

**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 236-6220

DATE: August 24, 2007

TO: Honorable Mayor and City Council Members

FROM: City Attorney

SUBJECT: Proposed Contract for Real Estate Brokerage Services with BRE Commercial, Inc. d/b/a Grubb & Ellis/BRE Commercial

INTRODUCTION

On July 27, 2007, the Office of the Mayor requested that the City Attorney examine a possible legal problem with an item that was continued from the City Council's July 30, 2007 agenda. The proposed Item #200 was a resolution providing that BRE Commercial, Inc. [BRE], among others, be awarded contracts to list, sell, and receive commissions from the sale of several pieces of City-owned commercial property. BRE is locally owned, does business in San Diego County under the name of "Grubb & Ellis/BRE Commercial," and is an "affiliate" of the Chicago-based national real estate services firm of Grubb & Ellis Co [Grubb & Ellis]. Previously, Grubb & Ellis had performed a study of the "Best Practices Methodology" for the City's Real Estate Assets Department [READ], reviewing and making comprehensive recommendations regarding nearly all of READ's practices [the BPM Report]. We have been asked to examine whether Grubb & Ellis's work on the BPM Report, in combination with the affiliate relationship between Grubb & Ellis and BRE, creates a conflict of interest that precludes BRE from performing real estate brokerage services for the City.

QUESTION PRESENTED

Does the awarding of a contract to BRE either a) violate the "Precluded Participation" clause of the RFP through which Grubb & Ellis Co. was awarded the contract to conduct the Best Practices Study, or b) present any other conflict of interest that would make the proposed contract with BRE unlawful?

SHORT ANSWER

No. Grubb & Ellis did not have, at the time it developed the BPM Report, a financial interest in any possible later contract between the City and BRE, nor does Grubb & Ellis have any such interest now that such a contract has been proposed. Grubb & Ellis's affiliate agreement with BRE does not provide for any form of compensation that would be affected by BRE's proposed work for, and receipt of commissions from, the City. In addition, even if Grubb & Ellis had a financial interest in the proposed BRE contract, it did not participate in the making of that contract because neither the BPM Report itself nor any other action of Grubb & Ellis contributed in any legally meaningful sense to the City's proposed award of a brokerage contract to BRE.

BACKGROUND

In 2006, the City's issued a Request for Proposals (RFP No. 8303-06-L) for a consultant to perform "review and analysis required to recommend improvements to READ's organizational structure, management practices, business processes and operations." This RFP, which closed on July 10, 2006, also specifically anticipated and sought to preclude the possibility that the winning proposer might make recommendations regarding the use of real estate brokerage services and, thereafter, seek to provide those same services. Thus, it contained this prohibition at page 14:

T. PRECLUDED PARTICIPATION

In order to avoid any real or perceived conflict of interest, the successful Proposer to this RFP will be precluded from participation in any follow-on contracts that incorporate the findings of this RFP. Pursuant to the Scope of Work section of this RFP, the successful Proposer will not be providing real estate brokerage services or recommendations regarding real estate brokerage services to the City under this RFP, and therefore would not, as long as no recommendations regarding brokerage services were provided by the successful Proposer, be precluded from any subsequent RFP that might call for brokerage services.

The winning proposer under RFP No. 8303-06-L was Grubb & Ellis. A purchase order to Grubb & Ellis was issued on August 23, 2006. Thereafter, a Grubb & Ellis team led by Noah Shlaes proceeded to conduct an in-depth analysis of nearly all of READ's practices. Ultimately, this resulted in the issuance of a report by Grubb & Ellis on January 31, 2007 [the Report]. Consistent with the quoted language from the RFP, at no point did the BPM Report recommend the use of real estate brokers to sell City property, or address the issue in any way.¹ In addition,

¹ There is one allusion, in a chart on page 32 of the Report, to the use of brokers as being among the options available to the City, but this single reference does not suggest that brokers actually be used.

we have reviewed all written communications between READ staff and Grubb & Ellis, and have interviewed READ staff, Grubb & Ellis's consulting staff, and the management of the local BRE office. No evidence that we have discovered suggests that real estate brokerage services were ever discussed with READ in the course of Grubb & Ellis's consulting work on the BPM Report. Finally, no substantive interchange between Mr. Shlaes' team and the local BRE team, which we also interviewed, appears to have occurred regarding Grubb & Ellis's work for the City.

READ's Director, James Barwick, presented the BPM Report to the City Council Committee on Land Use & Housing on February 7, 2007, along with a PowerPoint presentation that outlined READ's proposed implementation of the Grubb & Ellis recommendations. Mr. Shlaes did not attend this committee meeting. READ's PowerPoint did recommend, in its final slide, that "Properties may be Listed with Real Estate Brokers Selected through a Combination of RFP and Bid Process."² This statement is consistent with the San Diego Municipal Code, which has at all relevant times provided at section 22.0905 for the payment of commissions to real estate brokers. However, as Mr. Barwick reported to the Committee, READ has historically more often sold real estate at auction, as is the traditional practice among municipalities. It is also the preferred practice under the current Council Policy 700-10; READ recommended that this be revised.³ which recommendation the Committee ultimately approved on July 11, 2007. Thus, READ's proposed extensive use of brokerage services represents a significant shift in practices. The Committee took no action on February 7, 2007, but asked that Mr. Barwick return for further discussion of this topic.

Mr. Barwick then presented a discussion of READ's proposed plan for disposing of "surplus properties" to the City Council Committee on Rules, Open Government, and Intergovernmental Relations on April 25, 2007. This presentation was, principally, a report to the Committee on READ's proposed implementation of the recommendation to switch from auction sales to broker sales. At the time, READ had just issued, on April 5, 2007, a Request for Statement of Qualifications [RFQ] for brokerage services, which closed on May 11, 2007.⁴ Mr. Barwick's appearance before the Rules Committee was docketed as an informational presentation only. The Committee took no action.

² Prefacing his presentation of READ Staff's PowerPoint, Mr. Barwick characterized the presentation as answering the question "Where does Grubb say we ought to be going?" However, we have found no other evidence that Grubb & Ellis made any recommendation regarding brokerage services. This recommendation appears to have been independently developed by READ; this spontaneous statement by Mr. Barwick appears inapplicable to this particular policy recommendation.

³ The Committee ultimately approved this recommendation on July 11, 2007.

⁴ During that hearing, Councilmember Frye asked Mr. Barwick to explain the role of the Grubb & Ellis Report in READ's development of its proposal for property disposition, and specifically inquired as to whether Grubb & Ellis would be precluded from participating in the proposed broker sales. He replied that, because Grubb & Ellis had not provided recommendations to use brokers and had not had access to information about specific properties, Grubb & Ellis would not be precluded from providing brokerage services. The distinction between Grubb & Ellis and BRE was not discussed at that time. This memorandum does not examine Mr. Barwick's opinion that Grubb & Ellis itself would have been permitted to provide brokerage services, because no such provision of services has been proposed.

As requested, Mr. Barwick returned to the Land Use & Housing Committee, appearing again on June 13, 2007, this time accompanied by Mr. Shlaes. At that meeting, for the only time during the course of his work for the City, Mr. Shlaes was asked to address the idea of using brokers to sell City property. Councilmember Atkins initially directed an inquiry on this topic to Mr. Barwick, who provided a brief answer and then invited Mr. Shlaes to add his thoughts. Mr. Shlaes' response was, in relevant part:

A big part of the function of brokers is the immense communications burden, the immense explanations burden, that goes on in persuading a potential user, lessor or buyer of City parcels, land, of exactly what he, or what she's, getting into, what the process is, making sure the steps are known, etc...Our hope is that for properties that are normally obtained and normally researched through brokers – through moving the City properties through these channels – that you will be able to obtain superior economic benefits, broader exposure and closure.

Thus, there can be little doubt that, at least for these few moments before the Committee, Grubb & Ellis did recommend the use of brokers to sell City real estate, despite the RFP's explicit statement that the consultant would not do so, and despite the fact that the BPM Report did not address the issue.

As noted above, BRE is an "affiliate" of Grubb & Ellis. For this status, it pays 1) a flat annual fee; and 2) a percentage of any revenues it receives from deals that arise from referrals through Grubb & Ellis's national referral system. For these fees, BRE receives both the right to use the Grubb & Ellis name and access to that referral system.

BRE successfully responded to the April 5, 2007 RFQ, and was consequently placed on a list of qualified vendors, along with four other firms. Thereafter, Purchasing and Contracting issued an RFP for the sale of eight⁵ specific properties, to which only qualified vendors could respond. BRE responded to this RFP and was tentatively awarded contracts for the sale of four of the eight properties in this first traunch. This award was subject to Council approval, and it was this proposed action that was proposed as Item #200 for July 30, 2007, but subsequently continued due to the concerned addressed in this memo.

ANALYSIS

To determine whether Grubb & Ellis's consulting work for READ results in BRE's

⁵ These eight properties were designated as the first traunch of proposed sales; further properties are also anticipated to be proposed for broker sales, but the process of selecting brokers has not been conducted yet.

preclusion from providing brokerage services for the sale of specific properties, a two-part analysis is necessary. First, the “Precluded Participation” clause of the 2006 RFP refers only to preclusion of the “successful Proposer.” Thus, it must be determined whether the relationship between Grubb & Ellis and BRE is such that Grubb & Ellis’s status as the successful proposer on the 2006 RFP must be imputed to BRE. If such imputation is appropriate, the next inquiry is whether Grubb & Ellis recommended the use of the brokerage services that BRE would now be providing. If both questions yield answers in the affirmative, BRE would be precluded from providing brokerage services as proposed. However, neither prong of this analysis points to preclusion on these facts.

I. The Affiliate Relationship Between Grubb & Ellis and BRE does not Require that Grubb & Ellis’s Status as the Successful Proposer be Imputed to BRE.

Although the 2006 RFP precluded participation in any follow-on brokerage service contracts by the “successful Proposer,” it did not define the term “proposer.” Thus, to determine whether to extend this preclusive language beyond Grubb & Ellis to an affiliate like BRE, one must look to the purpose underlying the preclusion clause. This purpose is explicitly stated at the very outset of the paragraph: “In order to avoid any real or perceived conflicts of interest...” Thus, the provision is explicitly designed to serve essentially the same policy goals as sections 1090 and 87100 of the California Government Code, which ban public officials including consultants from participating in, respectively, the formation of government contracts and the making of governmental decisions.⁶ To serve this purpose, then, Grubb & Ellis’s status as successful proposer should be imputed to any affiliate if the award of a follow-on contract to that affiliate would bring a financial benefit, directly or indirectly, to Grubb & Ellis itself. In such a case, Grubb & Ellis’s would have a motivation to make recommendations from which it might benefit through that affiliate. The first question, then, is whether BRE is an affiliate in whose proposed contract Grubb & Ellis has a financial interest.

Section 87100 is particularly helpful here, because it is implemented by detailed regulations that define what constitutes a prohibited financial interest in a governmental decision. See 2 Cal Code Regs, §18703-18704.5. The first inquiry is whether the consultant has any interest that is “potentially” affected by the decision to which they contributed. In this case, the answer is no, and no further inquiry is required. Although BRE pays compensation to Grubb & Ellis for the use of the Grubb & Ellis name and its national referral system, the amount of this compensation will be completely unaffected by the City’s decision to use real estate brokers.⁷ And this is the only decision to which Grubb & Ellis might, even arguably, have contributed. Moreover, even the specific decision to award some of the City’s brokerage work to BRE – a decision in which Grubb & Ellis played no role - will not affect Grubb & Ellis because of the structure of the compensation provisions in the affiliate agreement between Grubb & Ellis and

BRE.⁸

In light of this analysis, it appears that Grubb & Ellis had no potentially affected economic interest in recommending the use of brokers by the City. To be sure, BRE, a Grubb & Ellis affiliate, is a major presence in the local commercial brokerage industry. It was therefore foreseeable that, if the City decided to shift to the use of commercial brokers, BRE might seek that business. But this would not and will not affect Grubb & Ellis in any substantial way. Thus, the purpose of the “Precluded Participation” clause of the 2006 RFP would not be served by imputing to BRE any preclusion that might affect Grubb & Ellis. To the contrary, extending such preclusion in this case would deprive the City of the services of a firm that has been found, through a rigorous selection process, to be well-qualified, and which would be performing those services at commission rates that are attractive to the City. To preclude BRE from providing these services at these rates would be contrary to the public interest.

II. Grubb & Ellis did not Substantially Contribute to the City’s Decision to Use Brokerage Services.

Although the analysis above is, in itself, sufficient to find that BRE is not precluded from providing brokerage services as proposed, it bears noting that Grubb & Ellis did not, in any event, contribute in any substantial way to the decisions that led to the proposed BRE contract. Consistent with the “Precluded Participation” clause of the 2006 RFP, the BPM Report did not recommend that the City shift to the use of brokers to sell City real estate. This topic is discussed nowhere in the BPM Report’s 75 pages.

There are only two places where the BPM Report even approaches the topic. First, at page 32, the BPM Report includes a flow chart representing the City’s overall review of its real estate portfolio. Of the more than 20 boxes on that chart, a single box acknowledges that disposition of real estate through sale or lease may occur, and tangentially notes that possible disposition methods are “RFP/List with Broker/staff sale.” Given that it contains no analysis at all, it cannot be fairly concluded that this single reference constitutes a recommendation that that City use brokers. Moreover, a discussion in the main text of the BPM Report, at page 42, lists possible means of marketing properties as “sale to adjacent owner, request for proposal process, online marketing, auction, and others.” Thus, methods of sale are only mentioned twice, no preference among methods is ever suggested, and in the second instance brokers are not even mentioned.

Nonetheless, there can be little doubt that, at the same time Grubb & Ellis was preparing the BPM Report, READ’s staff was preparing a marked shift toward increased use of brokers. In light of this, an inquiry into whether Grubb & Ellis recommended brokers on an informal basis is appropriate. In this vein, this Office reviewed not only the BPM Report, but also video archives of various committee meetings, written correspondence between READ Staff and Grubb & Ellis. In addition, interviews with READ Staff, the Grubb & Ellis team, and BRE’s management⁰⁹ were

⁸ The affiliate agreement between Grubb & Ellis and BRE is a proprietary document that has been provided to the Office of the City Attorney on a confidential basis for the purpose of accommodating this analysis. It is not subject to disclosure under sections 6254.15 and 6255 of the California Public Records Act, and its contents will not be discussed in detail here.

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conducted. There appears to be no direct evidence that Grubb & Ellis ever discussed the use of brokers, verbally or in writing, with any City representatives, with one exception.

As noted, although Grubb & Ellis's BPM Report did not recommend the use of brokers, READ Staff has initiated a process of selling real estate through brokers. In addition, Mr. Barwick presented his views on the question to two different City Council Committees, on four separate occasions. On the third such occasion, at the June 13, 2007 meeting of the Land Use & Housing Committee, Mr. Barwick not only advocated the use of brokers, but also asked Mr. Shlaes for his views on the topic. Mr. Shlaes supported Mr. Barwick's view.

Mr. Shlaes' brief remarks on this topic, on a single occasion, do not appear to have contributed in any significant way to the City's decision to use brokers, for several reasons. First, READ's decision to recommend the use of brokers pre-dated Mr. Shlaes' comments by several months, having originally been presented to the committee on February 7, 2007. Indeed, Mr. Barwick clearly anticipated the likelihood that READ would shift toward the use of brokers before the 2006 RFP was released in June of 2006, and clearly indicated this in numerous meetings where the RFP was developed. That recommendations regarding the use of brokers were specifically excluded from the RFP's scope of work is an indication that such a recommendation was already considered unnecessary before the consultant was even selected. Moreover, the Committee to which Mr. Shlaes made his statement was not considering, at that time, any action on this topic.⁰⁰ Finally, by the time Mr. Shlaes addressed this issue, the Council had already approved (on May 21, 2007) the use of brokers to sell 19 specific properties, and an RFQ for such services was already underway. Thus, Mr. Shlaes' remarks cannot reasonably be viewed as contributing in any meaningful way to the City's decision to use brokers.

Because Grubb & Ellis did not make any substantive contribution to the City's decision to use brokers, the currently pending brokerage service contracts are not "follow-on contracts" as that term is used in the "Precluded Participation" clause of the 2006 RFP.

CONCLUSION

In order to find that BRE is precluded from providing brokerage service for the City, two findings would be necessary. First, BRE and Grubb & Ellis would have to have a financial relationship that would give Grubb & Ellis an interest in BRE's winning contracts for brokerage services to the City, such that Grubb & Ellis would have had an incentive to make recommendations to the City that might have advanced that interest. Second, Grubb & Ellis's work for the City would have to have included an element that might reasonably have affected such an interest. Neither element is present. The financial relationship between Grubb & Ellis and BRE does not contain any element that has the potential to be affected by whether BRE performs brokerage services for the City. And even if there were such a relationship, Grubb & Ellis's work for the City did not address the use of brokerage services in any significant way. Thus, BRE is not precluded from providing brokerage services to the City as proposed.

⁰⁰ As noted above, the Committee did approve proposed changes to Council Policy 700-10 on July 11, 2007, and these changes did address READ's desire to shift to greater use of brokers. Thus, Mr. Shlaes' June 13, 2007 statements could be construed as having contributed to future use of brokers. But with respect to the proposal to use BRE for sales in the pending tranch, these sales are not dependent on the proposed revisions to the Council Policy.

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