



2011-2012 SANTA CLARA COUNTY CIVIL GRAND JURY REPORT

SAN JOSE'S CITY HALL – A PROMISE KEPT OR A PROMISE BROKEN?

Summary

The Grand Jury received a citizen's complaint, stimulated in part by the recent transfer of San Jose's old city hall to Santa Clara County, detailing concern about the 1996 Ballot Measure I. The complaint raised concern over whether the new San Jose City Civic Center was constructed with a revenue scheme as prescribed by Measure I. If so, is the project in compliance in 2012?

Background

For the purposes of this report, the reference to the new city hall is defined as an 18-story office building, rotunda and council chambers on 4.3-acres of a 32 acre site at 200 E. Santa Clara Street. The old city hall includes a 2 to 6-story office building on 10 acres at 801 N. First Street.

The City of San Jose's (the City) new city hall within the overall Civic Center Project was to have been financed under restrictive conditions and requirements. What began as a practical and affordable upgrade of the old city hall building at Mission and North First Streets turned into a new build project. As the cost grew, so did doubts about the City's ability to meet the Measure I criteria. The 1999-2000 Grand Jury first raised doubts about the City's ability to meet the voters' financial expectations of Measure I, requesting an independent audit at that time. The City's 2000 response was to not implement the Grand Jury's recommendation because it was "not warranted."¹

By law,² there were only two ways to pay for the new city hall:

- Proceeds from leasing or selling city-owned property
- Savings from using city-owned, rather than leased, office space.

The City was prohibited from using new taxes for the project, and from diverting tax revenues from other uses.

¹ Refer to Appendix A for the 1999 – 2000 Grand Jury Report and the City's response.

² Measure I, when approved, became San Jose City Ordinance 25224.

The new city hall complex has been open for business for seven years now. Virtually all the construction bills have been paid, all the departments have settled into their assigned offices, and the final cost of the project is known. Thus the City does not currently need to lease commercial space anymore to accommodate the new building's tenants.

So, is the project being paid for as promised by Measure I? The City of San Jose cannot answer this question. When asked, the City has again dismissed the Grand Jury's concerns about the issue. However, based on our investigation, the Grand Jury believes the new Civic Center Project does not currently comply with the 1996 intent of the voters or the language of Measure I.

City voters agreed to move City Hall from downtown to North First and Mission Streets in 1957. In 1968 the voters passed Measure Q, which required the city hall to remain at that location, unless the voters again approved another move.

In 1994, the City determined it was using too much rented office space. A study was conducted to compare the economies of continuing to rent with those of purchasing office space. After a lengthy study,³ in June 1996, it was reported to the City Council that city-owned office space would be cheaper over the long run. The City then prepared to proceed with implementing Measure I. One of the first steps was a financial "snapshot" of present and estimated future financial conditions to certify compliance with the intent of Measure I. The City's voluntary compliance reporting was done in 1999 and again in 2001.⁴ These compliance studies consisted of preparing a set of assumptions for either expanding on site, the "Remodel" scenario, or relocating downtown to a new building, the "Build" scenario.

Because of this rapid growth and in response to the requirements of Ballot Measure Q, Measure I asked San Jose voters to permit the construction of a new city hall somewhere in the downtown area:

Without imposing additional taxes or taking money from other city programs, shall Ordinance No. 14224.1 be amended to permit the relocation and consolidation of civic offices in the downtown so long as the costs are paid by using the proceeds from the sale or lease of the old civic complex and other land, savings from the elimination of leased office space, and consolidation of city facilities and services?

³ "Strategic Planning: Phase One San Jose Civic Operations Master Plan," Simon Martin-Vegue, Winkelstein Moris, Sedway Kotin Mouchly Group and The Steinberg Group, 1996.

⁴ City of San Jose, City Council Presentation, Updated Measure I Analysis, November 6, 2001.

The language in this ballot measure seemed clear and easy to accept.⁵ There was to be a balance of costs incurred and revenues generated. The measure passed with over sixty percent of the tally. As a result of that vote, the City explored several options, including remodel of existing, purchase existing or build new facilities. The City decided to build a new city hall at 200 East Santa Clara Street. The building opened for business in 2005.

Methodology

The Grand Jury interviewed elected and appointed officials knowledgeable about Measure I regarding the development of the new Civic Center project. Those interviewed included the Mayor of San Jose, the San Jose City Manager, County Fleet and Facilities Manager, a former City Councilmember, the Acting Finance Director, a former General Services Administrator, and the City Attorney.

The Grand Jury reviewed numerous documents related to the Civic Center Project. The bibliography for this report includes these reports as links. The Grand Jury also asked the City to provide documentation on several aspects of the project. Members of the Grand Jury conducted a site survey of the old and new city halls, a real estate parcel near old city hall referred to as “Lot E,” and the old City Hall Annex. See Appendix B for a list of documents reviewed.

Discussion

In 1996, Measure I did not ask voters how much could be spent on this project, but they did specify how it would be funded. In November 2001 the City decided that current and forecast economic conditions allowed construction of the planned city hall could be built while complying with the requirements of Measure I. Since then, the City of San Jose has not made any public effort to report on the plain language requirements of the 1996 ballot measure. Since then no sales of real estate have been made explicitly to help pay off the cost of the building.

Both the Remodel and Build scenarios anticipated a growing workforce that would someday fill any new city hall to capacity. The Remodel scenario included updating the existing building at 801 N. First Street and continuing to lease commercial space for 55 years as the workforce grew over time.

The Build scenario anticipated that nearly all city employees except the Police Department and Fire Department would be consolidated under one roof in a new building, along with a separate parking garage at a site somewhere downtown. It also included a remodel of the old city hall. The 2001 analysis confirmed the earlier

⁵ San Jose Mercury News, Scott Herhold, “Bid to Move City Hall Downtown Would Rectify a 1950s Mistake,” October 29, 1996, morning final, page 1A.

compliance and the City Council approved a budget figure of \$325M for the project. The City hired an outside consultant experienced in the economic analysis of municipal projects to create a model of the possible outcomes of the project.

From the available data collected in 2000, the consultant created projections that showed owning office space made economic sense. The money saved from not leasing commercial space along with the sale proceeds from Lot E would more than balance the costs of constructing and financing a new building. Using this data, the City Finance Department made a presentation to the Council in support of relocating to downtown⁶.

The Director of Finance at the time assured the City Council, “the Budget Test shows that . . . the City is within a comfortable cash flow margin to meet the Budget Test”⁷ and concluded that, all things considered, the City would save an estimated \$189M with the proposed building instead of leasing office space during the same period of 55 years. To its credit, the City Council gave a lot of thought to the requirements of the 1996 Measure I ballot measure. The 2001 projections indicated that, within what then seemed to be a reasonable range, the savings would exceed the costs of construction, justifying the Build scenario.

In hindsight, these projections seem overly optimistic. They were done during a period of sustained local growth and prosperity. Their assumptions did not take into account the possible collapse of the “dot-com boom.” The economic conditions for the City and all of “Silicon Valley” turned out to be quite different from any of the projections, but that was all in the future when City Council signed off on the project in 2001. That was the last time the City reported or analyzed its compliance with the language of Measure I and the intent of the voters. From 2002 through 2011, San Jose would suffer total annual General Fund shortfalls of anywhere from \$19.9M to \$118.5M dollars.

Old City Hall

Some of the assumptions used to justify the Build scenario were subsequently abandoned after the project was approved. For instance, the sale or lease of the old city hall was part of the Measure I argument, with sale proceeds going to help pay for the new city hall. According to the Build scenario, this building was to have been refurbished, put back to work as City-owned office space once the new city hall was occupied. The land was planned to be sold in 2006. Instead, the building was padlocked and remained empty and essentially abandoned at a reported annual on-going cost of \$250,000.⁸

⁶ City of San Jose, City Council Presentation, Updated Measure I Analysis, November 6, 2001.

⁷ Director of Finance John Guthrie, Letter to City of San Jose City Council, City Hall Relocation Economic Analysis – Update, May 28 1999, p. 3.

⁸ According to the County Facilities and Fleet estimate.

In 2011, the City transferred the old city hall to the County of Santa Clara in exchange for a \$10M credit on a Redevelopment Agency debt unrelated to the new civic center project.⁹ For members of the public who were expecting this property to make a significant contribution toward payoff of the project, the low selling price and that it was transferred without offsetting any costs of the Build, was a surprise and disappointment that was widely discussed in news media. According to City officials, the property's value had been assessed in 2006 in the range of \$30-40M, close to 10% of the estimated total project cost for new city hall. But in the end, the old city hall contributed nothing directly to paying for the project because the transfer was entirely unrelated to Measure I in any reports or statements by the City, and even the \$10M was offset by \$1.6M in carry costs while the old building was held vacant for the past seven years.

2001 Assumptions and Predictions

Project Cost and Financing

The City wanted to spend over \$500M for the new city hall project. In order to have the City Council certify compliance with Measure I, the City needed to demonstrate the project could generate revenues and savings to cover the costs. This is a review how the City proposed to meet those costs.

The project assumed that all non-public safety city workers would be consolidated into the new City Hall and that after the building became full, space in a refurbished old city hall would be used for the overflow. When the financial model was created the following assumptions existed:

- 298,000 square feet of leased commercial space
- \$42.00 per-square-foot annual lease cost
- 3,854 non-safety city employees
- \$10.73 per square foot for operating and maintenance costs.

To these assumptions the following adjustments would be made through the 55-year life of the project (5 years of construction plus a 50-year life):

- 3.0% yearly inflation
- 1.0% annual growth in non-safety city workers.

⁹ Santa Clara County, Office of the County Counsel, FORM DEED OF TRUST, between the Redevelopment Agency of the City of San Jose and the County of Santa Clara County, March 16, 2011.

Some additional factors were in a way “fixed” in their use:

- 300 square feet of space per employee
- 4.75% discount rate (to bring costs in the future to a value in 2000)
- 4.0% - 4.75% Borrowing Costs
- \$32.1 M sales of lot “E.”

The construction assumptions were:

- \$244M City Hall
- \$44M Parking Facility
- \$49.7M Land Acquisition.

The model also assumed the land under both the old and new city hall would be sold at the end of the review period. Since the model is unavailable, some of the financing cost assumptions are not known.

The Grand Jury read numerous reports on the project and asked for clarification from several City departments. The Grand Jury gleaned from these various reports the costs shown in Table 1.

Table 1: Final Costs of the Civic Center Project

Land and construction costs	\$310,824,814
4 th and St. John Streets Garage	\$37,352,282
Equipment, furniture, relocation costs	\$39,159,189
Subtotal of direct costs	\$387,336,285
Cost to issue bonds for financing	\$44,656,939
Interest paid during construction	\$78,199,326
Total	\$510,192,550

Measure I Financial Background

Construction and related costs were financed by bond issues in 2002 and other borrowings. Initially some of the site acquisition and development costs were financed by \$36M of tax increment Redevelopment Agency funds. However, the Sixth District Court of Appeal later ruled that tax increment dollars could not be used for this purpose and the funds were ordered returned to the agency, with interest. These costs were then rolled into the bond funding. The initial borrowings were refinanced in 2008 at lower rates.

The building was completed and occupied in 2005 at a total cost of \$510M. These costs include the building, an additional parking garage, fixtures, financing and interest during construction.

Since that analysis, the following is known:

- Lot E remains unsold
- The old city hall was transferred to Santa Clara County
- The city workforce has not grown but remained close to the original number of employees
- Lease rates over the period declined.

These factors resulted in a loss of planned revenue that the original analysis counted on. The exact losses are unknown, and unless the City updated its analysis since 2001, the taxpayers are not able to determine whether the City met its commitment to Measure I.

City Responses to the Grand Jury's Questions

After studying the issues regarding Measure I compliance today, and interviewing elected and appointed senior officials, the Grand Jury formally asked the City of San Jose administration four basic questions about the Civic Center project:

- What was the final true construction cost?
- What was the cost of the financing?
- How do the 2001 economic projections compare to the 2011 real-world experience?
- Is the Civic Center project paying for itself with savings as required by Measure I?

The City provided the Grand Jury with a written response on January 20, 2012 and provided a number for the total construction cost and the amount of the project's financing costs. The City did not have an answer to the next two questions and indicated that it would not use City resources to determine the cost effectiveness of the building.

A Broken Promise?

When voters approved Measure I in 1996, the proposal seemed clear and simple, a reasonable promise by the City to the voters. Today, the result is a completed project, paid for in ways that seem disconnected from the clear intent of the 61% of the voters who approved it. However, a reasonable voter who remembers what was originally promised and knows what was actually delivered has to wonder, if this is the way public projects should be built?

The new civic center project was apparently completed legally, and the 2001 certification of compliance was done in good faith. The City was committed to completing the building in spite of obviously changing economic conditions. Once certified as compliant in 2001, the City of San Jose appears to believe it had no further obligation to ever report to the voters again on the issue. The Grand Jury asked for an accounting of revenues from real estate sales and leases specifically connected to the project and none have been provided.

Now that the project is complete, the building itself seems entirely successful as a home for government – just the showpiece the City Council approved in 2001. But the City of San Jose cannot demonstrate that it was constructed in compliance with its promise to the voters who authorized the project only under very limited financial criteria.

It is common for ballot measures involving large expenditures to include provisions for citizen oversight to ensure that the intention of the voters is observed. For example, the 1996 Santa Clara County Measure B Transportation Improvement Program imposed an additional half-percent sales tax that raised \$2B for road, rail, and other transit projects. Built into Measure B was a detailed citizen oversight process that monitored the expenditure of the monies collected. A similar oversight program could have been included in Measure I, but was not.

Conclusions

The reported total cost to the City to build city hall was \$510M. Measure I required that this cost would be paid by using the proceeds from the sale or lease of the old civic complex and other land, savings from the elimination of leased office space, and consolidation of city facilities and services. The City spent the money but has not provided the taxpayers with the final accounting, or an interim accounting if the financial analysis period runs for 40 more years. The City has stated they do not intend to produce any future report. This determination to not report is important, because if taxpayers are to trust the City with future decisions of a similar matter, there is no credibility for the voters to grant the City that privilege in the future. Voters understand circumstances will change, but to avoid the conversation with taxpayers is disingenuous to the intent of the Measure.

The new Civic Center Project authorized by the 1996 ballot measure is a case study of good intentions. What began as a reasonable upgrade of the old city hall appears to have become a project that was far beyond what the voters intended. At \$178M, as initially estimated in 1997, the new Civic Center Project would probably have been entirely compliant with Measure I and the resources would probably have balanced the costs. But as the project became more ambitious and expensive, and as economic conditions continued to deteriorate, the resources available to cover its costs remained static or declined. Even using the City's model that looked out 55 years, it became apparent before construction began that real-world revenues were not going to match real-world costs.

Measure I was concise and clear. Although the Measure failed to detail safeguards, limits and controls, voters expected that the City would do what was necessary to fulfill the promise of Measure I. This did not happen. Rather, it appears that the City feels it had the latitude to broker the new Civic Center Project, notwithstanding the simple intent of Measure I. The Grand Jury concludes the City has not fulfilled its Measure I promise and in the future City measures should include appropriate safeguards to prevent the City from engaging in the latitude it did with Measure I.

Findings and Recommendations

Finding 1

The language of the 1996 Measure I seemed clear and simple, a reasonable promise by the City to the voters. However, it failed to provide for long-term accountability to the taxpayers.

Recommendation 1

The City should ensure that future measures include citizen oversight committees and should require periodic accounting reports to demonstrate compliance with the measure.

Finding 2

The City can perform a compliance update but has chosen to not certify ongoing compliance of the Civic Center Project to Measure I, meaning taxpayers are not able to determine whether the City met the will of the voters.

Recommendation 2

The City should commission an independent audit of the project to determine compliance to Measure I.

Appendix A: 1999 - 2000 Santa Clara County Civil Grand Jury Report and the City of San Jose Response

1999-2000 SANTA CLARA COUNTY CIVIL GRAND JURY

INQUIRY INTO ECONOMIC EVALUATION OF THE COST OF RELOCATING SAN JOSE CITY HALL TO THE DOWNTOWN AREA

INTRODUCTION

After receiving complaints from the public and based on concerns of the citizens of the City of San Jose regarding the relocation costs of City Hall, the Santa Clara County Civil Grand Jury initiated an inquiry into the requirements San Jose must meet to move City Hall to downtown San Jose.

The voters of San Jose passed Measure I that would permit the relocation of City Hall to downtown San Jose. However, a covenant was included in the measure that said "no additional taxes are imposed; and no money is taken from other city programs for this purpose."

DESCRIPTION

Since Measure I was passed, significant study and redesign of the proposed facility has occurred. Also, since that measure was passed, an additional bond request has been made for \$32 million to cover the cost of the additional design and improvements. There is high probability that the costs of the project have escalated. The measure stipulated that the cost of the building and moving City Hall from its present location must be essentially neutral.

FINDINGS

The city's use of a 50-year timeline for debt amortization does not conform to general accounting practices or the federal government guidelines. The City has indicated to the public that all conditions on Measure I have been met. Since the original cost estimate, new designs have been advanced for the facility. No evaluation of

costs based on the new design has been published to date.

CONCLUSIONS

- The additional costs, including the bond request and the corresponding design changes, lead the Grand Jury to believe that the cost of the proposal is escalating. It is difficult to determine the actual costs of the project until the design element has been completed.

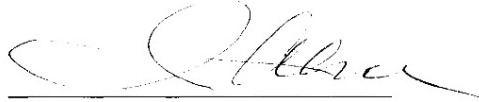
- Based on the facts stated above, the Civil Grand Jury of Santa Clara County has determined that a financial analysis should be conducted of the projected cost and funding sources required to construct the proposed new City Hall for the City of San Jose. A detailed analysis should include the reasonableness of the assumption, the projected impact on operating the proposed new square footage of office space compared with the existing owned and leased space being replaced, and other pertinent issues. It is within the purview of the Grand Jury to request that an independent, detailed and objective economic analysis be performed.

RECOMMENDATION

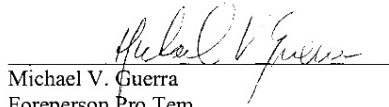
The Santa Clara County Civil Grand Jury recommends that the City Manager of the City of San Jose engage an independent firm to prepare and publish an objective cost analysis of the relocation of the City Hall project. The report should be issued before the elections of November 2000.

JUL 3 2000
SHREN: ...AVIS, County Clerk-Recorder
Santa Clara County
By _____ Deputy

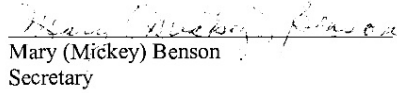
PASSED and ADOPTED by the Santa Clara County Civil Grand Jury this 11th day of May, 2000.



I. Alne
Foreperson



Michael V. Guerra
Foreperson Pro Tem



Mary (Mickey) Benson
Secretary



RICHARD DOYLE
City Attorney

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GRAND JURY

September 20, 2000

Honorable Jack Komar, Presiding Judge
Santa Clara County Superior Court
191 North First Street
San Jose, California 95113

Re: Response to Grand Jury Report on New City Hall

Dear Judge Komar:

Pursuant to Penal Code Section 933.05, this letter is in response to the 1999-2000 Santa Clara County Civil Grand Jury report entitled "Inquiry into Economic Evaluation of the Cost of Relocating San Jose City Hall to the Downtown Area", which was received by the City on June 28, 2000. That report recommended that the City Manager "engage an independent firm to prepare and publish an objective cost analysis of the relocation of the City Hall project."

The City has already caused an objective cost analysis prepared by an "independent firm" to be completed. That objective, independent analysis, prepared by the firm of PCR/Kotin, establishes that the City can relocate City Hall downtown consistent with Measure I -- the initiative ordinance approved by San Jose voters in 1996 that authorizes the relocation of City Hall downtown if certain financial parameters are met.

As you may know, the City's cost analysis was challenged in the case of *Albert Ruffo, et. al. v. Redevelopment Agency of the City of San Jose, et. al.*. In the *Ruffo* case, the City submitted extensive evidence regarding the independent, objective cost analysis. Based upon this evidence, the Santa Clara County Superior Court held that the City's relocation plan does not violate Measure I. Plaintiffs' appeal from the judgment is currently pending. We expect the appellate court to decide the case in the next few months and fully expect the Superior Court's judgment to be affirmed.

We are surprised that the Grand Jury would interject itself into a matter that is the subject of a judgment in the above-referenced litigation, let alone a matter in which an appeal is currently pending.

Honorable Jack Komar
September 20, 2000
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In any event, I am compelled to correct some factual errors in the Grand Jury's report. First, the statement that there has been "an additional bond request for \$32 million to cover the cost of the additional design and improvements" is incorrect. As the City Council record establishes, the City has always intended to issue bonds for this Project in two phases. The bond initial issue is to finance design and other costs during the pre-construction period, and a second issue will be sold at the time the construction bids are to be let. Consistent with that plan, the City of San Jose Financing Authority issued Lease Revenue Bonds in the amount of \$31.5 million on June 22, 2000.

Second, the above mentioned bonds have an amortization period of 30 years, as will those proposed to be issued in 2002 for construction of the Project, and not 50 years as the report seems to assume. The Grand Jury has confused the fact that the useful life of a building is 50 years, while the amortization of the debt is 30 years. The analysis of compliance with the financial parameters of Measure I was based upon the 50-year useful life of the building, while also taking into account that the amortization period of the bonds would only be 30 years. As such, the City respectfully disagrees with the finding of the Grand Jury that the "50 year timeline for debt amortization" is inappropriate.

Finally, the City Council is expected to consider, in a public meeting, an evaluation of costs based on the ongoing design process within the next several weeks. The revised estimates are within the Measure I requirements.

Based on the above explanations, the City will not be implementing the Grand Jury's recommendation in this matter because it is not warranted.

Sincerely,



Richard Doyle
City Attorney

PAD/aks

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Appendix B: List of Documents Reviewed

- City of San Jose, Ordinance No. 14224.1, Determining The Location Of City Hall, June 4, 1948
- City of San Jose, City Clerk's Office, N SC Ballot Type 056 – Page 040-053 (1996 ballot measure and supplemental text as delivered to voters)
- City of San Jose, Minutes of the City Council, December 3, 1996, "Strategic Planning: Phase One San Jose Civic Operations Master Plan," Simon Martin-Vegue, Winkelstein Moris, Sedway Kotin Mouchly Group and The Steinberg Group, 1996
- City of San Jose, Council Agenda: 6/1/99, Item 11D(1) Memorandum from John Guthrie, Director of Finance, to Mayor and City Council (City Hall Relocation Economic Analysis Update) May 28, 1999
- City of San Jose, Minutes of the City Council, Tuesday, June 8, 1999, Item 15a, Public Hearing On Appeal Of The Certification by the Planning Commission of the EIR
- City of San Jose, City Council Presentation, Updated Measure I Analysis, November 6, 2001.
- City of San Jose, Minutes of the City Council, November 6, 2001.
http://www.sanjoseca.gov/clerk/2001_CnclMins/11_06_01min.htm
- City of San Jose, Memo and Draft Resolution from Mayor Gonzales et. al., to City Council Regarding the New Civic Center Project, May 14, 2002.
http://www.sanjoseca.gov/clerk/agenda/5_14_02docs/5_14_02_4.2_NewCivicCenter.htm
- City of San Jose, SJFA Agenda: 10-15-02, Memorandum from Scott P. Johnson and Katy Allen to Mayor and City Council and City of San Jose Financing Authority Board, Civic Center Project Lease Revenue Bonds, October 9, 2002.
- City of San Jose, Office of the City Manager, Manager's Budget Addendum #8, May 17, 2006. <http://www.sanjoseca.gov/budget/fy0607/MBA/MBA08.pdf>
- City of San Jose, New City Hall Fact Sheet, December 11, 2011.
- Walton, M., June 20, 1997, Coming Soon: S. J. City Hall? Fast Action: The Council Has Ok'd A Proposed Site But Some Opposition To The Move Remains, *San Jose Mercury News*.
- Herhold, S., October 29, 1996, "Bid To Move City Hall Downtown Would Rectify A 1950s Mistake," *San Jose Mercury News*.

Appendix B – continued

Santa Clara County 1999-2000 Civil Grand Jury, Final Report, “Inquiry Into Economic Evaluation of the Cost of Relocating San Jose City Hall to the Downtown Area,” July 3, 2000. Also the City of San Jose’s Response to this report.

Santa Clara County, Office of the County Counsel, Form Deed Of Trust, between the Redevelopment Agency of the City of San Jose and the County of Santa Clara County, March 16, 2011.

Superior Court of California, County of Santa Clara, Stipulation By All Parties For Judicially-Supervised Settlement And [Proposed] Order, County of Santa Clara vs. City of San Jose, Redevelopment Agency of the City of San Jose, March 9, 2011.

Court of Appeal, Sixth District, California; Albert Ruffo, et al. Plaintiffs and Appellants v. Redevelopment Agency of The City of San Jose, May 1, 2000.

This report was **PASSED** and **ADOPTED** with a concurrence of at least 12 grand jurors on this 3rd day of May, 2012.

Kathryn G. Janoff
Foreperson

Alfred P. Bicho
Foreperson pro tem

James T. Messano
Secretary