

COUNCIL POLICY

SUBJECT: DISPOSITION OF CITY-OWNED REAL PROPERTY
POLICY NO.: 700-10
EFFECTIVE DATE: March 1, 2005

BACKGROUND:

The City of San Diego is owner of substantial real property which is used for various municipal purposes. As public service needs change, the requirements for these properties may be revised and, on occasion, certain parcels may be in excess of the City's current need. This requires that each individual site be reviewed in terms of its potential for future public use, as well as its potential economic benefit to the City.

The proceeds from the sale of City-owned lands are utilized for Capital Improvements Program projects, as required by the City Charter, Section 77, and the revenues generated from leases are normally utilized for General Fund purposes unless the property sold or leased belonged to an Enterprise Fund.

PURPOSE:

It is the purpose of this policy 1) to establish a procedure by which unused and marginally used City-owned real estate is reviewed for its potential public use, and for designating unneeded parcels for lease or sale; 2) to provide methodology for the sale or exchange of City-owned real estate and 3) to establish policies for the leasing of City-owned real property.

POLICY:

It is the City's policy to manage its real estate assets so that municipal needs which rely on these assets may be properly implemented. It is not the City's policy to speculate in real estate. The Mayor will review City-owned real estate not used for municipal purposes and determine the appropriate use of the property. Those properties not needed for either City or public use within the foreseeable future, may be made available for lease or sale.

The City shall optimize the sale price or lease rent from City-owned real estate based on relevant factors, including 1) an appraisal reflecting current market value when either a transaction or authorization to sell or lease is presented to the City Council, 2) prevailing economic conditions and market trends, and 3) any special benefits to accrue from the sale or lease. The City shall seek market value for its properties. Discounts will not be negotiated unless an extraordinary need or circumstance is recognized by Council Resolution setting forth the amount of the discount and the justification for the discount.

The Real Estate Assets Department shall prepare and present to the City Council a comprehensive Portfolio Management Plan on an annual basis, with periodic reviews and as-needed updates at City Council Committee. The Portfolio Management Plan shall include an overall review of the City's real estate portfolio (or inventory), an operating plan for corporate property, a disposition plan for

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surplus property, market research to support anticipated transactions and a request for authority to act within defined parameters (as described in this policy).

The major elements of the Portfolio Plan are to include:

- Property evaluation and characterization of real estate assets
- Strategy for City occupied real estate
- Investment Portfolio Plan (Leases to for-profit tenants)
- Review of Not-for-profit leases
- Disposition Plan for surplus assets
- Business Case development review to support proposed transactions
- Legal document development and review

POLICY REVIEW:

Revised Council Policy 700-10 shall be reviewed by the City Council for effectiveness one year after adoption and periodically thereafter as needed.

SALE OF CITY OWNED REAL ESTATE

PROCEDURE:

A. Real Estate Review

As part of an overall portfolio management plan for the City's real estate assets, the Mayor's staff will review the City's property inventory to determine which properties are no longer needed for public facilities or to support the elements of the General Plan and whose disposition will provide a greater public benefit. A City owned property may become available for sale if:

- The property is not currently used by a City department or does not support a municipal function.
- The property is vacant and has no foreseeable use by the City.
- The property is a non-performing or under-performing asset and greater value can be generated by its sale.
- Significant economic development opportunities can be generated by selling the property.

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Factors to be considered in determining whether a property should be sold include:

- Will the City be relieved of potential liabilities and/or cost of maintaining property that does not generate income or provide public benefit?
- Property tax increment that will be created by returning the properties to the tax rolls.
- Stimulation of the economy by providing opportunities for private sector investment.
- Generation of revenue for the Capital Outlay Fund or an Enterprise Fund.
- The sale of the property will generate greater economic value than a ground lease, if a ground lease is a feasible option.

B. Governmental Clearance Process

Government Code Section 54222 requires that a local agency proposing to dispose of surplus property must first notify all governmental agencies operating within the City as to the availability of the property. The agencies are given 60 days to respond with an intent to acquire, if not, the property may be deemed cleared for public sale.

Regarding the list of properties for sale:

- Governmental agencies are regularly contacted as the surplus list is updated.
- City departments, Park & Recreation, Fire, Police, Libraries, MWWD, Planning, Engineering and Capital Projects and Water are individually contacted as the surplus list is updated.
- Council offices are given a preliminary review to allow council staff to comment on foreseeable uses for the property.

C. Approval Process

- City-owned properties that have been identified by the Mayor as candidates for sale will be presented to Council for approval to be sold. If a property is of a type and location that would make a ground lease feasible, an economic analysis of the benefits of lease vs. sale will be conducted.
- If Council determines that the property may be sold, it shall authorize the Mayor to sell the property for a price equal to or greater than a minimum price established by a current (less than six month old) appraisal. The authorization to sell the property will be valid for twelve months from the date of Council action.
- The Mayor or his designee may enter into purchase and sale agreements, close escrows and execute and deliver grant deeds to the purchasers of the properties at prices equal to or greater than the minimum price approved by Council at terms and conditions deemed reasonable, and in the City's best interests, by the Mayor or his designee.

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- The Mayor will report out on the price, terms and conditions of all transactions.
- Properties that cannot be sold at a price equal to or greater than the minimum price approved by Council will be returned to Council for further consideration prior to their disposition. Council approval will be required to sell a property at a price less than the minimum price previously approved by Council.

D. Method of Sale

Properties may be sold by any method allowed by Council Policy and Municipal Code. This includes direct negotiation, request for proposal, listing with a broker, sealed bid, auction or other appropriate method as determined by the Mayor. Possible method of sale for all properties will be included in the enabling resolution authorizing their sales.

E. Marketing

Properties offered for sale shall receive the widest possible exposure to the open market place. This may be accomplished through direct marketing techniques, such as requests for proposals (RFPs), advertising, exposure through the real estate media, posting the property on the multiple listing service or any other appropriate method. When appropriate, properties may be listed for sale with qualified real estate brokers. The authorization to utilize the services of a real estate broker will be contained in the enabling resolution.

F. Real Estate Brokers

Real estate brokers may be used to represent the City in the sale of its properties. Brokers will be selected for individual assignments through Requests for Proposals (RFP) or Requests for Qualifications (RFQ) and a subsequent bid or other methods that result in the City receiving the services of a qualified broker at the best value to the City. The maximum approved commission rate will be contained in the enabling resolution for the property's sale. If the property is listed with a broker, the City reserves the right to exclude from the listing agreement potential buyers whose interest in purchasing a subject property has been made a part of the record prior to the execution of such agreement. All brokerage participation and brokerage fees shall comply with Municipal Code Section 22.0905, Broker's Fee and Registration.

G. Exclusively Negotiated Sales

It will be the City's policy to insure the highest price for its real estate by pursuing open market transactions. However, on certain occasions, an exclusively negotiated sale may be

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justified. Negotiated transactions shall comply with the requirements of Municipal Code Sections, as applicable, and may be approved under one of the following conditions:

1. When a parcel is landlocked.
2. When the sale to a contiguous owner would correct a site deficiency.
3. When a fee interest in a pipeline or other right-of-way is no longer required, it may be sold to a contiguous owner. A restrictive pipeline easement of adequate width or other required easements will be reserved from said sale.
4. When other governmental, public and quasi-public agencies submit acquisition proposals, a sale may be consummated per Municipal Code Section 22.0907, Sales of Real Properties to Public Agencies. These agencies shall include but not be limited to: Federal, State, and County agencies; school districts, special districts, and regulated utility companies.
5. When qualified nonprofit institutional organizations offer to purchase City-owned land, a negotiated sale may be consummated at fair market value providing there is 1) a development commitment, and 2) a right to repurchase or a reversion upon a condition subsequent. Institutional organizations such as churches, hospitals, extended care facilities, private schools and community service organizations are required to develop under the City's conditional use permit procedure.
6. When a property has been offered by public auction and no acceptable bids were received, it may be sold on a negotiated basis to any applicant submitting an acceptable offer within six months following the date of auction.
7. Real property exchanges may be consummated by direct negotiation per Municipal Code Section 22.0904, Exchanges of Real Property. However, exchanges will be considered only with other governmental agencies or when there is an advantage to the City.

H. Rezoning

Prior to completion of the sales transaction, City land shall be rezoned in accordance with the General Plan, existing community plans or other City Council direction if a higher sale price will result. Also, all unnecessary easements affecting title to the property shall be removed if this will result in a commensurate increase in value.

I. Easements

The City will receive current fair market value for the removal of restrictive easements or access rights previously paid for by the City or other governmental agency or reserved in a sale of City property.

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J. Priority Handling

Since time is of essence in land transactions, all such actions by Council and Committee shall be given the highest priority and special handling. Such action which must first go before a Council Committee will be placed on an early portion of the Committee agenda in order to assure prompt action. Subsequent to the Committee action, the item shall be placed on the docket of the next regular City Council meeting as a Supplemental Item.

K. Public Utilities Installed by Private Entities

The applicant for the use of unimproved City land for public purposes, such as streets, sewers, and other public utilities, shall compensate the City for the fair market value of the rights to be granted by the City. The amount of compensation shall be established by appraisal. However, lands which have been conveyed to the City after July 18, 1983, by private entities shall at the option of the grantor carry a reservation to the grantor for a period of 10 years following the date of conveyance to the City which would permit the grantor to install public utilities serving the grantor's adjacent land without the payment of compensation to the City therefore, and provided further that such installations shall not adversely affect any prospective use of the City's property. Persons who grant property to the City without charge shall have an automatic right to have such public service easements set aside on the donated property in the above manner.

LEASING OF CITY-OWNED REAL PROPERTY

The City of San Diego has a very diverse real estate portfolio. While the policies below are to act as the standard that governs most leases, the City acknowledges that parts of its leasing portfolio, such as Balboa Park, Mission Bay Park, Non-Profit organizations, Agricultural lands, Airports and Telecommunication Sites have specialized needs or restrictions. In these cases, Council Policy 700-10 will act as a framework for a sub-policy that will govern a specific area. Should a conflict arise between the framework policy and the sub-policy, the sub-policy will govern.

A. Criteria for Leasing

City property shall be considered for leasing when one or more of the following criteria apply:

1. The property is not required for current municipal use, but is to be held for possible future use and can be leased as an interim measure.
2. The property can only be leased because of legal restraints. For example, property held under Tideland trust grants or as dedicated parks.
3. The City requires substantial control over development, use and reuse of the property.

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4. The property has the immediate potential of a high return to the City because of its high demand and type of use, such as commercial and industrial land.
5. The property can be efficiently utilized by a provider of services needed by the City.
6. The property can be leased to promote a substantial economic development opportunity.

B. Portfolio Management Plan

The Mayor may execute lease transactions that meet the terms of the City's asset strategy for a particular property previously approved by City Council in an overall Portfolio Management Plan. Negotiated transactions that fall outside of the parameters of an approved Portfolio Management Plan either will be submitted individually for City Council approval, or deferred until the next periodic update and approval of the plan.

C. Lessee Selection for New Leases

Competitive offers for lease of City property shall be solicited from the open market place. This may be accomplished through a number of marketing techniques, such as Request for Proposals (RFPs) – Council Policy 700-41, a marketing subscription system, direct advertising, use of a Multiple Listing Service (MLS), listing with a broker, posting the property and any other appropriate means.

In certain limited situations, the City may exclusively consider a single proposal for lease of City property. Potential lessees wishing to exclusively negotiate with the City must submit for City staff review a business case with sufficient justification as to how it is capable of optimizing the use of the property and return to the City, thereby negating the need for a competitive process. This information will be included when the lease transaction is presented for City Council approval.

Leasehold proposals shall be evaluated in terms of:

1. The degree to which the proposed use is in compliance with the City's strategic plan for the property.
2. In terms of the amount of consideration offered in the form of rent.
3. In terms of the financial feasibility of the proposal.
4. The capability, expertise and experience of the potential lessee with respect to the proposed leasehold development and operation.

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5. If new development is proposed, a development plan that includes a description of the development team and its qualifications.
6. The details of each person or entity that will have an interest in the proposed lease to satisfy the requirements of City Charter §225.
7. Special public benefits to be derived (if any).

D. Rate of Return

The City shall obtain fair market rents for its leases commensurate with the highest and best use of the property. The fair market rent shall be based on an appraisal that complies with the definition of Market Rent found in the Uniform Standards of Professional Appraisal Practice (USPAP) published by the Appraisal Foundation. The appraisal shall be no more than six months old at the time the lease transaction is presented for City Council approval. If the cost of an appraisal is not justified by the anticipated rents, the City may choose an alternative method to establish rent. City leases shall contain terms and conditions which will sustain a fair rate of return throughout the duration of the lease.

E. Rental Terms

Rental terms may be negotiated on the basis of fixed rates (flat rent leases) or percentages of the lessee's gross income derived from business conducted on the property, with a provision for a minimum rental (percentage leases).

F. Percentage Leases

Minimum Rent

The minimum rent component for a new percentage lease shall be set at no less than eighty percent (80%) of the fair market rent as defined above. In certain cases, a portion of the minimum rent may be abated for new construction or redevelopment on the leasehold. The minimum rent shall be adjusted upward throughout the duration of the lease at intervals of not more than every five (5) years to reflect no less than eighty percent (80%) of the average annual rent actually paid or accrued during the three (3) years preceding the adjustment. In no event shall the adjusted minimum rent be less than the minimum rent in existence immediately preceding the adjustment.

Percentage Rates

Percentage leases shall provide for adjustment of percentages rates every ten (10) years to current fair market rates. For the purposes of determining fair market rent percentage rates, the City shall adopt and publish a schedule of benchmark percentage rates that will be updated to current market rates on a periodic basis by appraisal. The appraisal

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will be guided by prevailing market percentage rates for similar operations primarily within the Southern California area.

G. Flat Rate Leases

Market Rate Adjustments

Flat rate leases shall provide for upward adjustment of rent every ten (10) years to current fair market rent. In no event shall the adjusted rent be lower than the rent in existence immediately preceding the adjustment.

Consumer Price Index Adjustments

Flat rate leases shall provide for upward adjustment of rent in the interval term between market rate adjustments by changes in the consumer price index. In no event shall the adjusted rent be lower than the rent in existence immediately preceding the adjustment. The index used for consumer price index adjustments will be the All Urban Consumers index for Los Angeles - Riverside - Orange County, California with a base year of 1982-84. If the U.S. Department of Labor indices are no longer published, another substitute index generally recognized as authoritative will be used. Flat rate leases may include pre-determined periodic increases to rent instead of consumer price index adjustments. These periodic increases would occur at least every five (5) years.

H. Rent Arbitration

Leases shall provide for binding arbitration when the City and lessee cannot agree on the new rent for a rental period under review. The City and lessee shall each select a professional independent real estate appraiser who in turn will select a third independent real estate appraiser to determine the fair market rent. If the two selected appraisers fail to mutually select a third appraiser, then the third appraiser will be appointed by the presiding judge of the Superior Court of the State of California, County of San Diego. If the Superior Court judge declines to make the appointment, then the third appraiser shall be determined in accordance with the rules of the American Arbitration Association. The City and lessee shall pay the cost of its own selected appraiser and equally share the cost of the third appraiser.

I. Appraisal Assumptions

City leases shall include a definition of the fair market value to be used to adjust rent an identification of the premise for that value. In establishing the fair market value of leased property, any appraisal shall consider the property as a fee simple absolute estate and as vacant and available for lease or sale for the authorized purposes of the lease at the commencement of the rental period under review. Rates established for purposes of periodic percentage rental adjustments shall not consider any abatement as may be appropriate in a "new" development of vacant land. It shall also be assumed that all required regulatory approvals to permit the use authorized in the lease have been obtained.

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J. Lease Term

Short-Term Lease

In accordance with San Diego Municipal Code §22.0901, the Mayor, at all times, shall have power, without advertising, notice, or competitive bidding, and upon such terms as the Mayor may deem proper, to lease any City property for a term of three (3) years or less (short-term lease). The City Council will be notified of a short-term lease not later than fifteen (15) days following its execution. A short-term lease may not be renewed without approval of the City Council. The Mayor may also execute rental agreements covering month-to-month tenant occupancy of City-owned residential housing.

Long-Term Lease

A lease in excess of three (3) years requires a resolution passed by a majority vote of all members of the City Council.

The length of lease term shall be based on the level of capital improvements to be made by the lessee and the economic life expectancy of the development. These factors can be determined utilizing cost estimating and economic life expectancy resources such as tables provided by Marshall Valuation Service. The City may consider other relevant information in determining if a longer lease term is warranted, such as if the proposed leasehold development is expected to generate above average returns to the City or significantly improve the quality of the property.

K. Lease Amendments

Amendments to long-term leases require City Council approval. The City's agreement to an amendment may be contingent upon updating sections of the lease to incorporate current City standard lease provisions and an adjustment to fair market rent.

L. Subleases

A lessee may sublease all or part of the leased property to a qualified sub-lessee subject to approval by the City. No sublease shall be approved which would be detrimental to the City's rights under the master lease or for a use that is not consistent with uses allowed by the master lease. The Mayor may authorize subleases which meet these conditions and which do not require amendment of the master lease. Unless special circumstances exist, leases shall provide for the City to receive a minimum of fifty percent (50%) of the incremental gross rental revenues due to the lessee from subleases.

M. Leasehold Financing

The City will not subordinate its fee interest to encumbrances placed against any leasehold by a lessee. The Mayor may approve appropriate financial encumbrances of the leasehold interest, which provide that all loan proceeds are used for authorized improvement of the property. City staff shall take appropriate steps to review the proposed financing and insure

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that loan proceeds go into the leasehold. Maximum loan proceeds shall not be in excess of seventy-five percent (75%) loan-to-value, where “value” refers to the leasehold improvements, as determined by a lender’s appraisal which has been reviewed and approved by City staff. The loan term shall not exceed the term of the lease.

Loans or refinancing in the form of encumbrances against the lease for the purpose of reducing equity or financing the sale of leasehold interest will not be allowed until the property is fully developed for uses authorized in the lease. After the property is developed, such financing may be permitted so long as there is also substantial benefit to be gained by the City. This may take the form of either a percentage share of the loan proceeds or an upward adjustment to the rent.

N. Leasehold Improvements

Leasehold improvements installed by lessees shall be removed at the lease termination without cost to the City, or will revert to the City, at the City’s option. All leasehold improvements and alterations require prior written approval of the Mayor.

O. Maintenance and Utilities Responsibility

City leases shall require the lessee to maintain all improvements on the property at its own expense and be responsible for the cost of all utilities. Leases for multi-tenanted space shall include specific requirements delineating appropriate responsibilities.

P. Lease Audits

All percentage leases shall be audited by the City Auditor and Comptroller in the first year of operation to establish proper reporting procedures and at least once every three (3) years thereafter. More frequent audits may be made if appropriate. The City shall reserve the right to audit all other leases and agreements, if determined to be warranted by the City Auditor and Comptroller.

Q. Leasehold Assignments

Requests for assignment of leasehold interest shall be evaluated on the same basis as the criteria used in evaluating a leasehold proposal. The Mayor may authorize assignments which do not require amendment of the master lease. Consent may be contingent on the payment of additional consideration to the City, either as a percentage share of the purchase price of the leasehold interest or an upward adjustment to the rent. If new financing is involved in the sale, the requirements of ‘Leasehold Financing’ shall apply.

R. Lease Extensions & Renewals

Requests from existing lessees for lease extensions or renewals may be considered if such proposals promote capital investment and redevelopment of City property. Whenever an existing lessee is seeking renewal of an expiring long-term lease that is not contemplated in a previously approved Portfolio Plan, the Mayor will bring the issue before the applicable City Council Committee with an appropriate recommendation. In addition to the criteria used to assess new lease proposals, City staff also will review the lessee’s history with

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respect to: maintenance of the property; compliance with existing lease terms; prompt rent payments; and a rental return consistent with maximizing the property's full potential.

The lessee must propose capital investment that: will increase the value or the useful life of the leasehold improvements by an amount more than can be reasonably amortized over the remaining lease term; is not recurring in nature; and is at least ten percent (10%) or more of the value of the existing improvements. It specifically should exclude expenditures to correct deferred maintenance and expenditures for repairs to keep the existing improvements in good condition. The length of any extended lease term shall be calculated by the same method used for calculating the length of new leases.

S. City's Interest in Leasehold Improvements

City lease agreements provide the City the right to assume ownership of the leasehold improvements at the end of the lease. The value of the City's interest in the leasehold improvements can be appraised using widely accepted appraisal methods. In the event the City grants a lessee a lease extension, the City shall be compensated by an amount equal to the change in present value attributable to the deferral of its interest in the leasehold improvements. This amount either can be paid as an upfront payment at the beginning of the extended term or amortized over time with appropriate interest applied. The City shall offset from the value of its interest in the leasehold improvements any increased economic benefit derived from an extended lease. The City shall not receive any compensation for its interest in the leasehold improvements on leases extended prior to the last twenty percent (20%) of the existing term.

T. Security Deposits

The standard security deposit for a new lease agreement shall be equivalent to three (3) month's rent. The security deposit may take the form of cash, an instrument of credit or a faithful performance bond. For a lessee making a substantial investment in improvements, the security deposit will be refunded upon completion of the improvements.

U. Transaction Processing Fees

The City may charge a transaction processing fee in accordance with the schedule of fees adopted pursuant to Administrative Regulation 95.25. The fee may be waived for transactions that provide benefit to the City.

CROSS REFERENCE:

Council Policy 700-04 - Balboa Park Uses and Occupancy

Council Policy 700-08 - Mission Bay Park Policies

Council Policy 700-12 - Disposition of City Property to Non-Profit Organizations

Council Policy 700-15 - Airport Policy

Council Policy 600-43 - Telecommunication Antennae Policy

HISTORY:

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“Assignment and/or Subletting of City Leases”

Adopted by Resolution R-169946 03/15/1962

| Retitled to “Disposition of Surplus City-Owned Real Property” and

Amended by Resolution R-208091 06/05/1973

Amended by Resolution R-212957 04/04/1975

Amended by Resolution R-217309 12/21/1976

Amended by Resolution R-218125 04/12/1977

Amended by Resolution R-219507 10/19/1977

Amended by Resolution R-220842 05/09/1978

Amended by Resolution R-224022 07/16/1979

Amended by Resolution R-250319 10/01/1979

Amended by Resolution R-251154 02/11/1980

Amended by Resolution R-251943 06/02/1980

Amended by Resolution R-252266 07/14/1980

Amended by Resolution R-252313 07/21/1980

Amended by Resolution R-252966 10/27/1980

Amended by Resolution R-255014 09/15/1981

Amended by Resolution R-258160 03/28/1983

Amended by Resolution R-258896 07/18/1983

Amended by Resolution R-300187 03/01/2005