease exceeds \$60 per square foot per year as base rent. The San Diego Housing Commission requires an independent peer or desk review of appraisals obtained by the Commission for real estate acquisitions. We note that DREAM currently reviews all real estate appraisals: third-party appraisals are reviewed by the DREAM Valuations Team and appraisals completed by City staff are reviewed by the City’s Principal Appraiser. **Council may wish to consider requesting DREAM evaluate the costs and benefits of conducting formal Appraisal Reviews for property acquisitions above a certain threshold to ensure that appraisals contain sufficient information and analysis to support the recommended decision to engage in a transaction, without imposing cumbersome requirements for staff.**

Eminent Domain

The proposed policy clarifies the processes, conditions, and the City's obligations when exercising the power of eminent domain. The City is required to complete acquisitions expeditiously through negotiations whenever possible before exercising the power of eminent domain, and such power shall only be exercised when the City requires immediate possession of the property and negotiations are at an impasse. Under the State Eminent Domain Law, the City Council must adopt a Resolution of Necessity that makes prescribed findings before the City can start a legal proceeding to acquire a property for public use using eminent domain. The proposed policy aligns with applicable Eminent Domain Law and Relocation Law, including fairly administering relocation assistance if required. The City is already following these processes and requirements, and these changes to the proposed policy will not result in any operational impact.

CONCLUSION

This report provides an analysis of major changes to Council Policy 700-12: Leasing City Property to Nonprofit Organizations, and Council Policy 700-32: Acquisition of Real Property. An analysis of Council Policy 700-10: Disposition of City-Owned Real Property is included as **Attachment 1** to this report. For each Council Policy, we provide fiscal and policy considerations for proposed changes. We also make various recommendations for Council consideration, which are included in bold text throughout the report. These Council Policy updates will implement recommendations from four performance audits and one Grand Jury Report regarding the City's real estate management.

Overall, we believe the proposed changes are a positive step and will improve the management and oversight of the City's leasing and acquisition process, promote the best use of the City's real estate assets, and improve public transparency.

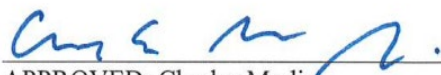
Key considerations and recommendations on Council Policy 700-12 and Council Policy 700-32 are summarized below:

Topic	Issues for Consideration
Council Policy 700-12: Leasing City Property to Nonprofit Organizations	
Leasing City Property to Nonprofits	We recommend requiring nonprofit organizations in the process of seeking designation to provide proof of designation to the City before the start date of the lease term.
Council Policy 700-32: Acquisition of Real Property	
Real Property Management Plan	We recommend either specifying in the proposed policy: 1) the requirement that acquisition decisions be made in consideration of the strategic real estate plan (Real Property Management Plan), or 2) defining the scope of a business case to include an analysis of how a building acquisition fits into the City's strategic real estate plan.
Conflict of Interest	Council may wish to consider revising language pertaining to conflict of interest in Council Policy 700-32 to ensure any newly arisen conflicts of interest are disclosed by consultants/brokers. Alternatively, as suggested by the Office of the City Attorney, the City could include a provision in purchase or lease agreements requiring the other contracting party (e.g., seller, buyer, landlord, tenant) to make a factual representation as to whether a broker or consultant has been retained and is owed any commission or fee with respect to the sale/lease transaction.
Appraisal/Valuation	We recommend establishing criteria for assessing whether an appraisal conducted more than six months before an action continues to reflect the market value of the property. Council may wish to request DREAM to provide information in staff reports that confirm the Department's conclusion that an appraisal remains valid for real estate transactions under consideration, for transactions subject to Council Policy 700-10 or 700-32.
	Council may wish to consider requesting DREAM to evaluate the costs and benefits of conducting formal Appraisal Reviews for acquisitions above a certain cost threshold to ensure that an appraisal contains sufficient information and analysis to support the recommended decision to engage or not engage in a transaction, without imposing cumbersome requirements for staff.

We would like to thank City staff from DREAM and the City Attorney's Office for answering our questions related to this analysis. Our office is ready to assist Council in any further steps.



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Attachment 1: Analysis and Recommendations on Council Policy 700-10: Disposition of City-Owned Real Property

Analysis and Recommendations on Council Policy 700-10: Disposition of City-Owned Real Property

CP 700-10: Disposition of City-Owned Real Property

Changes in Response to Audit Recommendations

Real Property Management Plan

The proposed policy replaces the former “Portfolio Management Plan (PMP)” with a “Real Property Management Plan (RPMP).” to serve as the City’s strategic plan for real estate management. The purpose of the plan largely stays the same – to enable a better understanding of the City’s real estate and how it can be best utilized to benefit the citizens of San Diego. Audit Recommendation 3 of the Building Acquisition Audit recommended that the City develop and use a strategic real estate and office plan that includes both the current and future space usage plan for City properties. The table below compares the major elements of PMP and RPMP.

Major Elements of Portfolio Management Plan	Major Elements of Real Property Management Plan
Property evaluation and characterization of real estate assets	Summary of the location, size, and current use of all City properties and all properties occupied but not owned by the City
Strategy for City occupied real estate	Strategies for management of all City properties and all properties occupied but not owned by the City, including a building-by-building and aggregate review detailing:
Investment Portfolio Plan (leases to for-profit tenants)	- current rent vs. most recent market rental value with valuation date
Review of not-for-profit leases	- lease expiration date and renewal options
Disposition plan for surplus assets	- identity of the tenant (applicable to City properties leased out by the City only)
Disposition plan for surplus assets	Disposition plan for surplus land
Business case development review to support proposed transactions	Pending and proposed sales and leases should be noted
Legal document development and review	

As reflected in the table above, the RPMP includes additional reporting requirements on properties and leases. Audit Recommendation 9 of the 2022 Lease Management Audit recommended reporting leases’ most recent market rental value, the date of said value, and the actual annual rent paid to the City. All these elements are incorporated into the proposed RPMP.

Notably, business case development and legal document development, which were recommended in the 2007 Grubb & Ellis study, are removed from the proposed plan. According to DREAM, legal documents, such as lease and lease renewal forms, are kept in DREAM’s lease management system. Business case reviews are generally conducted as specific transactions come up and are

provided in staff reports and backup documentation, and it may be operationally challenging to conduct comprehensive business reviews as part of the RPMP given that the changes in business needs may not overlap with when RPMP is developed or updated. However, we note that it is important to provide a high-level business case review for known space needs in the RPMP so that Council can be informed of what is driving upcoming space needs. The business case development review component of RPMP should identify departments that have changing space needs, and the rationale for changes - such as headcount increase, operational changes, lease expiration, and space requirements.

Additionally, the proposed policy does not include a plan for future office space usage for City properties, as recommended in Audit Recommendation 3 of the Building Acquisition Audit. DREAM has engaged real estate consultant Jones Lang LaSalle (JLL) to conduct an office space optimization study, which is currently underway, to assist in this effort. The results of the study could be incorporated into the RPMP to provide a mechanism for future office space planning. **We recommend consideration be given to including in the RPMP a high-level business case review of known space needs and a plan for future office space usage, which could incorporate the results from the JLL office space study. A strategic real estate plan can help ensure properties the City acquires fit into a coherent long-term plan that has been publicly vetted and approved by the Council.**

DREAM anticipates presenting RPMP to the City Council every two years as recommended in Audit Recommendation 4 of the Portfolio Management Audit. The Land Use and Housing Committee (LU&H) may request periodic reviews of and updates to the RPMP. Notably, the draft policy does not specify how the RPMP will be presented (i.e. formally at a public hearing or informally), nor does it require the Council's approval. The previous PMP was not presented to the City Council or Committees between 2011 and 2017, despite a policy requiring the PMP to be presented to Council. According to then-department management, the PMP was distributed to City Council via email and posted on the City's website and therefore the department complied with the Council Policy requirements. However, as the Audit noted, not formally presenting the plan to Council at a public hearing could deprive the Council and the public of an opportunity to provide *input* on the City's real property management strategy. DREAM does intend to docket RPMP for LU&H and subsequently for City Council meetings every two years, following the implementation of the newly procured lease management system. **To avoid potential ambiguity in the future, we recommend including in Council Policy 700-10 a requirement that the Real Property Management Plan be presented to the City Council by DREAM at a public hearing.**

We note that the most recent PMP was developed in FY 2019. A new plan has not been completed under the current administration as it has been pending the results of the recent audits on real estate management, subsequent updates to related Council Policies, and the procurement and implementation of DREAM's new lease administration software. **Given the proposed RPMP is intended to be the City's strategic real estate plan which will inform Council's decision-making regarding real estate transactions, it is crucial to have the Plan in place in the near future. Council may wish to ask DREAM to present a timeline for the completion of the RPMP.**

Lease and Sale of City Property

The policy includes updates for the process for the administration, sale, and lease of City property, partially in response to Audit Recommendation 2 of the 2018 Portfolio Management Audit. The proposed policy adds greater specificity by stating that the general sale price or leasehold rent should be at market rate based on a timely appraisal. Additionally, it revises the circumstances in which a discounted rate could be allowed. Instead of identifying an “extraordinary need,” a discount to market rate would be allowed if the sale or lease transaction will serve public purposes or provide public benefits, while complying with other applicable Council Policies. The following table compares the general guidance on sale price and lease rent provided under current and proposed policies.

	Current Policy	Proposed Policy
General Sale Price or Leasehold Rent	Market value	Current market value or market rent reflected in the timely appraisal
Discount	Allowed if an extraordinary need or circumstance is recognized by Council Resolution	Allowed if Council makes a finding that the sale or lease transaction will serve one or more identified public purposes or provide one or more identified public benefits, and if the transaction complies with other applicable Council Policies

The proposed policy also revises the *criteria for selling* City property and additional factors to be considered should the criteria be met. We note that most of the revisions clarify existing language. The only two significant changes are:

- Adding as one of the criteria for sale that “selling will provide a greater public benefit than retention or lease, on a short-term or long-term basis,” and
- Adding as one of the factors to be considered in determining whether the property should be sold, “production of affordable housing on the property.”

Our Office supports the addition of affordable housing production as one consideration. However, for the other criteria – allowing a sale when there are either short- or long-term public benefits – we note that benefits should not be determined in isolation: both short- and long-term benefits should be considered and weighed against each other. While a decision to sell may be justified on a short-term basis by weighing the immediate public benefits from selling against leasing, long-term benefits of retention may sometimes still outweigh short-term benefits. While every real estate transaction has its own complexities, involving many uncertainties, and public benefits often include intangible benefits that may not be easily quantified, **we recommend that the first criteria above should read “selling will provide a greater public benefit than retention or lease, taking into consideration both short-term and long-term benefits and tradeoffs.”**

The proposed policy further updates the *criteria for leasing* by adding to existing criteria opportunities for assembling adjacent parcels. This addition introduces a long-term lens for a property that has the potential to be assembled into a larger site and that can be leased on an interim

basis. The proposed policy also adds as a criterion when considering leasing, if it provides a public benefit (e.g., constructing or preserving affordable housing units, or operating a homeless shelter). Since public benefits have been a consideration in the City’s current disposition decision-making process, the proposed change would not likely have a significant operational impact.

Alternative Method to Determine Rent Amount

The current Council Policy 700-10 states that fair market rent must be based on an appraisal of market rent, as defined therein. It allows the City to choose an alternative method to establish rent if the anticipated rent amount is not high enough to justify the cost to obtain an appraisal. This is typically the case with short-term leases, for which a statement of value is used instead. Audit Recommendation 10 of the 2022 Lease Management Audit recommends ensuring that using statements of value instead of appraisals is permitted by the San Diego Municipal Code. According to the Office of the City Attorney, using a statement of value presents no conflict with the Municipal Code. Consequently, the proposed policy specifies that an alternative method to determine rent amount could include determining the current market rent through a statement of value prepared by a qualified DREAM employee or an update to the most recent leasehold appraisal in response to the Audit recommendation.

Our office believes alternative methods of determining value can be justified so long as that method contains sufficient information and analysis to support the determination of the market rent amount. **To ensure alternative methods are used prudently, we recommend DREAM provide explanations in Council staff reports as to how the department determined an alternative method is justified for a given transaction, and provide documentation of the alternative method when such a method is used in lieu of an appraisal.**

Additional Changes Beyond Audit Recommendations

Incorporation of Surplus Land Act Process

The Surplus Land Act (SLA) requires local governments to follow certain procedures to make land available for affordable housing before selling or leasing the land for another purpose. The City has been following SLA requirements, and the proposed policy formally incorporates and reflects the City’s implementation of the SLA process. The proposed policy defines “surplus land” as City property that is no longer needed for City use and, therefore, is subject to the standard SLA disposition process.⁶ This definition conforms to the “surplus land” definition under the State law, and thereby helps incorporate SLA requirements into the City’s disposition process.

The proposed policy requires the City to dispose of each City property through a method consistent with SLA, including issuing a Notice of Availability (NOA) of the land for development of affordable housing to designated parties when applicable. Generally, the City can convey a property for development only if at least 25% of the units to be developed must be affordable to and occupied by lower-income households for a period of at least 55 years for rental units, and 45 years for for-sale units. If at the conclusion of a 60-day NOA noticing period, no qualified party responded or if the local government did not reach an agreement with an interested developer, the

⁶ The Surplus Land Act defines surplus land as “land owned in fee simple for which a local agency’s governing body takes formal action at a regular public meeting declaring land to be surplus and not necessary for a local agency’s use.”

property in question may be disposed of outside of the SLA process, subject to additional obligations, such as a deed restriction requiring that 15% of residential units be set aside for affordable housing if 10 or more residential units are developed on the land.

The proposed policy also provides that the City may dispose of exempt surplus land without regard to the standard SLA disposition process, consistent with State law. Under State law, surplus land that meets one or more of the prescribed 14 conditions is exempt from the SLA process provided that a local government supports its determination of exempt surplus land with written findings and provides the written findings to the California Department of Housing and Community Development. In addition to the 14 exemptions provided in the SLA, leases that do not allow for the development or demolition of the property, and leases that have a term of less than five years are also excluded. A lease that allows for tenant improvements and minor maintenance would not be considered a disposition of surplus land. Local governments do not need to pass a resolution to declare surplus land or exempt surplus land in these cases.

The proposed policy also aligns with Senate Bill 747 and Assembly Bill 480, which were recently signed into law and clarified provisions of SLA relating to leasing and expanded the definitions of exempt surplus land, providing greater flexibility for local government when disposing of surplus lands.

The State's SLA process creates an opportunity for the City to review its property portfolio in alignment with the City's long-term housing and economic development goals. The Real Property Management Plan should assist in this review by providing a property inventory with key attributes of available properties to allow the City to assess SLA applicability and identify properties that could be repurposed for affordable housing or spur economic development.

City's Clearance Process

The proposed policy also updates the clearance process to clear a City property for disposition. Under the proposed process, DREAM will provide a 30-day notice to all applicable City departments, including the IBA's Office and City Council Offices. With Mayoral approval, City departments may place a hold on City property for five years or longer, if the property is to be used for a planned Capital Improvements Program project with identified funding. We note that the proposed policy *removes* an existing requirement to provide a preliminary review to Council offices to allow Council staff to comment on foreseeable uses for the properties as part of the clearance process. Since the proposed policy requires DREAM to also provide the 30-day notice to Council Offices, an opportunity for Council office staff to provide input would still exist.

The clearance process is intended to identify potential surplus land or exempt surplus land, which could involve both for-sale and for-lease properties. At the time DREAM initiates the clearance process, the City may have not made a determination whether a property will be offered for lease or for sale. **Council may wish to amend SLA-related sections in Council Policy 700-10 so that they apply to the disposition of City properties, including both for-lease and for-sale properties.** Additionally, the proposed policy requires that any department holding a City property assumes maintenance responsibilities for the property within 90 days. **Given the holding department may not necessarily have the resources in place to properly maintain a subject property, and that this may be contingent upon budgetary actions, we recommend the holding department identify the short-term and long-term opportunities for the property as**

well as resources that would be required to maintain the property if the department is unable to assume the maintenance responsibilities.

General Requirements for Leases

The proposed policy changes the minimum rent for a percentage lease from 80% to 100% of the fair market rent based on an appraisal. It also increases the frequency of rent adjustments for flat rate leases from every ten years to every five years. These adjustments could help the City generate additional revenue. The proposed policy also clarifies the market rent requirements for airport land and facilities to conform to federal regulations.

The proposed policy further outlines the process for approving lease extensions, which requires the submission of a written proposal from lessees interested in lease extensions and a review by DREAM to ensure the tenant is in good standing. While DREAM has largely been following this process, the proposed policy details elements to be included in the lessee's written proposal and the criteria to be used by DREAM to determine whether the tenant is in good standing, which helps to clarify expectations and ensure this process is consistently followed.

Finally, the proposed policy defines qualifying capital investment for a lease extension, clarifies the method to determine an extended lease term, and upholds the City's right to claim compensation related to reversionary interest.⁷ With these amendments, DREAM may be better equipped to negotiate with the lessees and maximize the City's return from the leased properties.

CONCLUSION

Several proposed changes to Council Policy 700-10 are directly driven by audit recommendations, including the development of a Real Property Management Plan and specifying that a statement of value could be used as an alternative method to determine rent amount. Other non-audit related changes are being proposed as well, such as aligning the City's processes with the State Surplus Land Act requirements, amending the frequency of rent adjustments, and outlining the processes for lease extension. To ensure the proposed Policy meets the intent of relevant audit recommendations and improve Council's oversight of the disposition process, we provide consideration of additional changes, as summarized below:

⁷ A reversionary interest is an interest that reverts back to the original owner if certain conditions are met.

Topic	Issues for Consideration
Council Policy 700-10: Disposition of City-owned Properties	
Real Property Management Plan	We recommend consideration be given to including in the Real Property Management Plan a high-level business case review of known space needs and a plan for future office space usage, which could incorporate the results from the JLL office space study.
	We recommend specifying in Council Policy 700-10 that the Real Property Management Plan shall be presented to the City Council by DREAM at a public hearing.
	Given the proposed Real Property Management Plan is intended to be the City’s strategic real estate plan which will inform Council’s decision-making regarding real estate transactions, it is crucial to have the Plan in place in the near future. Council may wish to ask DREAM to present a timeline for the completion of the Real Property Management Plan.
Process to Lease and Sell City Property	We recommend amending Section II, A(3) to read “selling will provide a greater public benefit than retention or lease, taking into consideration both short-term and long-term benefits and tradeoffs” so that benefits are not determined in isolation.
Appraisal/ Valuation	We recommend DREAM provide explanations in Council staff reports as to how the department determined an alternative method is justified for a given transaction, and provide documentation of the alternative method when such a method is used in lieu of an appraisal.
Surplus Land Act	Council may wish to amend SLA-related sections in Council Policy 700-10 so that they apply to the disposition of City properties, including both for-lease and for-sale properties. Additionally, we recommend the holding department identify the short-term and long-term opportunities for the property as well as resources that would be required to maintain the property if the department is unable to assume the maintenance responsibilities.