



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Docket Date: July 22, 2024

Review of Proposed Lease for a 1,000-Bed Shelter at Kettner and Vine Site

OVERVIEW

On July 22, 2024, the City Council will consider a proposed long-term lease agreement for a former industrial facility at the intersection of Kettner Boulevard and Vine Street that the Mayor plans to convert into a new 1,000 bed permanent emergency shelter. Our Office believes the significant financial implications of the long-term lease, associated lease costs, and programmatic operations as presented in this report should be considered as Council evaluates the merits of this proposal:

- **Lease and Upfront Costs:** A thorough financial analysis of the lease was conducted by our Office, in consultation with our real estate consultant, Kosmont Companies. Based on this analysis, the proposed lease terms are above market rates, considering the high starting rent cost of \$1.95 per square foot per month, a 3.5% annual rent escalator, and the City's anticipated upfront investment of approximately \$13.0 million for tenant improvements.
- **Operation Costs:** Beyond the lease, ongoing shelter operation costs are estimated at \$25.0 million to \$30.7 million annually. Assuming all 1,000 shelter beds are newly added capacity above the existing baseline, the shelter would require up to an estimated \$29.8 million in new ongoing funding (above what is budgeted in FY 2025) to operate starting in FY 2026 – no new resources have yet been identified or secured to fund new operational expenditures. Absent new funds, other City expenditures for existing programs and services may need to be reduced to support shelter operations.

If Kettner and Vine's shelter beds will instead include replacement beds for several shelter relocations planned in FY 2025, we estimate the shelter would provide an estimated 429 replacement beds and 571 net new beds. If this number of replacement beds is assumed, it would allow \$13.7 million in existing operational funds budgeted in FY 2025 to be redirected to Kettner and Vine in future years, reducing the reliance on new ongoing funding. Consolidation of existing shelter programs should be considered as a contingency funding strategy, should new ongoing revenue not be available in the near future.

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Additionally, there are non-rent lease operating costs, such as property taxes, maintenance, utilities, and insurance, which are estimated to cost \$32,000 monthly (or about \$390,000 annually).

- ***Programmatic Impacts:*** This proposal does not fully align with the City’s Community Action Plan on Homelessness Update, which calls for more resources for prevention, diversion, and permanent housing. While this proposal would have the immediate impact of adding more needed shelter beds to the City’s shelter network, the use of identified one-time funding for upfront tenant improvements would divert funds *away* from new permanent affordable housing developments, which the Community Action Plan sees as a more long-term solution to addressing homelessness.

Council should also consider how program outcomes will be regularly monitored, the timing of this proposal given both the need for additional efforts to combat homelessness as well as the City’s limited budgetary resources, and whether a more competitive process for identifying permanent emergency shelter sites could result in more financially beneficial terms for the City.

BACKGROUND

On April 4, 2024, the Mayor announced plans to enter a long-term lease agreement for a former industrial facility at 3554-3590 Kettner Boulevard to establish a new 1,000 bed emergency shelter. Constructed in the 1960s, the 64,939 square foot property is located at the intersection of Kettner Boulevard and Vine Street in the Middletown neighborhood and sits on a 1.8-acre lot spanning two parcels. The property consists of one two-story building – portions of which are one-story due to site topography – and includes 134 parking spaces across rooftop parking, gated parking, and surface lot parking areas. Since the building was most recently used as a printing press, portions of the building resemble an industrial space, including a loading dock, but the site is zoned for mixed commercial and residential use. Based on available information, the property was vacated by the printing press in January 2015, sold in March 2015 for \$8.3 million, then listed for sale in October 2019 with an asking price between \$11.5 million and \$12.5 million. The property was recently sold on April 2, 2024 with a purchase price of \$13.25 million to the current owner, who approached the City with the idea of using the site as a permanent location for a homeless shelter in late fall of 2023. Since then, the Mayor’s Office and Economic Development Department (EDD) have been involved in negotiating lease terms with the site’s current owner.

According to EDD, its Real Estate Division has been searching for warehouse properties to use for emergency shelter prior to 2017,¹ and the Kettner and Vine location is the first viable property for permanent emergency shelter the Administration has formally proposed. The Homelessness Strategies and Solutions Department (HSSD), which is involved in the proposal’s development and charged with coordinating the citywide response to homelessness, and the Mayor’s Office have cited various favorable aspects of the property, including a location near public transit, away from residential neighborhoods, and in close proximity to known existing homeless encampments, as well as property features such as at minimum three distinct internal spaces for different target

¹ As will be discussed, while the City has been seeking properties capable of hosting a shelter prior to 2017, it only began looking for properties larger than 30,000 square feet in April 2023.

populations (with bed capacities of 715 beds, 184 beds, and 108 beds, respectively), inclusion of parking for staff and outdoor space, and adequate plumbing and electricity capacity. In addition to 1,000 new shelter beds and 134 parking spaces, the proposal includes adding a large commercial kitchen for meal preparation, 67 restrooms and showers, two outdoor dining areas, a smoking area, a pet relief area, an outdoor play area, and offices for service providers. An estimated \$18.0 million in improvements to the site is expected to be necessary for the property to be used as a shelter.

FISCAL AND POLICY DISCUSSION

This section analyzes the proposed lease terms and tenant improvements compared to market rates, reviews the process through which the property was identified and the City's due diligence efforts, discusses ongoing operational costs along with the merit of consolidating existing shelter programs at the site, and considers the proposal in the larger context of the City's strategy to address homelessness, as reflected in the Community Action Plan on Homelessness Update.

Proposed Lease Is Above Market Rates

To help evaluate lease terms, our Office analyzed expenses to the City – as well as potential returns for the owner – based on relevant lease terms. Key metrics include the monthly rent cost per square foot, total rent payment over the duration of the lease, upfront cost of one-time tenant improvements to convert the property into shelter, as well as the present value (PV)² of the City's investment, and the owner's initial capitalization rate (cap rate)³.

Key financial elements of the final lease terms are summarized below:

- 30-year term
- \$1.95 per square foot as the starting basis for monthly rent
- 19-month rent abatement⁴
- 3.5% cost escalator for year-over-year rent increases, commencing 12 months after the Substantial Completion Date of the Tenant Improvements
- \$5.0 million allowance for/landlord contribution towards Tenant Improvements⁵

The proposed lease is also a triple-net lease, whereby the City agrees to pay for rent and utilities as well as three other property expenses: property taxes, insurance (for both the City and landlord),

² "Present value" represents the current value of the City's total proposed investment in Kettner and Vine, including up-front costs and costs over time. Present value accounts for a higher value from money in hand today which can be invested to increase future earnings, as opposed to money in the future due to the lost investment opportunity and lower buying power from inflation. The present value amounts for the City assume a discount rate of 4.5%, which is roughly tied to the City's cost of borrowing.

³ "Initial capitalization rate" is the net operation property income in the first year divided by the property value or the initial rate of return based on the income an investment property is expected to generate. Generally, a higher capitalization rate indicates the potential for higher returns but also higher risk. Our consultant has advised that an initial capitalization rate of 6.0% to 8.0% is typical for a real estate investor where an owner is responsible for tenant improvements.

⁴ If tenant improvements are not substantially complete by month 19 due to delays incurred by the landlord, then rent is based on a portion of square footage that has been substantially completed relative to the entire building's square footage.

⁵ This \$5.0 million allowance could be used towards rent but given the magnitude of the tenant improvements required at the site it is anticipated that it would be used to offset a portion of the \$18.0 million in required tenant improvements.

and maintenance/repairs. As part of the final lease terms, at the City’s expense the owner would complete tenant improvements to the building that are expected to total slightly less than \$18.0 million, as will be detailed in the proposed lease as Exhibit B.⁶ Notably, Exhibit B is not available for review at the time of this writing, and is pending additional negotiation.⁷ The owner agrees to provide a \$5.0 million tenant improvement allowance, and the City would reimburse the owner for the remaining cost of tenant improvements. Improvements needed to bring the building up to working condition could include replacing the existing roofing and HVAC system, while improvements to accommodate use as a shelter include adding in kitchen, shower, and restroom facilities. **If the proposed lease is approved, upon Exhibit B being complete and available, if total Tenant Improvement costs detailed therein exceed the currently estimated \$18.0 million, staff should report back to Council to seek further direction.**

Initial Property Costs	
Owner Purchase Price	\$13,250,000
Tenant Improvements (TI)	\$18,000,000
Total Purchase/TI cost	\$31,250,000

Proposed Lease Terms	
Term (Years)	30
Rent/sqft	\$1.95
Escalator	3.5%
Rent Abatement (Months)	19
TI Allowance/Credits	\$5,000,000

City Investment	
Total Rent Payments	\$72,000,945
<i>As Share of Purchase/TI costs</i>	<i>230.4%</i>
NPV Total Rent	\$33,903,433
Tenant Improvements	\$13,000,000
City Investment (PV)	\$46,903,433
<i>As Share of Purchase/TI costs</i>	<i>150.1%</i>

Value/Return for Owner	
Owner Initial Cap Rate	8.3%

As seen in the tables above, based on our financial analysis of the proposed terms, the City would pay \$72.0 million in rent during the lease period (\$33.9 million net present value), and cover an estimated \$13.0 million for tenant improvements, resulting in a present value total City investment of \$46.9 million.⁸ In comparison, the total cost to purchase the property (\$13.3 million) and complete the tenant improvements (\$18.0 million) is \$31.3 million. The City’s investment for leasing the property is \$15.7 million more than if the City were to own the building outright and

⁶ The \$18.0 million estimation excludes \$400,000 that would be required for City staff project management oversight.

⁷ Although Exhibit B is not available for review at the time of this writing, our analysis incorporates information based on the building condition report issued by the landlord’s contractor and initial price quotes for tentatively identified tenant improvements.

⁸ As another point of reference, our Office reached out to the Engineering and Capital Projects Department to review available cost estimates for converting the Old Central Library into a permanent homeless shelter. Estimated construction costs dating back to 2021 ranged from \$36.8 million to \$46.8 million. However, an updated cost estimate would likely be higher due to inflation and further degradation and/or damage to the building systems.

make the tenant improvements itself. For the owner, this project has a 8.3% initial cap rate, more favorable than a typical real estate investor would expect, which might range from 6.0% to 8.0% for industrial properties in the local market.⁹ Note, this portion of our analysis does not include all costs the City would be responsible for associated with operating the site as a shelter or non-rent costs of a triple-net lease, such as insurance, maintenance, property taxes, and utilities.

Regarding the \$5.0 million tenant improvement allowance, Kosmont's initial analysis of the proposed building improvements suggests that the allowance would *not* cover tenant improvements for *tenant-specific* uses, but rather would fund the repairs and general capital improvements necessary to bring the property into working condition for any use, which totals \$5.0 million in expenditures and includes some electrical and plumbing, glass installation, and structural work. As a result, the City essentially would be fully funding the additional tenant improvements necessary to convert the facility for use as a homeless shelter.

The proposed lease is not competitive with market rates for similar properties and is likely to further trend above market due to the high annual rent escalator. Based on a review of other 37 comparable properties that were offered for lease throughout the City in April, the average asking rent price for comparable properties is \$1.44/sqft/month; an updated July review of 9 comparable properties in the surrounding submarket found average asking rent prices of \$1.54/sqft/month. One directly comparable site, which has many similar characteristics to Kettner and Vine, has an advertised asking price of \$1.45/sqft/month.¹⁰ Accordingly, we believe that the going market rate for comparable properties ranges from \$1.45 to \$1.55/sqft/month. Although the proposed rent rate at \$1.95/sqft/month is \$0.50/sqft/month higher than market rate, this difference results in the City paying almost \$390,000 more in the first year of rent payments alone compared to market rate. Furthermore, due to the annual rent escalator, the City's rent rate is likely to further diverge from competitive market rates over time, as an annual rent escalator of 3.5% is high and an annual escalator *below* 3.0% would be expected for a long-term lease with the City for a comparable property based on the proposed terms. As discussed above, it appears the \$5.0 million tenant improvement allowance would only be sufficient to cover general building work to bring the building to a usable state. Tenant improvements to support the City's desired buildout for shelter purposes will essentially be fully funded by the City.

In sum, the proposed lease terms represent a premium above competitive market rates. It may be reasonable for the City to pay some premium for the Kettner and Vine site if the site's unique characteristics make it more valuable to the City than it would be to any other party, but the Council and public should be aware of how much that premium is, and fully consider associated tradeoffs.

⁹ Beyond the Initial Cap Rate, the owner's unlevered internal rate of return (IRR) under the proposed lease is 10.8%.

¹⁰ 5260 Anna Avenue, a 72,000 square foot warehouse built in 1968, was listed for lease with an asking rent of \$1.45/sqft/month. City staff advised that that property's sewer and electrical capacities would likely need upgrades to be used as a shelter, and that its building configuration is not as advantageous as the Kettner and Vine site for use as a shelter. However, it is illustrative of the *overall market rate* for comparable properties.

Underlying Process for Identifying Shelter Properties Lacks Competition

Although the Mayor's Office and EDD have been searching for facilities suitable for permanent shelter prior to 2017, past search parameters did not accommodate facilities the size of Kettner and Vine. Search parameters were expanded to include properties greater than 30,000 square feet starting in April 2023, around one year before the Mayor announced the Kettner and Vine proposal. We note that Kettner and Vine was put up for sale in October 2019, indicating that had City search parameters included larger facilities at the time, the City could have considered directly acquiring the site, rather than leasing it as is currently proposed. Although EDD's routine real estate searches may have been conducted diligently, the fact that the City is pursuing permanent shelter for the first time at a site that was not identified through routine real estate searches but rather because the prospective owner approached the City suggests either how challenging it is to find an appropriate site, or that the current approach is not the most productive approach, or both.

Another approach would be for the City to issue a citywide Request for Proposals (RFP) for permanent emergency shelter sites. This would result in a more competitive process compared to how the City learned about the Kettner and Vine site. Under an RFP, prospective owners across the City could submit proposals for the City to either lease or purchase property that could be converted into permanent shelter. This could provide the City more information about the market and allow the City to better gauge competitive offers relative to other proposals, including Kettner and Vine. Conceptually, a competitive process, similar to the City's procurement process for other services and contracts, would encourage prospective landlords to offer lease or sale terms that are more favorable compared to other competing bids, benefitting the City overall. This process could also allow the City to develop a shortlist of potential sites with different features that could be revisited in the future as different shelter needs arise. The City would also gain insight into how desirable the City is as a tenant aiming to operate a new homeless shelter, and how much of a premium the market might expect the City to pay for a permanent shelter facility. The Mayor's Office recently indicated that efforts to release an RFP are currently underway.

Due Diligence Conducted but May Lack Independence

As recommended in the [2021 Performance Audit of the City's Major Building Acquisition Process](#), EDD developed a due diligence checklist that includes a high-level summary of due diligence items such as appraisals, building condition assessments, environmental assessments, and test fit. This checklist was presented at the Land Use and Housing Committee on October 19, 2023, along with proposed updates to three Council Policies pertaining to real estate transactions. Although the proposed Council Policy updates and the due diligence checklist have not yet been presented to and adopted by the City Council, EDD used the checklist to guide its due diligence process for evaluating the Kettner and Vine site.

For instance, staff obtained and reviewed the preliminary and final title reports of the site to ensure the property is free of liens and to identify any easements and restrictions. A State of California business search and a search of available records in the Superior Court of California was conducted to ensure the site and the owner were in good standing. Staff also engaged the Development Services Department and the City Planning Department to review pertinent land regulations related

to the proposed shelter use, California Environmental Quality Act (CEQA) requirements, and the history of building code violations and open permits.

Our Office reviewed the due diligence checklist completed by EDD and associated supporting documents, as recommended by the Audit. This section discusses key issues identified during our review for Council consideration.

An independent appraisal was not completed for this site, as staff determined an appraisal was not appropriate since the City is seeking to lease rather than purchase the property. The due diligence checklist requires the City to conduct its own independent appraisal as part of the due diligence process. According to staff, an independent appraisal was not conducted given the City is seeking to enter into a lease agreement where the City is a tenant of the proposed property; instead, staff reviewed commercial real estate market data provided by a professional real estate platform. However, as noted in the Building Acquisition Audit, the appraised value of leased properties can help the City determine if rental rates are within current market rates, especially when tenant improvements are planned. By doing so, the City will know the appraised value prior to the improvements and then after improvements, which should provide better negotiating power at the end of the lease term. Additionally, although a review of market data can provide relevant data points for reference, an appraisal performed by a licensed or certified appraiser provides a more thorough evaluation of the property's market rent value, taking into account interior and exterior conditions and necessary repairs or renovations. A formal appraisal, reviewed by staff, along with a comparative rent analysis, would shed more light on the reasonableness of lease terms.

Absent an appraisal, we asked our real estate consultant, Kosmont, to review comparable properties currently offered for lease. As mentioned above, the average asking price for comparable properties is \$1.44-\$1.54/sqft/month. The most comparable site identified by Kosmont has an advertised asking price of \$1.45/sqft/month, which is \$0.50/sqft lower than the proposed rent of \$1.95/sqft/month.

An independent building condition assessment was not completed for this site, but the City hired its own consultant to validate the condition assessment provided by the landlord. The due diligence checklist calls for an independent building condition assessment. The City did not conduct its own condition assessment but contracted with a third-party consultant to validate a condition assessment completed in early February by the landlord's consultant. The scope of the assessment provided by the landlord includes structural steel, roofing, the storefront system, fire sprinklers, plumbing, HVAC, electrical and site utilities, lighting, and power systems. It was conducted to determine what existing building systems could potentially be re-used based on building conditions, and provide a construction estimate on tenant improvements. We note that the estimated tenant improvement cost of \$18.0 million was developed by the landlord's consultant at the City's direction to the landlord based on the intended use as a shelter. The City has requested its own consultant to validate the cost of tenant improvements needed. The validation results of the building condition assessment and tenant improvement costs have not been made available to our Office at the time this report was developed.

The landlord's assessment noted significant deficiencies with the existing plumbing, HVAC, electrical systems, roofs, and storefront systems and recommended complete replacements of

several building systems. For instance, the assessment recommended replacing the existing cast iron sewer line in its entirety; installing a new grease interceptor, water heaters, hot water pump, and piping; and replacing roof drain piping and cold water hose bibs, with an estimated cost of \$3.2 million. Other significant costs include the complete replacement of the existing HVAC systems and various electrical work, which is estimated to cost \$2.3 million and \$2.1 million, respectively.

As the building condition assessment was conducted by a consultant retained by the landlord, the City does not have oversight over the consultant's qualifications and any conflict of interest that might render the condition assessment less reliable. It also remains unclear what property records, such as historical receipts for repairs and improvements, drawings, and previously prepared condition assessments, were reviewed by the consultant and whether any reasonable exploratory probing or testing was performed, which may affect the results of the condition assessments. Hiring a third-party consultant to validate the assessment performed by the landlord's contractor could help mitigate these risks and ensure reliability of the tenant improvement cost estimates. **Council should request EDD provide the results of the validation work performed by the City's own consultant.**

According to staff, several site inspections have also been conducted by City staff since December 2023, including staff from the Fire-Rescue Department, Chief Building Official, Structural Inspectors, and other representatives from the Development Services Department and Department of General Services/Facilities Division. As our Office was not provided written records for these inspections, we were not able to review the scope of work and results of these inspections.

Hazardous materials, such as asbestos and lead, were not tested at the proposed site. The landlord, however, will be responsible for any remediation measures, if required, including any remediation required to complete tenant improvements, prior to substantial completion. After the Substantial Completion Date, the City will be responsible for the remediation cost.

As the property was constructed in the 1960s, a period when asbestos-containing materials (ACMs) and lead-based paint were extensively used in building construction, there is a potential that ACMs and lead-based paint are present. Notably, the scope of the condition assessment provided by the landlord does not include any hazardous material testing at the site. The Phase I Environmental Site Assessment (ESA), to be discussed in more detail below, included a limited, visual evaluation of accessible areas for the presence of Asbestos-Containing Materials (ACMs) and identified suspect ACMs in drywall systems, floor tiles, floor tile mastic, and spray-applied acoustic materials throughout the building interior. The ESA report noted that suspect ACMs and painted surfaces were observed in good condition, although actual material samples would be required to determine the presence or absence of ACMs and lead-based paint. The ESA recommended a comprehensive asbestos survey of the property prior to any disturbance and continued monitoring and maintenance of the interior and exterior painted surfaces to ensure the paint does not deteriorate.

Under the proposed lease agreement, the landlord will be responsible for investigating and remediating hazardous materials, as required by environmental laws, prior to the Substantial Completion Date of the Tenant Improvements. It is important to ensure the landlord completes

such remediation, if required, prior to the Substantial Completion Date. According to EDD, Engineering & Capital Projects Department's staff will oversee the tenant improvements work on behalf of the City, along with support from EDD staff, to ensure work performance.

We note that after the Substantial Completion Date, the City will assume all remediation costs if hazardous materials are released at the property due to future City improvements or activities. **Given the risk related to future remediation costs, it is crucial for the City to gain a comprehensive understanding of the presence and condition of potential hazardous materials that may exist on the site as well as the costs of monitoring, maintenance, abatement, and removal of the hazardous materials that may be required in the future.**

A Phase I Environmental Site Assessment was conducted by a consultant retained by the landlord, which indicates no environmental conditions would preclude repurposing the property for residential purposes. The City obtained a reliance letter from the consultant to enable due diligence.¹¹ The Assessment was completed in March this year by a consultant retained by the landlord. The purpose of the Assessment was to ascertain if any environmental conditions at the property would preclude it from being repurposed for residential use. The consultant reviewed existing reports and data for neighboring sites and landlord-provided environmental assessment reports prepared by third parties for the property. The consultant also collected and analyzed indoor air samples. Staff noted that, although the Assessment was not conducted independently by the City, it was conducted by a reputable consultant with a current timeframe such that the City could rely on the information included in the report. Staff also obtained a reliance letter from the landlord's consultant to enable the City to rely on the accuracy of the report.

Based on documents and data reviewed by the consultant, the Assessment concluded that no environmental conditions at the Project Site would preclude the repurposing of the existing buildings for residential purposes. It is worth noting that the Assessment stated an HVAC system was not present at the time of the indoor air sampling. Assuming a new HVAC system will be installed, indoor air sampling will need to be conducted by the consultant post HVAC installation. The Assessment further noted that, in the unlikely event additional vapor mitigation is necessary prior to residential occupancy, the landlord will implement, at its own expense, appropriate additional vapor mitigation measures, as may be necessary. As discussed earlier in the report, the landlord will be responsible for any remediation measures prior to the Substantial Completion Date. It is important to be aware of any remediation that would be required prior to that date.

Proposal Lacks Ongoing Operations Funding Plan, Estimated to Cost up to \$30.7 Million Annually

In addition to ongoing leasing and one-time tenant improvement costs, the proposed shelter program will require significant resources to fund ongoing operations. Although specific shelter programming is still in development, pending approval of a lease, HSSD intends to convene a

¹¹ A reliance letter is a written document from the consultant who provided the professional services (e.g. environmental assessment) to allow a third party to rely on the contents of the consultant report. The letter typically sets forth the scope of the reliance and includes limitation of liability to allow the consultant to manage its potential liability to the relying party.

working group consisting of HSSD, the San Diego Housing Commission (SDHC), the County of San Diego, the Regional Task Force on Homelessness (RTFH), shelter residents, and, potentially, service providers to help develop and provide feedback on programming at Kettner and Vine. Initial proposals from HSSD include prioritizing shelter space for families due to recent increases in unsheltered homelessness among families, veterans who currently lack a dedicated shelter, and individuals experiencing homelessness for the first-time, which aligns with recent practices in other jurisdictions. **If the Kettner and Vine lease is approved, Council should request HSSD provide regular updates to Council during the shelter program development and initial implementation phases.**

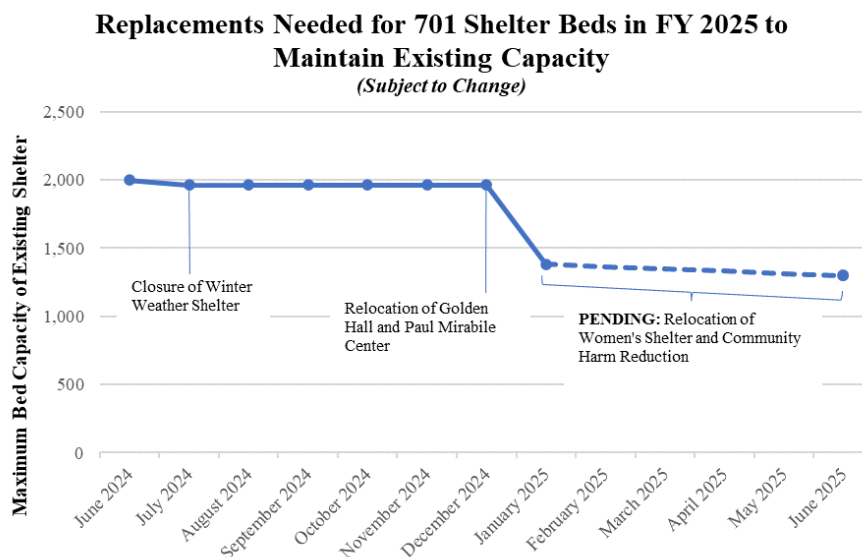
Without further developed plans for programming, current annual operational costs are estimated at up to \$30.7 million. Operational cost estimates use two generalized measures of average per bed-night costs in the City’s shelter system – \$68.49 per bed night which represents the City’s portion of funding for all shelter beds receiving City funding, including shelters that leverage outside funding (e.g., philanthropic dollars); and \$84.00 per bed night which is the assumed true per bed night cost removing outlier shelters that have extremely high or low per bed night costs, and is the cost used in the City’s Community Action Plan on Homelessness Update, to be discussed later. The resulting estimates for operational costs range from \$25.0 million (based on \$68.49 per bed night) to \$30.7 million (based on \$84.00 per bed night). Actual operation costs will depend on a variety of factors, including the specific populations served, additional supportive services provided, the ability to leverage outside funding, and other variables.

By approving a 30-year lease, Council would also be committing the City to fund operations at the facility for the duration of the lease agreement, but uncertainty exists over how these new operations would be funded. If the 1,000 beds are assumed to be all new beds, as contemplated by the Administration, operation costs and the need for new ongoing revenue – that has not yet been identified – will grow notably starting in FY 2026, due to the ramp up of *new* shelter beds at Kettner and Vine. Even though the FY 2025 Adopted Budget includes \$1.9 million from the General Fund for a new 1,000-bed shelter, only \$875,000 is for ongoing operational funding for 350 beds assumed to start operating June 2025.¹² Hence, of the \$30.7 million in potential operational costs, only \$875,000 (accounting for 2.9% of the total) is already budgeted – the remaining \$29.8 million would represent new ongoing expenditures; revenues to support these operations have not been identified. There is currently no long-term funding plan for Kettner and Vine shelter operations, as the Administration plans to prioritize requesting additional funds as needed to operate the facility. Should the City enter into the 30-year lease and be unable to secure additional revenue, other City programs would likely need to be reduced to accommodate these expenditure increases to operate the site as a shelter. **Council should be provided the contingency plans the Administration has, if any, to fund Kettner and Vine shelter operations out of existing resources– and any potential impacts that doing so would have on core City services – if additional resources to operate the site are not otherwise identified.**

¹² Of the remaining funds, \$650,000 covers one-time start-up costs, such as beds and furniture for 350 beds, and \$389,634 ongoing for FY 2025 non-rent lease operation expenses, such as property taxes and insurance (estimated at \$32,000 per month).

Consolidating Existing Shelter Programs Could Provide Alternative Funding Strategy, As Needed Replacement Sites Have Yet To Be Identified

Although the Administration cites the 1,000 beds planned for Kettner and Vine to be all net *new* beds to the City’s shelter capacity, there remains ambiguity regarding whether some of these beds would in practice be replacement beds. As of June 2024, City-funded shelter capacity includes 1,998 beds across 19 emergency shelter programs for various populations.¹³ In June 2023, HSSD released a [Comprehensive Shelter Strategy](#) summarizing existing shelter bed capacity, planned shelter relocations, and possible options to expand sheltering operations. Since the strategy’s release, there have been several updates affecting shelter capacity in the near-term, including the recently announced closure of the 350-bed Paul Mirabile Center Interim Housing for Homeless Adults planned by the end of 2024 and the extended timeline for continued operations of the 16th and Newton bridge shelter, which was previously planned for relocation.¹⁴ HSSD plans to release an update to the shelter strategy to accompany the Kettner and Vine proposed lease when heard by Council on July 22, 2024, but is not available at the time of this writing. In the meantime, based on the latest available information, up to 701 shelter beds (representing 38.1% of current bed capacity) are planned for relocation in FY 2025 due to various site-specific reasons, as shown in the figure below. Given the pending release of an update to the shelter strategy, we note these numbers are subject to change and reflect information as known at the time of this report’s writing.



Notes: Reflects Golden Hall relocation, resulting in 272 beds, as well as expansion of non-congregate family shelter that was funded in the FY 2025 Adopted Budget from 32 beds to 71 beds. Figure only represents existing shelter bed capacity over time based on known and planned shelter relocations. Any replacement beds, which are to be identified, are not represented here.

¹³ This differs slightly from the 1,890 shelter beds listed on the City’s [website](#) due to the inclusion of the City’s 160-bed domestic violence shelter and the loss of 52 beds from the relocation of Golden Hall, effective April 2024 – both of which were not reflected on the website at the time of this writing. Golden Hall’s single adult program had a maximum capacity of 324 beds but now operates at a lower 272-bed capacity after relocating from the first floor to the second floor.

¹⁴ Although details remain pending on the relocation of 16th and Newton, this report assumes the site will continue operations for FY 2025, based on recent updates from HSSD and EDD.

Planned shelter relocations known at this time include:

Anticipated FY 2025 Shelter Relocations (subject to change)

- **656 beds by end of calendar year 2024:** Paul Mirabile Center Interim Housing for Homeless Adults (350 beds), Golden Hall Single Adults (272 beds), and Winter Weather Shelter at the Old Central Library (34 beds)
- **84 beds by end of FY 2025 (details pending):** Community Harm Reduction Shelter (44 beds) and Women’s Shelter (40 beds)

One underlying question is how the City would classify Kettner and Vine beds as *new* shelter beds when other replacement beds to maintain existing shelter capacity have not been identified. According to HSSD, the Department has tentatively identified alternative options for the relocation of the Golden Hall single adults shelter program, but details about the replacement beds have not been made available at the time of this writing. Assuming one-for-one replacement beds for Golden Hall are identified, 429 of the 701 beds pending relocation do not have clear replacement sites. **As the Kettner and Vine proposal is more developed than other still unknown replacement bed alternatives, for practical purposes, of the 1,000 shelter beds proposed at Kettner and Vine, 429 beds are likely to function as replacement beds until other relocation sites can be identified, with the remaining 571 beds being net new beds.** These numbers are subject to change depending on the number of replacement beds the alternative plans for Golden Hall will provide. Notably, the FY 2025 Adopted Budget includes \$1.2 million for the San Diego Housing Commission to identify a new emergency shelter location to replace the Paul Mirabile Center shelter program, but it remains unclear how many replacement beds will result from this funding.

If Kettner and Vine’s total beds included replacement beds, there would be a corresponding reduction in the need for new ongoing resources, since existing operating funds from relocated shelters could be redirected to fund Kettner and Vine operations. The operational funding for the five shelter programs planned for relocation in FY 2025 totals \$13.7 million, including operational funds already appropriated in the FY 2025 Budget for new/replacement shelter outside of Kettner and Vine. If these funds were fully available for Kettner and Vine, the amount of new ongoing funding needed to cover full operations would be reduced to \$17.0 million – significantly less than the \$29.8 million that could be needed beyond funds budgeted for FY 2025 if all beds were new. **The consolidation of existing shelter programs at the Kettner and Vine site should be considered as a contingency funding strategy if the City does not identify new ongoing revenue, since consolidating shelter programs requires less additional ongoing funding compared to operating the site as all new beds.** Notably, there would be a lag in when replacement beds would go online, as only 350 beds at Kettner and Vine are anticipated to be available starting June 2025, at the earliest, and the remaining beds will depend on the timing of the planned tenant improvements, which is uncertain.

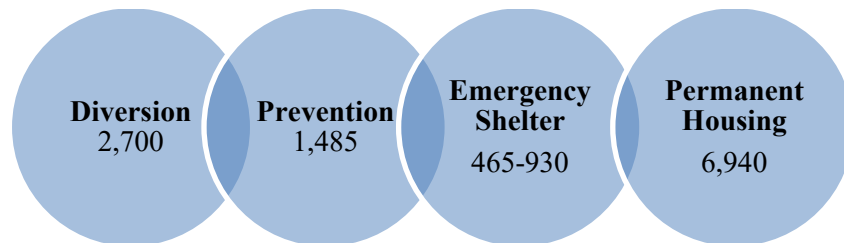
Depending on the availability of \$17.0 million in new ongoing resources to support consolidation of existing shelter at Kettner and Vine, the City could need to consider expanding the consolidation to include shelters that are not currently planned for relocation, or explore folding in other

homelessness programs at the site such as the Homelessness Response Center, the Neil Good Day Center, or other existing programs. This would help to support full operations at Kettner and Vine by redirecting up to \$29.8 million in existing operational funds, while minimizing impacts to core City services, if Council were to approve the proposed lease and only limited new operational funds are available.

Community Action Plan Prioritizes Other Interventions Over Emergency Shelter

In October 2019, the City Council approved the Community Action Plan on Homelessness, which intends to systemically address homelessness. In November 2023, Council heard the [Community Action Plan Update \(Update\)](#), reflecting progress since the initial plan’s release and changes due to the pandemic. The Update identified the need for between 465 and 930 new shelter beds – a range that reflects the dynamics across prevention, diversion, and permanent housing efforts and demand for additional emergency shelter. If prevention, diversion, and permanent housing interventions ramp up and effectively reduce overall homelessness, the demand for more shelter beds would be reduced. Given these dynamics, the Update identifies a significant need for other interventions beyond shelter bed needs, including 2,700 diversion, 1,485 prevention, 3,080 rapid rehousing, 3,520 supportive housing, and 340 low-income housing resources, as summarized below. Although the Update calls for additional emergency shelter, the Update focuses largely on other homelessness interventions that would prevent, divert, or resolve homelessness, rather than solely on shelter. Although the City could meet the Update goal for emergency shelter if Kettner and Vine provided 1,000 new beds, **Council should consider whether the significant investments called for in the Kettner and Vine proposal align with the overarching priorities and strategies underlying the Community Action Plan Update and how Kettner and Vine providing both replacement and new beds (as opposed to all new beds) might factor into such an assessment.**

Community Action Plan Update Intervention Need Estimates



In one particular respect, the Kettner and Vine proposal appears contrary to the Update’s permanent housing goals. **Specifically, the funding identified for the upfront Kettner and Vine tenant improvements would be diverted from new affordable housing, which is considered a more permanent long-term solution to homelessness.** The table on the next page shows the funding sources that have been identified to date to cover the City’s tenant improvement costs.

\$13.8M in City Funds Identified for Tenant Improvements

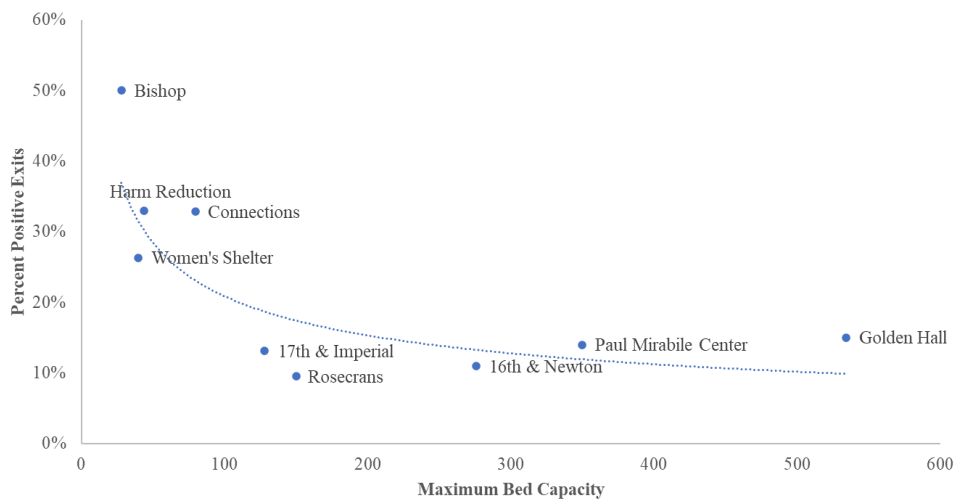
Proposed Funding Source	Proposed Use	Amount
FY2025 Community Development Block Grant	Tenant Improvements	\$10,425,000
Unobligated Community Development Block Grant CARES Act	Tenant Improvements	2,700,000
Reallocated General Fund Capital Improvements Program Contributions	Project management oversight	400,000
Low & Moderate Income Housing Asset Fund	Tenant Improvements	250,000
Total City Resources		\$13,775,000

Several funding sources identified for tenant improvements would be diverted from new affordable housing development or existing homelessness operations. For instance, \$10.4 million from the FY 2025 Community Development Block Grant proposed for tenant improvements would otherwise go to the FY 2025 Bridge to Home and SDHC Notices of Funding Availability (NOFAs) to spur new affordable housing development. Another \$250,000 is proposed from the Low- and Moderate-Income Housing Asset Fund, which in recent years funded the Homelessness Response Center. The diversion of these funds away from affordable housing and homelessness programs occurs in the context of recent actions taken during adoption of the FY 2025 Budget that likewise divert \$8.0 million in Affordable Housing Fund dollars from new affordable housing development in the next SDHC NOFA to instead cover operational expenditures for the City’s existing homelessness programs. Altogether, these actions will likely have ripple effects in the City’s affordable housing pipeline in future years, as these projects take multiple years to complete.

As the Kettner and Vine shelter would be the City’s largest single shelter, if approved to move forward it will be critical to routinely measure and monitor outcomes for households. **If Kettner and Vine proceeds, Council should require outcome data, including the average length of stay, indicators of housing readiness, and percentage of exits into permanent housing, be routinely reported to the public and Council.** Based on a preliminary analysis of outcomes for shelter programs serving single adults from FY 2023 as seen in the figure on the next page, smaller shelters with fewer than 100 beds typically have better outcomes, averaging 35.5% of individuals leaving shelter for permanent or other long-term housing (positive exits), than shelters with more than 100 beds, which average closer to 12.5% positive exits. According to SDHC, better outcomes in small shelters may be due to several factors, including smaller shelters generally having a special target population, availability of additional on-site services, more frequency in engagement and trust building, and site location, among other factors. Shelters serving special target populations, such as transition-age youth, veterans, and families, likely have better outcomes because of priority status and/or dedicated housing resources available for these specific populations. Even though Kettner and Vine will likely be divided into separate spaces, the largest congregate space is proposed to hold 715 beds – more comparable to the pandemic-era Operation Shelter to Home,

which housed over 1,000 individuals in approximately 175,000 square feet at the Convention Center, than shelter programs the City has operated since, with the Golden Hall bridge shelter being the largest operating 534 beds at its peak. If program outcomes at Kettner and Vine more closely resemble larger shelters, **Council may wish to evaluate the merits of the Kettner and Vine proposal, given that positive program outcomes will likely be more challenging to achieve with such a large shelter site.**

Loose Correlation Between Small Shelter Size and Positive Outcomes in FY 2023



Note: "Positive Exits" refers to individuals exiting from shelter programs into permanent housing or other longer-term housing. This figure only includes outcomes for the single adult population to provide a reasonable basis for comparison, including the Golden Hall single adult program, as the shelter also served families and transition-aged youth.

Notably, Operation Shelter to Home had a high positive exit rate of approximately 36.6%, largely due to daily coordination and enhanced operational support across key stakeholders, as well as the availability of new housing resources tied to the pandemic. A dedicated cross-agency team consisting of the City, SDHC, RTFH, and the County provided additional daily operational and housing support, allowing service providers to focus on client needs and program operations. The on-site cross-agency team met regularly to discuss operational issues, provide recommendations, and implement a course of action. SDHC also had an on-site Housing Navigation Unit, supported by RTFH staff, to help expedite matching households to available housing resources, which at the time included special vouchers and two new Homekey projects that provided 332 permanent supportive housing units. Shelter operations at Kettner and Vine could implement a similar cross-agency model, which could include formal commitments from community partners, such as the County and health providers, to provide on-site services.

Permanent Shelter Could Be Worthwhile, But Comes With Unknown Financial Risks

The pursuit of permanent shelter has merit. Since the beginning of City-funded shelter programs, dating back to FY 2018, numerous shelter programs have been relocated or closed due to the temporary nature of the City’s shelter programs. This includes the relocation of the bridge shelter for families and single women at 14th and Commercial Street in April 2019, the bridge shelter for families with children and transition-age youth at Golden Hall in August 2023, and the closure of

the Veterans Village of San Diego in November 2020, as well as previously discussed shelter relocations planned for FY 2025. The temporary nature of some shelters also makes them more vulnerable to natural disasters, such as flooding and extreme weather events. In December 2018, the 325-bed sprung shelter at 16th and Newton was relocated due to severe flooding. In August 2023, the 20th and B Safe Sleeping site was temporary relocated to Golden Hall in anticipation of dangerous conditions from Hurricane Hilary. Earlier this year, the 16th and Newton bridge shelter was temporarily relocated following damage to the sprung structure sustained during the January storms and only recently moved back in May.

Having a permanent location for emergency shelter comes with various tradeoffs. On the plus side, a permanent location would provide more clarity, stability, and safety to individuals staying at the shelter, individuals interested in seeking shelter, service providers, and HSSD and SDHC staff administering shelter contracts. Staff time and resources that would otherwise be spent identifying alternative sites for recurring shelter relocations and planning transitions or emergency evacuations would also be saved. In addition to limiting disruptions to services, according to HSSD, permanent shelter allows the City to build out shelter sites in compliance with existing fire and building codes, which has been a contributing factor to past shelter relocations. However, a permanent location for shelter could also increase costs for the City associated with maintaining a facility over the long-term, including emergency repairs, maintenance and replacement of building systems, and other unexpected expenses. Since this would be the City’s first attempt at permanent emergency shelter, unexpected expenses could be variable and high given the large size of the Kettner and Vine property. **Council may wish to ask that the Administration conduct and present to Council a comprehensive cost-benefit analysis comparing permanent emergency shelter and the City’s current approach. Based on such an analysis, Council could consider whether starting with a smaller facility could provide insights into the tradeoffs of operating permanent shelter before scaling up to a 1,000-bed shelter.**

LEGISLATIVE CONSIDERATIONS

Council should consider a number of key questions before deciding whether to enter into the proposed 30-year lease agreement at Kettner and Vine that would obligate significant one-time and ongoing funds to support the operation of a 1,000-bed shelter. This section summarizes the key questions, as raised in our analysis.

Topic	Key Questions
Lease and Upfront Costs	<ul style="list-style-type: none"> • Should the City be willing to pay a premium to lease a facility to use for permanent emergency shelter? If so, how should such a premium be appropriately determined? • What are the advantages and trade-offs of leasing versus buying a property for permanent shelter purposes?
Site Selection Process/Due Diligence	<ul style="list-style-type: none"> • Should the City consider issuing a citywide Request for Proposals for permanent emergency shelter sites, either instead of or in addition to pursuing the Kettner and Vine proposal? • Is the City well-positioned to make a long-term lease decision without an independent appraisal and an independent building condition assessment?

<p>Site Selection Process/Due Diligence (cont.)</p>	<ul style="list-style-type: none"> • What is the contingency plan for any unanticipated building improvement costs due to any unforeseen site conditions? • How will the City ensure any hazardous mitigation that is required is properly addressed by the landlord before the Substantial Completion Date? • What costs could be associated with monitoring, maintenance, abatement, and removal of any hazardous materials that may be required in the future?
<p>Operations</p>	<ul style="list-style-type: none"> • What priorities does the Council have for shelter programming and operations? • If Kettner and Vine were to proceed, how does the Council expect to be involved or informed about shelter programming details as they are developed? • What contingency plans does the Administration have, if any, to fund Kettner and Vine shelter operations out of existing resources if the proposed lease is approved and the City is unable to secure new ongoing revenue? How might core City services be impacted or what specific steps might the City take to mitigate impacts to core services? • Will the Administration consider consolidation of existing shelter programs at the Kettner and Vine site as a contingency long-term funding plan, if necessary? • Can the Administration provide a comprehensive cost-benefit analysis comparing the cost of permanent emergency shelter to the City’s current approach? • What are the tradeoffs associated with starting permanent emergency shelter at a smaller facility, on a pilot basis, as opposed to the 1,000-bed shelter proposed at the Kettner and Vine site?
<p>Overarching Homelessness Strategy</p>	<ul style="list-style-type: none"> • Is the Kettner and Vine proposal aligned with the main priorities under the City’s Community Action Plan on Homelessness Update which calls for a range of interventions? • How should the diversion of funds from new affordable housing and existing homelessness efforts for one-time tenant improvements factor into Council’s evaluation of the merits of the Kettner and Vine proposal? • How will program outcome data be routinely reported and provided to the Council and public? • Given the significant 1,000 bed capacity planned at the Kettner and Vine shelter, what specific program designs or precautions would the City implement to ensure that program outcomes are better or comparable to the City’s existing shelter programs?

CONCLUSION

Our Office acknowledges the urgent and pressing need to address the City's homelessness crisis. More resources are needed to provide emergency shelter for people experiencing unsheltered homelessness, to prevent more people from falling into homelessness, and to provide more long-term affordable housing throughout the City. Given the City's limited resources, it is critical for the City to carefully evaluate all aspects of its response to homelessness, and to fully vet new proposed shelters, programs, and approaches.

On July 22, 2024, a 30-year lease for the 1,000-bed shelter proposed at Kettner and Vine will be presented to and considered by the Council. The proposal represents an opportunity to change the City’s current approach to shelter by pursuing permanent emergency shelter and potentially provide needed replacement and new shelter beds. However, the proposal also comes with an above market rate lease, as well as significant upfront and ongoing costs associated with rent, lease operating, tenant improvement, and program operating costs. If the 30-year lease is approved, the City would need to identify up to \$29.8 million annually in new revenue (above FY 2025 budgeted levels) for operational funds – which are not readily available and have not yet been secured – in addition to rent and non-rent lease operating costs. If the City enters the lease and cannot secure new revenue, the City may need to reduce current expenditures to core services or consider consolidating existing shelter programs at Kettner and Vine to fully implement the 1,000-bed shelter. Although the City would certainly benefit from additional shelter capacity, entering a long-term lease without a clear long-term funding plan, including contingency funding options, could put the City’s existing core services at risk. Additionally, the funding proposed for tenant improvements diverts funds away from new affordable housing development, which runs counter to the Community Action Plan Update which sees affordable housing as a long-term solution to homelessness.


Our report identifies several key questions and considerations Council should weigh as it evaluates the proposal. If Council ultimately approves the proposal, we further recommend that:

- Upon Exhibit B being complete and available, if total Tenant Improvement costs detailed therein exceed \$18.0 million, staff report back to Council to seek further direction;
- HSSD provide regular updates to Council during shelter program development and initial implementation phases;
- Council be provided any contingency plans to fund Kettner and Vine shelter operations out of existing resources – and any potential impacts that doing so would have on core City services – if additional resources to operate the site are not otherwise identified; and
- City staff routinely report outcome data, including the average length of stay, indicators of housing readiness, and percentage of exits into permanent housing, to the public and Council.

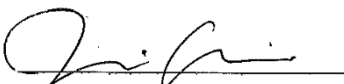
Our Office thanks SDHC, HSSD, EDD, and the Mayor’s Office for responding to our questions during development of this report.



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