Performance Audit of the
San Francisco Real Estate Division

Prepared for the

Board of Supervisors
of the City and County of San Francisco

by the

San Francisco Budget and Legislative Analyst

April 3, 2017

BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST

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April 3, 2017

Supervisor Jane Kim, Chair, Government Audit and Oversight Committee
Supervisor Aaron Peskin, Co-Chair, Government Audit and Oversight Committee
and Members of the San Francisco Board of Supervisors
Room 244, City Hall
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4689

Dear Supervisor Kim, Supervisor Peskin, and Members of the Board of Supervisors:

The Budget and Legislative Analyst is pleased to submit this *Performance Audit of the San Francisco Real Estate Division.* In response to a motion adopted by the Board of Supervisors on May 17, 2016 (Motion No. 16-063), the Budget and Legislative Analyst conducted this performance audit, pursuant to the Board of Supervisors powers of inquiry as defined in Charter Section 16.114 and in accordance with U.S. Government Accountability Office (GAO) standards, as detailed in the Introduction to the report.

The performance audit contains four findings and seven recommendations directed primarily to the Director of Real Estate. The Executive Summary, which follows this transmittal letter, summarizes the Budget and Legislative Analyst's findings and recommendations.

The Director of Real Estate has provided a written response to our performance audit, which is attached to this report, beginning on page 30.

We would like to thank the Director of Real Estate and his staff for the assistance they provided.

Respectfully submitted,

Severin Campbell, Director
Budget and Legislative Analyst's Office

cc: President Breed
Supervisor Cohen
Supervisor Farrell
Supervisor Fewer
Supervisor Ronen
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City Administrator
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Director of Real Estate

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Executive Summary

The City's Administrative Code defines the responsibility of the Director of Real Estate in leasing, selling and buying real property, including requirements for appraisals. The City's Real Estate Division within the Department of Administrative Services is responsible for transactions involving the City's General Fund departments' properties (both leased and owned).

The real estate function of the City government must operate in a market dominated by private industry that is not subject to public disclosure and approval of property transactions. In contrast to private real estate companies, which rely on confidential or proprietary information to price assets, the City's Real Estate Division must report to and gain approval from the Board of Supervisors for property transactions. While the public approval process can delay property transactions or potentially reduce the negotiated price, the public process is intended to protect the public interest.

The City does not have a sufficient process to plan for space needs over the long term

The Real Estate Division is responsible for managing the City's General Fund properties: in its consulting role to City departments, the Division can only recommend, but not require, certain steps or decisions in real estate transactions. The space needs of City departments tend to be managed on an individual case-by-case basis. While the Director of Real Estate has convened working groups to collaborate on real estate needs, no formal process exists to reorganize, relocate or co-locate City programs and services in order to reduce the high costs to the City of leasing private property in San Francisco's real estate market.

For example, because the City has no formal planning process to co-locate City programs, City will incur costs of approximately $1.3 million in FY 2016-17 for leases of two separate properties, less than 0.25 mile from each other, in which the Sheriff's Department and the Adult Probation Department each provide programs to offenders, ex-offenders, and probationers offered by the same non-profit organizations. Also, in the absence of a long-term plan, the Human Services Agency was unable to identify alternative locations for essential Medi-Cal eligibility services when the lease came up for renewal, resulting in a tripling of rent from $1.2 million in FY 2016-17 to $3.6 million in FY 2017-18.

Recommendation 1: The Director of Real Estate should work with the Director of Capital Planning on Administrative Code recommendations for a long-term planning process that:

(a) defines the respective roles of Real Estate and Capital Planning, including appointing the Director of Real Estate to the Capital Planning Committee;

(b) aligns this long term planning process with the City's capital and financial plans; and

(c) establishes criteria and priorities for use of leased and City-owned properties.

The City needs to develop a long-term plan for growth in space needs to accommodate General Fund programs and services, which should focus on placing essential City services in City-owned buildings to reduce the risk of displacement.

Current asset management systems are inadequate and underused

Recommendation 2: The Director of Real Estate should collaborate with the Capital Planning Program to build on the reporting capabilities of the Facility System of Record to incorporate information relevant to long-term planning.

Long term planning for the City's space needs will be hampered by the inadequacy of the Real Estate Division's asset management system, resulting in insufficient information on the condition and utilization of the City's existing properties. The Real Estate Division does not currently have sufficient tools for asset management planning at the portfolio level and must rely on institutional knowledge of property conditions and needs. The existing Real Estate Information System (REIS) has missing or inaccurate values and does not contain information about the physical condition of facilities under the jurisdiction of City departments. In addition, the Capital Planning Programs' facilities tracking database (Facility Resource Renewal Model or FRRM) is outdated and rarely used by Real Estate Division real property officers. The Capital Planning Program is in the process of replacing the REIS with the Facility System of Record, which will consolidate facility data from the REIS, FRRM and other sources. The Facility System of Record, which is intended to solve current data integrity issues, will not be owned by the Real Estate Division, and will not provide a portfolio-level view of facility conditions. Information about facility geography, uses, and capital needs will still need to be manually compiled in a report at the facility rather than portfolio level.

The Real Estate Division's role includes accommodating the City's public processes in a competitive private market

Recommendation 3: The Director of Real Estate should consult with the President of the Board of Supervisors to (a) identify potential policy priorities, and (b) incorporate these policy priorities into property purchases and sales.

The City's goals in property transactions are not always the same as a private buyer's or seller's goals. While private property transactions prioritize the financial components of a sale or purchase, public property transactions may prioritize policy goals. If these policy goals are not sufficiently identified, property transactions may not be approved. For example, the Board of Supervisors did not approve the sale of 30 Van Ness Avenue to a private buyer largely because the potential residential development of 30 Van Ness Avenue did not include the percentage of affordable housing that the Board of Supervisors wanted to be included.

The Real Estate Division is assuming property development responsibilities beyond its traditional role

Recommendation 4: The Real Estate Division should establish written protocols on the respective roles of the Real Estate Division, Public Works, and other agencies.

The Real Estate Division has recently assumed responsibility for complex development of City property under its jurisdiction. According to the Director of Real Estate, this follows a national trend in which public works functions are part of the real estate function, and the combined real estate/public works function assume a lead role in public-private development. However, in San Francisco, the real estate function and public works function are separate, requiring a formal definition of roles and responsibilities in project oversight. The Real Estate Division needs to ensure that Public Works is brought early into the development process. According to the Director of Real Estate, for the public-private development of 1500 Mission Street, the Real Estate Division brought Public Works into the process earlier in the design phase than in the Central Shops Project and executed a Memorandum of Understanding (MOU) to clarify roles, responsibilities, funding requirements, and accountability.

The Real Estate Division relies on the institutional knowledge of its real property officers

Recommendation 5: The Director of Real Estate should assign real property officers to team together on lease and purchase or sale transactions where a less-experienced agent lacks expertise.

Experienced agents rely on institutional knowledge and informal relationships with industry contacts for market information, which presents a risk to the City upon retirement or resignation of experienced staff. Transactions agents tend to be assigned projects based on their experience with particular departments and their unique needs. Individual agents also tend to be involved in the entire life cycle of a project, from identifying sites and negotiating terms to exercising options to extend leases. The Real Estate Division should encourage agents to team on projects outside of their area of expertise to promote overlap in areas of expertise and increase the resiliency of the Transactions team.

The City does not have a policy for the use of public property for non-governmental uses

Recommendation 6: The Director of Real Estate should recommend policies on (1) uses of City property other than those that are determined to be highest and best use or for government purposes; and (2) non-profit leases of City property as part of the recommended long-term planning process.

The City does not have an explicit policy for best use of City property for non- government purposes. Current non-City uses on City property include: cafés, storage, smog testing, construction staging sites, a theatre, a drug store, a bank, and an optometry office. In some instances the City is limited in its ability to change uses since some leases were inherited as part of the site acquisition.

Some City-owned properties, such as the gas station in Twin Peaks and the beer garden in Market Octavia, are zoned for housing or mixed development, which is a higher value use than the current use.

A large number of City-owned properties are leased by non-profit organizations with varying lease terms and rents. Our review of existing leases found 17 non-profit leases that paid no or nominal rent, while another 11 non-profit leases paid rent ranging from $5,820 to $84,432 per year, depending on the size of the space. The City does not have standards on subsidizing the rents of non-profit organizations.

The City does not have consistent standards for cell sites on City-owned property

Recommendation 7: The Director of Real Estate should establish a rate sheet for cellular site leases on buildings housing General Fund departments.

The Real Estate Division, as well as the City's enterprise departments, has leases for cell sites with various providers. None of the leases have standardized lease rates. The Real Estate Division currently holds seven leases with private companies, three of which were negotiated within the last five years. The monthly rental rate varies, from the lowest of $2,724 per month for a lease with T-Mobile, to the highest of $5,800 per month for a lease with Sprint Spectrum. The variation remains even when taking into account expected price differentials based on the lease initiation dates. In fact, two leases negotiated in 2002 have significantly higher monthly rental rates than others negotiated more recently.

Introduction

The Board of Supervisors directed the Budget and Legislative Analyst's Office to conduct a performance audit of the Real Estate Division through a motion (M16-063) passed on May 17, 2016.

Scope

The scope of this performance audit includes: (1) planning for the City's property needs; (2) purchase, sale, and lease transactions managed by the Real Estate Division over the past three fiscal years; (3) the status of active leases; (4) uses of City property; and (5) a review of industry standards and practices to implement other successful strategies related to publicly-owned real property.

The City Services Auditor is currently conducting an audit of City-wide facilities maintenance, so facilities maintenance functions were not included in the scope of this performance audit.

Methodology

The performance audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS), 2011 Revision, issued by the Comptroller General of the United States, U.S. Government Accountability Office. In accordance with these requirements and standard performance audit practices, we performed the following performance audit procedures:

- Conducted interviews with executive, management, and other staff at the Real Estate Division of the City Administrator's Office, and a sample of client departments.
- Reviewed purchase/sale and lease files for presence of fair market value determinations and other data pertinent to audit objectives.
- Conducted a literature review and interviews with representatives of other city real estate departments to identify best practices in public real estate functions.
- Submitted a draft report, with findings and recommendations, to the Real Estate Division on February 22, 2017; and conducted an exit conference with the Real Estate Division on March 8, 2017.
- Submitted the final draft report, incorporating comments and information provided in the exit conference, to Real Estate Division on March 15, 2017.

Functions of the Real Estate Division

Functions of the Real Estate Division include: (1) property transactions, (2) facilities management, (3) custodial services, (4) stationary engineer and building trade services, (5) farmers and flea markets, and (6) technical services. Prior to a functional reorganization in 2008, the Real Estate Division was only responsible for property transactions and the other functions were administered by other City entities, including the Department of Public Works, War Memorial, and City Hall under the City Administrator.

Property Transactions

The Real Estate Division's Transactions group has a staff of five and is responsible for real estate transactions, mostly for the City's General Fund departments, including the acquisition of real property required for City purposes, the sale of surplus real property owned by the City, and the leasing of City property to outside tenants, and leasing of property owned by private owners or other public agencies, as needed for City programs. The Transactions group also completes market value appraisals, or contracts with third party appraisers, for property transactions.

Facilities Management

The Facilities Management group with approximately 35 staff is generally responsible for providing property management services at City-owned buildings including City Hall, 1 South Van Ness Avenue, 25 Van Ness Avenue, 30 Van Ness Avenue, 1640 - 1680 Mission Street, the Hall of Justice (850 Bryant Street), and 555 7th Street. Property management involves handling the day-to-day activities and functions of a particular real estate asset or campus of assets (i.e., the Civic Center and Public Safety campuses), including maintenance and repairs, property inspections, occupant interactions, and timely and professional delivery of engineering, custodial, security, pest management, and waste management services.

Custodial Services

The Real Estate Division employs over 143 staff that provides custodial services to 53 facilities.

Stationary Engineers and Building Trades

The Real Estate Division provides stationary engineer and building trade services to about 50 facilities with a staff of approximately 63 stationary engineers, electricians, plumbers, painter, carpenters, and laborers. Stationary engineers are responsible for monitoring long-term maintenance needs of the City's assets through the Computerized Maintenance Management System (CMMS).

Markets

The Real Estate Division manages the day-to-day and long-term operations of the Alemany Farmers' Market and the Alemany Flea Market held at 100 Alemany

Boulevard, the UN Gift Gallery at UN Plaza, and the UN Plaza Mobile Food Truck events.

Technical Services

The Technical Services group operates and maintains City Hall's television broadcast and building security systems, provides audio engineering for civic functions, and audio/visual support to for gatherings in City Hall hearing rooms and as needed at off-site locations. The Technical Services group also maintains drawings of City-owned buildings and leased spaces, administers the CMMS, and maintains the building access system for City-occupied facilities.

As noted above, the City Services Auditor is currently conducting a separate audit of facilities maintenance, so the scope of this performance audit is limited to the Transactions group.

Budget Structure of the Real Estate Division

The Real Estate Division uses an aggregate rent model to charge client departments that occupy City-owned buildings. Client departments are charged for facilities maintenance costs at City-owned buildings depending on the number of staff assigned to the building and the amount of space a department occupies in the building. Fire life safety and elevator contracts are charged to the building based on the cost of the contract. Before the Real Estate Division shifted to the aggregate rent model in FY 2007-08, departments paid rent partially based on the debt owed on the building and other factors.

The budget for each building owned by the Real Estate Division is broken down with line items for property rent, building maintenance services, building maintenance supplies, facilities management, and utilities. The Real Estate Division receives payment from client departments through work order recoveries.

Summary of the City's Real Estate Portfolio

The City owns approximately 1,100 buildings located within City limits or in seven outside counties. The City owns approximately 2,000 parcels within City limits totaling approximately 6,000 acres. The Real Estate Division maintains approximately 100 leases of public property to private entities as well as approximately 100 leases of private property for public purposes.

Authority of the Director of Real Estate

The authority of the Director of Real Estate, who is the head of the Real Estate Division, is primarily outlined in Chapter 23 of the City's Administrative Code. In general, the Director of Real Estate is responsible for:

1. Purchase or sale of any real property owned by the City.
2. Determining the fair market value of property for purchase or sale.
    a. If the value of the property exceeds $10,000, an appraisal is required.
    b. If the value is more than $200,000, an appraisal and appraisal review is required.
3. Receiving payment in connection with negotiating leases or purchase/sale, managing City property, consulting with departments, or other interdepartmental work.
4. Summarizing, maintaining, and presenting information on the physical condition and current utilization of City property in an Annual Real Property and Facility Report, which includes a Real Estate Asset Management Plan for the upcoming fiscal year.

City departments are supposed to report to the Director of Real Estate annually about the physical condition and current utilization of real property and facilities under their jurisdiction.

Other Administrative Code provisions further outline the responsibilities of the Director of Real Estate in property transactions and oversight of public properties, including the City's Plaza Program.

Fair Market Determinations and Appraisals

The Board of Supervisors amended the City's Administrative Code in July 2016 requiring the Director of Real Estate to determine the fair market value of property for purchase or sale or for lease. An appraisal report is required if the value of the property exceeds $10,000 or the fair market value of the lease exceeds $45 per square foot per year.

Fair Market Determinations

The Real Estate Division determines fair market rent for its transactions through analyzing market information obtained by a combination of industry contacts and data sources, such as quarterly and annual reports from brokerage firms and various real estate professional associations.

The Budget and Legislative Analyst's Office conducted a file review of 36 recent City lease transactions. These transactions included the City as landlord and the City as tenant. Of this sample review, we found that all transactions files provided documentation of the fair market value determination, whether determined by industry contacts or other data sources. We also found the final negotiated price for the sample lease transactions was either within or below the range (in which the City was tenant) of the comparable properties analyzed.

Appraisals

A review of 22 purchase and sale transactions completed since the beginning of Fiscal Year (FY) 2013-14 showed that the Real Estate Division obtained an appraisal for every property valued over $10,000 with two exceptions: 1) the sale of Parcel P on Octavia Boulevard in August 2013; and 2) the purchases of 555 Selby Street and 1975 Galvez Avenue in February 2016.

In the case of Parcel P, the Board of Supervisors approved an ordinance in May 2009 that authorized the Director of Real Estate to sell 12 City-owned properties located along the former Central Freeway right-of-way (now known as Octavia Boulevard) without requiring subsequent Board of Supervisors approval for a sale price at or higher than the fair market value at the time of signing the Purchase and Sale Agreement (Ord No. 104-09). The City signed a Purchase and Sale Agreement with the buyer of Parcel P in December 2010 for a price of $9,250,000. In August 2013, the Director of Real Estate notified the Board of Supervisors of the closing of the sale of Parcel P for $187 per square foot and provided comparable sales data from 2010 that ranged from $170 to $196 per square foot.

The 555 Selby Street and 1975 Galvez Avenue properties were purchased in February 2016 for the relocation of the General Services Agency's Central Shops, currently located at 1800 Jerrold Avenue. Instead of obtaining appraisal reports, the Director of Real Estate determined that the purchase price for each property was comparable to the sales prices of other industrial properties.[1]

Lease Management

The Real Estate Division currently manages 215 active leases for various City departments. The City is the tenant in a privately-owned building for 117 of the leases, and the landlord, where Real Estate manages leases for uses inside City-owned buildings, for 98 of these leases. In general, the Real Estate Division is managing the City's leases adequately. Their files are complete and well organized, making it easy to find information about lease transactions within their current structure.

[1] In February 2016, the City purchased 555 Selby Street for $6,300,000, or $87 per square foot, and 1975 Galvez Avenue for $5,000,000, or $103 per square foot. According to the Director of Real Estate, comparable sales prices ranged from $57 per square foot to $96 per square foot. Although the price per square foot of 1975 Galvez Avenue of $103 exceeded this range, the Director of Real Estate considered the price to be reasonable because (1) typically, smaller properties such as the Galvez property, sell for more on a per square foot basis, and (2) the Galvez property had fewer improvements to demolish and a cleaner environmental condition than similar properties in the area.

The Budget and Legislative Analyst audit staff conducted an in-depth review of a sample of 36 leases where the City was either the tenant or landlord. The sample included a review of:

- Lease status (current, holdover, or expired)
- Fair market value determination compared to final lease rental rate
- Competitive process (if applicable)
- Cost of tenant improvements
- Tenant insurance (City as Landlord only)

Fair Market Value Determination

Of this sample review, audit staff found that all transactions files provided documentation of the fair market value determination, and the final negotiated rental rate was either within or below the range of the comparable properties analyzed.

Expired and Holdover Leases

When the City is a tenant in a lease with a private landlord, expired or holdover leases can expose the City to unnecessary risk including increased holdover rents or the threat of eviction, which could potentially disrupt City services. In addition, increased holdover rents are often not accounted for in a City department's budget.

Terms of expired or holdover leases must be approved retroactively when they are eventually agreed upon between the City and the other party. Retroactive approval of leases poses risk because it is possible that a City approving body, such as the Board of Supervisors or a department's commission, would not approve the retroactive lease. In that case, there is no time to renegotiate the terms under the original conditions as there would be in a timely renewal, and the City would remain in an uncertain state between the terms of the old and new lease.

We found two instances of expired leases where the City is the tenant in a privately-owned building. In our review of expired and holdover leases, the cause for these leases generally seemed to be unsettled negotiations between the City and the private landlord that continue for extended periods of time, rather than neglect by the Real Estate Division.

The Real Estate Division should prioritize negotiating all expired or holdover leases between the City and private entities in order to mitigate risk to the provision of City services, and avoid complications that could arise during retroactive lease approval.

Temporary Parking Lot Leases on City-Owned Property

Over the past few years, the City has entered into leases with privately-owned companies to provide parking on City-owned properties for temporary or interim uses. Most parking lots and garages on City property are under the jurisdiction of the San Francisco Municipal Transportation Agency (SFMTA), which is currently evaluating the best use of this property, including non-parking uses.[2]

The three privately-run surface parking lots listed in Exhibit 1 below, which are not under the jurisdiction of SFMTA, have future development plans including affordable housing and the future site of a park, and are ripe for interim revenue-generating parking uses.

Exhibit 1: Recent Surface Parking Lot Leases on City-owned Property

Tenant	Dept.	Address	Start Date	End Date	Square Feet	Monthly Rent
West Coast Parking	MOHCD	Broadway & Davis	1/1/1995	Month-to-month	10,656	$8,498
Tower Valet Parking, Inc.	SFMTA*	Grove & Gough	4/24/2003	Month-to-month	11,279	$5,120
Imperial Parking	Real Estate	17th & Folsom	7/1/2013	12/31/2017	545	Net Revenue[3]

Source: Real Estate Information System

*Revenues for this parking lot accrue to SFMTA, but the lease is managed by the Real Estate Division.

However, as shown in the exhibit above, the parking lot at Broadway & Davis has been considered an interim temporary parking lot for 22 years, and the parking lot at Grove & Gough for 14 years. Holding land for this long should no longer be considered temporary, and other uses for the site should be considered.

For example, the City currently operates a temporary homeless shelter on a vacant lot slated for future development in the Mission District while the developer goes through the entitlement process. A similar temporary development should be considered for these sites given the length of time the sites expect to be vacant, and the critical need for new homeless shelter beds in the City.

Public Function Operating in a Private Market

The real estate function of the City government is unique as it must operate in a market dominated by private industry that is not subject to public disclosure and

[2] The City originally began developing public parking garages and parking lots in the 1950s to support stores, restaurants, and other commercial activity. The City has since that time adopted "transit first" policies, in which public transit is preferred to the use of cars, thus reducing the need for public parking.

[3] Most privately-leased parking facilities on City property operate under management agreements, which do not have set monthly rental amounts. Rather, the contractor pays to the City net revenue after deducting all expenses. Management agreements are awarded through a Request for Proposal (RFP) process every five to six years. In addition, the City pays the contractor a management fee of $450 per month to perform these duties. According to the City Administrator's Office, the parking lots earn the City approximately $8,000 to $20,000 each per month.

approval of property transactions. In the private real estate industry, most companies rely on confidential or proprietary information to price assets. Brokers often conduct negotiations over the phone or in person with little documentation of processes.

As a City entity, the Real Estate Division is required to be more transparent in its pricing determinations and documentation practices in order to protect public assets and assure citizens that public assets are purchased, utilized, or disposed in a way that protects the public interest. However, public transparency can potentially put the City at a disadvantage in negotiating real estate transactions involving private landlords or tenants.

In addition, the private real estate market operates at a much quicker pace than the City's public real estate process. Public real estate transactions often must go through multiple levels of approval, which can extend transaction timelines much longer than would be seen in the private market.

While the public transparency requirements and lengthy timelines can have their drawbacks, engaging in real estate transactions with a City entity includes several advantages to private real estate entities as well, including a guaranteed source of rental income and long lease terms from a stable tenant, or access to high-value public properties through leasing or purchase.

Acknowledgements

We would like to thank the staff of the Real Estate Division for their assistance during this audit process.

1 Long-Term Planning for the City's Space Needs

The City does not have a process to plan comprehensively for space needs over the long term. The Real Estate Division is responsible for managing the City's General Fund properties; in its consulting role to City departments, the Division can only recommend, but not require, certain steps or decisions in real estate transactions. The space needs of City departments tend to be managed on an individual case-by-case basis. While the Director of Real Estate has convened working groups to collaborate on real estate needs, no formal process exists to reorganize, relocate or co-locate City programs and services in order to reduce the high costs to the City of leasing private property in San Francisco's real estate market.

The City needs to develop a long-term plan for growth in space needs to accommodate General Fund programs and services, which should focus on placing essential City services in City-owned buildings to reduce the risk of displacement.

The City does not have a sufficient process to plan for space needs over the long term

Planning for the City's space needs over the long term is not well defined. The City's Administrative Code requires the Director of Real Estate to summarize and maintain information about the physical condition and current utilization of the City's General Fund facilities in an annual report, which includes a real estate asset management plan for the upcoming fiscal year. The existing real estate databases are insufficient for assessing the physical condition and utilization of City facilities, as discussed in *Section 2, Asset Management* of this report, and the Real Estate Division is not currently preparing a Real Estate Asset Management Plan. The Real Estate Division last published an annual report in 2014, but the document does not include an inventory of the physical condition or utilization of facilities.

The space needs of City departments tend to be managed on an individual case-by-case basis as requests are made. The Mayor's Office reaches out to the Real Estate Division to notify them about costs associated with space needs to be included in the City's budget, but the Real Estate Division does not always receive advanced notice from client departments. While some departments that have in-house facilities staff coordinate with the Real Estate Division, departments without facilities staff do not always notify Real Estate Division staff before engaging with brokers.

Long-term planning requests and decisions are coordinated through the Capital Planning Program and are reviewed by the Capital Planning Committee, which reviews new debt as part of the two-year update to the City's 10-Year Capital Plan. The Director of Real Estate meets regularly with the Director of Capital Planning, but does not have a seat on the Committee. The Capital Planning Committee is rarely involved in building sales or leases. The Capital Planning Committee is primarily involved in rehabilitation of existing City properties or development of new properties that require debt financing.

If funding is available in the annual budget, there is limited oversight and scrutiny of real estate requests. With some recent exceptions such as the development of 1500 Mission Street, in which the Real Estate Division is coordinating the development of a new City office building to house several City departments, departments do not coordinate on long-term space needs. The Director of Real Estate lacks authority to deny or curtail departmental requests. As a result, the real estate expertise of the Director of Real Estate and other Real Estate Division staff is routinely underutilized or dismissed by departments with the budget to exceed Real Estate Division recommendations.

City Real Estate Working Groups

The Director of Real Estate convenes three working groups to discuss the City's real estate needs. The first is a "Brainstorming Group" consisting of staff from the Controller's Office, Mayor's Budget Office, and the Capital Planning Committee that meets quarterly to discuss City-wide real estate needs.

The second consists of staff from: San Francisco Unified School District, Office of Economic and Workforce Development, Recreation and Park Department, Human Services Agency, Department of Public Health, Office of Community Infrastructure and Investment, and the SF Municipal Transportation Agency. This group meets monthly to review space planning and execution status.

The third group consists primarily of staff from the Capital Planning Committee and the Department of Public Works.

While these groups informally provide opportunities for collaboration and information sharing across departments, little formal processes exist to coordinate City departments' space needs or engage in longer range space planning for City departments as a whole.

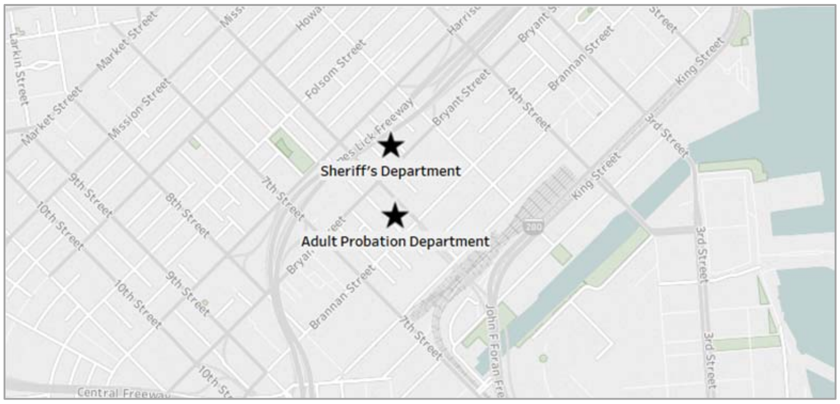
Risks and Inefficiencies in the Absence of Long Term Planning

The City's largely decentralized processes for space planning can be inefficient. As shown in the examples below, the City's current processes are not sufficient to consolidate City departments' programs into shared space, maximize use of City-owned space, or plan for essential City services to occupy City-owned space to minimize exposure to market rents or reduce extensive City-financed tenant improvements to private property.

Consolidation of Shared Space for Similar Programs and Uses

Both the Sheriff's Department and Adult Probation Department provide respective re-entry programs and services carried out by the non-profit organizations Five Keys Charter School and Leaders in Community Alternatives to current offenders in and ex-offenders released from the County Jails as well as probationers. These services are provided at two separate properties leased from private property owners (70 Oak Grove Street leased by the Sheriff's Department and 564 6th Street leased by the Adult Probation Department) which are less than 0.25 mile away from one another as shown in Exhibit 2 below. The City will incur General Fund costs of approximately $1.3 million in FY 2016-17 for these two leases, which will increase annually.

Exhibit 2: Location of Adult Probation & Sheriff's Departments' Reentry Programs



The Budget and Legislative Analyst previously recommended consolidating these two programs into one space in 2014 (when the Sheriff's Department's lease for 70 Oak Grove came up for renewal) and in 2016 (when the Adult Probation Department's lease for 564 6th Street came up for renewal). In both instances, the Director of Real Estate or the Director of Capital Planning stated that the ongoing planning for a new Sheriff's Department facilities master plan would consider space for program needs. However, the facilities master plan continues to be delayed because replacement of the County Jails in the Hall of Justice and relocation of City departments from the Hall of Justice have not been determined.

In the interim, the Budget and Legislative Analyst recommended in 2016 that the Capital Planning Committee evaluate alternatives to the Adult Probation Department's long-term lease for 564 6th Street and 70 Oak Grove as part of the evaluation of the Sheriff's Department's and Adult Probation Department's space needs, and incorporate these alternatives into the City's 10-Year Capital Plan.

Underutilization of City-Owned Property

The City owns a building at 2789 25th Street adjacent to Potrero Avenue that was originally planned to house emergency medical services when these services were under the jurisdiction of the Department of Public Health. To obtain an "essential services" rating for 2789 25th Street to house emergency medical services, the City invested in extensive seismic upgrades to the building to meet the California State Essential Services Building Code.

However, in 1997, the City decided to transfer emergency medical services to the San Francisco Fire Department, relocating emergency medical services to Fire

Department facilities. As a result, the building at 2789 25^{th} Street was no longer needed for emergency medical services.

The building is now underutilized by the City given its above-code seismic safety reliability. It is currently used for a variety of public health offices including: the University of California, San Francisco (UCSF) Center for Vulnerable Populations, San Francisco General Hospital Foundation, and Department of Public Health offices, among others.

Although the previous capital investment prior to 1997 would not fully comply with the current seismic standards for an Essential Facility, some investment has already been made, and should be accounted for in the City-wide space planning process.

Limited Property Options for Essential City Services

The City renewed a sublease in February 2017 for space in which the Human Services Agency provides eligibility services to Medi-Cal and other social service applicants. Because the Real Estate Division was unable to identify other privately-owned properties that could be used for these services, the Human Services Agency was faced with the near tripling of rent by the master tenant from $1.2 million in FY 2016-17 to $3.6 million in FY 2017-18 to remain at the same location. Over the eight-year term of the lease extension, the City will pay nearly $39 million for the leased space, of which 64 percent are General Fund costs.

In this instance, the lack of alternative locations limited the City's ability to negotiate better lease terms with the master tenant. Providing such services in privately owned buildings, in which the City has limited options for relocation, exposes the City to the risk of either displacing essential services or paying high rent.

Tenant Improvements to Private Property

Tenant improvements are common, and often necessary in order for the City to carry out its programs and services at leased sites. However, these can be costly investments into privately-owned buildings that the City may only occupy for a limited time.

For example, the Public Safety Division of the Department of Technology (DT) maintains specialized telecommunications infrastructure for law enforcement agencies and emergency responders, SFMTA, and SFPUC at a leased space at 200 Paul Avenue in the Bayview Hunters Point neighborhood. In order to accommodate the Public Safety Division's highly specialized needs, DT determined that it needed $6.1 million worth of tenant improvements at 200 Paul Avenue, of which the landlord would provide a rent credit for $0.2 million of the improvements. While the lease term could be up to 15 years, giving the City time to amortize the value of these improvements, the City is investing $5.9 million in a privately-owned property.

The Need for Long-Term Planning for City Space Needs

The City currently maintains a Five-Year Financial Plan for General Fund expenditures and a 10-Year Capital Plan for General Fund capital projects. Neither of these plans evaluates growth and changes in programs and services provided by the City's General Fund departments. Less formal plans have been developed for long-term space needs, such as the planning and implementation of the City office project at 1500 Mission Street.

The City needs to develop a long term plan for growth in space needs to accommodate General Fund programs and services. This could be a stand-alone plan, such as the SFMTA's long-term asset management strategic plan titled, the *SFMTA Real Estate and Facilities Vision for the 21st Century Report*, or incorporated into the existing financial plan or capital plan.

Recommendation 1: The Director of Real Estate should work with the Director of Capital Planning to recommend Administrative Code provisions to the Board of Supervisors for a long-term planning process for the General Fund departments' space needs that (a) defines the respective roles of Real Estate and Capital Planning in the long term planning process, including appointing the Director of Real Estate to the Capital Planning Committee; (b) aligns this long term planning process with the City's capital and financial plans; and (c) establishes criteria and priorities for leased and City-owned properties.

2 Asset Management

The Real Estate Division is responsible for maintaining the Real Estate Information System and for reporting on the physical condition and current utilization of City-owned buildings. However, current systems are inadequate and underused by Real Estate Division staff for assessing the City's property portfolio. The Capital Planning Program in the City Administrator's Office intends to launch a new facility tracking system in 2018. The Real Estate Division will need to commit to routine data input and use of the new system for it to be a useful tool for asset management planning.

Current asset management systems are inadequate and underused

Prior to 2008, the Real Estate Division had the sole function of handling the City's real estate transactions. In 2008 and 2009, facilities management, custodial services, engineering/trades, and technical services functions administered by a variety of departments such as the Department of Public Works, War Memorial, and City Hall under the City Administrator were consolidated under the Real Estate Division.

Whereas the Real Estate Division's role was previously limited to purchase, sale, and lease transactions, the Division is now responsible for asset management[1] of a large share of the City's property portfolio. Comprehensive asset management planning is inhibited by the limitations and segregation of facilities data across three databases.

Stationary engineers in the Real Estate Division are responsible for inputting data and monitoring the status of building systems in the Computerized Maintenance Management System (CMMS), which is used to manage day-to-day and preventive maintenance needs for the wide range of building systems in City facilities.

The Capital Planning Program in the City Administrator's Office administers the Facility Resource Renewal Model (FRRM), which is used to track long-term capital needs. Real Estate Division staff rarely interact with the information in the FRRM because (1) the system is difficult to use and outdated, and (2) Real Estate Division upper management do not have ownership of the system.

The Real Estate Division is responsible for maintaining the Real Estate Information System (REIS), which is a database containing the property name, address, department with jurisdiction, land and building areas, use, and vacancy status of City-owned property. A review of the REIS by the Budget and Legislative Analyst found issues with data integrity, such as: (1) missing information and blank fields for many properties; (2) records with defunct or incorrect listings for the

[1] Asset management is the process of operating, maintaining, and disposing of real property assets cost-effectively in order to maximize the allocation of scarce resources.

department with jurisdiction; and (3) inconsistent descriptions for building use. These data integrity issues make it difficult to understand the breadth of the City's property portfolio and to classify and analyze the uses on all of its properties.

The REIS does not contain information about the physical condition of facilities under the jurisdiction of City departments. As mentioned above, stationary engineers are responsible for monitoring short- and long-term maintenance needs of the City's assets through the CMMS, but the system is not suited for running reports on portfolio-wide asset management. As a result, upper management at the Real Estate Division does not currently have sufficient tools for asset management planning at the portfolio level and must rely on institutional knowledge of property conditions and needs.

The Capital Planning Program is in the process of replacing the REIS with the Facility System of Record, which will consolidate facility data from the REIS, FRRM, Assessor parcels, records maintained by the Department of Public Works and the San Francisco Public Utilities Commission, and other data into a single consistent source. According to the Director of Real Estate, the Real Estate Division and the Capital Planning Program are addressing data completeness and integrity issues with the development of the Facility System of Record. The Facility System of Record is expected to replace the REIS as an asset management tool in 2018.

The Facility System of Record, which is intended to solve current data integrity issues, will not be owned by the Real Estate Division. Reports from the Facility System of Record will be provided to Transactions staff by Real Estate Division administrative staff upon request and will not provide a portfolio-level view of facility conditions. Information about facility geography, uses, and capital needs will still need to be manually compiled in a report at the facility rather than portfolio level. The Real Estate Division should work with the Capital Planning Program to expand the reporting capabilities of the Facility System of Record to be a more effective tool for asset management planning.

Recommendation 2: The Director of Real Estate should collaborate with the Capital Planning Program to build on the reporting capabilities of the Facility System of Record to incorporate information relevant to long-term planning.

3 Combining the Public and Private Market Roles of the Real Estate Division

The City's goals in property transactions are not always the same as a private buyer's or seller's goals. The Real Estate Division needs to accommodate both the priorities of the private market and City government, which has different standards of public information and oversight.

While private real estate transactions focus on the best financial outcomes for the parties, public property transactions may include additional policy goals. Large scale property transactions can be delayed or not approved if the policy goals of the transaction are not sufficiently identified.

The Real Estate Division has recently assumed responsibility for complex development of City property under its jurisdiction. According to the Director of Real Estate, this follows a national trend in which public works functions are part of the real estate function, and the combined real estate/public works function assume a lead role in public-private development. However, in San Francisco, the real estate function and public works function are separate, requiring a formal definition of roles and responsibilities in project oversight.

Experienced agents rely on institutional knowledge and informal relationships with industry contacts for market information, which presents a risk to the City upon retirement or resignation of experienced staff.

The Real Estate Division's role includes accommodating the City's public processes in a competitive private market

The City's goals in property transactions are not always the same as a private buyer's or seller's goals. The Real Estate Division needs to accommodate both the priorities of the private market and City government, which has different standards of public information and oversight.

As an example, a private real estate broker recommended to the Real Estate Division that 30 Van Ness be sold a public auction in order for potential bidders to see that the City was serious about selling the property for private development. The legislation submitted to the Board of Supervisors by the Real Estate Division would have authorized the sale of the property at public auction without further Board approval. The priority of the Board, however, was to retain their authority to approve the final transaction, including the name of the purchaser and the purchase price.

Incorporation of the City's Policy Goals into Large Scale Transactions

While private property transactions prioritize the financial components of a sale or purchase, public property transactions may prioritize policy goals. If these policy goals are not sufficiently identified, property transactions may not be approved. For example, the Board of Supervisors did not approve the sale of 30 Van Ness Avenue to a private buyer largely because the potential residential development of 30 Van Ness Avenue did not include the percentage of affordable housing that the Board wanted to be included.

The potential residential development at 30 Van Ness Avenue called for 15 percent affordable housing on site.[1] The City would have had the right to increase the number of affordable units up to 33 percent if the City paid the developer the actual cost of constructing the additional affordable units. In the discussion at the December 8, 2015 Board of Supervisors meeting, members of the Board were concerned that the City's potential subsidy to the developer to construct additional affordable units was in an amount greater than the City's affordable housing development impact fee assessed to developers. Members of the Board also stated that the standards applied to City-owned property should be different than the standards applied to privately-owned property.[2]

In order to reduce the risk in large scale transactions, the Director of Real Estate should work with the City's elected officials to clarify any specific policy goals or requirements.

Recommendation 3: The Director of Real Estate should consult with the President of the Board of Supervisors to (a) identify potential policy priorities, and (b) incorporate these policy priorities into property purchases and sales.

The Real Estate Division is assuming property development responsibilities beyond its traditional role

The Real Estate Division has recently assumed responsibility for complex development of City property under its jurisdiction. According to the Director of Real Estate, this follows a national trend in which public works functions are part of the real estate function, and the combined real estate/public works function assume a lead role in public-private development. However, in San Francisco, the real estate function and public works function are separate, requiring a formal definition of roles and responsibilities in project oversight.

For example, the Director of Real Estate entered into a Project Delivery Agreement with the developer, Oryx Development, LLC (Oryx) in February 2016 to design and construct the Central Shops Project at a cost of $55 million.[3] The Project Delivery

[1] The proposed 15 percent on site affordable housing in the residential development at 30 Van Ness was more than the required 12 percent on site affordable housing for residential development in the Market Octavia Plan Area (which includes 30 Van Ness Avenue).

[2] In September 2016, the Real Estate Division again engaged a broker to market 30 Van Ness Avenue and is now in the process of seeking Board of Supervisors approval to sell the property for $70 million, with a 25 percent affordable housing requirement for new residential development.

[3] The City purchased two properties at 1975 Galvez Avenue and 555 Selby Street and leased one property at 450 Toland Street to relocate the General Services Agency's Central Shops from 1800 Jerrold Street, which was acquired by SFPUC from the City as

Agreement was divided into two phases: the design phase and construction phase. The agreement provided for Oryx to select the architect and general contractor to develop the project, with assistance from the Director of Real Estate in consultation with the Director of Public Works. The Board of Supervisors authorized Oryx to proceed with the design phase but required further Board of Supervisors approval prior to the construction phase if the agreement costs exceeded $55 million. Under legislations submitted to the Board of Supervisors in February 2017, the agreement costs increased to $60.2 million to account for site conditions that were not know at the time of the original agreement.

The Real Estate Division needs to ensure that Public Works is brought early into the development process. According to the Director of Real Estate, for the public-private development of 1500 Mission Street to develop City office space[4], the Real Estate Division brought Public Works into the process earlier in the design phase than in the Central Shops Project and executed a Memorandum of Understanding (MOU) to clarify roles, responsibilities, funding requirements, and accountability. The 1500 Mission Street project, which includes both property purchase and development of office space, represents a shift in the Real Estate Division's process of long-term planning for City space needs. Unique elements of the project include: (1) consolidation of multiple City departments in a single facility; and (2) public-private partnership for development of the combination of City office space, residential units, and retail space.

Recommendation 4: The Real Estate Division should establish written protocols on the respective roles of the Real Estate Division, Public Works, and other agencies.

The Real Estate Division relies on the institutional knowledge of its real property officers

The concentration of institutional knowledge with a small number of real property officers presents a risk to the City upon retirement or resignation of experienced staff. The length of tenure of the Real Estate Division's Transactions agents ranges from one year to 27 years. There are no formal training requirements for agents. Some, but not all, of the Transactions agents are licensed real estate agents, and all have some amount of private-sector real estate experience. Newer agents seek unofficial mentorship and team with more experienced staff on some large

part of the Wastewater Enterprise's Capital Improvement Program. The Board of Supervisors approved the agreement as a sole source agreement in February 2016.

[4] The project will increase City office space to accommodate growth in the Department of Public Works, Department of Planning, and Department of Building Inspection (DBI) and relocate these three departments' offices and other City department offices. Construction of the proposed project at 1500 Mission Street is expected to begin in 2017 and be completed in approximately three years. The goals of the project are to: (1) create a One-Stop Permitting Center that would improve constituent service by co-locating the DBI, Planning, and Public Works; (2) consolidate human resources-related functions to improve staff service; (3) improve the building quality and resiliency of the Civic Center portfolio; and (4) migrate from leasing to ownership.

projects. The experienced staff have detailed knowledge about the City's real estate portfolio (both owned and leased assets) and unique departmental needs, but many details are not documented.

Experienced agents also rely on informal relationships with industry contacts for market information that is not publicly available. Transactions agents frequently ask brokers to provide property value data. Brokers are encouraged to work informally with the City because landlords tend to pay their commission on City-as-tenant leasing deals.

Transactions agents tend to be assigned projects based on their experience with particular departments and their unique needs. Individual agents also tend to be involved in the entire life cycle of a project, from identifying sites and negotiating terms to exercising options to extend leases. The Real Estate Division should encourage agents to team on projects outside of their area of expertise to promote overlap in areas of expertise and increase the resiliency of the Transactions team.

Recommendation 5: The Director of Real Estate should assign real property officers to team together on lease and purchase or sale transactions where a less-experienced agent lacks expertise.

4 Standards for Non-City Uses of City Property

The City does not have an explicit policy for use of City property for non-government purposes, including temporary, revenue-generating and non-profit uses, other than the Administrative Code provision requiring surplus property to be used for affordable housing.

Without standards and criteria for non-governmental uses of City property, the City could be missing opportunities to promote development deemed to be the highest and best use, and in alignment with City priorities, on City owned land.

The City does not have a policy for the use of public property for non-governmental uses

Use of City Properties by Private Entities

The City does not have an explicit policy for use of City property for non-government purposes. Current non-City uses on City property include: cafés, storage, smog testing, construction staging sites, a theatre, a drug store, a bank, and an optometry office. In some instances the City is limited in its ability to change uses since some leases were inherited as part of the site acquisition.

The City does have a policy, codified in Administrative Code Section 23.A, to prioritize the use of surplus City property for development of affordable housing. However, the City has missed opportunities to use City property to better serve the City's policy priorities.

Twin Peaks Gas Station

For example, the City has a lease for a gas station at 598 Portola Drive, which is a non-conforming use. 598 Portola Drive has been used as the Twin Peaks gas station, convenience store, and garage since 1972. The property, which is under Department of Public Health jurisdiction and is located adjacent to the Youth Guidance Center, is currently zoned Public, which limits the permitted uses on the site.

Exhibit 3: Twin Peaks Gas Station

Source: Google Maps

In October 2015, the City awarded the existing tenant, Twin Peaks Petroleum, Inc., a new five-year lease, with one five-year option to extend through 2025, without undergoing a competitive bidding process, as is generally required by the City. The lease had expired and been on holdover since June 30, 2014.

An appraisal conducted in 2013 determined the highest and best use of the property to be residential or mixed-use commercial and residential development. This conclusion was based on the assumption that the site would be vacant and not impacted by environmental remediation.

The appraisal valued the property at $1,885,000 for a mixed-use development of up to 26 units. At the time of the lease expiration in June 2014, the City missed the opportunity to reconsider the current property's use as a gas station and pursue a mixed use development that would better conform to the City's housing goals.

Extension of the Lease for Parcel L

The City often enters into short-term leases for temporary uses on City-owned property during holding periods, where property is going through the entitlement process or being held vacant due to market conditions. Temporary uses can help to activate vacant property during this holding period, rather than having an empty lot that becomes an abandoned eyesore for the community.

Parcel L was one of 22 parcels transferred to the City from the State of California in November 2000 after the demolition of the Central Freeway in Hayes Valley. It is located on the northeast corner of Octavia Boulevard and Fell Street, and is one of the 15 parcels slated for market-rate housing. Parcel L is expected to produce approximately 15 units of housing, and is currently the only one of the 22 Central Freeway parcels being held off of the market.

In 2010, the City entered into a four-year lease (through 2014) for interim uses with Proxy Development, LLC (Proxy), a company associated with Berkeley-based architecture firm, envelope a+d. Proxy currently provides retail activities on the empty lot, including an outdoor beer garden.

Exhibit 4: Parcel L's Temporary Use as Biergarten

Source: SocketSite

The Parcel L lease for retail activities was originally supposed to end in 2014, and was initially extended for an additional year through Amendment No. 1, through November 2015. However, in September 2015, the Board of Supervisors approved a new lease through January 31, 2021, for a total lease term of 10 years and three months, or seven years longer than initially anticipated.

According to the City, Parcel L continues to be held off the market for two primary reasons: 1) to correspond to the expected development of the adjacent 100 percent affordable housing Parcel K, whose timing is set by expected City funding availability, in order to achieve balanced affordable and market-rate housing opportunities in the neighborhood; and 2) strong community support and input of the current temporary uses, which include an outdoor beer garden.

Use of City Properties by Non-Profits

The Budget and Legislative Analyst prepared a report in 2013 on policy options to prevent non-profit displacement, including the option of offering underutilized City property to non-profit organizations at subsidized rent.

The City established the Nonprofit Displacement Mitigation Program in 2014 with $4.5 million in City funding. The program evaluated the potential for the City to purchase buildings or serve as a master tenant to lease to non-profit organizations. The program, which is carried out by the Northern California Community Loan Fund, primarily focuses on providing technical assistance to non-profits including: financial planning, space planning, site evaluation, lease negotiation, project management and identification of funding sources. The final round of grant recipients was awarded funding in December 2016.

While the City currently leases space in City-owned buildings to non-profit organizations when it is not suitable for use by City departments, the City has not formalized a specific policy on leasing City-owned space to non-profit organizations that differs from leasing to for-profit tenants.

Currently the City rents some City-owned property for $0 or $1 annual base rent to non-profit agencies, and other City-owned property to non-profits at fair market value, as shown and further discussed in Exhibits 6 and 7 below.

Some non-profits are located on property that could potentially serve other public or revenue-generating uses. Other non-profits with subsidized rent 1) had planned lease renegotiations in the upcoming months due to future redevelopment (e.g., all UCSF leases at the new Zuckerberg SF General Hospital and the Little League Field on Treasure Island), or 2) were on property that could not likely find other revenue-generating tenants, including: a children's waiting room at the Hall of Justice, a garden at County Jail #5, Tenderloin National Forest located in an alley, 50 square feet of roof space for a public radio (KALW) telecommunications site, and a lot line permit.

According to Budget and Legislative Analyst staff file review, some decisions to subsidize rent for non-profit organizations were publicly made policy decisions with justifications for rent subsidies, and approved by the Board of Supervisors at the time, including: non-profits serving public benefits, cultural contributions of the non-profit, and City backfill of subsidies after a loss in federal grant funding. In addition, some instances, such as the Mexican Museum, are part of development agreements entered into by the former Redevelopment Agency, inherited by the Real Estate Division.

For other leases, there was no documented reason for the rent subsidy.

Exhibit 5: Non-Profits in City-owned Buildings with Subsidized Rents

Organization	Use	Square Feet	Annual Rent	Start Date	End Date
San Francisco Market Corporation	Wholesale Produce Market	382,000	$0.00*	5/15/1998	1/31/2073
Mexican Museum	Museum	48,000	$1.00	3/20/2015	3/19/2081
SF Convention & Visitor's Bureau	Non-profit marketing organization	4,695	$1.00	11/1/2007	Month-to-month
Marin Day Schools	Childcare	3,500	$1.00	7/1/1999	Annually self-renews
Young Community Developers	Youth social service organization	3,000	$1.00	7/1/1988	Annually self-renews
Friends & Foundation	Bookstore at Main Library	387	$1.00	7/1/2003	11/30/2017
UCSF Arthritis Research Center	Medical research lab	7,645	$1.00	3/14/1980	Month-to-month
UCSF Liver Research Center	Medical research lab	4,065	$1.00	3/14/1980	Month-to-month
509 Cultural Center	Tenderloin National Forest	3,438	$1.00	10/29/1999	10/24/2015
Center on Juvenile and Criminal Justice	HOJ Children's Waiting Room	294	$1.00	8/1/2008	Month-to-month
SFUSD	KALW Radio Site	50	$1.00	12/20/1973	Month-to-month
The Garden Project	Gardening at County Jail #5	Unknown	$1.00	11/1/1997	Month-to-month
SF Little League Field (Treasure Island)	Youth sports	Unknown	$0.00	3/17/2003	Month-to-month
	Total	**457,074**			

Source: BLA Staff File Review
* The Wholesale Produce Market lease includes a downstream fiscal participation component that could provide the City with revenue.

As shown in Exhibit 5 above, some leases were initiated as recently as 2015, whereas others were initiated as far back as 1965 under different policies and political contexts. Although some of the subsidized leases have expiration dates 60 to 70 years in the future, others including, San Francisco Convention & Visitor's Bureau, Marin Day Schools, and Young Community Developers, are on a month-to-month or annual self-renewing basis.

Unsubsidized Non-Profits

In contrast to the non-profits receiving subsidized rent above, Exhibit 7 below lists other non-profit organizations that lease 129,973 square feet of space in City-owned buildings that do not receive subsidized rent, and instead pay fair market value.

Exhibit 6: Non-Profits in City-owned Buildings Not Receiving Subsidized Rent

Organization	Use	Square Feet	Annual Rent	Lease Initiation Date	Lease Expiration Date
New Conservatory Theatre	Theatre	12,792	$84,432	12/1/2008	3/31/2016
Seneca Family of Agencies	Community and family services	2,971	$38,952	7/1/2013	6/30/2018
APA Family Support Services	Family services, counseling, and case management	6,161	$36,972	9/1/2016	8/31/2021
Faces SF	Community services, job placement	2,259	$29,628	7/1/2013	6/30/2018
Herbst Foundation	Office	1,158	$26,424	9/27/2001	Month-to-month
Family Services Agency of San Francisco	Community and family services, storage	1,506	$20,976	7/1/2013	6/30/2018
APA Family Support Services	Family services, counseling, and case management	9,300	$19,668	5/1/2013	4/30/2018
Activate S.F. Events	Community art events at the Mint	92,000	$15,500	11/1/2015	Month-to-month
Sheriff's Five Keys Charter School	Adult Education	899	$11,784	8/1/2013	7/31/2018
APA Family Support Services	Family services, counseling, and case management	483	$6,144	9/1/2013	8/31/2018
Sojourner Truth Foster Family Agency	Community and family services	444	$5,820	7/1/2013	6/30/2018
	Total	**129,973**	**$296,300**		

Source: BLA Staff File Review

Subsidizing rent for non-profits is not a widespread issue City-wide, given that it only occurs in a small portion of the total portfolio of leases. However, the disparity between non-profits receiving subsidized rent and those paying fair market value exposes a lack of standards in rental subsidies provided.

The justifications for subsidized rent discussed above such as serving public benefits and providing cultural contributions could also describe other non-profits leasing City-owned space that pay full market rate.

While certain department commissions including SFPUC, Recreation and Park, Port and SFMTA, have the ability to set rental rates less than market rate for public purposes, the Board of Supervisors must still determine by resolution that the subsidized rent furthers a public purpose. This policy only applies to those departments governed by the commissions mentioned above.

Policies for Subsidizing Non-Profit Rents

While City agencies and the Board of Supervisors can make policy decisions to provide subsidies to non-profits if they choose, there should be clear and equitable policies setting forth the terms and conditions of how non-profits could qualify for such subsidies under specific circumstances. Currently, no such policy exists.

Grubb Ellis, a national commercial real estate firm developed a report evaluating best practices for real estate departments using the City of San Diego as a case study. The report suggested that any non-profit seeking reduced rent should develop a business case for the subsidy that adheres to criteria in an established City policy. Any City leasing policy should include the following criteria:

- The non-profit organization can deliver services cheaper than if provided by the City;
- The location is appropriate and the non-profit could not provide services at a less desirable property; and
- If a non-profit does not alleviate the burden of the City to provide services, any discounted rent is a subsidy, and should be considered as such under the City's policy on subsidizing non-profit organizations, rather than a policy on leasing at below market rates.

Non-Profit Portfolio Review

In addition, the Grub Ellis report suggests that real estate departments conduct a review and summary of their non-profit portfolio to understand the extent of their subsidies. Key suggested steps include:

- Aggregate the value of properties leased to non-profits
- Quantify the difference between market rent and actual rent paid
- Aggregate the value of City costs alleviated by tenants
- Measure services provided by the non-profit, compared to how much it would cost the City to provide similar services

Once a city has taken these steps and understands the extent of its non-profit portfolio including any subsidies, the City should review their non-profit leases for renegotiating opportunities, including leases with upcoming expirations, leases on holdover, and any month-to-month leases.

> **Recommendation 6:** The Director of Real Estate should recommend policies to the Board of Supervisors on (1) uses of City property other than those that are determined to be highest and best use or for government purposes; and (2) non-profit leases of City property, including criteria for subsidizing such leases; as part of the recommended long-term planning process for the City General Fund departments' space needs, which includes establishing criteria and priorities for use of leased and City-owned properties.

The City does not have consistent standards for cell sites on City-owned property

Private cellular telecommunications carriers lease small sites on rooftops of City-owned buildings for equipment that allows them to provide cellular service to its customers. The Real Estate Division currently holds seven leases with private companies, three of which were negotiated within the last five years, as shown in Exhibit 7 below.

Exhibit 7: City Leases for Cellular Telecommunications Sites

Tenant	Dept.	Address	Start Date	End Date	Monthly Rent
A T & T	HSA	260 Golden Gate Ave	6/1/1996	5/31/2011 (holdover)	$2,785
Metro PCS	Fire	1000 Ocean Ave	2/25/2002	2/24/9999	$4,538
T-Mobile	Fire	2155 18th St	2/25/2002	2/24/9999	$4,348
A T & T	DPH	375 Laguna Honda	4/1/2012	3/31/2017	$2,783
T-Mobile	Fire	720 Moscow St	6/5/2012	6/4/2017	$3,945
T-Mobile	Fire	11 Phelan Ave	7/1/2012	6/30/2017	$2,724
Sprint Spectrum	ZSFGH	887 Potrero St	2/8/2016	2/7/2021	$5,800

Source: REIS

The monthly rental rate varies, from the lowest of $2,724 per month for a lease with T-Mobile, to the highest of $5,800 per month for a lease with Sprint Spectrum. The variation remains even when taking into account expected price differentials based on the lease initiation dates. In fact, two leases negotiated in 2002 have significantly higher monthly rental rates than others negotiated more recently.

Enterprise Departments

The list shown in Exhibit 5 above does not include any cellular site leases held by enterprise departments (San Francisco Municipal Transportation Agency, Port, San Francisco Public Utilities Commission, and the Airport), which have jurisdiction over their own property. As a result, each enterprise department can negotiate separately with telecommunications companies for use of cell site space on their properties in addition to the leases for non-enterprise departments negotiated by the Real Estate Division.

Decentralized leasing practices across departments can undermine the City's negotiating power, as private telecommunications companies might expect similar lease rates throughout the City, regardless of which department they are working with.

SFMTA Cellular Site Lease Rate Sheet Model

In order to coordinate celluar site lease pricing across SFMTA buildings, the SFMTA, in coordination with the Real Estate Division, recently adopted a rate sheet that includes minimum and maximum rates for sites depending on demand for the particular location. A similar rate sheet model cellular site leases for City buildings housing General Fund departments should be considered and coordinated by the Real Estate Division.

Recommendation 7: The Director of Real Estate, in coordination with enterprise departments, should establish a rate sheet for cellular site leases on buildings housing General Fund departments to provide a consistent and predictable pricing model across telecommunications infrastructure in the City.

Conclusion

The City is exposed to San Francisco's high cost property market through leases and purchases of properties for City use. While individual leases and purchases of properties for City use are generally negotiated at or below market rate, the Real Estate Division does not have control over the timing of transactions resulting in some purchases and leases being negotiated at the top of the market. Because the City has some essential services housed in leased space, the City is also vulnerable to incurring high long-term costs if a lease comes up for renewal during a peak period in the market.

Although there are administrative costs associated with an expanded effort towards asset management and long-term planning for the City space needs, there is great potential for cost savings from avoiding costly leases at the height of the market or consolidating essential services in owned properties.

List of Accomplishments and Written Response from the Real Estate Division

Real Estate Division Accomplishments

FY17 Midyear:

Transactions

- Acquired four properties -- 490 South Van Ness, 1036 Mission, 1101 Connecticut, 101 Hyde -- for development of affordable housing.
- Facilitated land transfers between SFPW and SFPUC in and around DPW Corporate Yard.
- Executed lease for 202 Paul Avenue for DT Public Safety relocation from 1800 Jerrold.
- Facilitated Request for Proposals for historic Onondaga property.

Property Management

- HOJ: Relocated District Attorney's Office into newly updated and improved space on 4th floor and completed a door replacement project for two elevators.
- Unity Plaza: Assisted with opening and managing the plaza.
- 30 Van Ness: Made considerable progress improving working conditions, including a replacement of two chiller units.

FY16 Year-End:

Transactions

- Acquired easements for PUC's Groundwater Storage and Recovery Project in the City and San Mateo County.
- Acquired two properties and executed one lease for relocation of Central Shops.
- Facilitated vacation and sale of portions of Jessie Street and Elim Alley for Oceanwide Center Project, generating over $22M in General Fund revenue.
- Facilitated land transfers for Daggett and Unity Plazas.
- Secured Board approval of several City department tenant leases, including 1360 Mission, and Opera Plaza for Human Services Agency.
- Secured Board approved lease for existing homeless service and drop-in center in the Bayview.
- Secured Board approval for two Options to Ground Leases for no cost.
- Facilitated Request for Proposals for historic Fillmore Heritage Center property.
- Facilitated filming projects through lease and sublease authority including the HULU series "Chance."

Property Management

- City Hall: Completed solar installation, dome repairs, waterproofing, and bike room expansion.
- 25 Van Ness: Completed elevator door replacement project.
- 1650 Mission Street: Replaced heat pumps, VFD to improve air circulation and efficiency, fire panel, and completed Emergency Generator project.

- 1660 Mission Street: Replaced HVAC unit for 6th floor and upgraded Digital Drive Controls to improve efficiency.
- Mission Cultural Center, Bayview Opera House and 66 Raymond: Installed new Fire Panels.
- African American Cultural Center Complex: Completed major electrical upgrade.

FY15 Year-End:

Transactions

- Secured approval by the Board of Supervisors of the conditional purchase agreement between the City and Related California for the development of a new 460,000 ft^2 City office building (one-stop permitting center) on the Goodwill site at Mission Street and South Van Ness Avenue.
- Secured Board approval for acquisition of three sites for 100% affordable housing.
- Assisted with opening, programming, and securing the new Dog/Skate Park in west SOMA.
- Closed escrow on the acquisition of 900 Innes - the city's future "Crissy Field of the Southeast".
- Facilitated the transfer of the Francisco Reservoir to the Recreation and Park Department.
- Assumed jurisdiction and responsibility for McCoppin Plaza, which is the first City plaza under the new Plaza Program.
- Obtained Board approval for a total of 18 leases covering more than 300,000 ft^2 of space.
- Acquired 66 Raymond at no cost to the City.
- Secured Board approval of lease for Mexican Museum.
- Completed the relocation of the department for the SF Employee Retirement System to 1145 Market Street.

Campus Upgrades

- Secured LEED Platinum Certification for City Hall; Gold Certification for 1 South Van Ness; and Silver Certification for 1145 Market and SFMTA's Transportation Management Center at 1455 Market Street.
- Opened a new digital Visitor's Kiosk at City Hall which is fully language access compliant. Completed installation of LED lighting system at City Hall and played key role in Centennial Celebration planning and execution of June 19 event.
- Completed repaving the 4 acre site at the Alemany Farmer's Market.

Edwin M. Lee, Mayor
Naomi M. Kelly, City Administrator

City and County of San Francisco
REAL ESTATE DIVISION
John Updike
Director of Real Estate

MEMORANDUM

DATE: March 24, 2017

TO: Severin Campbell
San Francisco Board of Supervisors Budget & Legislative Analyst

FROM: John Updike
Director of Real Estate

SUBJECT: Performance Audit of Real Estate

The Real Estate Division greatly appreciates the considerable time and effort put into this performance audit by the Budget & Legislative Analyst's Office, and we welcome the opportunity to provide comment on the final draft tendered on March 16, 2017. We have reviewed the analysis and the recommendations contained in the report, and largely agree with them; in fact many are aligned with efforts already underway to improve transparency of operations to the public and to decision-makers around critical real property asset management issues.

Enclosed are Real Estate's responses to the individual recommendations contained in the performance audit draft of March 16, 2017.

encl: recommendation matrix

c: Naomi Kelly, City Administrator
Brian Strong, Director of Capital Planning

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March, 2017 Performance Audit of Real Estate

Recommendation	Response (Agree/Disagree)	Real Estate Comments
1. The Director of Real Estate should work with the Director of Capital Planning on Administrative Code recommendations for a long-term planning process that: (a) defines the respective roles of Real Estate and Capital Planning, including appointing the Director of Real Estate to the Capital Planning Committee; (b) aligns this long term planning process with the City's capital and financial plans; and (c) establishes criteria and priorities for use of leased and City-owned properties.	Agree with qualifications	Both referenced Directors report to the City Administrator, serve together on several informal working groups around various space planning initiatives, and meet regularly on capital improvement requests and financing strategies. Formalizing that relationship through Real Estate's appointment to the Capital Planning Committee would require that the Board of Supervisors amends section 3.21 of the Administrative Code. Criteria and priorities for use of leased and owned city property is a policy matter for the Board of Supervisors.
2. The Director of Real Estate should collaborate with the Capital Planning Program to build on the reporting capabilities of the Facility System of Record (FSR) to incorporate information relevant to long-term planning.	Agree	The Directors of Real Estate and Capital Planning co-chair the FSR project, which went live in early March 2017. FSR will be a continuously improving platform for further data reporting and transparency of public asset status for the public and elected officials.
3. The Director of Real Estate should consult with the President of the Board of Supervisors to (a) identify potential policy priorities, and (b) incorporate these policy priorities into property purchases and sales.	Agree with qualifications	Consultation with San Francisco elected officials facilitates transparency and are essential elements of the effectiveness and efficiency of the Director of Real Estate and the City Administrator. Ultimately policy priorities, purchases and sales are policy matters for the Board of Supervisors.
4. The Real Estate Division should establish written protocols on the respective roles of the Real Estate Division, Public Works, and other agencies.	Agree	Real Estate will continue to deploy Memorandums of Understanding (MOU's) with sister departments to clearly delineate roles, responsibilities and funding arrangements for all joint projects.
5. The Director of Real Estate should assign real property	Agree	Real Estate will continue its practice of our most experienced

officers to team together on lease and purchase or sale transactions where a less-experienced agent lacks expertise.		agents mentoring our less experienced agents, and will place due consideration on the opportunities for growth and learning of less senior staff when making team assignments.
6. The Director of Real Estate should recommend policies on (1) uses of City property other than those that are determined to be highest and best use or for governmental purposes; and (2) non-profit leases of City property as part of the recommended long-term planning process.	Agree with qualifications	Ultimately, such use decisions are policy matters for the Board of Supervisors.
7. The Director of Real Estate should establish a rate sheet for cellular site leases on buildings housing General Fund departments.	Agree with qualifications	Real Estate has informally maintained a minimum required rate for cellular leases of city owned building rooftops, adjusted periodically based on market updates, and subject to final determination by the Board of Supervisors.