



THE CITY OF SAN DIEGO

DATE: June 24, 2022

TO: Honorable Members of the City Council

FROM: Andy Hanau, City Auditor

SUBJECT: Implementation Status of Major Building Acquisition Audit Recommendations

Overview

As you know, in July 2021, we released the Performance Audit of the City's Major Building Acquisition Process.^{1,2} The audit identified serious issues with the City's building acquisition process, which led to the City committing more than \$230 million towards acquiring major buildings it did not understand the condition or value of. Importantly, we made 10 comprehensive recommendations to help ensure the City follows best practices when acquiring major buildings in the future.

Given the recent announcement of a potential settlement of litigation surrounding 101 Ash and Civic Center Plaza, which would result in the City taking ownership of those two properties, we have received questions about the implementation status of our recommendations. To be clear, the Office of the City Auditor has not been and should not be involved in the settlement negotiations. We remain separated from management functions to ensure our independence when conducting future audits. As such, we have no position on the current settlement decision before the Council, and we became aware of the details of the proposal as they became public this week. The purpose of this memorandum is solely to provide information about our recommendations and their implementation status.

Summary of Recommendations and Status

The overall intent of our 10 recommendations is for the City to develop a comprehensive framework for building acquisitions. Central to this framework are checklists of key best practices

¹ The final audit report is available here: https://www.sandiego.gov/sites/default/files/22-002_building_acquisition_process.pdf

² The City Administration provided an updated response after the issuance of the final report, which is available here: https://www.sandiego.gov/sites/default/files/city_auditors_comments_to_the_revised_management_response_to_the_july_2021_performance_audit_of_the_citys_major_building_acquisition_process.pdf



and due diligence steps that should be conducted, thorough review to ensure these best practice and due diligence steps are completed, and disclosure of supporting documents so the City Council and the public are informed of all material facts. In addition, to help prevent conflicts of interest, we recommended that all influential advisers be under contract with the City and that the City determine what financial disclosures advisers should make.

To date, one recommendation has been fully implemented, which was for the Independent Budget Analyst (IBA) to consider retaining a consultant to assist that office with evaluating proposed real estate transactions. The IBA retained such a consultant earlier this year, who issued an analysis of a settlement proposal that, according to the IBA, was substantially similar to the proposal now being considered. While progress has been made on other recommendations, we have not found any of them to be fully implemented based on our most recent review in early 2022.³ For example, best practices and due diligence checklists have not yet been adopted into Council Policy. Management provided estimated implementation dates of July 1, 2022 for many of the remaining recommendations, and we plan to review and report on current implementation status in detail soon after.

Key Best Practices and Due Diligence Outlined in Recommendations

However, while the comprehensive framework we recommended has not yet been fully implemented, it is still possible for the City to achieve the intent of the framework in the meantime by ensuring that key best practices and due diligence steps are completed, that the City Council and the public are provided with all material facts, and that the City takes appropriate steps to protect itself from conflicts of interest. The key steps we outlined in our recommendations are listed below for your convenience, and we recommended that supporting documentation for each be made available to the public (where possible—for example, in some cases, legal analysis may be required to remain confidential). The City Administration, the Department of Real Estate and Airport Management, the Office of the City Attorney, and/or the IBA should be able to provide you with the status of the items below, or explain why such information is not applicable or attainable for the settlement proposal.⁴

- Determination of how the acquisition fits into the City's Strategic Real Estate and Office Plan

³ See our Recommendation Follow-Up Dashboard for more detailed information on each recommendation and the status as of early 2022 here: <https://www.sandiego.gov/auditor/reports/recommendation-follow-dashboard/current>

⁴ It should be noted that our audit was of the City's building acquisition process. The subject proposal is a settlement that would result in the City's acquisition of 101 Ash and Civic Center Plaza. The settlement process is likely more complex than a typical building acquisition, and thus some steps for building acquisitions may be infeasible or inapplicable in this context.

- Determination of what the building will be used for and how it fits the business case for acquisition
- Funding method analysis
- Determination of estimated tenant improvement costs, supported by relevant data
- Completion of an overall economic analysis, including consideration of other acquisition options
- Analysis of significant legal risks
- Independent (i.e., commissioned by the City and not the seller or other party) appraisals
- Independent building condition assessments
- Phase 1 environmental assessment
- Independent asbestos assessment
- Test fit
- Confirmation that all advisors and consultants that have significant input on the transaction are under contract with the City, and have either filed financial disclosures with the City or the City has filed a Consultant Determination Form with the City Clerk finding that disclosures are not required
- Presentation of the proposed transaction to the applicable Council Committee, in order to provide the Council and the public with sufficient time to evaluate the proposal
- IBA should review, evaluate, and report on the sufficiency of the above items, and consider retaining a consultant to assist

According to the IBA, the IBA's consultant had access to and reviewed all relevant materials when preparing its evaluation of potential settlement proposal impacts.

I hope you find this information helpful. Please contact me with any questions about our report or recommendations.

Respectfully submitted,



Andy Hanau, MPP, CIA, CFE
City Auditor

cc: Honorable Mayor Todd R. Gloria
Honorable Members of the Audit Committee
Honorable City Attorney Mara Elliott
Jay Goldstone, Chief Operating Officer
Charles Modica, Independent Budget Analyst
Penny Maus, Director, Department of Real Estate and Airport Management
Christiana Gauger, Chief Compliance Officer