



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: June 7, 2007 REPORT NO: 07-110

ATTENTION: Committee on Land Use and Housing
Agenda of June 13, 2007

SUBJECT: Acceptance of Consultant Report for Best Practices Methodology for Real Estate Assets Department Performed by Grubb & Ellis Corporate Services Dated January 31, 2007. Proposed changes to Council Policy 700-10 Sale and Leasing of City-owned real estate.

REFERENCE: Council Policy 700-10

REQUESTED ACTION: Accept the Grubb & Ellis report and recommend that the City Council approve changes to Council Policy 700-10, Disposition of City Owned Real Property, that incorporate revised sale and leasing policies.

STAFF RECOMMENDATION:

COMMUNITY PLANNING GROUP RECOMMENDATION: None

SUMMARY:

The Real Estate Assets Department of the City of San Diego needed a new business model. It had previously applied methods and policies to situations as they arose without a clear plan. There was no portfolio plan for the City's income producing real estate. Facilities for municipal uses were provided on an as needed basis without considering how they might best be integrated into an overall facility plan. The organization lacked direction, authority to manage its portfolio, and the support systems necessary to provide a timely flow of information to its decision makers.

To help remedy the situations, Grubb & Ellis Corporate Services was engaged to do the following:

- Provide a best practice methodology based on private and governmental real estate industry standards for the management of the City's real estate assets.
- Provide performance measures for the department and its real property inventory.
- Provide an assessment of the organization's real property management practices and its ability as a lessor, and provide recommendations to improve efficiency and accountability.

- Provide a review and analysis of existing authority (statutes, regulations, policies and other authority) that govern the management of real property and recommend changes to the existing authority to improve required processes and maximize efficiency.
- Provide a real property abstract suitable for tracking each site in the City's real estate inventory.
- Provide a brief summary of available information technology systems with recommendations as to which system would be best suited to support the department.

BACKGROUND

Grubb & Ellis Report

The City of San Diego is unique among municipalities in the size and diversity of the real estate portfolio that it owns and manages. The City's assets include:

- 120,000 acres
- 3,400 properties
- 680 ground leases
- Facilities for 11,000 employees

Other municipal real estate organizations do not have the size and diversity of the City's portfolio. Therefore, the best practice model for READ is a hybrid of public and private sector practices.

The mission of READ has three major components:

- Acquire/manage real estate required for governmental functions and services.
- Generate revenues through leasing and sale of surplus assets.
- Maximize the overall financial return to the City's real estate portfolio.

To effectively accomplish its mission, READ has been reorganized to reflect its core lines of business:

- **Acquisition / Disposition** (acquiring and disposing of City's properties)
- **Asset Management** (Managing the City's ground lease portfolio)
- **Corporate Services** (Managing the facilities needs for governmental functions and services)
- **Support Functions** (Valuation and Administrative Support)

The following (in outline form) is a brief summary of the pertinent findings of the Grubb & Ellis Report. The full report has been posted on the City's website.

PRIOR STATE OF READ:

People:

- Need improvement in knowledge of real estate techniques
- Need training from outside sources (CCIM, MAI, CPM).

Operations:

- Current computer systems are out of date. New system needed to improve efficiency, standardization and accountability.
- Access to information about properties is dependent on paper files.
- Lease forms and other documents needed standardization.
- Time for legal review is excessive due to attorneys' work load.
- No definitive library of legal forms.
- Need effective event reminders and means to record communications with tenants.
- Need greater use of databases and websites.
- No receptionist at the department.

Authority and Governance:

- Council approval required for virtually all transactions, adding time to transaction.
- No formal agenda to review and evaluate portfolio.
- Authority to negotiate transactions scattered throughout City departments.
- No clear leasing policies.

DESIRED STATE:**Institution of a Portfolio Plan:**

A comprehensive portfolio plan will be presented and approved by Council on an annual basis. It should include:

- A review of the portfolio
- An operating plan for corporate property
- A disposition plan for surplus property
- Market research to support anticipated transactions
- A request for authority to act within defined parameters

Once the Portfolio Plan is approved by Council, no further approvals needed for transactions within the defined parameters of the Plan. Plan is to be revised and reviewed by Council on a periodic basis.

Major elements of a Portfolio Plan

- 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
- Legal document development and review

Corporate Services (Occupancy) Strategy

- Gather Data: current portfolio, utilization, departmental changes, market data
- Analysis: eliminate redundancies, improve functionality reduce cost, identify underutilized areas, consolidation.

- Business case development required by user groups
- Recommendations: long and short term facility solutions

Asset Management (leasing) Strategy

- Analyze current leases
- Hold/Sell analysis
- Leasing strategy and plan
- Value enhancement strategy
- Standardize leasing policies (for profit)
- Standardize not-for-profit leasing policies

Acquisition/ Disposition Strategy

- Determine if property is surplus
- Appraise Value
- Determine best disposition strategy (sell, lease, other)
- Execute strategy

Technology

READ requires a modern system that supports:

- Portfolio monitoring
- Performance measures
- Project tracking
- Information necessary for property agents to accomplish their work

This system will allow READ to have:

- A central repository for documents and formats by scanning documents and storing originals off-site
- Database tools or shared environment rather than spreadsheets for shared data
- Organization-standard spreadsheets, databases and word processing tools
- Electronic document management, including hosting of scanned versions of lease and property documents
- Departmental views of portfolios, as well as data on individual properties

Authority

For READ to achieve superior performance of its real estate, it requires improved authority:

- **Batched approval** – Presentation of groups of properties or entire strategies for City Council approval
- **Authority Within a Box** – Pre-approval of transactions that meet defined standards
- **Management by Exception** – Approvals should be required only for departures from standards established by the Portfolio Plan.

SALE OF CITY OWNED REAL PROPERTY: Council Policy 700-10

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 to 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.

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 Capitol Outlay Fund or Enterprise Fund.
- The sale of the property will generate greater economic value than a ground lease.

B. Governmental Clearance Process

Government Code Section 54222 requires that a local agency proposing to dispose of surplus property 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 is deemed cleared for public sale.

- Governmental agencies are regularly contacted as the surplus list is updated.
- City departments, including Park & Recreation, Fire, Police, Libraries, MWWD, are individually contacted as the surplus list is updated.

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 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 or terms and conditions deemed reasonable and in the City's best interests by the Mayor or his designee.
- The Mayor will report on the price, terms and conditions of all transactions.
- Properties that are not 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.

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, sealed bid, auction or other appropriate method as determined by the Mayor. The method of sale for all properties will be contained in the resolution authorizing their sale.

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 (RFP's), 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 brokerage services 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 for commission or other methods that result in the City receiving the services of a qualified broker at the lowest possible commission rate. The maximum approved commission rate will be contained in the enabling resolution for the properties sale. All brokerage participation and brokerage fees shall comply with Municipal Code Section 22.0905, Broker's Fee and Registration.

LEASING OF CITY OWNED REAL PROPERTY:

The current City leasing procedures have remained substantially unchanged since 1983. In addition to updating these procedures, the Grubb & Ellis report recommended a clearly defined description of the City's leasing policy. With this in mind, staff recommends the adoption of

revised policies solely dedicated to the leasing of City-owned real estate (See Attachment). The following is a summary of the important changes contained in the proposed policy:

- The rate of return for leased property will be based on an appraisal that complies with the Uniform Standards of Professional Appraisal Practice (USPAP).
- More specific requirements for the establishment of percentage rents and minimum rents for percentage rate leases.
- Percentage rate adjustment every ten years to current fair market rents for percentage rate leases.
- Market rate adjustments every ten years and Consumer Price Index Adjustments in interval terms between market rate adjustments for flat rate leases.
- Rent arbitration process for situations where the City and Lessee cannot agree on new rent for a rental period under review.
- Defined Appraisal Assumptions.
- Required analysis of level of capital improvements and economic life expectancy of the development in order to determine length of lease term.
- Clearly defined maximum leasehold financing and refinancing restrictions including a requirement for substantial benefit to the City in refinancing situations.
- Specification that the maintenance to improvements and the costs for utilities are the responsibility of the lessee.
- Requirement that requests for assignment of leasehold interests will be evaluated with the same criteria as new leasehold proposals and may include additional consideration to the City.
- New requirements for lease extensions and renewals based on investment to City property and sound business practices in order to determine the appropriate length of any new term.
- Requirement that agreements provide the City the right to assume ownership of the leasehold improvements at the end of the lease. In the event that the lessee is granted an extension, the City will be compensated by an amount equal to the change in present value attributable to the deferral of the reversionary interest.
- Standard requirement for security deposit for new leases in an amount equivalent to three month's rent.
- Requisite that the City may charge a transaction processing fee in accordance to Administrative Regulation 95.25.

FISCAL CONSIDERATIONS:

The recommendations outlined in the Grubb & Ellis Report will enable READ to manage the City's real estate portfolio in a manner that will maximize its value. The revisions to Council Policy 700-10 will establish procedures for the sale and leasing of the City's surplus that will maximize the value of the City's real estate assets.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

None.


COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

None.

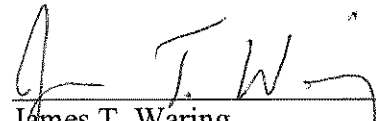
KEY STAKEHOLDERS AND PROJECTED IMPACTS:

None.

Respectfully Submitted,



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Deputy Chief Operating Officer of
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BARWICK/TM

Attachment I: Council Policy 700-10

Attachment II: Leasing of City-Owned Real Property