Performance Audit of the San Diego Housing Commission's Property Acquisition Process

MARCH 2024 | OCA-24-09

Finding 1

The Housing Commission largely follows property acquisition best practices, but the agency used an appraisal that potentially overvalued a hotel property by $6.7 million.

Finding 2

The Housing Commission should establish a documented acquisition strategy and an annual acquisition goal to improve transparency and to support both the agency and the City's priority of expanding affordable and permanent supportive housing.

Andy Hanau, City Auditor
Matthew Helm, Assistant City Auditor
Danielle Knighten, Deputy City Auditor
Joseph Picek, Principal Performance Auditor
Geoff Teal, Senior Performance Auditor
Nadia Torkman, Performance Auditor

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The Office of the City Auditor would like to thank staff from the San Diego Housing Commission for their assistance during this audit.

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Performance Audit of the San Diego Housing Commission's Property Acquisition Process

Why OCA Did This Study

The City of San Diego (City) has struggled to supply sufficient affordable housing options, which has, in part, perpetuated the rise in the population of individuals experiencing homelessness. The City's housing agency, the San Diego Housing Commission (Housing Commission) is responsible for helping create affordable housing for lower-income households and permanent supportive housing for individuals experiencing homelessness throughout the city. Due to City leadership's prioritization of affordable housing and homelessness prevention efforts, and because building acquisitions can be areas of high risk, we conducted a performance audit of the San Diego Housing Commission's property acquisition process with the following objectives:

Determine whether the Housing Commission follows best practices when acquiring properties to increase affordable housing in the City.

Determine whether the Housing Commission has a property acquisition strategy and a funding strategy for property acquisitions based on best practices.

What OCA Found

Finding 1: The Housing Commission largely follows property acquisition best practices, but the agency used an appraisal that potentially overvalued a hotel property by $6.7 million.

- We found the Housing Commission did not follow the best practice of using an appraisal with a valuation date that corresponded to the appraisal inspection date for its $67 million acquisition of the Residence Inn Hotel Circle property in November 2020.
- We estimate that the agency might have overpaid by approximately $6.7 million for this acquisition had the appraisal's valuation accounted for the roughly 10 percent decrease in hotel property values at the time of the appraisal site inspection.
- We found the Housing Commission's staff report to its oversight bodies for the Residence Inn Hotel Circle acquisition did not disclose that the appraisal used a pre-COVID valuation, and the appraisal report was not attached for review.

The Housing Commission Largely Followed Best Practices for All Property Acquisitions, Costing $158.6 Million for 642 Units, From FY2014 through FY2023, Except for One

Source: OCA generated based on information provided by the Housing Commission.

Finding 2: **The Housing Commission should establish a documented acquisition strategy and an annual acquisition goal to improve transparency and to support both the agency and the City's priority of expanding affordable and permanent supportive housing.**

The Housing Commission lacks a formal property acquisition strategy and does not commit to an annual acquisition goal.

- Having a formal acquisition strategy and annual goal would help ensure the Housing Commission is communicating to stakeholders how it intends to use its limited resources and track its progress in helping the City reach its goal of creating 2,802 units of permanent supportive housing by 2029.
- Even though the Housing Commission does not have a dedicated funding source for acquisitions, the agency could provide more transparency to stakeholders into how the agency's property acquisitions, which on average cost $31.7 million per acquisition over the last 10 years, fit into to the agency's overall strategy to increase affordable and permanent supportive housing in the City.

Housing Commission Property Acquisitions Made Up Roughly 35 Percent of All Permanent Supportive Housing the Agency Was Involved in Creating During the FY2020 through FY2023 Period

Method of PSH Creation	Number of PSH Properties Created (FY2020–FY2023)	Number of PSH Units Created (FY2020–FY2023)	Percent of Total PSH Units Created (FY2020–FY2023)
Property Acquisition	4	435	35%
Financing Developers	14	802	65%
Total	**18**	**1,237**	**100%**

Source: OCA generated based on the Housing Commission's FY2022 and FY2023 Annual Reports.

What OCA Recommends

We made four recommendations, and the Housing Commission agreed to three. Recommendations include:

- The Housing Commission should update its policies and procedures to include the following requirements:
  - Appraisal valuation dates must correspond to appraisal site inspections date.
  - Copies of appraisal reports must be included as attachments in Housing Commission staff reports to its oversight bodies.
  - The Housing Commission should follow up with contracted vendors if requested services were not provided in full prior to moving forward with any major property purchase.
- The Housing Commission should complete a vendor performance evaluation for CBRE documenting its performance in providing appraisals for Residence Inn Hotel Circle and Residence In Kearny Mesa.
- The Housing Commission should update its Strategic Plan to include a property acquisition strategic component.
- The Housing Commission should establish an annual acquisition goal based on available funding for acquisitions in the upcoming fiscal year.

The Housing Commission did not agree to establishing an annual acquisition goal.

For more information, contact Andy Hanau, City Auditor, at (619) 533-3165 or cityauditor@sandiego.gov.

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Background

The City of San Diego (City) has struggled to supply sufficient affordable housing options, which has, in part, perpetuated the rise in the population of individuals experiencing homelessness. The City's housing agency, the San Diego Housing Commission (Housing Commission), is responsible for helping create affordable housing for lower-income households throughout the City by providing financing to housing developers and by directly acquiring properties.[1] The Housing Commission also uses these methods to help address the homelessness crisis by increasing the number of permanent supportive housing units in the City for individuals experiencing homelessness.[2]

Due to City leadership's prioritization of affordable housing and homelessness prevention efforts, the high risk that can accompany building acquisitions, and high-profile acquisition issues discussed below, we conducted a performance audit of the Housing Commission's property acquisition process. Also, as shown in **Exhibit 1**, the Housing Commission is responsible for a wide variety of affordable housing and homelessness-related activities but only those specific to property acquisitions were included in the scope of this audit.

Exhibit 1

This Audit Only Covers Housing Commission Activities Specific to Property Acquisitions

San Diego Housing Commission Activities and Responsibilities

Audit Scope

Building Acquisitions for Affordable and Permanent Supportive Housing

Out-Of-Scope

Rapid Re-Housing
Shelters
Transitional Housing Partnerships
Safe Parking
Coordinated Outreach
Family Reunification
Section 8 Voucher Program
Landlord Engagement
Rental Assistance
Developer Funding

Source: OCA generated based on information reported by the Housing Commission annual reports.

1 The Housing Commission's target population for affordable housing is households that earn 80 percent or less of the Area Median Income. We use the term "affordable housing" throughout this report to describe housing intended for this population.

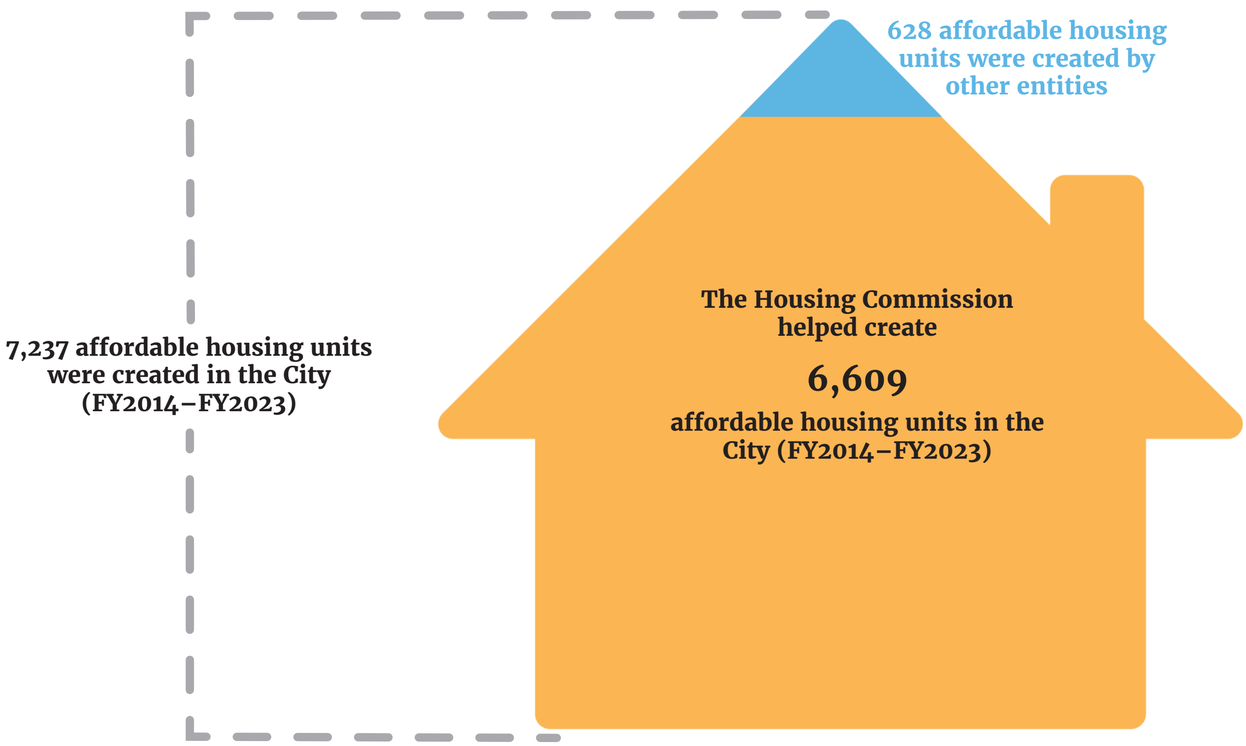
2 Permanent supportive housing is a type of affordable housing which involves long-term rental assistance and intensive supportive services for target populations, such as individuals who chronically experience homelessness.

The Housing Commission helps create housing options for lower-income households and individuals experiencing homelessness.

The Housing Commission is involved with creating and preserving most of the affordable housing in the City. From fiscal year (FY) 2014 through FY2023, the Housing Commission provided financing to developers and directly acquired properties to help create more than 6,600 affordable housing units throughout the City. During the same time period, the City gained a total of 7,237 affordable housing units, which means the Housing Commission was involved in more than 90 percent of all affordable housing produced in the City, as shown in **Exhibit 2**.

Exhibit 2

The Housing Commission Was Involved in Creating 6,609 Out of a Total of 7,237 Affordable Housing Units in the City During the FY2014 through FY2023 Period



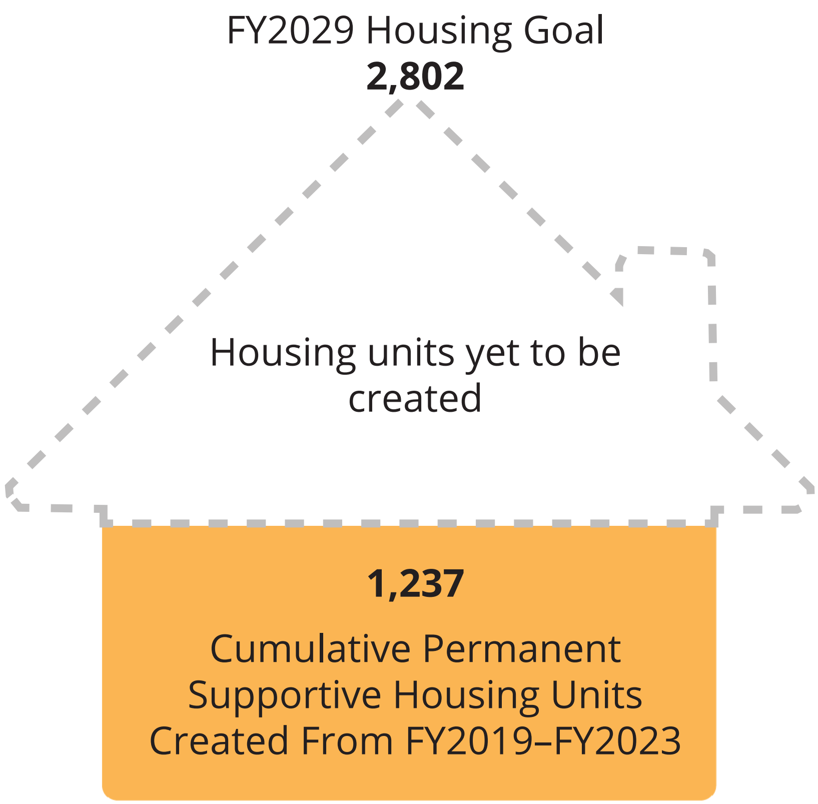
Source: OCA generated based on affordable housing data provided by the Housing Commission.

Also, according to the Housing Commission, it was also involved in creating most of the permanent supportive housing in the City for individuals experiencing homelessness over the last three years. According to the Regional Task Force on Homelessness, as of September 2023, on average, for every 10 homeless individuals who found housing, 16 additional individuals experienced homelessness for the first time in San Diego County. In other words, the number of people falling into homelessness is outpacing the number of unhoused individuals finding housing in San Diego County. To expand housing efforts, the City's Community Action Plan on Homelessness, which was adopted by the City Council in October 2019, identified a need for more than 2,800 permanent supportive housing units over 10 years, with a goal of creating 1,681 in the first 4 years.

As shown in **Exhibit 3** below, as of June 28, 2022, the Housing Commission has helped the City create 1,227 permanent supportive housing units, or 70 percent of the City's 4-year goal and 44 percent of its 10-year goal, using the same methods for creating affordable housing discussed above. However, according to the Housing Commission, additional consistent, substantial funding will be required to continue the current rate of production of permanent supportive housing in the City of San Diego.

Exhibit 3

The Housing Commission Has Helped Produce 44 Percent of the City's 10-Year Goal for Permanent Supportive Housing from FY2019 through FY2023



Source: OCA generated based on affordable housing production data from the Housing Commission's FY2022 and FY2023 Annual Reports.

Most Housing Commission-created affordable housing during the FY2014 through FY2023 period resulted from providing financing options to developers.

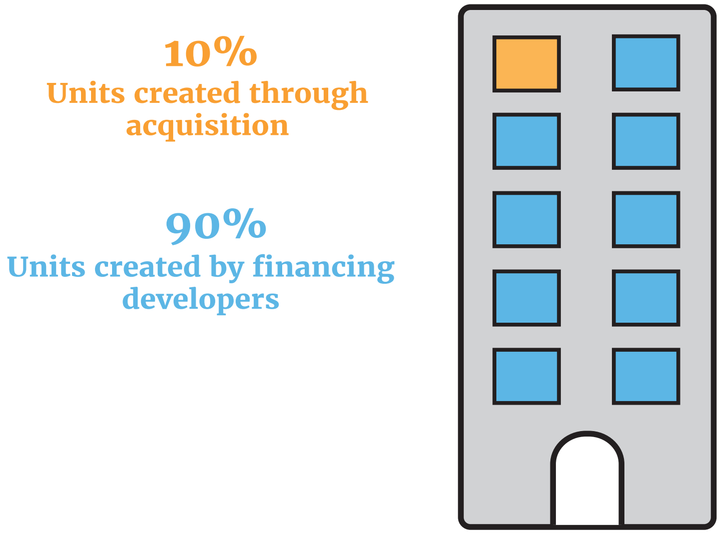
The Housing Commission's principal method of increasing affordable housing is through its competitive Notice of Funding Availability process. This process requires developers to apply directly with the Housing Commission to request funding for affordable housing projects. Once the Housing Commission selects a project, it awards the funds to the developer as loans that are repaid over time. The Housing Commission administers several funding sources that can be awarded to affordable housing developers, such as Federal HOME Investment Partnership Program funds and Federal Community Block Development Grant funds, State of California Local Housing Trust Fund Program funds, and City of San Diego Affordable Housing Fund.

The Housing Commission also issues Multifamily Housing Revenue Bonds, which help affordable housing developers obtain below-market financing and federal low-income housing tax credits, both of which are essential financing sources for affordable housing projects.

As shown in **Exhibit 4**, almost all of the affordable housing the Housing Commission helped create in the last 10 years was accomplished through providing funding to developers.

Exhibit 4

90 Percent of the Total Affordable Housing Units the Housing Commission Helped Create During the FY2014 through FY2023 Period Involved Providing Financing to Developers



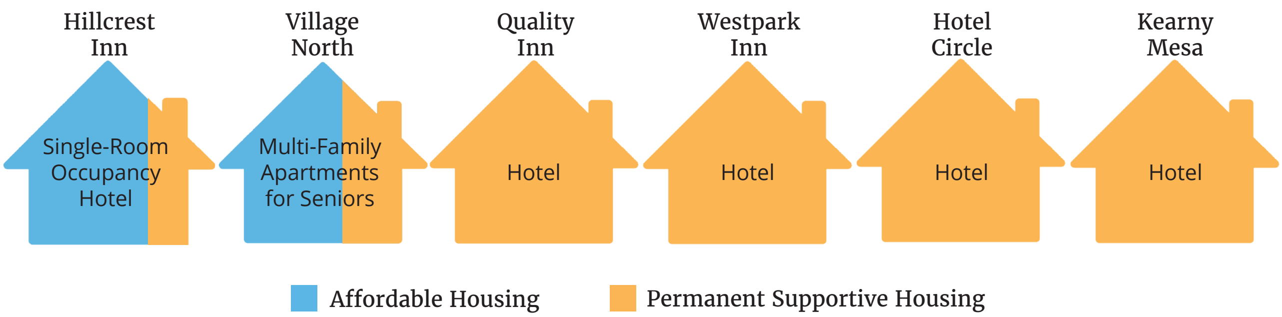
Source: OCA generated based on Housing Commission units created data.

The Housing Commission acquired six properties for affordable housing and permanent supportive housing in the last 10 years.

Though the Housing Commission primarily uses financing opportunities for developers to meet its goal of increasing affordable and permanent supportive housing solutions, it occasionally acquires properties to help achieve this objective. During the FY2014 through FY2023 period, the Housing Commission purchased six properties in five separate acquisition transactions, which created a total of 642 affordable and permanent supportive housing units for a total cost of approximately $158.6 million. As shown in **Exhibit 5**, four of the properties were hotels, one was a multi-family apartment complex for seniors, and one was a single-room-occupancy hotel building. **Exhibit 5** also shows that the Housing Commission acquired all six properties to be used, at least in part, as permanent supportive housing.

Exhibit 5

The Housing Commission Acquired Units to Provide Both Affordable and Permanent Supportive Housing



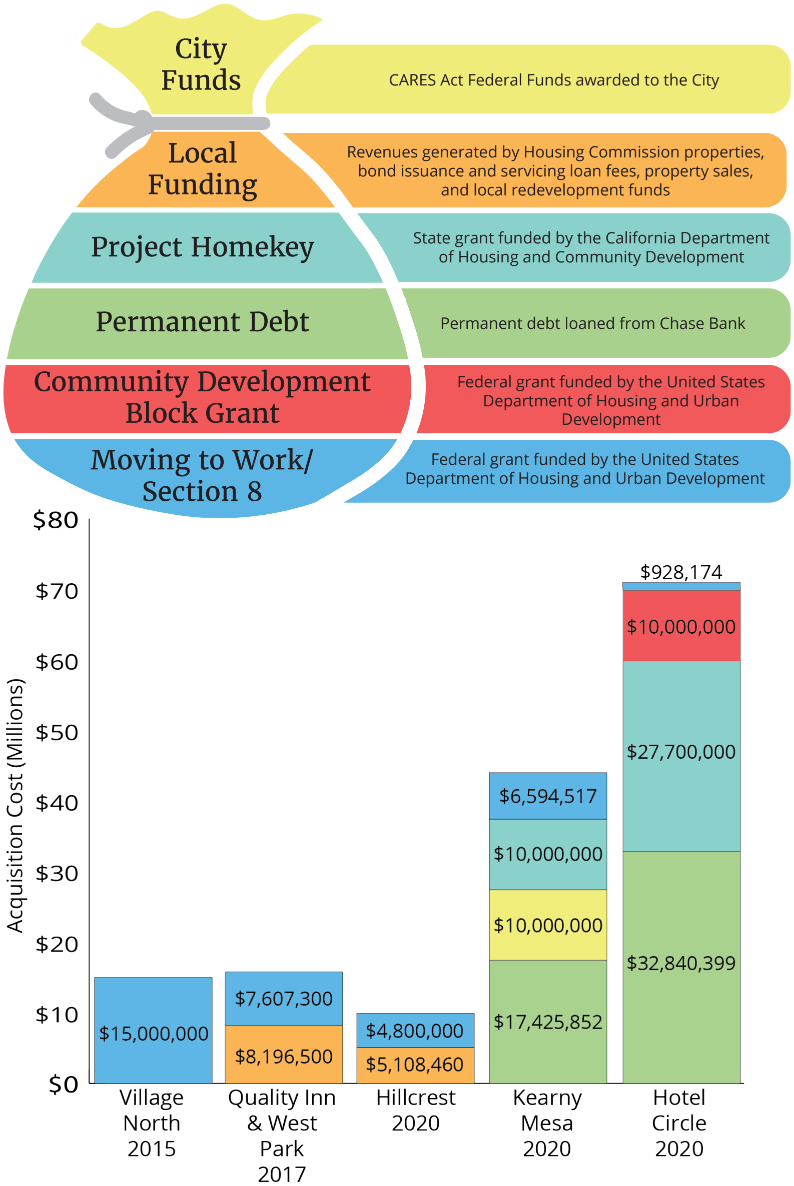
Source: OCA generated based on units created data from the Housing Commission.

The Housing Commission uses a mix of federal, state, and local funding sources to acquire properties for affordable and permanent supportive housing.

The Housing Commission can use various funding sources when it acquires a property. For instance, as shown in **Exhibit 6**, the Housing Commission used multiple funding sources, as well as debt financing, for five property acquisitions (totaling six acquired properties) during the FY2014 through FY2023 period, including Moving-to-Work/Section 8, Community Development Block Grant, and CARES Act federal funds, the State of California's Project Homekey program funds, and local funds.[3; 4] The agency also took out a Chase Bank loan (permanent debt) to purchase the Residence Inn Hotel Circle and the Residence Inn Kearny Mesa hotel properties in 2020.

Exhibit 6

The Housing Commission Used a Mix of Different Funding Sources to Acquire Six Properties During the FY2014 through FY2023 Period



Source: OCA generated based on Housing Commission budget data.

3 According to the Housing Commission, local funds consist of revenues generated by Housing Commission properties, fees received for administering bond issuances and servicing loans, sales of Housing Commission properties, and local redevelopment funds.

4 The Housing Commission purchased the Residence Inn Hotel Circle property with State of California Homekey funds. The State's Homekey program in 2020 required awarded funds to be expended by December 30, 2020.

The members of the City of San Diego's City Council govern the Housing Commission in their role as the Housing Authority.

The Housing Authority of the City of San Diego, which consists of the nine members of the San Diego City Council, has final authority over the Housing Commission's budget and major policy changes. The actions of the Housing Commission's Board of Commissioners (Board) are advisory to the Housing Authority.

Specific to property acquisitions, the Housing Authority can request to review any acquisition-related action of the Housing Commission or the Board, such as approving or blocking a property acquisition, within seven days of the date of any Housing Commission approval of an acquisition, by notice of any two members of the Housing Authority. If the Housing Authority does not request such a review, the Housing Commission may proceed with the acquisition.

Though the Housing Authority is not required to approve Housing Commission property acquisitions, we found that the Housing Authority reviewed and approved four out of the five Housing Commission acquisitions during the FY2014 through FY2023 period.[5]

The Housing Commission's property acquisition process aims to protect the public interest by ensuring thorough review of acquisitions.

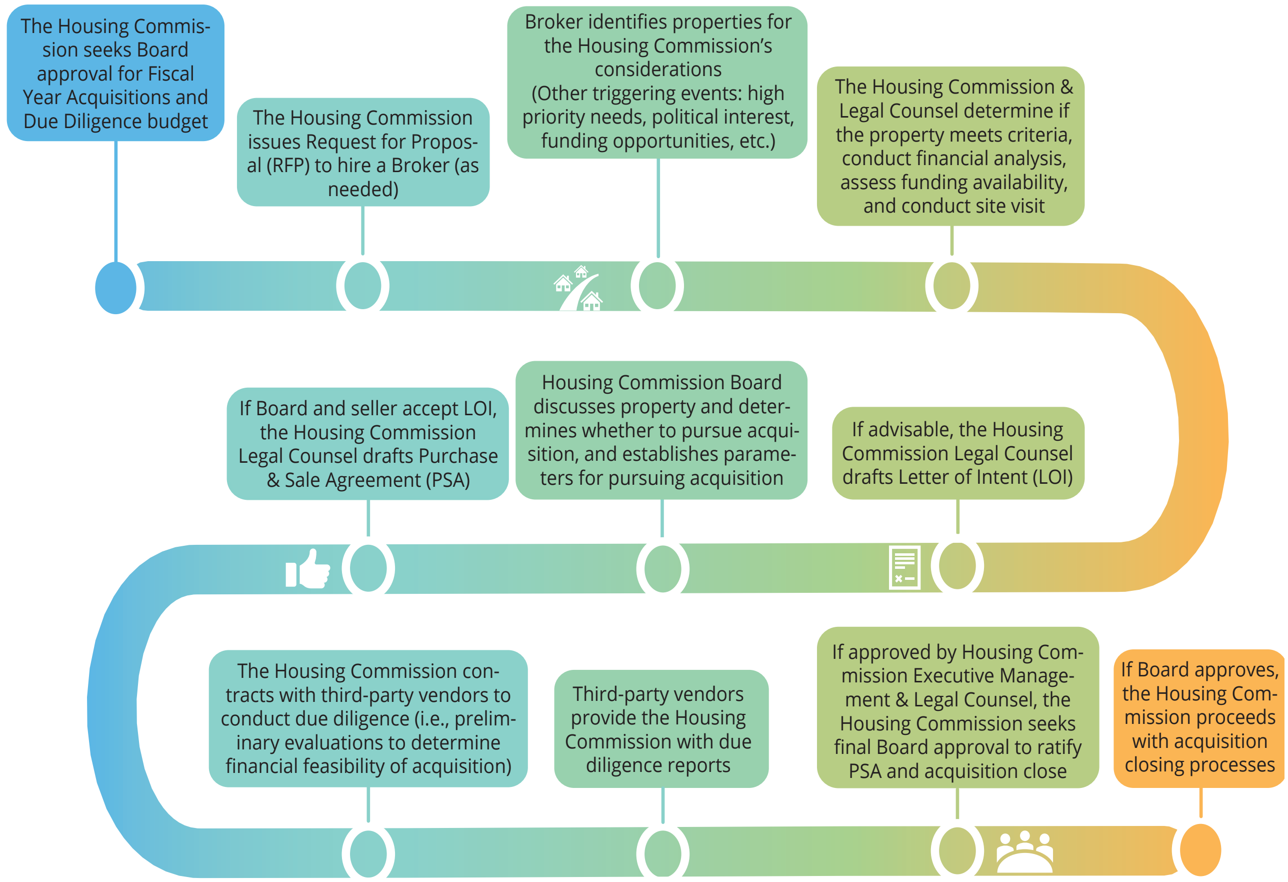
As illustrated in **Exhibit 7**, the Housing Commission's property acquisition process entails various steps involving agency staff, its Legal Counsel, its Board of Commissioners (Board), brokers, and third-party vendors.[6] This process helps ensure that the Housing Commission is complying with its internal acquisition policy and that the property fits the criteria for what the agency is looking for. For a more detailed description of the Housing Commission's acquisition process, see **Appendix C**.

5 The Housing Authority did not review the Housing Commission's Board of Commissioners' approval of the Quality Inn/West Park Inn acquisition, which involved the purchase of two properties, in September 2017.

6 The Housing Commission's Board of Commissioners acts as an advisory body for the agency. Besides reviewing property acquisitions, the Board also reviews proposed changes to housing policy, allocation of resources, revisions to personnel policies and annual administrative and operating budgets. The Board's seven members are appointed by the Mayor and confirmed by the City Council. Two of the Board's seats are reserved for residents of agency-owned housing units or recipients of federal Section 8 Housing Choice Voucher rental assistance.

Exhibit 7

The Housing Commission's Property Acquisition Process Involves Multiple Layers of Review and Approval to Finalize an Acquisition



Note: According to the Housing Commission, the agency generally employs a strategy to not be represented by a broker in most transactions. When the Housing Commission is represented by a broker, guidelines in place specify the maximum fee the broker can earn and the broker's duties and responsibilities during the engagement.

Source: OCA generated based on SDHC's Acquisition Process PowerPoint presentation.

The City Attorney took legal action against the broker for the Residence Inn Hotel Circle acquisition.

Specific to the acquisition of the Residence Inn Hotel Circle and Kearny Mesa hotel properties, the Housing Commission hired a real estate broker to identify hotel properties for potential purchase and negotiate hotel purchase transactions. Several months after the purchase of the two hotels, the Housing Commission's General Counsel became aware that the broker had purchased stock shares in the parent company of the Residence Inn Hotel Circle property before the close of the Housing Commission's purchase.

In August 2021, the City Attorney's Office brought legal action against the broker for fraud, breach of fiduciary duty, breach of contract, and violation of the State of California's government code barring public officials from being personally financially interested in the contracts they oversee.

At its September 12, 2022, meeting, the Housing Authority approved a settlement agreement, which the City Attorney's Office negotiated, requiring the broker to pay the Housing Commission $845,000 for the Residence Inn Hotel Circle acquisition and an additional $155,000 to the City to compensate for City Attorney resources used to prosecute the lawsuit. As part of the settlement agreement, the Housing Commission and the City released all potential claims against the broker related to this issue.

Finding 1

The Housing Commission largely follows property acquisition best practices, but the agency used an appraisal that potentially overvalued a hotel property by $6.7 million.

Finding Summary

We found that the Housing Commission followed real estate acquisition best practices for all of its property acquisitions from fiscal year (FY) 2014 through FY2023, except for one, the purchase of the Residence Inn Hotel Circle in November 2020. In this one case, we found that the Housing Commission accepted and used an appraisal report that had a valuation date almost six months prior to the appraisal inspection date to acquire the Hotel Circle property. Also, the appraisal valuation date predated the onset of the COVID-19 pandemic and therefore did not consider any impact the pandemic had on the hotel's value. Since the Housing Commission does not have a policy requiring it to provide appraisal reports in its supporting documentation to its oversight bodies, the Board of Commissioners (Board) and the San Diego Housing Authority (Housing Authority), the Commission only provided the oversight bodies with the appraised value amount but did not provide them with the full appraisal report, which would have informed them that the appraisal predated the pandemic. Real estate acquisition best practices typically recommend appraisal valuation dates correspond with property inspection dates. Therefore, by using a retrospective valuation date to purchase the property, the Housing Commission did not follow best practices and consequently may have overpaid for the acquisition by $6.7 million.

The Housing Commission largely followed best practices when it acquired several properties for affordable and permanent supportive housing during the FY2014 through FY2023 period.

As discussed in the Background section, the Housing Commission executed five property acquisition transactions, from FY2014 through FY2023, which resulted in the acquisition of six properties to provide affordable and permanent supportive housing. During this audit, we reviewed the policies and processes the Housing Commission used to acquire the following properties displayed in **Exhibit 8**.

Exhibit 8

The Housing Commission Completed Five Acquisitions, Totaling Six Properties Costing $158.6 Million for 642 Units From FY2014 through FY2023

1 Village North Senior Gardens

- Purchase price: $14.8 million
- Total cost: $14,936,028
- Purchase year: 2015
- Units: 120
- Property type: Multi-family
- Housing type: Affordable and permanent supportive

2 Quality Inn & Westpark Inn

- Purchase price: $15.2 million
- Total cost: $15,798,557
- Purchase year: 2017
- Units: 139
- Property type: Hotel
- Housing type: Permanent supportive

3 Hillcrest Inn

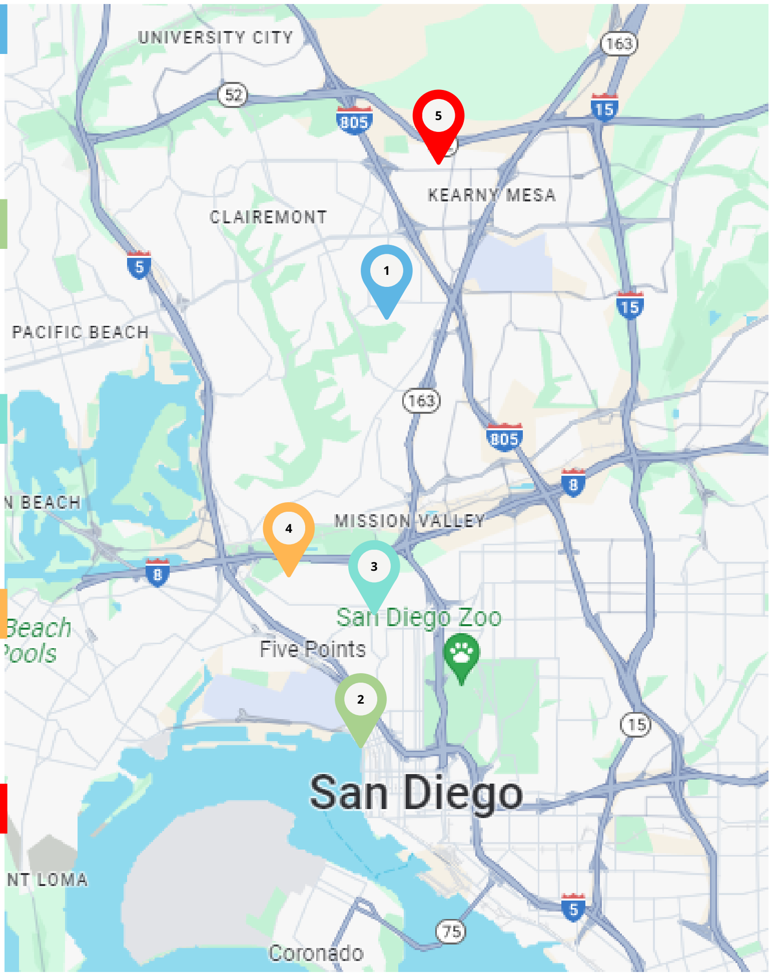
- Purchase price: $8 million
- Total cost: $10,096,727
- Purchase year: 2020
- Units: 47
- Property type: Single-room occupancy
- Housing type: Affordable and permanent supportive

4 Residence Inn Hotel Circle

- Purchase price: $67 million
- Total cost: $72,746,370
- Purchase year: 2020
- Units: 192
- Property type: Hotel
- Housing type: Permanent supportive

5 Residence Inn Kearny Mesa

- Purchase price: $39.5 million
- Total cost: $44,999,958
- Purchase year: 2020
- Units: 144
- Property type: Hotel
- Housing type: Permanent supportive



Source: OCA generated based on information provided by the Housing Commission.

We found that the Housing Commission largely followed industry best practices when acquiring the six properties. Specifically, as shown in **Exhibit 9**, the Housing Commission's acquisition process includes a robust and comprehensive due diligence phase that uses a checklist to track and note completed steps, a third-party review to verify due diligence was properly followed, legal counsel review of the acquisition process, and oversight approval of the acquisition prior to purchase.

Exhibit 9

The Housing Commission's Acquisition Process Incorporates Most Acquisition Best Practices

Followed?	Best Practice
—	Acquisition strategy
✓	Property need clearly established
✓	Due diligence checklist
✓	Use of third-party contractors
—	Appraisal valuation date aligns with property inspection date
✓	Conduct physical inspection
✓	Purchase price is at or below appraised value
✓	Third-party review
✓	Legal review
✓	Oversight approval

Source: OCA generated based on information gathered from benchmarking entities.

However, as shown in **Exhibit 9** above, apart from not having a formal acquisition strategy, which we discuss in Finding 2, we found that the Housing Commission did not follow the best practice of using an appraisal with a valuation date that corresponds to the appraisal inspection date for its acquisition of the Residence Inn Hotel Circle property. As shown in **Exhibit 10**, according to multiple sources, the best practice when performing an appraisal is to value the property the same day the appraiser visits the property site.

Exhibit 10

Several Government Organizations Recommend Using an Effective Value Date That Corresponds to the Appraisal's Inspection Date as a Best Practice

U.S. Department of Housing and Urban Development (HUD)	The **effective date of the opinion of value** for an appraisal should be the **date that the designated appraiser inspected the subject** property.
Uniform Standards of Professional Appraisal Practice (USPAP)	The **effective date of value** will be the **date of the appraiser's inspection**.
California Department of Housing & Community Development (HCD) Homekey 3.0 Appraisal Guidelines	Appraiser must **report the fair market value** of a property's existing use at the **date of inspection**, without consideration of Homekey or other funding.
U.S. General Services Administration (GSA)	Appraiser inspects the property and **determines a value based on the day of the last inspection**.

Note: California's Department of Housing and Community Development's Homekey 3.0 Appraisal Guidelines were issued during the third round of Homekey funding awards in 2023, and thus were not in effect at the time of the Housing Commission's purchase of the Residence Inn Hotel Circle property in November 2020.

Source: OCA generated based on federal and state real estate appraisal guidelines/policies.

The Housing Commission acquired the Residence Inn Hotel Circle property using a retroactive appraisal valuation date, which may have overstated the actual value of the property.

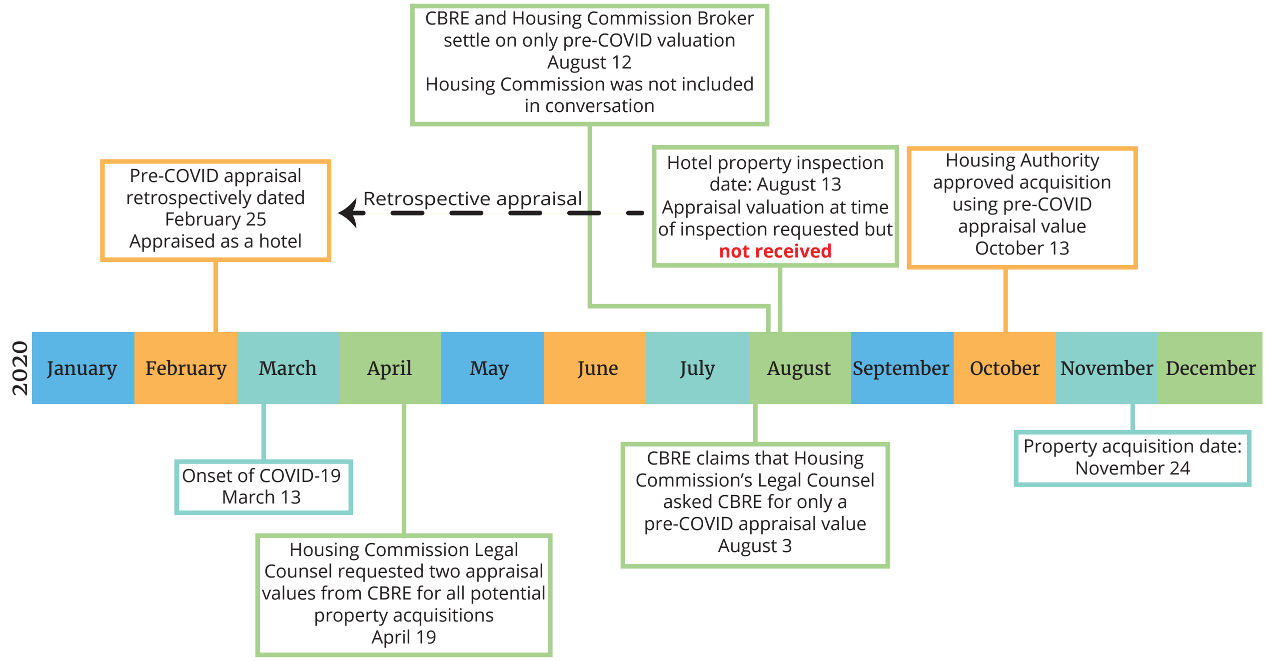
We found that the Housing Commission followed industry best practices for the Residence Inn Kearny Mesa hotel acquisition, while the acquisition of the Residence Inn Hotel Circle did not—even though both properties were purchased on the same day and the Housing Commission contracted the same companies to conduct appraisals and market studies, and to review due diligence reports. The Residence Inn Hotel Circle property acquisition used a retrospective fair property value dated nearly six months earlier, whereas the Kearny Mesa property appraisal was dated July 21, 2020, which was the same day the appraiser performed the site visit, and months closer to the Housing Commission's purchase date.

As described in the Background section and **Appendix C** of this report, when the Housing Commission identifies a potential property for purchase, there are a series of steps the agency takes to identify the value and condition of said property; these steps are part of the agency's due diligence process. A property appraisal is one part of the Housing Commission's due diligence process where the agency hires an appraiser to inspect the property and determine its fair market value. To determine the property value, the appraiser must determine what the best use of each property is. This means the appraiser inspects the property and decides what the best legal, maximally productive, and financially feasible use of a property is that will result in the highest value.

During the due diligence process for this acquisition, the Housing Commission's legal counsel requested in April 2020 that the appraisal company, CBRE, provide two appraisal valuations for all prospective hotel acquisitions: one to determine the current as-is value of the hotel in the midst of the COVID-19 pandemic, and one to determine the value of the hotel before the onset of the COVID-19 pandemic to show that, over time, the property's value would approach the pre-pandemic valuation, which could have presumably been higher. However, according to the Housing Commission, CBRE only provided one appraisal for the Residence Inn Hotel Circle property with a pre-COVID valuation date. As discussed further in **Appendix D**, CBRE and the Housing Commission's legal counsel disagreed over the chain of events that led to the delivery of an appraisal with just the pre-COVID valuation date. **Exhibit 11** provides a timeline of the events we were able to verify.

Exhibit 11

After Initially Requesting Two Appraisals, One with a Pre-COVID Valuation and the Other with a Current Valuation, for the Residence Inn Hotel Circle Property, the Housing Commission Accepted One Appraisal with a Pre-COVID Valuation for the Hotel



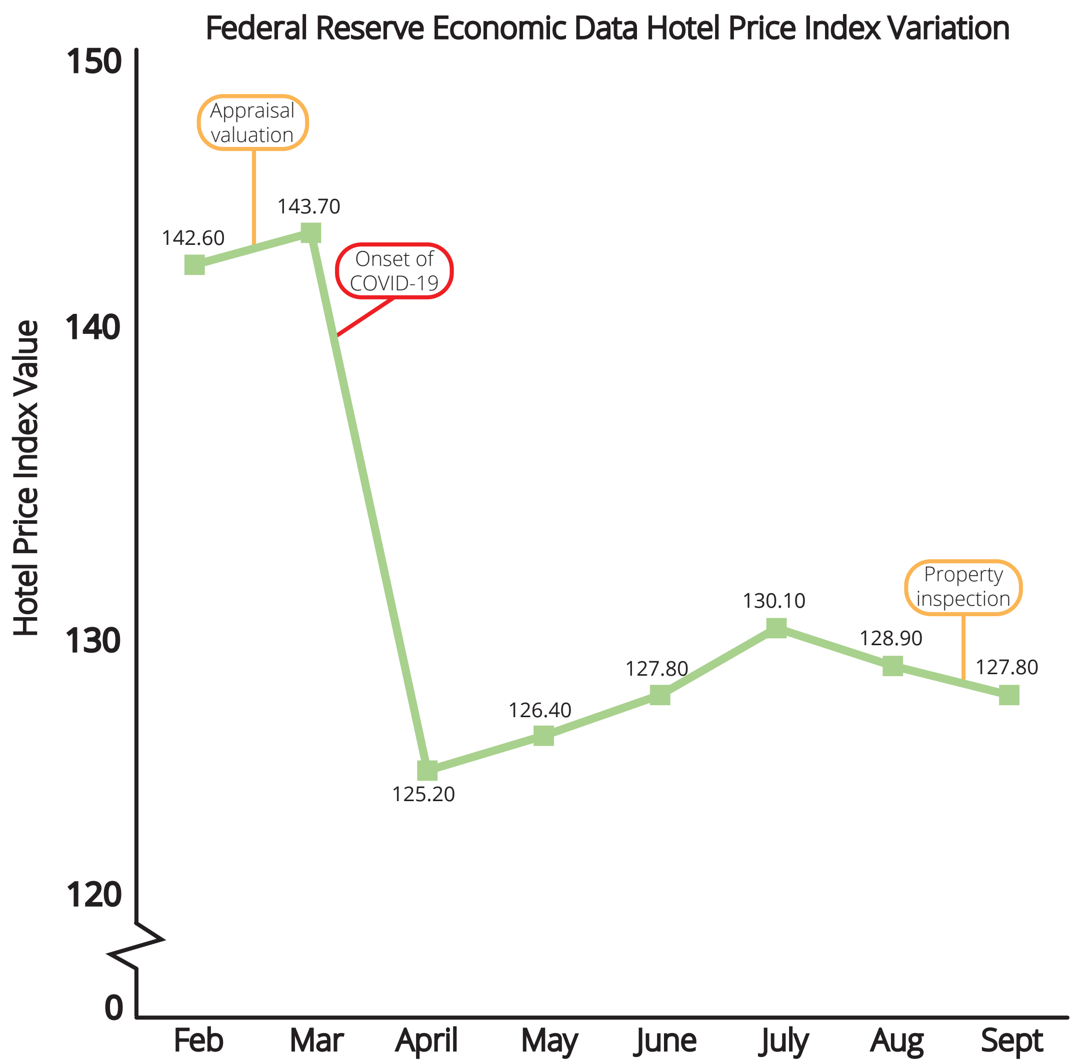
Source: OCA generated based on appraisal information supplied by the Housing Commission.

Ultimately, the Housing Commission accepted CBRE's pre-COVID appraisal valuation for Residence Inn Hotel Circle—which did not reflect a likely lower value for the property at the time of purchase—and used it as the basis for the agreed upon acquisition price of $67 million. We found that the best practice is for an appraiser to determine a fair market value and the property's highest and best use on the same day the property is inspected. By contrast, for Residence Inn Hotel Circle, CBRE performed the property assessment on August 13, 2020, and reported that the property was worth $68.1 million as of February 25, 2020, six months prior to the property inspection and nearly a month prior to the onset of the COVID-19 pandemic.

The COVID-19 pandemic generally reduced the value of hotels due to a sudden decline in travel. CBRE's appraisal even included a section in its report titled, "Important Warning – Market Uncertainty from Novel Coronavirus," which stated that when the report was issued in August 2020, "...market conditions and corresponding values for hospitality properties throughout the country have been materially impacted by the onset of the COVID-19 pandemic." We reviewed the value of hotels reported by the Federal Reserve Economic Data (FRED) and found that the price index of hotel values between February and August of 2020 decreased by approximately 10 percent nationwide within these six months, as shown in **Exhibit 12**.[7]

Exhibit 12

Hotel Values Decreased as a Result of the COVID-19 Pandemic



Source: OCA generated based on FRED hotel index report for 2020.

7 According to the Housing Commission, the Residence Inn Hotel Circle property is an extended stay hotel, and the pandemic may not have impacted this property to the same extent as other types of hotels. The agency also notes that it pursued this property (i.e., extended-stay hotel model) for Homekey program funding largely because the seller was willing to cause the property to be vacant at time of closing and the property was equipped to function as apartments as-is. The FRED hotel price index used to perform our analysis on the effect of COVID-19 on hotel prices does not specify how the pandemic affected different types of hotels; therefore, we performed the analysis with the data available, which considered all hotel types.

We estimate that the agency might have overpaid by $6.7 million for one acquisition.

Since the Housing Commission accepted CBRE's appraisal with a retrospective valuation of $68.1 million in February 2020, and subsequently purchased the property for $67 million in November 2020, we estimate that the agency might have overpaid by $6.7 million for this acquisition had the appraisal's valuation accounted for the 10 percent decrease in hotel property values at the time of the appraisal site inspection.[8]

The Housing Commission's staff report to its oversight bodies for the Residence Inn Hotel Circle and Kearny Mesa acquisitions did not include key information about Residence Inn Hotel Circle's appraisal.

We found that the Housing Commission's Executive Summary Report to both its Board of Commissioners and the San Diego Housing Authority for the Residence Inn hotels' acquisitions did not indicate that the Residence Inn Hotel Circle property's appraisal value was based on a retrospective valuation that pre-dated the onset of the COVID-19 pandemic. We reviewed the Housing Commission's Property Acquisition Policy and found that the policy's appraisal requirement does not specify that an appraisal valuation date should correspond to the date the designated appraiser inspected the subject property. The policy also does not require the Housing Commission to provide appraisal or third-party review reports to its Board of Commissioners or the San Diego Housing Authority when seeking approval to acquire a property.

For the reasons outlined above, both the Housing Commission's Board of Commissioners and the San Diego Housing Authority approved the Housing Commission's request to acquire Residence Inn Hotel Circle for $67 million without receiving key information regarding the Residence Inn Hotel Circle property's appraisal valuation. As stated above, we found that the effects the COVID-19 pandemic reduced hotel market prices by approximately 10 percent nationwide from February 2020 to six months later in August when the appraisal site visit was performed—the time when best practices state the property valuation should be made. Therefore, we estimate that the Housing Commission

8 The Housing Commission demonstrated awareness of the pandemic's potential impact on property value when acquiring the Hillcrest Inn property, purchased nearly two months earlier, by requesting that the appraiser, CBRE, value the property in June of 2020, four months after the property inspection date. However, CBRE determined that COVID-19 did not affect the property price because Hillcrest Inn was valued as multifamily apartments and apartment building prices were increasing at the time. Additionally, the email from the Housing Commission's legal counsel requesting two appraisal dates for the hotel acquisitions showed awareness of this impact, since it stated that the current value was for the purpose of making the purchase and the retrospective was for considering potential value in the future.

may have saved $6.7 million, which could have been used for other permanent supportive housing efforts, had it acquired the property for a purchase price based on the appraisal inspection date (August 2020) rather than the retrospective valuation (February 2020).

Recommendations

Overall, while we found that though the Housing Commission followed best practices for most of its affordable and permanent supportive housing acquisitions during the FY2014 through FY2023 period, it did not do so for its November 2020 acquisition of the Residence Inn Hotel Circle property. For this acquisition, the Housing Commission accepted an appraisal that did not follow best practices and used a retrospective valuation that pre-dated the COVID-19 pandemic to inform the purchase price. Because the Housing Commission used an appraisal value that did not align with current hotel market conditions, it increased the risk of overpaying for the property.

To better align the Housing Commission's future property acquisitions with best practices and avoid potentially overpaying for future properties, we recommend:

Recommendation 1.1 (Priority 2)

The Housing Commission should update its policies and procedures related to appraisals to:

a. Include a requirement stating that appraisal valuation dates must correspond to the date that the appraisal site inspection is performed. If circumstances require the Housing Commission to deviate from this best practice, the policy should require that the Housing Commission inform its Board of Commissioners and the Housing Authority as to why it has done so.

b. Require that a copy of the third-party due diligence report and all appraisal reports be included as attachments in the Housing Commission's Executive Summary, which is presented to the Housing Commission's Board of Commissioners and the San Diego Housing Authority.

c. Include a statement that requires the Housing Commission to follow up with contracted vendors if the entirety of the requests and services the Housing Commission requested were not provided in full prior to moving forward with any major property purchase. The statement should specify that the Housing Commission will not pay for services that are incomplete and also require the Housing

Commission's Executive Vice President of Real Estate or above to sign off on all appraisal scope of work requests. This step should also be included in the agency's due diligence acquisition checklist.

Management Response: Agree [See full response beginning on page 41.]

Target Implementation Date: July 2024

Recommendation 1.2 (Priority 2)

As part of the Housing Commission's Procurement Optimization Project, which the agency anticipates will include the establishment and implementation of a contractor evaluation project, the Housing Commission should complete a vendor performance evaluation for CBRE documenting its performance in providing appraisals for Residence Inn Hotel Circle and Residence Inn Kearny Mesa.

Management Response: Agree [See full response beginning on page 42.]

Target Implementation Date: Target date pending. According to the Housing Commission, the agency is in the process of a comprehensive procurement optimization project, which will incorporate a Contractor Performance Evaluation Program. Once the Contractor Evaluation Program is updated, the Housing Commission will conduct a contractor evaluation of CBRE.

Finding 2

The Housing Commission should establish a documented acquisition strategy and an annual acquisition goal to improve transparency and to support both the agency and the City's priority of expanding affordable and permanent supportive housing.

Finding Summary

While the San Diego Housing Commission (Housing Commission) acquired a relatively small number of properties to create affordable housing or permanent supportive housing during the fiscal year (FY) 2014 through FY2023 period, we found that the Housing Commission does not use a formal acquisition strategy to guide its decision-making process in pursuing such acquisitions. We also found that the Housing Commission does not have a formal annual acquisition goal to track and measure the results of the agency's property acquisitions. According to the Housing Commission, this is a result of not having a dedicated revenue source to regularly pursue property acquisitions. However, as the Housing Commission was involved in creating nearly all of the affordable and permanent supportive housing in the City during the FY2014 through FY2023 period, the establishment and use of a formal acquisition strategy and an annual acquisition goal could increase transparency and accountability in how the Housing Commission's acquisition activities directly impact the agency and City of San Diego's (City) goal of expanding affordable and permanent supportive housing in the City.

The Housing Commission could use a formal property acquisition strategy and an annual acquisition goal to guide and measure the agency and the City's affordable and permanent supportive housing efforts.

We found that the Housing Commission lacks a formal property acquisition strategy and an annual acquisition goal that could increase stakeholders' awareness of how the agency's acquisition activities contribute to both the City's Regional Housing Needs Allocation (Regional Housing) target of producing approximately 45,000 affordable housing units and its goal of creating 2,802 permanent supportive housing units for individuals experiencing homelessness by calendar year 2029.[9] According to the Housing Commission, its

9 Regional Housing Needs Allocation targets are determined by the California Department of Housing and Community Development for each region of the state based on factors such as population and housing supply. The State, with input from local jurisdictions and the San Diego Association of Local Governments (SANDAG), decide the share of the region's housing needs that the City of San Diego is responsible for creating.

FY2022–FY2024 Strategic Plan (Plan), which includes identifying opportunities to produce and retain affordable and permanent supportive housing options as its first strategic priority, helps guide the agency's strategic initiatives. However, the Plan does not describe how property acquisitions fit into the agency's overall strategy to increase such housing. Furthermore, none of the Housing Commission's annual reports or annual budget documents include an annual acquisition goal.

The Housing Commission plays an outsized role in helping produce the overwhelming majority of affordable housing in the City.

Though the Housing Commission is not directly responsible for ensuring the City reaches its Regional Housing goal, it plays an outsized role in helping produce the overwhelming majority of affordable housing in the City.[10] As noted above, the Housing Commission is involved in creating most of the affordable and permanent supportive housing options in the City, through both the provision of funding to developers and the direct acquisition of properties. Therefore, having a formal property acquisition strategy, along with an annual acquisition goal, that clarifies the extent to which the Housing Commission pursues property acquisitions to increase such housing options, as well as communicates how the agency is performing with respect to its property acquisition activities, would help provide additional transparency and accountability for stakeholders, such as the Mayor, City Council, and the public.

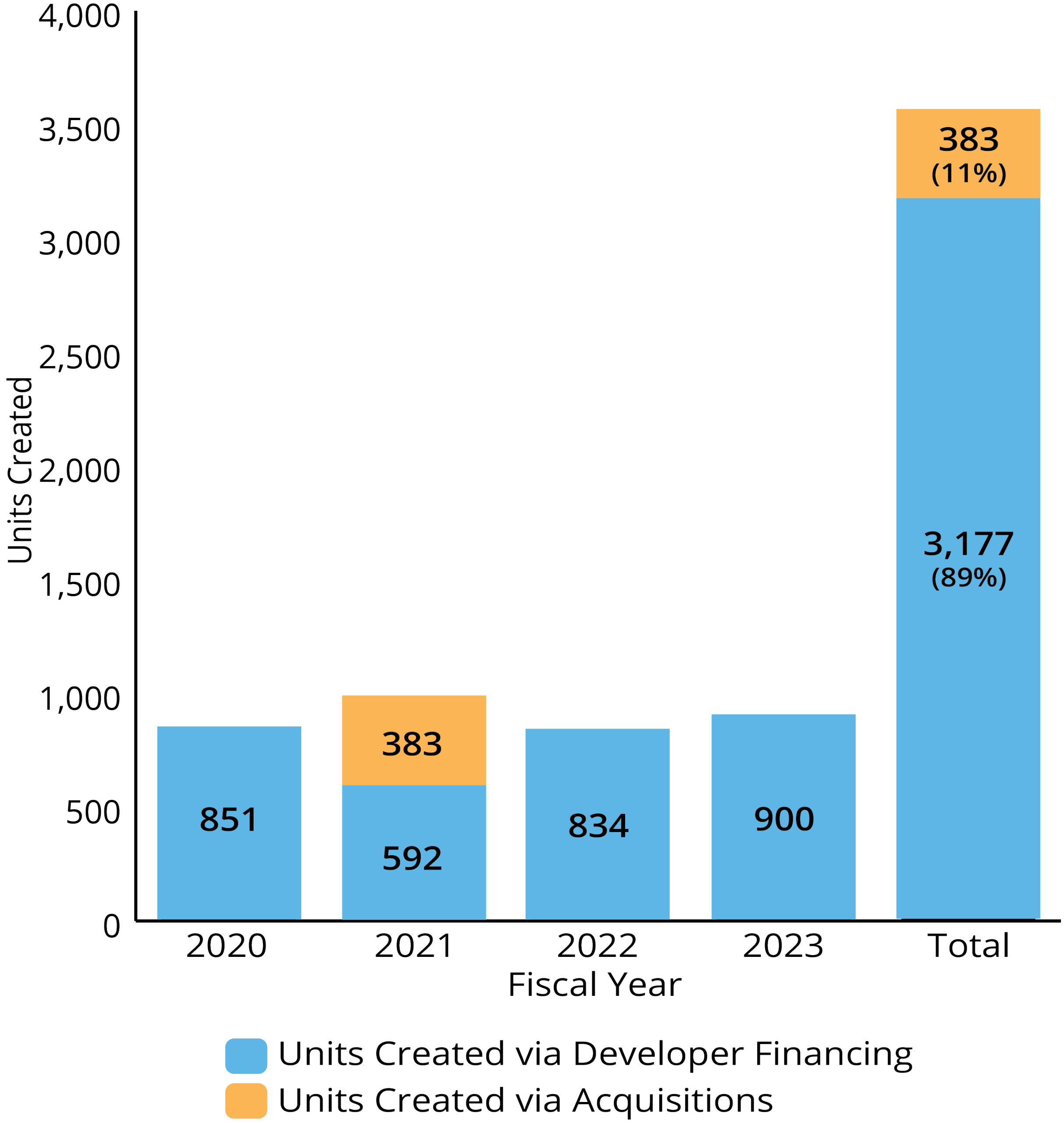
As shown in **Exhibit 13** below, based on Housing Commission data of the total number of affordable housing units it has helped create in the City during the FY2020 through FY2023 period, acquisitions accounted for 11 percent of such units. While most of the affordable housing the Housing Commission helps produce is accomplished through financing for developers, having a documented property acquisition strategy with an annual acquisition goal would clarify to stakeholders how property acquisitions align with the Housing Commission's overall strategy to increase affordable housing throughout the City, which directly contributes to the City's progress toward its Regional Housing goal.[11]

10 According to the Housing Commission, progress toward the City's Regional Housing goal is measured by the number of permits the City's Development Services Department issues each year.

11 According to the Housing Commission, though the agency does not set an annual acquisition goal, it does set annual affordable housing production goals associated with the agency's financing of affordable multifamily housing developments. These goals, which are set through the budgeting process, depend on the availability of regular and foreseeable funding sources, such as the City of San Diego's Inclusionary Housing Fund and federal HOME funds, which vary from year to year.

Exhibit 13

Though Acquisitions Have Made Up a Relatively Small Portion of the Housing Commission's Total Housing Production Since FY2020, They Still Help Contribute to the City's Progress Toward Its Regional Housing Goal



Source: OCA generated based on affordable housing production data provided by the Housing Commission.

Other California housing agencies use an acquisition strategy to help inform stakeholders of efforts to increase affordable housing.

We found that other major California cities' housing agencies use acquisition strategies and annual acquisition goals to guide their affordable housing production activities and that industry best practices recommend the use of such strategies, as shown in **Exhibit 14** below.

As part of its efforts to increase affordable housing options, the Housing Authority of the City of Los Angeles (HACLA) uses a property acquisition strategy that prioritizes the acquisition of improved residential properties, which do not require significant repairs or improvements. Also, the agency has a goal to acquire 100–250 units per year to advance its overall strategy of increasing affordable housing options and diversifying housing options in response to market demands.

The City and County of San Francisco's Mayor's Office of Housing and Community Development (MOHCD) also uses an acquisition strategy, known as its Small Sites Program, which involves acquiring multifamily rental properties with 5–40 units to convert to permanent affordable housing and prioritizes buildings where tenants are at risk of eviction due to the sale of the property. Also, according to the agency's 2020–2021 Action Plan, the Small Sites Program has an annual goal to acquire 171 units of existing housing units for preservation as affordable housing.

Acquisition strategies and annual goals help clarify to stakeholders the types of acquisitions an agency prioritizes.

Both San Francisco's and Los Angeles' acquisition strategies and annual acquisition goals help clarify to stakeholders the types of acquisitions the agencies prioritize, as well as the extent to which the agencies' resources will go toward property acquisitions relative to other methods the agencies use to create affordable housing. According to the Housing Commission, these housing agencies rely upon consistent funding streams, which not only allow them to regularly pursue acquisitions, but also aid in establishment and use of acquisition strategies.

Exhibit 14

San Francisco and Los Angeles' Housing Agencies' Acquisition Strategies Clarify the Types of Acquisitions the Agencies Prioritize

	Types of Acquisitions Outlined in Acquisition Strategy	Annual Acquisition Units Created Goal	Dedicated Funding Source?
San Francisco	Multifamily rental properties with 5–40 units and tenants at risk of eviction due to sale of property.	171 units	Yes
Los Angeles	Residential properties that do not require significant repairs/improvements.	100–250 units	Yes

Source: OCA generated based on annual reports of San Francisco's and Los Angeles' housing agencies.

Industry best practices also recommend making individual real estate decisions in the context of a larger portfolio strategy. The primary goal of portfolio strategies in the private sector is typically to achieve a specific annual average rate of return and to adjust the portfolio to a more attractive risk/reward relationship. However, in the case of a public entity, such as the Housing Commission, a portfolio strategy might establish an annual average production of affordable housing units rather than an average rate of return, as well as assess risk/reward relationship in the context of deciding whether to make funding available for developers to create affordable housing or use such funding to directly acquire a property to accomplish the same goal.

The Housing Commission could be more transparent about how property acquisitions advance its overall strategic goals with an official documented acquisition strategy.

According to Housing Commission staff, its property acquisition strategy, which they describe as an informal strategy, is largely driven by the agency's annual budget process, which involves determining, year-by-year, whether there are funding opportunities for property acquisitions. In the context of acquisitions, the Commission also notes that its Strategic Plan guides the agency's strategic initiatives.

Though the Housing Commission's Strategic Plan states that its first priority is to increase affordable and permanent supportive housing options, it does not specify how acquisitions tie into this strategy, nor does it commit to a specific annual goal of units acquired. As a result, the Housing Commission could be providing stakeholders, such as the Mayor, the City Council, and the public more transparency into how the Housing Commission's property acquisitions, which on average cost $31.7 million per acquisition over the last 10 years, contribute to the agency's overall strategy to increase affordable and permanent supportive housing in the City.

The Housing Commission's acquisitions from FY2014 through FY2023 make up only 10 percent of all affordable housing the agency was involved in creating in the City during that period. However, since the City's adoption of the Community Action Plan on Homelessness in Fiscal Year 2020, acquisitions make up 35 percent of all permanent supportive housing units created with the involvement of the Housing Commission. The plan aims to create 2,802 permanent supportive housing units by calendar year 2029. As displayed in **Exhibit 15**, the Housing Commission acquired four properties, which led to the creation of 435 permanent supportive housing units out of a total of 1,237 units the agency was involved in creating during this time period.

Exhibit 15

Housing Commission Property Acquisitions Made Up Roughly 35 Percent of All Permanent Supportive Housing the Agency Was Involved in Creating During the FY2020 through FY2023 Period

Method of PSH Creation	Number of PSH Properties Created (FY2020–FY2023)	Number of PSH Units Created (FY2020–FY2023)	Percent of Total PSH Units Created (FY2020–FY2023)
Property Acquisition	4	435	35%
Financing Developers	14	802	65%
Total	**18**	**1,237**	**100%**

Source: OCA generated based on the Housing Commission's FY2022 and FY2023 Annual Reports.

Because property acquisitions make up a significant portion of the Housing Commission's efforts to increase permanent supportive housing for individuals experiencing homelessness in the City, we recommend the Housing Commission create an acquisition strategy that includes an annual acquisition goal. Having a formal strategy and annual goal would help ensure the agency is communicating to stakeholders how it intends to use its limited resources and track its progress in helping the City reach its goal of creating 2,802 units of permanent supportive housing by calendar year 2029.

Recommendations

Given the Housing Commission's pivotal role in creating most of the permanent supportive housing and affordable housing in the City, having a documented acquisition strategy and an annual acquisition goal would help improve transparency for stakeholders as to how its property acquisitions fit into the agency's overall strategic priority of increasing affordable and permanent supportive housing options in the City as well as increase accountability by better tracking how its property acquisitions are helping the City reach its affordable and permanent supportive housing goals. Establishing an acquisition strategy could also better position the Housing Commission to respond when funding opportunities for potential acquisitions arise.

To help improve transparency and increase accountability of the Housing Commission's property acquisition activities, we make the following recommendation:

Recommendation 2.1 (Priority 2)

As the Housing Commission updates its Strategic Plan, it should include a property acquisition strategic component that clarifies how property acquisitions fit into the agency's strategic priority of increasing affordable and permanent supportive housing options in the City.

Management Response: Agree [See full response beginning on page 42.]

Target Implementation Date: Target date pending. According to the Housing Commission, as the agency updates its Strategic Plan, it will incorporate a written acquisition strategy.

Recommendation 2.2 (Priority 2)

The Housing Commission should develop an annual performance metric specific to property acquisitions based on available funding for acquisitions in the upcoming fiscal year and include this metric in either its Annual Budget document or its Annual Report. If acquisition funding is not available for the upcoming fiscal year, a goal of zero is appropriate and logical. However, if funding becomes available in future years for acquisitions, a specific acquisition metric should be established.

Management Response: Disagree [See full response beginning on page 43.]

Target Implementation Date: N/A

The Housing Commission's funding strategy for property acquisitions generally lines up with benchmark housing agencies' strategies and general best practices.

As part of our objective to determine whether the Housing Commission has a funding strategy for property acquisitions based on best practices, we also compared the Housing Commission's Strategic Plan's overall funding strategy to other California housing agencies' funding strategies and general local housing funding strategy best practices.

The Housing Commission's Strategic Plan (Plan) for FY2022 to FY2024 provides a broad outline of the agency's overall funding strategy to support the Plan's first priority of identifying opportunities to produce and retain affordable and permanent supportive housing solutions. The Plan notes that the Housing Commission uses funding mechanisms, such as public-private partnerships, local, county, state, and federal collaboration, Notice of Funding Availability, and tax-exempt bonds and tax credit financing, to help increase and preserve affordable housing solutions throughout the City. Also, specific to the Housing Commission's efforts to advance homelessness solutions, the Plan states that the agency will proactively explore new funding mechanisms and external partners with funding capabilities (e.g., County of San Diego, philanthropic and public-private opportunities). Though not explicitly stated in the Plan, the Housing Commission uses property acquisitions to further its goal of both increasing affordable housing and advancing homelessness solutions in the City.

As shown in **Exhibit 16**, we concluded that the Housing Commission's funding strategy to increase affordable housing and advance homelessness solutions, which includes directly acquiring properties, lines up with public sector best practices, such as pursuing additional funding mechanisms and partners as well as using a mix of different funding sources to help create affordable and permanent supportive housing options. Therefore, we did not make any recommendations specific to this objective.

Exhibit 16

The Housing Commission's Funding Strategy Incorporates Public Sector Best Practices

<table>
<tr><th>Agency/Organization</th><th>Funding Strategy Best Practice</th><th>San Diego Housing Commission Funding Strategy</th></tr>
<tr><td>Sacramento Housing & Redevelopment Agency</td><td>Affordable Housing Plan
• Obtain ongoing annual commitments of additional funding from partners.
• Pursue additional opportunities for federal funds
• Pursue ballot & bond initiatives for increased funding.
• Explore adoption of a residential vacancy tax.</td><td rowspan="3">Funding Strategy
• Proactively explore new funding mechanisms and external partners with funding capabilities (e.g., County of San Diego, philanthropic and public-private opportunities).
• Increase and preserve affordable housing solutions throughout the City by using funding mechanisms such as public-private partnerships, local, county, state, and federal collaboration, Notice of Funding Availability, and tax-exempt bonds and tax credit financing.</td></tr>
<tr><td>Orange County</td><td>Housing Funding Strategy
Use a mix of Federal (HOME, Community Development Block Grants), State (Homekey), and local funding sources for the production of supportive/affordable housing in Orange County that meet the goals in the County's funding strategy.</td></tr>
<tr><td>Local Housing Solutions (housing policy think-tank)</td><td>Funding a Local Housing Strategy Article
Use housing trust funds (local source), general obligation bonds, multi-family private activity bonds, state funding, and federal funding to help create and preserve dedicated affordable housing.</td></tr>
</table>

Source: OCA generated based on information from benchmarked entities.

Appendix A

Definition of Audit Recommendation Priorities

The Office of the City Auditor maintains a priority classification scheme for audit recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration's responsibility to establish a target date to implement each recommendation, taking into consideration its priority. The City Auditor requests that target dates be included in the Administration's official response to the audit findings and recommendations.

PRIORITY CLASS*	DESCRIPTION
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent nonfiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls exists.
3	Operation or administrative process will be improved.

* The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation that clearly fits the description for more than one priority class shall be assigned the higher priority.

Appendix B

Audit Objectives, Scope, and Methodology

Objective

In accordance with the Office of the City Auditor's Fiscal Year (FY) 2023 Audit Work Plan, we conducted a performance audit of the San Diego Housing Commission's (Housing Commission) property acquisition process. The objectives of this audit were as follows:

1. Determine whether the Housing Commission has a property acquisition strategy that aligns with organizational goals.
2. Determine whether the Housing Commission has a funding strategy for property acquisitions based on best practices.
3. Determine whether the Housing Commission's policies and procedures for acquiring property incorporate industry best practices to increase affordable housing in the City of San Diego (City).

Scope

The scope of this audit included all properties acquired by the Housing Commission to provide affordable housing and permanent supportive housing for individuals experiencing homelessness from FY2014 through FY2023. The Housing Commission is the leading provider of affordable housing and permanent supportive housing in the City through both acquisitions and by acting as a lender to fund developer-built housing, but the scope of this audit only included the Housing Commission's property acquisitions to create affordable and permanent supportive housing units during the scope period.

Our audit focuses on five acquisitions, totaling six properties, within our scoping period up until the date of purchase. The scope of this audit does not include an analysis of the steps that occur after the property is purchased.

The Housing Commission is involved in developing two different types of housing: affordable housing and permanent supportive housing for individuals experiencing homelessness. Affordable housing is defined as housing provided for households who make 80 percent or less of the area median income (AMI). And permanent supportive housing is defined as affordable housing services for people who have a history of homelessness or are at risk of becoming homeless. The scope of this audit includes properties acquired to supply both types of housing in the City.

The property acquisitions included in the scope of this audit are:

- Village North Senior Garden Apartments (2015)
- Quality Inn (2017)
- West Park Inn (2017)
- Hillcrest Inn (2020)
- Residence Inn Hotel Circle (2020)
- Residence Inn Kearny Mesa (2020)

Methodology

Objective 1: To determine whether the Housing Commission has a property acquisition strategy that aligns with organizational goals, we:

- Reviewed the Housing Commission's property acquisition policies and procedures.
- Analyzed number of affordable housing units the Housing Commission was involved in creating during the FY2014 through FY2023 period and compare those figures to benchmark agencies/cities.
- Reviewed and documented public sector property acquisition best practices and compared to the Housing Commission's policies and procedures.
- Interviewed benchmark housing agencies/cities to identify best practices.

Objective 2: To Determine whether the Housing Commission has a funding strategy for property acquisitions based on best practices, we:

- Reviewed documentation for the Housing Commission's funding strategies, policies, and procedures for funding property acquisitions.
- Compared the Housing Commission's strategies, policies, and procedures for funding property acquisitions to benchmark agencies/cities.
- Reviewed the Housing Commission's annual reports.
- Analyzed the Housing Commission's Homekey funding awards and other types of grant awards used for property acquisitions during the FY2014 through FY2023 period and compared to benchmark agencies/cities.
- Interviewed staff at the Housing Commission and benchmark agencies/cities.
- Analyzed budget to actual costs for previous Housing Commission acquisitions.
- Verified that the Housing Commission provides property acquisition training to staff.
- Analyzed the Housing Commission's fund allocation expenditures.
- Reviewed and compared affordable housing funding sources that were received by the Housing Commission and benchmarking agencies.

Objective 3: To determine whether the Housing Commission's policies and procedures for acquiring property incorporate industry best practices to increase affordable housing in the City, we:

- Reviewed previous City of San Diego Office of the City Auditor and Independent Budget Analyst (IBA) reports on the Housing Commission's building acquisitions, improving affordable housing, and the Housing Commission's budget.
- Reviewed previous property and land acquisition processes and affordable housing audits from the City of Los Angeles, Austin, San Francisco, Calgary, Washington D.C., the State of Michigan, the City of Seattle's Sound Transit, and the South Florida Water Management District.
- Interviewed IBA staff that had previously performed audits of the Housing Commission.
- Interviewed Housing Commission staff.
- Interviewed the following authorities responsible for providing public housing in different cities and counties of California to determine best practices for providing affordable housing:
    - Sacramento Housing Authority
    - Housing Authority of the City of Los Angeles
    - Kern County Housing Authority
    - San Francisco's Mayor's Office of Housing and Community Development
    - Long Beach Development Services Department
    - Anaheim Housing Authority
- Reviewed documentation for the Housing Commission's appraisal policies and procedures for property acquisitions.
- Reviewed the Housing Commission's documentation of previous property acquisitions.
- Reviewed the Housing Commission's conflict of interest policy and documents.
- Reviewed previous acquisition projects.
- Review the Housing Commission property acquisition policy and checklists.
- Analyzed San Diego Housing Authority meeting summary reports and resolutions.
- Reviewed the Housing Commission's acquisition checklist compliance.
- Requested official responses from the Housing Commission, the Housing Commission's legal counsel, and CBRE (appraisal company) to answer questions related to the Housing Commission's acceptance and use of an appraisal with a pre-COVID valuation to purchase the Residence Inn Hotel Circle property. See **Appendix D** for more details.

Data Reliability

During this audit, we collected and referenced data from the following sources:

- Data provided by the San Diego Housing Commission from internal information systems
- Data from housing authority and benchmark city websites
- Federal Reserve Economic Data (FRED)
- Point-in-time homelessness count data from the Department of Housing and Urban Development
- Housing units created data pulled from public housing authority annual reports
- Grant funding data from the Department of Housing and Urban Development and California Department of Housing and Community Development reports

According to the Housing Commission, the agency uses Microsoft Excel, websites, databases, and software to source information for its property acquisition process. Because the Housing Commission receives federal and state government funds, it is regularly subject to financial audits by such entities and therefore, we determined that data provided by the Housing Commission's internal systems were sufficiently reliable for the purposes of our audit.

Internal Controls Statement

We limited our review of internal controls to specific controls relevant to our audit objectives, described above. We reviewed San Diego Housing Commission policies and procedures, the Housing Commission's completion and review of its property acquisition checklists, and the role of Housing Commission oversight bodies.

Compliance Statement

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

Appendix C

The Housing Commission's Acquisition Process

As shown in **Exhibit 17** below, the Housing Commission's acquisition process begins with the agency seeking San Diego Housing Commission's Board of Commissioners' approval for a property acquisition and due diligence budget. The Housing Commission will also issue a Request for Proposal to retain a broker, if needed. Once the Board approves the budget, the Housing Commission and Legal Counsel provide "Site Specific Criteria" to the retained broker, which includes location, property type, building occupancy, zoning, unit criteria, proximity to community serving amenities, and other property characteristics. Throughout the year, the Housing Commission also continues to seek additional funding to augment the approved budget.

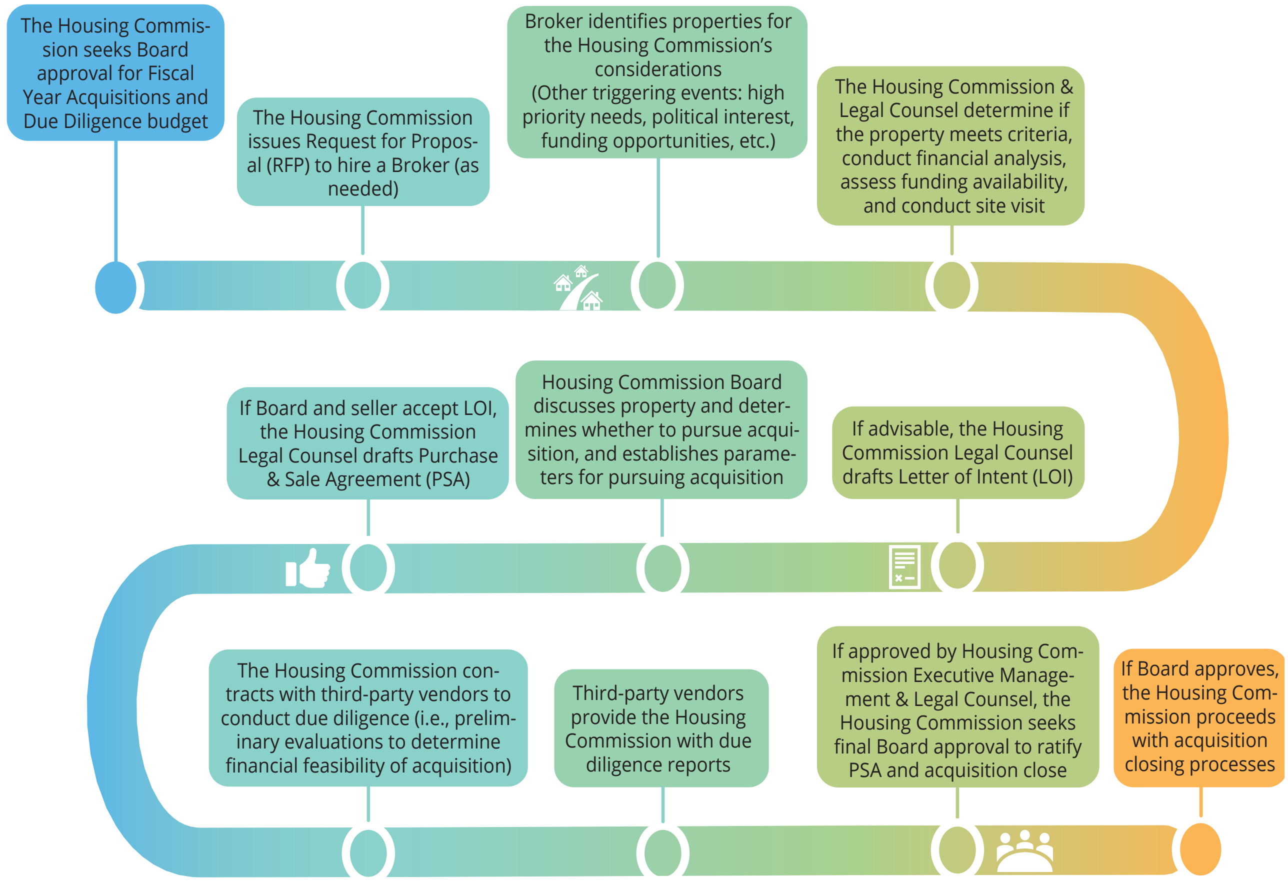
Next, the broker presents properties to the Housing Commission and Legal Counsel for consideration. The agency will then identify a preliminary list of interested properties for site visits, conduct initial financial feasibility for properties of interest (e.g., financial pro formas are prepared for multiple funding scenarios), and identify potential funding sources and determine the amounts available from each source, application timelines, and restrictions.

If the Housing Commission and Legal Counsel determine the acquisition is advisable, its Legal Counsel drafts a Letter of Intent (LOI) to send to the Board. The Board discusses general attributes of the property and determines if there is a consensus as to whether an acquisition is worth pursuing as well as what the parameters are for pursuing said acquisition. If the LOI is accepted by the Board and seller, Legal Counsel drafts a Purchase Sale Agreement (PSA).

Next, the Housing Commission contracts with third-party vendors to provide the agency with due diligence reports covering title reports, zoning and land use, physical need assessment, environmental reports, and other due diligence considerations to determine the property's fair market value and suitability for acquisition. The Housing Commission, Legal Counsel, and third-party reviewers prepare due diligence feasibility analyses to determine if the project is viable for the Housing Commission's Executive Management for consideration to recommend to the Board for approval. If approved by Housing Commission Executive Management and Legal Counsel, the agency seeks final Board approval to ratify the PSA and close out the acquisition process. Once the Board approves, the agency proceeds with acquisition closing processes.

Exhibit 17

The Housing Commission's Property Acquisition Process Involves Multiple Layers of Review and Approval to Finalize an Acquisition



Note: According to the Housing Commission, the agency generally employs a strategy to not be represented by a broker in most transactions. When the Housing Commission is represented by a broker, guidelines in place specify the maximum fee the broker can earn and the broker's duties and responsibilities during the engagement.

Source: OCA generated based on SDHC's Acquisition Process PowerPoint presentation.

Appendix D

Request for Appraisal with Pre-COVID Valuation Date

We contacted CBRE to inquire as to why they had not provided the Housing Commission with an appraisal with a current valuation for the Residence Inn Hotel Circle property, as the Housing Commission's legal counsel requested. CBRE stated that the Housing Commission's legal counsel, in August 2020, changed the appraisal request for Residence Inn Hotel Circle to only one appraisal with a pre-COVID valuation. Furthermore, during this time period, CBRE noted in an email correspondence with the Housing Commission's broker, who was referenced in the Background section, that providing an "as is" value based on a current date would likely be lower than the contract price range of $63–$67 million that CBRE had discussed with the Housing Commission. Nonetheless, the broker claimed in an email that the Housing Commission's legal counsel confirmed that the agency only wanted a pre-COVID appraisal valuation for the property. The email communication did not include anyone from the Housing Commission or its legal counsel as recipients.

We asked the Housing Commission's legal counsel to respond to CBRE's statements regarding the Residence Inn Hotel Circle appraisals. While CBRE's contract did not require both a pre- and post-COVID valuation, the Housing Commission's legal counsel asked CBRE for both valuations in writing. The Housing Commission's legal counsel stated that they did not ask exclusively for a pre-COVID appraisal valuation nor were they aware of or included in the discussion on authorizing the sole use of a pre-COVID valuation. The Housing Commission's legal counsel also referenced correspondence which confirmed CBRE was aware the contract requested that CBRE provide "…an As Is value of the property, which is assumed to be a current date of value which would reflect post-COVID values." According to the Housing Commission's legal counsel, the decision to use a pre-COVID date was made between CBRE and the Housing Commission's broker without involvement by or knowledge of SDHC or SDHC's legal counsel.

SAN DIEGO HOUSING COMMISSION

MEMORANDUM

To: **Andy Hanau, City Auditor, City of San Diego**

From: **Lisa Jones, President and CEO, San Diego Housing Commission**

Date: **March 4, 2024**

Subject: **Response to City of San Diego Performance Audit of San Diego Housing Commission's Property Acquisition Process**

The San Diego Housing Commission (SDHC) appreciates the effort the Office of the City Auditor committed to conducting this audit. Your finding that SDHC largely follows property acquisition best practices reinforces SDHC's core value of belief in transparency and being good financial stewards.

Additional context will be helpful for an appropriate understanding of SDHC's property acquisitions and the specific acquisition of the extended-stay hotel property on Hotel Circle in Mission Valley that is discussed in the report.

Hotel Circle Property in Mission Valley

SDHC's acquisition of the Mission Valley property, now known as Valley Vista, created 190 affordable housing units for people experiencing homelessness during the COVID-19 pandemic. Within two and a half weeks after SDHC purchased the property, people who had been experiencing homelessness began moving into this property as their rental homes. The property remains in use today as permanent affordable rental housing units with supportive services for people who experienced homelessness. The state's Homekey program was a significant source of funds for this acquisition. Homekey in 2020 required awarded funds to be expended by December 30, 2020. In addition, the continuation of Operation Shelter to Home beyond December 2020 was uncertain at that time. Hundreds of people experiencing homelessness during the pandemic were sheltered at the San Diego Convention Center at the time through Operation Shelter to Home, many of whom moved into the Mission Valley and Kearny Mesa properties SDHC acquired.

Property Value

To obtain additional clarity for members of the SDHC Board of Commissioners, the City Council and the citizens of San Diego regarding the propriety of the amount SDHC paid to acquire the Valley Vista property, SDHC obtained new independent appraisals of the property last year. One appraisal was based on real estate market conditions as they existed in 2020, when SDHC purchased the property, and the second appraisal was based on market conditions in 2022. These appraisals were performed by a highly qualified and respected organization, BTI

Appraisal. The fair market value of the property on March 1, 2022, was determined to be $88 million, a 31 percent increase from what SDHC paid for the property. The fair market value on August 20, 2020, was determined to be $69 million, or $2 million higher than what SDHC paid for the property in 2020. The appraised values were based on the "highest and best use" of the property, which the appraiser independently determined to be market-rate apartments. The BTI Appraisal reports were completed "in accordance with requirements dictated by the Uniform Standards of Professional Appraisal Practice, 2022-2023 Edition @ The Appraisal Foundation." The results reflected that the amount SDHC paid for the property in 2020 was reasonable based on the conditions at the time and that the property has increased in value.

In footnote 8 of your report, you mentioned a comparison with the appraisal for Hillcrest Inn in 2020, stating, "However, CBRE determined that COVID-19 did not affect the property price because Hillcrest Inn was valued as multifamily apartments and apartment building prices were increasing at the time." This statement from your office supports the reasonableness of the price SDHC paid for the Mission Valley property. BTI Appraisal independently determined that the "highest and best use" of the Mission Valley property was market-rate apartments, the value of which, as discussed in the footnote, was not affected by COVID-19.

In accordance with program requirements for the Homekey grant funds used for this acquisition, SDHC always intended to operate the Mission Valley property as multifamily housing and has operated it as such for more than three years. As a public agency, SDHC would never have considered operating the property as a hotel. The average price per unit for apartments during the same time period, according to Costar, was $385,000 per unit. The cost per unit for SDHC's purchase of the Mission Valley property was $348,958. SDHC recognized an opportunity in the market to reposition the property as a residential property for less than the replacement value of apartment units.

While only data that reflect the specific conditions of the real estate market in San Diego would give a truly accurate assessment of value, we share with you numerous sources not represented in your report that also indicate that the extended-stay hotel segment was not impacted by the pandemic to the degree assumed for the hospitality segment at large. These include:

- https://www.nytimes.com/2021/05/20/magazine/extended-stay-hotels.html
- https://lodgingmagazine.com/the-extended-stay-segment-reaches-new-heights/#:~:text=While%20many%20of%20the%20hotel,according%20to%20an%20IBISWORLD%20report.
- https://www.costar.com/article/282568541/extended-stay-hotels-a-pandemic-success-story-remain-investors-darling
- https://www.hotelmanagement.net/operate/extended-stay-report-extended-stay-still-tough-enough-tough-times
- https://www.phgproperties.com/news/2021-extended-stay-hotel-market-recap

Footnote 7 of your report acknowledges the limitations on the data you relied on in estimating a potential overpayment for the Mission Valley property. The footnote states, "The FRED hotel price index used to perform our analysis on the effect of COVID-19 on hotel prices does not specify how the pandemic affected different types of hotels; therefore, we performed the analysis with the data available, which considered all hotel types."

The data limitations your report acknowledged and observed regarding the hotel price index you used, and the additional details provided above strongly suggest it is highly unlikely that SDHC overpaid for the Mission Valley property. Additionally, the federal index does not reflect local or project-specific conditions in San Diego's unique real estate market. It is well established that in San Diego, supply of land available for residential construction is scarce, and cost of real estate is particularly high. The Federal Reserve Economic Data (FRED) hotel price index incorporates data from other areas with far different conditions that are not comparable to San Diego. In 2020, San Diego ranked as the fourth most expensive city in the U.S., and California as the third most expensive state, with an overall increase in the cost of goods and services over the prior year despite the pandemic's effects. (https://www.sfchronicle.com/bayarea/article/San-Francisco-metro-area-retains-No-1-spot-as-16701789.php).

Your report's speculation that SDHC "potentially overvalued" and "may have overpaid for" the property is not supported by the evidence. In addition, the Mission Valley property has increased in value since SDHC acquired it and remains an asset in efforts to address homelessness by continuing to operate as 190 affordable rental housing units with supportive services for residents.

CBRE Appraisal

SDHC's contract with CBRE for an appraisal of the Mission Valley property in 2020 required the property to be appraised "as is," which in August 2020 would have included the effects of COVID, if any. SDHC's multiple efforts to ascertain from CBRE why they provided only the retrospective appraisal for this property have been unsuccessful to date, due in part to litigation related to the transaction after SDHC had acquired the property.

CBRE's appraisal report anticipated a rapid return to pre-pandemic economic health in the hotel industry. For example, the CBRE appraisal report said, "Our forecasts suggest that while the impact will be severe, it is expected to be short lived. In our most likely forecast scenario, the hotel sector is expected to rebound sharply beginning in the second half of the year." The CBRE appraisal report further identified that the property's value based on the Sales Comparison Approach ($67,700,000 or $352,604/unit) was similar to the value based on the Income Capitalization Approach ($68,100,000 or $354,688/unit).

Actions Taken

Issues related to the broker involved with SDHC's purchase of the property in 2020 were litigated by the City Attorney's Office and resulted in a settlement in which the broker agreed to pay $845,000 to SDHC and $155,000 to the City of San Diego. The broker also agreed to never again conduct business with the City of San Diego or any City-affiliated entities. The San Diego City Council approved the settlement on September 12, 2022.

SDHC also has taken further action to strengthen its processes for real estate acquisitions by adopting an Administrative Regulation regarding Retention of Real Estate Brokers; Operating Procedures for Brokers; and Peer or Desk Review of Appraisals. The Housing Authority approved this Administrative Regulation on March 15, 2022, and it continues to apply to SDHC real estate acquisitions today.

Community Action Plan on Homelessness for the City of San Diego
Your report refers to the permanent supportive housing 10-year goal established in the initial Community Action Plan on Homelessness for the City of San Diego (Action Plan), which the San Diego City Council accepted in October 2019. In fall 2022, the Action Plan's Leadership Council requested that an updated analysis of the crisis response and housing needs in the Action Plan be conducted. As a result, the Action Plan's Implementation Team worked with Corporation for Supportive Housing (CSH) to conduct an updated needs analysis. CSH is a nationally recognized consultant that worked with the Steering Committee to develop the Community Action Plan in 2019. The updated needs analysis was presented to the San Diego City Council on November 14, 2023, and the SDHC Board of Commissioners on November 20, 2023. The updated projected need is supportive housing for 3,500 individuals and 20 families.

As we explained during the audit process, the significant progress made to date in the creation of additional permanent supportive housing in the City of San Diego largely reflects SDHC's efforts to aggressively commit rental housing vouchers to help pay rent for residents of these units, instead of utilizing them for households on our waiting list with low income, including seniors, people with disabilities and families with children. The progress made to date also reflects the use of *one-time* funding sources, such as the State Department of Housing and Community Development's Homekey program.

All the permanent supportive housing units in service, under construction or approved with finance pending—1,540 units toward the Action Plan's original goal of 2,802 units—include SDHC rental housing vouchers. However, the federal funding for the rental housing voucher program is limited. The same funding applies to vouchers for permanent supportive housing and rental assistance for families with low income in the City of San Diego. The need for rental assistance already far exceeds the number of households for which SDHC receives federal rental assistance funding. Without additional voucher funding being made available by the federal government through its annual budgeting process, SDHC will not be able to continue to commit rental housing vouchers to permanent supportive housing units in the future at anywhere near the same level that SDHC has in the past. This will limit the number of additional permanent supportive housing units that may be created in the coming years.

Funding for permanent supportive housing developments is also limited. The state's Homekey program has provided essential resources in recent years toward the creation of additional units, such as 332 units SDHC created through two hotel properties it acquired in 2020 with funds awarded in the first round of Homekey. Those units are among the 1,540 units counted toward the Action Plan's original goal. With funding from subsequent rounds of Homekey, SDHC recently completed the purchase of another hotel property that will provide 62 permanent affordable housing units with supportive services for people experiencing homelessness, and SDHC is collaborating with developers on two Homekey-funded projects that will produce an additional 53 permanent supportive housing units. In addition, on February 16, 2024, the state announced the award of an additional $35 million in Homekey funds to SDHC for the proposed acquisition of an extended-stay hotel property to create 161 permanent affordable housing units with supportive services for people experiencing homelessness.

Two crucial elements that have contributed to the production of permanent supportive housing in San Diego will no longer be available at the same level unless funding changes. Additional funding from Homekey or an alternative consistent, substantial funding source and additional federal funding for rental housing vouchers would be needed to be able to achieve the updated Action Plan's goal.

Audit Finding #1: The Housing Commission largely follows property acquisition best practices, but the agency used an appraisal that potentially overvalued a hotel property by $6.7 million.

Recommendation 1.1: The Housing Commission should update its policies and procedures related to appraisals to:

a. Include a requirement stating that appraisal valuation dates must correspond to the date that the appraisal site inspection is performed. If circumstances require the Housing Commission to deviate from this best practice, the policy should require that the Housing Commission inform its Board of Commissioners and the Housing Authority as to why it has done so.
b. Require that a copy of the third-party due diligence report and all appraisal reports be included as attachments in the Housing Commission's Executive Summary, which is presented to the Housing Commission's Board of Commissioners and the San Diego Housing Authority.
c. Include a statement that requires the Housing Commission to follow up with contracted vendors if the entirety of the requests and services the Housing Commission requested were not provided in full prior to moving forward with any major property purchase. The statement should specify that the Housing Commission will not pay for services that are incomplete and also require the Housing Commission's Executive Vice President of Real Estate or above to sign off on all appraisal scope of work requests. This step should also be included in the agency's due diligence acquisition checklist.

SDHC Response: Agree with the Recommendation
The finding that the SDHC largely follows property acquisition best practices and the conclusions within the report that the SDHC acquisition process "aims to protect the public interest by ensuring thorough review of acquisitions" demonstrate that the public can rely on SDHC to exercise prudence and responsibility in its property acquisitions. The circumstances involving the appraisal for the Mission Valley property, as discussed in detail above, were an anomaly. SDHC has acknowledged the error and has already implemented changes to further strengthen its property acquisitions processes, including the Administrative Regulation adopted in 2022, as described above. This recommendation does not require a revision to SDHC's Acquisition Policy as its application is captured in SDHC's Administrative Regulation 219.000, which provides guidance for broker activities and SDHC's appraisal process. SDHC will implement

Recommendation No. 1 by updating its Administrative Regulation 219.000, Retention of Real Estate Brokers; Operating Procedures for Brokers; and Peer or Desk Review of Appraisals, on or before July 1, 2024.

Recommendation 1.2: As part of the Housing Commission's Procurement Optimization Project, which the agency anticipates will include the establishment and implementation of a contractor evaluation project, the Housing Commission should complete a vendor performance evaluation for CBRE documenting its performance in providing appraisals for Residence f Inn Hotel Circle and Residence Inn Kearly Mesa.

SDHC Response: Agree with the Recommendation
As previously noted, SDHC is in the process of a comprehensive procurement optimization project (Project) that began in March 2023. This initiative, among other things, includes enhancing our supplier risk management capabilities, which will incorporate a comprehensive review of the Contractor Performance Evaluation Program established in 2019 to ensure best practices are followed and is not limited to construction contractors. The Project is being implemented in phases because of the various components involved. Once the Contractor Performance Evaluation Program is updated, SDHC will conduct a contractor evaluation of CBRE. Any future evaluation of CBRE's performance will be based on best practices.

Audit Finding #2: The Housing Commission should establish a documented acquisition strategy and an annual acquisition goal to improve transparency and to support both the agency and the City's priority of expanding affordable and permanent supportive housing.

Recommendation 2.1: As the Housing Commission updates its Strategic Plan, it should include a property acquisition strategic component that clarifies how property acquisitions fit into the agency's strategic priority of increasing affordable and permanent supportive housing options in the City.

SDHC Response: Agree with the Recommendation
SDHC's Strategic Plan identifies increasing and preserving housing solutions as the first Strategic Priority Area. One of the indicators of success is the number of affordable housing units created through acquisitions or new construction. One of many methods SDHC considers to create and preserve affordable housing is property acquisition. As you noted in your report, only approximately 11 percent of the total affordable housing units SDHC helped create in the past 10 years involved SDHC property acquisitions. SDHC's ability to acquire properties depends on funding availability. There is no dedicated funding source upon which SDHC can rely to support property acquisitions from year to year. Constrained by the availability of limited funding sources, which varies from year to year, SDHC's practice has been to identify properties for potential acquisition that are move-in ready or require as little rehabilitation as possible to become move-in ready as affordable rental housing, while also evaluating properties that may require more extensive rehabilitation. SDHC monitors the market for acquisition opportunities and attempts to line up funding sources available at that time to attempt to

acquire properties. As SDHC updates its Strategic Plan, SDHC will incorporate a written acquisition strategy that reflects this practice and acknowledges the reality that SDHC cannot establish a measurable metric for property acquisitions as a proportion of its broader strategy to increase and preserve housing solutions unless a consistent, reliable funding source to support acquisitions each year is created or identified.

Recommendation 2.2: The Housing Commission should develop an annual performance metric specific to property acquisitions based on available funding for acquisitions in the upcoming fiscal year and include this metric in either its Annual Budget document or its Annual Report. If acquisition funding is not available for the upcoming fiscal year, a goal of zero is appropriate and logical. However, if funding becomes available in future years for acquisitions, a specific acquisition metric should be established.

SDHC Response: Disagree with the Recommendation
SDHC cannot develop a meaningful annual performance metric in either its Annual Budget document or its Annual Report specific to acquisitions without an identified consistent, reliable funding source or significantly limiting the funding made available to local development partners through SDHC's Notices of Funding Availability. Consequently, if funding is not available for the upcoming fiscal year, the acquisition goal for that year would be zero.

In reference to Exhibit 14 of this report, the funding circumstances for property acquisitions in the City of Los Angeles are far different than the City of San Diego. As a result, attempts to compare the two regarding property acquisition metrics are not meaningful or realistic because they are comparisons of completely disparate circumstances. Regarding acquisitions, the Housing Authority of the City of Los Angeles (HACLA) states on its website, "HACLA has ready capital to invest through its own equity and a series of other debt and equity sources." This is not the case in San Diego.

Your report also cited the City and County of San Francisco's Mayor's Office of Housing and Community Development's (MOHCD) Small Sites Program as an example of an acquisition strategy. However, the Small Sites Program provides loans to qualified nonprofit organizations. It is not a program for the City and County of San Francisco to directly acquire properties similar to the SDHC acquisitions discussed in your report. SDHC awards funds to developers through Notices of Funding Availability, which frequently include the City of San Diego Affordable Housing Fund as a source of funds. The goals for financing for the Affordable Housing Fund are reported in the Affordable Housing Fund Annual Report, which is submitted to the City Council.

If funding becomes available, it will have its own restrictions and parameters that must be followed. Subject to the conditions on such funds, SDHC will develop a specific acquisition metric that will depend upon the following additional considerations: market conditions, availability of capital, cost of capital, property inventory, vacancy rates, local priorities and regional goals.

Conclusion
As noted in the audit, SDHC followed best practices for property acquisitions in all but one transaction in the past nine years. SDHC continues to follow best practices and already has strengthened its procedures regarding appraisals and in the rare instances when SDHC works with real estate brokers. SDHC agrees with the audit's recommendations 1.1, 1.2 and 2.1 and will implement them within the parameters referenced above to further strengthen our efforts going forward.

The Mission Valley property that is discussed in the audit report has operated with its intended use for more than three years. SDHC acquired the property specifically to become affordable rental housing with supportive services for people who were experiencing homelessness and otherwise would be in shelters or locations not meant for habitation, such as streets or canyons. SDHC began to operate the property with that use within two and a half weeks of SDHC's purchase of the property. The property value has increased in that time from what was a reasonable purchase price in 2020, and the property remains a valuable asset.

DATE: March 5, 2024

TO: Honorable Members of the Audit Committee

FROM: Andy Hanau, City Auditor

SUBJECT: **City Auditor Comments to the Management Response**

We appreciate the San Diego Housing Commission's (Housing Commission) cooperation, assistance, and commitment to implement many elements of our recommendations. The insights and documentation they provided helped us conduct the audit and identify improvements for the agency's property acquisitions process. We are pleased to note that the Housing Commission agreed with our recommendations to strengthen the agency's appraisal policies and procedures as well as establish a formal property acquisition strategy.

However, the Housing Commission raised several concerns with how our audit estimated the effect of the agency's use of a retrospective appraisal for the acquisition of the Residence Inn Hotel Circle property. We acknowledge in the report that we were unable to calculate with certainty what the correct appraisal value on the inspection date would have been, and we estimated it based on the nationwide hotel property market decline at that time. Therefore, our conclusion that the Housing Commission used an appraisal that potentially overvalued the Hotel Circle property by $6.7 million is accurate and supported by available evidence showing that hotel values were significantly impacted by the COVID-19 pandemic. The Housing Commission also disagreed with our recommendation to establish an annual acquisition goal. We maintain that such a goal would help improve transparency and accountability for how the agency's acquisition efforts increase affordable and permanent supportive housing throughout the City.

The Housing Commission included the following concerns specific to the retrospective appraisal issue discussed in **Finding 1** of our report in its Management Response:

1.) The Housing Commission obtained new independent appraisals of the Residence Inn Hotel Circle property, performed by the appraisal company BTI, last year. One appraisal was based on real estate market conditions as they existed in 2020, when SDHC purchased the property, and the second appraisal was based on market conditions in 2022. The fair market value on August 20, 2020, was determined to be $69 million, or $2 million higher than what the Housing Commission paid for the property in 2020. The appraised values were based on the "highest and best use" of the property, which the appraiser independently determined to be market-rate apartments.

OCA RESPONSE: The BTI appraisal valued the property as ***market-rate apartments*** whereas the original appraisal, performed by CBRE, appraised the property as a ***hotel***. Therefore, it is not possible to compare the two appraisals as they used different methodologies to value the property.

Also, when BTI performed its appraisal, it made an assumption about the potential buyer of the property, which in this case was the Housing Commission, being able to rezone the property at-will to become a multifamily property. This would not be true of most other competitors in the market.

Finally, the Housing Commission notes that the value of the property has increased by 31 percent ($67 million to $88 million since November 2020) from what the agency paid for the property, thus implying that the acquisition was a prudent financial investment. However, if the Housing Commission overpaid for the property, possibly by up to $6.7 million, then its return on investment for this acquisition would be even higher.

2.) In footnote 9 in our report, we mentioned a comparison with the appraisal for Hillcrest Inn in 2020, stating, "However, CBRE determined that COVID-19 did not affect the property price because Hillcrest Inn was valued as multifamily apartments and apartment building prices were increasing at the time." The Housing Commission asserts that this statement supports the reasonableness of the price the Housing Commission paid for the Mission Valley property. BTI Appraisal independently determined that the "highest and best use" of the Mission Valley property was market-rate apartments, the value of which, as discussed in the footnote, was not affected by COVID-19.

OCA RESPONSE: The Housing Commission's response links footnote 9 to the BTI appraisal to argue that the value of market-rate apartments was not negatively impacted by the pandemic and therefore the acquisition price for the Residence Inn Hotel Circle property was reasonable at the time of purchase. However, as we noted in the response above, the original appraisal for the Hotel Circle property valued the property as a ***hotel,*** not multifamily apartments (i.e., ***market-rate apartments***), which precludes a direct comparison between the CBRE appraisal (hotel valuation) and the BTI appraisal (market-rate apartments valuation). As noted above, the property was a hotel when it was purchased by the Housing Commission in the midst of the COVID-19 pandemic, which significantly decreased hotel values.

3.) Numerous sources not represented in the report indicate that the extended-stay hotel segment was not impacted by the pandemic to the degree assumed for the hospitality segment at large. The Housing Commission included several news articles discussing the pandemic's impact on extended stay hotels in its Management Response.

OCA RESPONSE: The Housing Commission included in its response several articles reporting on how extended-stay hotels fared better during the pandemic than the hospitality industry at large in terms of occupancy rates. We agree and made a footnote that the extended-stay market was unique and may have affected our estimate of overvaluation. However, the articles did not demonstrate that sales of extended-stay hotels significantly outperformed the hotel market as a whole, and the provided article from Pro Hospitality Group (PHG) showed a significant decline in extended-stay hotel sales volume as well.

Overall, the Housing Commission's responses questioning our report's presentation of possible effects of using a retrospective valuation to purchase the Hotel Circle property are based on the premise that a property valued as a hotel in February 2020, before the onset of the COVID-19 pandemic, would have the same value in August 2020, at a time in which hotel market conditions had been materially impacted by the COVID-19 pandemic. Although the Housing Commission might give compelling reasons why it contends the price it paid for the property was reasonable in light of the post-pandemic hotel property market rebound, we believe it has not provided sufficient evidence to show that an appraisal with a valuation date that corresponds to an inspection date in August 2020 for the Residence Inn Hotel Circle property would have included the same value as an appraisal with a pre-COVID valuation. To further support this point, as discussed in **Appendix D** in our report, CBRE noted in an email correspondence with the Housing Commission's broker at that time that providing an "as is" value based on an August 2020 date would likely be lower than the contract price range of $63–$67 million that CBRE had discussed with the Housing Commission. Therefore, we stand by our assertion that using an appraisal with a pre-COVID valuation to purchase the Residence Inn Hotel Circle property likely resulted in the Housing Commission overpaying for the property by up to $6.7 million.

As previously mentioned, the Housing Commission also disagreed with our recommendation to establish an annual performance metric specific to property acquisitions which would help increase stakeholder awareness of the agency's efforts to expand affordable and permanent supportive housing options in the City.

Recommendation 2.2

The Housing Commission should develop an annual performance metric specific to property acquisitions based on available funding for acquisitions in the upcoming fiscal year and include this metric in either its Annual Budget document or its Annual Report. If acquisition funding is not available for the upcoming fiscal year, a goal of zero is appropriate and logical. However, if funding becomes available in future years for acquisitions, a specific acquisition metric should be established.

Housing Commission Response:

SDHC cannot develop a meaningful annual performance metric in either its Annual Budget document or its Annual Report specific to acquisitions without an identified consistent, reliable funding source or significantly limiting the funding made available to local development partners through SDHC's Notices of Funding Availability. Consequently, if funding is not available for the upcoming fiscal year, the acquisition goal for that year would be zero.

We acknowledge and understand the concerns the Housing Commission raises with respect to the absence of an identified consistent and reliable funding source for property acquisitions. However, we concluded that establishing an annual acquisition goal would help ensure the Housing Commission is communicating to stakeholders how it intends to use its limited resources and track its progress in helping the City reach its affordable and permanent supportive housing goals. Furthermore, we found that other large California cities also use such metrics to help inform stakeholders of efforts to increase affordable housing. We also note that in FY2018 and FY2019, the Housing Commission identified an acquisition goal in its budgets for those years. And finally, our recommendation states that a goal of zero acquisitions would be appropriate if acquisition funding is not available in a given fiscal year, which addresses the Housing Commission's concern of having to report such a metric.

In closing, we thank the Housing Commission for its cooperation and professionalism throughout this audit. Although the Housing Commission did not agree with Recommendation 2.2, we look forward to working with the agency to verify the implementation of the recommendations to which it agreed.

Respectfully submitted,

Andy Hanau

City Auditor

cc: Lisa Jones, President and Chief Executive Officer, San Diego Housing Commission sandiego.gov/auditor