



Management Audit of District Owned Residential Properties

Final Report

Peter Sakai, Temporary District Auditor

3/3/2011

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**Management Audit of District Owned Residential Properties
Final Report – March 3, 2011**

The Temporary District Auditor has completed his management audit of the District’s practices for managing its residential properties as requested by the Board of Directors at its November 10, 2009 meeting. The audit included an examination of agreements for property management and agreements for rental/lease of District owned residential properties. The audit also included interviews with District staff responsible for overseeing the management of these properties and a physical inspection/tour of residential properties owned by the District in San Jose, Mountain View and Morgan Hill.

As authorized in the Santa Clara Valley Water District Act, the District acquires residential property in preparation for its public projects and has acquired residential properties in lieu of projects (where the District has been determined that a project is not feasible or cost effective to protect properties from flood damage). During the time after the District acquires the property, up to demolition, the District leases these residential properties. The District maintains a policy that prohibits the District from renting or leasing property to District employees, Board members or immediate family members¹.

This examination disclosed that District staff is exercising reasonable care in managing District owned residential properties.

Background Information

The District’s goal is to protect District assets as required by the Board’s Executive Limitation Policy on Asset Protection (EL-7) by maintaining the rental properties “in a safe, habitable condition, and in an equal or superior condition to properties in the surrounding neighborhood.” In total, 53 residential properties are owned and leased by the District:

Residential Properties Owned by the Santa Clara Valley Water District²

Location	Year of Purchase	Reason for Purchase	No. of Properties	Range of Monthly Rental Income
Along Stevens Creek in Mountain View	1974-1980	In lieu of bank erosion project	19	\$2,375 - \$2,900
Along Guadalupe River and Los Gatos Creek	1983-2001	In advance of Upper Guadalupe river Project; one property purchased due to severe bank erosion	30	\$925 - \$2,895
Along Llagas Creek	2003-2008	In advance of Upper Llagas Creek Project	2	\$1,700 - \$1,795
Along Lower Silver Creek	2004	Lower Silver Creek Project	1	\$1,813
Adjacent to San Pedro Recharge Ponds	2000	San Pedro Recharge Ponds Project	1	\$2,500

¹ DRAFT SCVWD Work Instruction W630D02, Roles and Responsibilities – Special Note, Page 2 of 3

² On September 28, 2010, in response to Board Member Request R-10-0039, District staff provided information to the Board on the status of District owned residential properties.

The term of residential leases vary according to location. Properties in Guadalupe/San Jose and Silver Creek areas are leased on a month-to-month basis. The District prefers annual leases for properties in the Stevens Creek/Mountain View area but will rent properties in this area on a month-to-month basis if an annual lease cannot be obtained. Lease/rental rates are set at fair market value upon turnover and are reviewed annually.

Findings and Recommendation

1. **Income and Expenses** - The District’s management of its residential properties has been effective in maintaining income for the District and a high occupancy rate. Monthly rental rates are set at fair market value and are reviewed and adjusted by the District when turnover in occupancy occurs. For Fiscal Year 2009-2010, net income for leased residential property totaled \$906,258:

Gross Income Residential Leases	\$1,366,306
Less Expenses:	
• Water Utilities	\$2,406
• Gas and Electric Utilities	7,430
• Garbage Disposal	11,198
• Plumbing	16,355
• Landscape Maintenance	60,042
• Pool Maintenance	4,197
• Property Mgmt (Cal Western)	95,732
• Other Expenses (includes major repairs and maintenance)	262,688
Total Expenses	460,048
Net Income from Residential Leases	\$906,258

Notes:

1. *Generally, all utilities are paid by the tenants. However, there are cases where the District will pay the utilities and charge an extra amount added to the rent.*
2. *Gross Income may include security deposits and utility costs where the District pays for utilities and recovers those costs from tenants.*

2. **Outsourcing of Property Management** - The District has contracted Cal-Western Property Management (San Jose, CA) to provide property management services for these residential properties at a rate of 8% of gross collected rent. For Fiscal Year 2009-2010, Cal Western received \$95,732. Services provided by Cal-Western include:

- Collection of rents/deposits and other fees
- Advertising available properties (at District’s “reasonable” expense)
- Verifying information and references on rental applications
- Executing, renewing and terminating lease agreements
- Instituting and prosecuting court actions necessary to evict tenants and to recover possession of the property

- Monitoring fair market values of rental rates (rent increases on existing tenants must be approved by the District).
- Periodically conduct drive-by visits, conduct annually interior inspections, conduct meet and greet appointments with tenants and neighbors to take care of maintenance concerns and establish better relationships

Cal Western, by its contract with the District, is required to maintain liability insurance and fidelity bonds in an amount not less than \$1,000,000 per employee covering all employees who handle or are responsible for the collection and safekeeping of District monies.

The contract between the District and Cal Western sets limits on Cal Western's authority to incur maintenance expenditures without District approval. With some exceptions for emergencies, Cal Western is required to solicit at least three written bids for any single repair and maintenance expense greater than \$2,500 and submit those bids to the District for review and decision. Cal Western must also receive prior written approval before incurring any single expense greater than \$1,000. All expenses incurred are reimbursed at the Cal Western's cost with no markup.

Based on an informal review of average local property management fees, the 8% property management fee on gross rents collected is competitive with the going rate for property management for single family residences. If the District were to manage these properties directly, it would require additional personnel at a cost that would likely exceed the \$95,732 in property management fees received by Cal Western for managing District properties. Cal Western presently employs 3 property managers for District residential properties. The District's contract with Cal Western was executed in December 2008 and the contract term is for 3 years with the option to renew for another 3 years at the District's discretion. Cal Western was selected after a competitive bidding process involving 2 other local San Jose area property management firms.

3. **District Oversight** - Oversight of the District's residential properties and Cal Western is provided by the District Real Estate Unit (within the Watersheds Capital Divisions) and Facilities Management Unit (within the Procurement and Operational Services Division). The District's Facilities Management Unit maintains project plans for the management and maintenance of residential properties. Staff annually updates these plans to budget for anticipated costs.

Staff from the Facilities Management and the District's Real Estate Units work together to ensure that the District's interests in these properties are protected and that the goal to maintain the rental properties "in a safe, habitable condition and in an equal or superior condition to properties in the surrounding neighborhood³" is met. A field visit to a number of these properties conducted with the Senior Real Estate Agent as part of this review show that by appearance, they are being maintained at what could be subjectively considered the overall neighborhood standard.

³ DRAFT SCVWD Work Instruction W630D02, Purpose and Scope, Page 1 of 3

Consideration of Future Costs for Improvements and Major Repairs – During 1974-1980, the District acquired 21 residential properties adjacent to Stevens Creek in Mountain View. The first 2 homes acquired were immediately demolished. The remaining 19 homes are occupied by tenants under lease agreements with the District. The District purchased these homes following District planning and geotechnical studies in 1974 and 1978 for improvements to Stevens Creek. The creek bank adjacent to these homes was determined to be a geologic hazard. Geotechnical studies by District consultants concluded that in order to retain the natural condition of the stream, repairing the bank instability would be costly and the repair method would not be in keeping with the natural character of the stream. Consequently, the District purchased these properties for eventual demolition, in lieu of a bank stabilization project.

Homes in this neighborhood now have a value of just over \$1 million each. While these homes are habitable and are generating revenue for the District, they were built in the early 1960's and will require a major investment of funds in the near future to maintain them within the relatively high standards of the neighborhood. This investment includes landscaping, heating and ventilation upgrades, flooring, upgraded windows, repairing/renovating driveways and walkways, and upgrading baths and kitchens.

In 2005, District staff discussed if there was a need for the District to retain these properties and whether the erosion problem still exists. No change in the planned disposition of these homes resulted from this discussion. The erosion and geologic condition is still present. At the point at which bank erosion becomes a safety hazard, the homes will be demolished.

Recommendation:

In deciding whether to begin setting aside funds for major repairs/upgrades for these Mountain View homes, the District should assess the condition of the creek bank adjacent to each property to determine how much longer each home will remain safe and habitable. This assessment should be followed by a cost-benefit analysis to determine if and when the District should fund and undertake major repairs/upgrades to the homes, or initiate planning for eventual demolition.

ATTACHMENT 1

DISTRICT RESPONSE

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MEMORANDUM

FC 14 (01-02-07)

TO: Peter Sakai, Temporary District Auditor

FROM: Sharon Judkins, Chief Administrative Officer; and Marc Klemencic, Chief Operating Officer

SUBJECT: Management Audit of District Owned Residential Properties Draft Report, dated December 21, 2010

DATE: January 10, 2011

Recommendation

In deciding whether to begin setting aside funds for major repairs/upgrades for these Mountain View homes, the District should assess the condition of the creek bank adjacent to each property to determine how much longer each home will remain safe and habitable. This assessment should be followed by a cost-benefit analysis to determine if and when the District should fund and undertake major repairs/upgrades to the homes, or initiate planning for eventual demolition.

Response

The District agrees with this recommendation.

The District currently performs annual monitoring of the creek bank adjacent to the 19 District owned properties along Stevens Creek. There has been no significant deterioration of the creek banks since 1978 when the last geotechnical analysis was performed.

The District currently performs routine maintenance and repairs to these properties to ensure that they remain safe and habitable. However, prior to any significant improvements being made on any of these properties, District staff will perform an engineering analysis of the creek banks adjacent to the property.

Sharon Judkins
Chief Administrative Officer

Marc Klemencic
Chief Operating Officer

cc: Patty Ross