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Introduction

In accordance with the City Auditor's 2003-04 Audit Workplan, we have completed an audit of the Department of Public Works' Real Estate Division Real Property Acquisition Process. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

The City Auditor's Office thanks the employees in the Department of Public Works' Real Estate and Management and Administration Divisions, the Redevelopment Agency, and the City Attorney's Office that gave their time, information, and cooperation during this audit.

Background

The Department of Public Works' Real Estate Division (Division) provides real estate services, including property acquisition, property valuation, relocation, site identification and analysis, and telecommunication-related leases. The Division acquires right of way for City departments constructing capital projects. Right of way is when the City fully or partially takes private property for a public use. Division Real Property Agents order title reports and property appraisals, meet with property owners, present offers, and negotiate property sales transactions. In 2000-01, 2001-02, and 2002-03, Real Estate Division costs to provide acquisition-related real estate services were \$320,162, \$353,839, and \$398,368, respectively, totaling about \$1.1 million.

Real Estate Division Budget And Staffing

In 2003-04, the Division budget was \$1.3 million, of which \$1.2 million funded 11 full-time equivalent (FTE) positions and the remaining amount funded non-personal services. The Department has proposed spending \$1.0 million in personal services and about \$65,000 in non-personal services for 2004-05. The 2003-04 and 2004-05 Division budgets are compared in Exhibit 1 below.

Exhibit 1 Real Estate Division 2003-04 And 2004-05 Budgets

Budget Item	2003-04	<i>Proposed</i> 2004-05	Percent Change
Personal Services	\$1,206,168	\$1,015,723	-16%
Non-Personal	\$81,322	\$64,579	-21
Total	\$1,287,490	\$1,080,302	-16
FTEs	11	9	-18

Source: Department of Public Works.

The Division staff currently consists of the following:

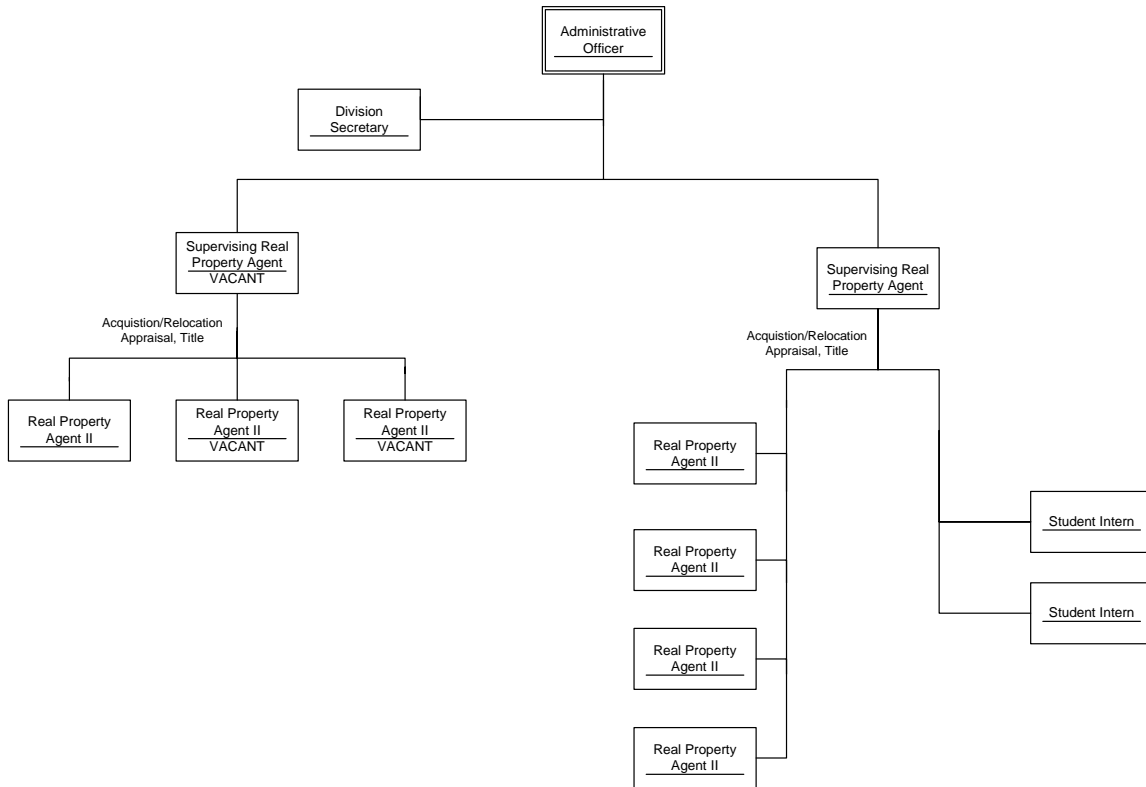
- 1 Administrative Officer
- 2 Supervising Real Property Agents (one is vacant)
- 7 Real Property Agents (2 vacant positions)
- 1 Secretary
- 11 FTE Positions
- plus
- 2 Student interns – part-time
- 13 Total Real Estate Division staff positions

All Real Property Agents have been cross-trained to handle each aspect of the acquisition process and manage a project from beginning to end.

Organizational Chart

The Real Estate Division organizational chart is shown below in Exhibit 2.

Exhibit 2 Real Property Services Division Organizational Chart

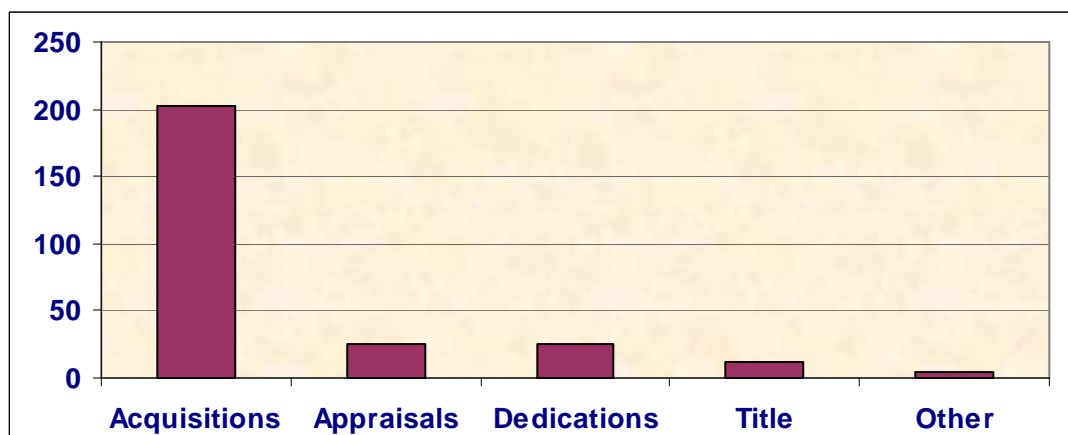


Source: Real Estate Division.

Division Workload

The Division receives Requests for Services memoranda from City departments requiring property to construct capital projects. The Division Secretary uses the memoranda to create Work Requests for various property acquisition-related activities. A Real Property Agent is assigned and the project is added to the Division’s Master Overview of Work Requests Report, which lists the following types of acquisition work requests – Fee Title, Right of Entry, Dedication, Disposition, Donation, Appraisal, Easement, Relocation, and Acquisition. Exhibit 3 shows the 269 open acquisition work requests by request type assigned to Real Property Agents as of March 22, 2004.

Exhibit 3 Open Acquisition Work Requests By Type As Of March 22, 2004



Source: Real Estate Division.

The Division may have to perform all of the activities shown in Exhibit 3 to acquire a single parcel. Of the 269 open work requests, 204 (76 percent) are Acquisition, of which, three were assigned to Supervising Real Property Agents. The remaining 201 were assigned to five Real Property Agents as shown in Exhibit 4 below.

Exhibit 4 Allocation Of Open Work Requests To Real Property Agents As Of March 22, 2004

Real Property Agent	Acquisition Work Requests Assigned	Other Work Requests Assigned	Total
#1	93	12	105
#2	37	25	62
#3	6	13	19
#4	52	15	67
#5	13	0	13
Total	201	65	266

Source: Real Estate Division.

As shown above, two agents had far fewer assignments when compared to the other agents. According to a Supervising Real Property Agent, the reasons for this workload disparity are (1) supervisors had re-assigned other agents the work requests of two agents who were planning to retire and (2) one agent

only recently began handling acquisition work requests. The Division is currently authorized 7 FTE Real Property Agents but will propose eliminating two vacant positions in 2004-05.

Acquisition Process

In most situations relating to the public acquisition of private property, California state law requires a governmental entity to base its purchase offer on an independent third party appraisal. The Real Estate Division contracts with certified Real Property Appraisers to prepare the property appraisal reports. A property appraisal must be based on “highest and best use” of the property and present its current “fair market value” to equitably compensate the property owner. The completed appraisal is either reviewed in-house or by an independent fee review appraiser. Based on the completed appraisal, the Real Property Agent prepares a Statement of Just Compensation, which is the City’s offer to purchase from the property owner. A seller may accept the City’s initial offer, privately arrange for a second appraisal, and/or enlist legal services in order to counteroffer. When a fair price is agreed upon, a Purchase and Sales Agreement (PSA) is drawn up, the property closes escrow, the deed is recorded, and the City takes ownership. According to Division staff, 85 to 90 percent of the City’s real property acquisitions proceed in this manner. In the remaining 10 to 15 percent of cases, when negotiations reach an impasse, the staff brings the matter to the City Council for a Resolution of Public Use and Necessity. If the resolution is passed, the City Attorney’s Office is instructed to initiate condemnation proceedings to acquire the property by eminent domain.

Eminent Domain

Eminent domain is the inherent power of government to acquire private property for public use. California law requires that a public entity cannot commence an eminent domain proceeding until its governing body has adopted a resolution of necessity describing, among other things, “a general statement of the public use for which the property is being taken.” Further, California Government Code, Section 7267.1 states: *Prior to initiating an eminent domain action, a public entity must appraise the property and make every reasonable effort to acquire the property by negotiation.* The Division attempts to minimize the use of eminent domain to acquire private property.

**Scope And
Methodology**

This is the third audit report on the Department of Public Works' Real Estate Division. The first and second audits dealt with the Real Estate Division's Appraisal Process and Property Management Operations, respectively. The objective of this audit was to evaluate the Real Estate Division Real Property Acquisition Process.

During the course of our audit we

- reviewed written policies and procedures;
- interviewed Real Estate Division clients in the following departments:
 - ✓ Parks, Recreation, and Neighborhood Services,
 - ✓ Transportation,
 - ✓ Library,
 - ✓ Airport,
 - ✓ Housing, and
 - ✓ Public Works Development Division;
- visited acquisition sites;
- met with the Deputy City Attorney providing legal services for the acquisition process;
- met with the Redevelopment Agency and their consultant;
- randomly selected and tested a sample of 20 Real Estate Division acquisitions to identify issues of concern regarding the acquisition process;
- judgmentally selected and tested a sample of 12 Real Estate Division acquisitions to obtain time and cost information; and
- judgmentally selected and tested a sample of 3 Redevelopment Agency acquisitions.

The scope of our review was all open Work Requests for acquisition-related real estate activities the Real Estate Division received from 1998 to March 2004 that were listed on their Master Overview of Work Requests Report. Additionally, we analyzed the timeliness and costs of 12 real property acquisitions the Division completed during 2001-2003.

We used various computer reports and database information during our audit. We did not review the general and specific application controls for the computer systems used in compiling the various computer reports and database information.

**Major
Accomplishments
Related To This
Program**

In Appendix B, the Real Estate Division informs us of its major accomplishments regarding Real Property Acquisition Services.

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Finding I

The Administration Can Reduce The Cost And Time To Acquire Real Property By Continuing To Address The Issues That Impact Acquisition Timeliness And Cost

The Department of Public Works' Real Estate Division (Division) acquires private property for public use. Private property is acquired to develop and improve parks, libraries, trails, community facilities, and streets. To accomplish these tasks, the Division works closely with other City entities, such as the Office of the City Attorney, the Department of Public Works' Management and Administration, Development, Design and Construction, and Engineering Services Divisions; the Department of Transportation; Department of Planning, Building, and Code Enforcement's Planning Division; Environmental Services Department (ESD); and the City Manager's Office. During the course of our audit:

- The Division and City Attorney's Office made procedural and administrative changes to improve real property acquisition timeliness and
- The Division started participating in the capital project plan process.

Additional improvements in communication and coordination are possible which can reduce the time and costs associated with real property acquisitions. Specifically, we found that:

- Temporary construction easements were not requested in a timely manner;
- Capital construction plan changes required the Division to order updated title reports, after requesting revised legal descriptions, and surveyors' maps;
- California Environmental Quality Act issues impacted the time to complete property acquisitions; and
- The Division needs to establish performance standards for project costs.

By addressing these additional issues the Administration and Division can reduce real property acquisition costs and improve acquisition timeliness.

**Legal-Related
Procedural And
Administrative
Changes May
Improve
Acquisition
Timeliness**

The City Attorney’s Office provides legal services to the Division related to real property acquisitions. An assigned attorney reviews and revises real estate-related documents, such as purchase and sales agreements, temporary construction easements, California Environmental Quality Act documents, licenses for right of entry, eminent domain documents, and use agreements. The assigned attorney also reviews acquisition memoranda that City Council approves to acquire real property.

During the course of the audit, the Division and the assigned attorney made procedural and administrative changes that may improve acquisition timeliness. According to Division staff and the assigned attorney, they are in the process of implementing 14 standardized acquisition-related documents for routine transactions. The standardized documents include purchase agreements, license for right-of-entry, easements, title, and donations. The Division staff and the assigned attorney expect that standardizing these documents will streamline the legal review process for routine transactions by reducing the time for agreement preparation, signature, and approval.

We found that in the cases reviewed there were instances of Division staff and the assigned attorney editing and re-editing the acquisition-related legal documents. In our opinion, standardizing these documents should reduce the number of revisions and the time necessary to finalize key acquisition documents.

We recommend that the Division and City Attorney’s Office:

Recommendation #1
Continue to standardize legal documents related to the real property acquisition process. (Priority 3)

**The Division
Started
Participating In
The Capital Project
Plan Process**

Changes in capital project construction plans impact the acquisition process. Capital project plan changes sometimes result in additional property acquisition work for the Division. When the square footage originally identified necessary to complete a capital project changes as a result of changes to the project plan, most of the acquisition-related activities must be repeated. In order to legally obtain the additional property necessary to complete the project, the Division requests new

legal descriptions and plats¹, updated preliminary title reports, re-appraisals, and then re-negotiates purchase agreements with property owners. In the past, the Division has not been made aware of capital project plan changes until after the fact.

To minimize re-work and the impact of capital project plan changes, the Division and Public Works project managers have begun holding meetings to discuss proposed projects and conduct site visits to identify potential real estate issues. According to Division staff, project managers have been encouraged to involve them earlier in the planning process. Since May 2003, Public Works has held right of way certification meetings with project managers and Division staff to review proposed projects. In addition, Division Real Property Agents have started accompanying Public Works and Department of Transportation staff on proposed project site visits. The site visits, together with the certification meetings, allow Division staff to provide guidance to project managers on acquisition-related issues and requirements. Another benefit is that Division staff become more knowledgeable about upcoming project requirements. In our opinion, involving Division staff in right of way certification meetings and participating in site visits should continue.

Additional Improvements In Communication And Coordination Can Reduce The Time And Costs Associated With Real Property Acquisition

The acquisition of private property for public use requires the involvement of City staff in several departments. To accomplish these tasks, the Division works closely with other City entities, such as the Office of the City Attorney, the Department of Public Works' Management and Administration, Development, Design and Construction, and Engineering Services Divisions; the Department of Transportation; Department of Planning, Building, and Code Enforcement's Planning Division; Environmental Services Department (ESD); and the City Manager's Office.

Requests for documentation and information necessary to accomplish property acquisitions are made in memoranda and through email and telephone calls. Staff performs many acquisition-related tasks concurrently to obtain property in time for planned capital project construction to begin. Unclear or delayed requests for some types of project information affected property acquisition timeliness. We found that in some cases temporary construction easements were not requested in a

¹ Plats are surveyors' maps that delineate property boundaries and indicate legal easements.

timely manner. In other cases, capital construction plan changes required the Division to order updated title reports, after requesting revised legal descriptions, and plats. Finally, California Environmental Quality Act (CEQA) issues impacted the time to complete property acquisitions.

*Temporary
Construction
Easements*

We found that Division clients did not request temporary construction easements (TCE) on a timely basis. A TCE allows work crews and equipment access to property adjacent to a project construction site. TCEs are issued for a specific period with a commencement and an expiration date. When construction is complete and the TCE expires, the City files a quitclaim, deeding the TCE parcel back to the property owner. We found that in one instance, an initial request for acquisition was made in December 2002. In February 2003, after all title and appraisal work was complete and the City had made an offer of just compensation, the client department notified Division staff that an additional portion of the property was needed for a TCE. As a result, the Division needed to do additional work to revise the appraisal report, the Statement of Just Compensation, the purchase agreement, and a City Council memorandum approving the acquisition.

In 2002, a Supervising Real Property Agent held a training for Department of Public Works project engineers to inform them of the importance of defining the property take area as early as possible, including identifying any TCEs necessary. In our opinion, the Department of Public Works needs to ensure that clients using their services request TCEs on a timely basis.

*Capital Project Plan
Changes*

Changes in capital project construction plans also impact the acquisition process. When plan changes occur, the Division must request a re-survey and revised legal descriptions, plats, and title reports. In one case, we found that the Division had to request four title reports in order to finally complete the acquisition. Specifically, the Division initially used a title report dated April 26, 2001 to order the appraisal on the entire parcel. A partial take of the parcel required a second title report, dated May 3, 2002. An adjustment to fee title on the partial take led to yet a third updated title report request which was dated June 24, 2002. In September 2002, the broker representing the owners claimed that the property had changed hands. However, the title transfer was never properly recorded. Due to the uncertainty of title, City staff decided to treat all the

entities as potential owners for purposes of proceeding with the need and necessity process. Therefore, the Division had to request yet a fourth title report, dated July 2, 2002.

According to the Division, to expedite this part of the real property acquisition process, and minimize re-work of these steps in the process, they recently began requesting aerial photos with property take lines simply drawn in. While complete survey and legal descriptions/plats work is being accomplished, property lines on the aerial photo allow Division staff to initiate requests for title and appraisal on the property.

*California
Environmental
Quality Act*

We also found that coordination issues regarding California Environmental Quality Act (CEQA) requirements impacted eight of 12 acquisition projects reviewed. Specifically, in one case the Redevelopment Agency provided the wrong CEQA section number for the City Council memorandum. In another case, the City Council memorandum included the CEQA section number, but lacked a Planning Permit (PP) number indicating that the Planning Division had reviewed the project. In a third case, the Planning Division incorrectly exempted a project from CEQA requirements. During our review of project files we saw voluminous correspondence among many individuals to rectify these mistakes. As a result, many individuals had to re-do this work and City Council approval of the property acquisition was delayed for two of the 12 cases we reviewed.

We recommend that the Department of Public Works:

Recommendation #2
Establish a process to ensure capital project construction plan changes are communicated when known and temporary construction easements and CEQA documents are requested timely. (Priority 3)

**Cost-Related
Performance
Standards Are
Needed**

The Division maintains milestones for project completion timeframes, but does not have standards for project costs. The Division also needs to establish performance standards for project costs. The Division may benefit from establishing performance standards to determine the reasonableness of the costs to acquire real property. By establishing a cost standard or benchmark, management can scrutinize any project that surpasses a certain cost measure. This would allow

management to improve the acquisition process by identifying those projects that have problems or deficiencies in the process. As a result, management would be able to assign additional resources to address the problems and complete delayed projects.

We recommend that the Real Estate Division:

Recommendation #3

Establish performance standards or benchmarks related to the costs to acquire real property. (Priority 2)

CONCLUSION

The Administration and City Attorney’s Office have made procedural and administrative changes to improve real property acquisition timeliness. Additional improvements in communication and coordination are possible which can reduce the time and costs to acquire real property. Specifically, the Division needs to work with the Administration to address issues affecting project timeliness. Moreover, the Administration and the Real Estate Division should establish a process to ensure capital project construction plan changes are communicated when known and temporary construction easements and CEQA documents are requested timely. Finally, the Division needs to establish performance standards for project costs. As a result, the City may reduce property acquisition costs and acquire real property on a timelier basis.

RECOMMENDATIONS

We recommend that the Division and City Attorney’s Office:

Recommendation #1 **Continue to standardize legal documents related to the real property acquisition process. (Priority 3)**

We recommend that the Department of Public Works:

Recommendation #2 **Establish a process to ensure capital project construction plan changes are communicated when known and temporary construction easements and CEQA documents are requested timely. (Priority 3)**

We recommend that the Real Estate Division:

Recommendation #3 Establish performance standards or benchmarks related to the costs to acquire real property. (Priority 2)

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Other Pertinent Information

The Redevelopment Agency Had Lower Acquisition Costs On A Per Parcel Basis Compared To The Real Estate Division's Costs

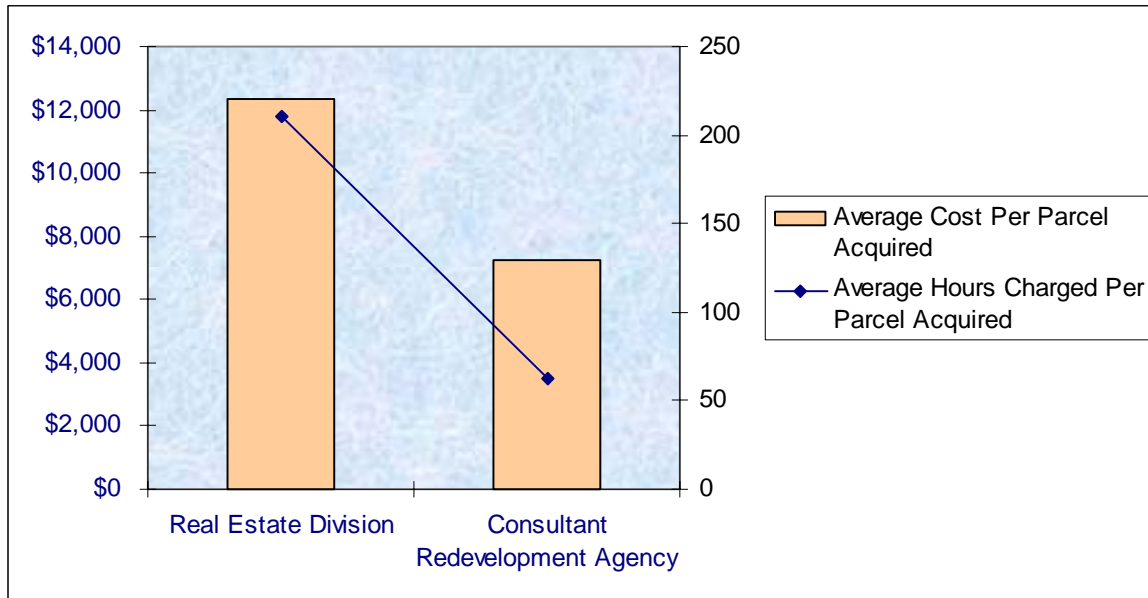
Since March 2000, the Redevelopment Agency (Agency) has relied on an outside consultant, Cutler and Associates, to provide real estate acquisition services. The Agency reported that the consultant was involved in 36 projects that resulted in the acquisitions of 315 parcels and 323 relocations through June 2003. The agreement provided compensation of \$5.95 million through June 2003. On June 24, 2003, the Agency Board approved a new master agreement with Overland, Pacific & Cutler, Inc. (formerly Cutler and Associates) for "real estate and relocation coordination services for an amount not to exceed \$700,000 through December 31, 2003."

We reviewed three real estate acquisition projects involving 31 parcels that the Agency outsourced to the consultant and 12 real estate acquisition projects involving 26 parcels the Real Estate Division acquired with their staff. We found that the Agency incurred on average a fully-loaded² acquisition cost of \$7,249 per acquired parcel, with acquisitions ranging from \$5,728 to \$8,475 per parcel. On the other hand, we found that the average fully-loaded total acquisition cost per parcel for the Division was \$12,352, with acquisitions ranging from \$3,853 to \$26,899 per parcel.

We should note that the Agency use of a consultant produced lower acquisition costs despite the Agency's average hourly rate being almost twice that of the Real Estate Division's hourly rate. Specifically, we found that the Agency's average cost was \$115.91 per hour compared to the Division's average cost of \$60.66 per hour. The Agency's lower cost on a per parcel basis is due to the consultant charging significantly fewer hours to acquire the property. The Agency's consultant on average spent 63 hours acquiring each parcel, compared to the Division's staff spending 210 hours for each parcel acquired. In other words, for every hour the Agency's consultant charged, the Division's staff charged 3.3 hours. This information is shown in Exhibit 5 below.

² The fully-loaded cost includes the consultant's direct charges and the Agency's oversight cost.

Exhibit 5 Comparison Of Agency And Division Average Costs And Hours Charged Per Parcel Acquired



Source: Auditor analysis of Real Estate Division and Redevelopment Agency data.

Citywide Overhead Cost Allocation May Account For Lower Agency Acquisition Costs

Citywide overhead cost allocation payments may explain why the Agency’s acquisition costs are lower than the Division’s acquisition costs. Overhead rates recover costs for indirect services by applying overhead rates developed annually to direct labor charges. The Department of Public Works assigns its Citywide overhead cost allocation on a per project basis. About 43 percent of the total Division acquisition costs were classified as indirect costs, which included fringe benefits, capital redistribution, and Citywide overhead cost allocation. The Department of Public Works’ Citywide overhead cost allocation rate was 37 percent in 2002-03. The Agency does not assign its Citywide overhead allocation on a per project basis³. Consequently, the Agency calculations do not include Citywide overhead cost allocation.

Almost all of the consultant projects reviewed entailed eminent domain proceedings that necessitated longer consultant involvement in the acquisition process. We found that 28 of the 31 parcels the consultant acquired went to eminent domain because property owners rejected the Agency’s initial purchase offers. In comparison, eminent domain proceedings were

³ The Finance Department removes the overhead portion from their balance sheet on a monthly basis.

necessary for 6 of the 26 parcels the Division acquired. In the projects requiring eminent domain proceedings, the consultant was involved for 32 months and the Division for 8 months. Once eminent domain proceedings began, both the consultant and the Division continued to negotiate with property owners to purchase their parcels. In cases where parcels were acquired without eminent domain, the consultant acquisition process required 10 months, compared to 14 months for the Division.

**Recent Changes To
The Agency's Use
Of Consultants**

The Agency is changing from relying on consultants for real estate acquisitions, to using in-house staff because of decreased workload. On March 9, 2004, the Agency Board approved a Master Agreement with Overland, Pacific, and Cutler, Inc. (formerly Cutler and Associates) reducing the scope of real estate and relocation coordination services from the prior agreement. The agreement has a maximum compensation limit of \$75,000 and is in effect through June 30, 2005. The Agency plans on performing real estate services moved in-house under the direction of an Agency Deputy Director. Further, the Agency hired a Development Specialist, who previously worked for the consultant, to undertake work Cutler and Associates previously performed.



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