

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

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**THE STATE COULD HAVE  
MORE EFFECTIVELY MANAGED  
THE SALE AND REPAIR OF  
SURPLUS RESIDENTIAL PROPERTY**

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REPORT BY THE  
OFFICE OF THE AUDITOR GENERAL

P-494

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MANAGED THE SALE AND REPAIR OF  
SURPLUS RESIDENTIAL PROPERTY

SEPTEMBER 1985



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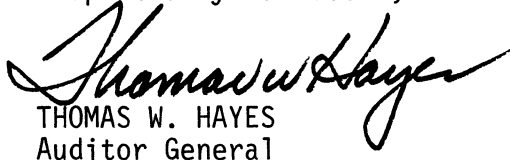
P-494

Honorable Art Agnos, Chairman  
Members, Joint Legislative  
Audit Committee  
State Capitol, Room 3151  
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the sale and repair of surplus residential property on the rescinded portion of State Highway Route 2 in the City of Los Angeles. Although the Department of Transportation and the Department of Housing and Community Development followed statutory procedures, the departments erred in determining some selling prices of single family residences and provided funds to contractors for work of some single family residences that was either never performed or performed poorly.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

## TABLE OF CONTENTS

	<u>Page</u>
<b>SUMMARY</b>	i
<b>INTRODUCTION</b>	1
<b>CHAPTER</b>	
I    THE STATE MADE ERRORS IN DETERMINING SOME SALES PRICES OF SINGLE FAMILY RESIDENCES	7
II   THE STATE PAID FOR SOME REPAIRS THAT CONTRACTORS DID NOT COMPLETELY PERFORM	15
III  THE DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT HAS INADEQUATE RECORDKEEPING PRACTICES	25
IV   CONCLUSION AND RECOMMENDATIONS	29
<b>RESPONSE TO THE AUDITOR GENERAL'S REPORT</b>	
Business, Transportation and Housing Agency	33
<b>APPENDICES</b>	
A    GLOSSARY OF TERMS	A-1
B    WORKSHEET FOR CALCULATING THE FINAL REASONABLE SALES PRICE	B-1

## SUMMARY

The State followed statutory procedures in the sale and repair of surplus residential property in the rescinded portion of State Highway Route 2 (Glendale Freeway) in the City of Los Angeles. However, the California Department of Transportation (Caltrans) and the Department of Housing and Community Development (HCD) erred in determining some selling prices of single family residences. As a result, the departments overcharged 3 purchasers a total of \$23,196 for the 34 sales we reviewed. The total sales price for the 34 residences was \$1,121,129. In addition, we identified 9 other discrepancies in which one purchaser paid \$500 more, and 8 purchasers paid \$500 to \$1,901 less than we calculated. Because neither Caltrans nor the HCD had complete records, we could not confirm why our calculations differed from those of the departments. The State also paid some contractors for repair work that was not performed. Of the \$470,733 paid to repair 19 residences, the State paid approximately \$35,192 for repair work that was either never performed or performed incompletely. Finally, the HCD did not retain complete records for the administration of the repair of the single family residences.

### Errors in Determining Selling Prices

Caltrans adhered to statutory procedures in selling surplus residential property by offering to sell single family residences to their occupants at the prices required by law. Caltrans offered to sell single family residences first to former owners who were occupants, then to occupants, and then to housing-related entities. However, Caltrans and the HCD erred in calculating affordable prices for 3 of the 34 sales we reviewed, and the departments overcharged 3 purchasers by \$23,196. These errors occurred because the departments did not fully review affordable sales price calculations. We found 9 other discrepancies in which one purchaser paid \$500 more than, and 8

purchasers paid \$500 to \$1,901 less than we calculated. Because the two departments did not always maintain complete records, we could not confirm why our calculations differed from theirs.

Caltrans also adhered to statutory procedures by imposing conditions and restrictions on the sale of single family residences at less than fair market values to ensure that the residences remain available to people of low and moderate incomes. Caltrans also adhered to statutory procedures by selling all other residences to housing-related entities at reasonable prices to afford economic use of the properties for families of low and moderate incomes. Furthermore, Caltrans adhered to statutory procedures by requiring housing entities to repair the residences and convert them to limited-equity housing cooperatives.

#### Payments for Incomplete Repairs

Contractors under the supervision of Caltrans and the HCD did not perform all required repairs to single family residences. Contractors did not perform all work required under contract in 10 residences and did not perform to contract specifications in 16 residences out of the 19 residences we inspected. As a result, the State paid \$35,192 for repair work that was either not done or done incompletely. The State paid a total of \$470,733 to repair the 19 residences.

#### Incomplete Records

The HCD did not retain complete records of its administration of the repair process for single family residences. Of the 22 files we reviewed, we found only one in which there was evidence that the HCD had informed the homeowner formally that he or she could object to the contractor selected by the HCD to carry out the repair work. In addition, the HCD did not have all inspection reports to show that it

inspected construction work during interim phases to verify that contractors completed repairs as required under contract. The inspection reports verify the quality and completeness of work completed by contractors and authorize lenders to release funds for payment of interim work completed.

Finally, the HCD did not maintain adequate records of construction delays by contractors. In 10 of 12 projects we reviewed, contractors exceeded completion dates by one day to 141 days. Although it could have assessed fines of \$16,600 for five of the delays, the HCD assessed fines of only \$3,400. We did not find any records of fines for the remaining five delays. According to the HCD, it negotiated fines for the delays but did not maintain any records to document these negotiations.

## INTRODUCTION

In the late 1960's and early 1970's, the California Department of Transportation (Caltrans) purchased over 250 parcels of land for approximately \$7 million in the Echo Park and Silverlake areas in the City of Los Angeles. The State intended to use this land for the future freeway location of State Highway Route 2 between Route 101 and Glendale Boulevard. More than 530 single family and multiple family residences are located on these parcels.\* Because Caltrans did not plan to begin construction for some time, it rented the residences to tenants who were primarily persons and families of low or moderate income.

In 1975, the Legislature decided not to build the section of Route 2 between Route 101 and Glendale Boulevard, and the residences became surplus residential property. Prior to enactment of the statute dealing with such property, Caltrans' policy was to sell surplus residential property at fair market value. The tenants, however, petitioned the Governor for the right to purchase their residences below fair market values without having to compete with other buyers.

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\*Because we frequently refer to statutory and technical terms in this report, we have included a list of these terms and their definitions in Appendix A.



In April 1978, the Attorney General ruled that Caltrans could justify selling the property at less than fair market value if a Caltrans study of the impact of the sale of the residences showed that selling the residences at fair market value would dislocate a large number of households. Caltrans made the study and found that selling the property at fair market value would disrupt the community. Therefore, on January 30, 1979, Caltrans issued its report of the study and called for the sale of surplus residential properties on Route 2 at less than fair market values.

In 1979, the California Legislature enacted Chapter 1116, Statutes of 1979 (Government Code Section 54235 et seq.), which prescribes a process for selling surplus residential property such as that located on the proposed site of Route 2. The purpose of the statute was to ensure that the predominantly low and moderate income renters would not be displaced if the properties were sold back to the public.

The law requires Caltrans to offer the single family residences at fair market value to occupants who were the previous owners of the property. Caltrans is also required to offer to sell all the other single family residences to their present occupants; however, the law stipulates that these occupants must pay an affordable price. This price must be not less than Caltrans' acquisition price, unless the acquisition price was greater than the current fair market value, and not more than fair market value. Caltrans is also required

to impose conditions and restrictions when residences are offered at less than fair market value to ensure that such housing will remain available to persons of low and moderate income or to persons having incomes no greater than the incomes of the occupants in proportion to the area median income. In addition, Caltrans must provide repairs required by lenders and government housing assistance programs. Finally, all single family residences not sold according to the above provisions and all multiple family residences must be offered first to private or public housing-related entities at a reasonable price with conditions and restrictions that ensure that this housing will remain available to persons and families of low or moderate income. Under this last stipulation, the purchaser is responsible for the repair of the properties.

In April 1980, Caltrans entered into an interagency agreement with the Department of Housing and Community Development (HCD) to assist Caltrans in selling and repairing the surplus residences according to the requirements of Government Code Section 54235 et seq. As part of the agreement, the HCD was to assist in the sale of single family residences by determining occupants' incomes, determining affordable sales prices jointly with Caltrans, inspecting single family residences to identify repairs required by lenders and governmental housing assistance programs, and monitoring the progress of repair work.

The surplus residential property that was part of the Route 2 project consisted of 125 single family residences and 96 parcels of land with multiple family residences. As of May 1, 1985, Caltrans has sold 95 single family residences for \$3,459,302. Caltrans acquired these residences for \$2,347,482 and spent \$2,407,830 to repair them. Caltrans estimated the fair market value of these residences to be \$8,487,750. According to the Chief of Caltrans' Relocation Assistance and Housing Branch, Caltrans is offering to sell the remaining 30 single family residences to occupants and to housing-related entities. Caltrans has also sold 79 parcels of land with multiple family residences to five housing entities and has received \$3,025,261 from the sales. Caltrans acquired these residences for \$3,025,261, and estimated their fair market value to be \$11,312,890. According to the chief, Caltrans is offering the remaining 17 parcels for sale according to provisions of Government Code Section 54237.

#### SCOPE AND METHODOLOGY

The purpose of this audit was to determine whether the State met statutory requirements in selling and repairing surplus residential property on the proposed State Highway Route 2. We evaluated the procedures that Caltrans and the HCD followed in calculating sales prices for surplus residential property, and we evaluated these departments' administration of the repair process, including their assessment of the contractors' performance in adequately completing the repairs required under contract. We interviewed staff members at

Caltrans and the HCD, representatives of the mortgage lending institutions that financed the sale of single family residences, and purchasers of the single family residences.

To determine that the two departments followed statutory requirements in selling the single family residences, we selected a sample of 47 residences and reviewed the files maintained by Caltrans and the HCD as well as the files maintained by the lenders that financed the sale of the single family residences. To verify that the departments calculated sales prices correctly, we determined the income classification of purchasers and recalculated the affordable sales prices for them. To verify that Caltrans imposed the conditions and restrictions required by law, we reviewed the sales agreements between the department and those purchasing the residences. To determine that the two departments followed statutory requirements in selling the multiple family residences, we reviewed the two departments' files and recalculated the sales prices for two of the five sales involving 49 parcels of land.

To evaluate the departments' administration of the repair process for single family residences, we reviewed their procedures and files to determine if they monitored the repair process. We also contracted with a private building inspection consultant and the Office of the State Architect to inspect a sample of 20 single family residences and to assess the repairs made by the contractors that the two departments hired. Our sample consisted of 10 residences whose

homeowners, as a result of a survey of all homeowners, had complained about the repairs that contractors performed on their residences. We eliminated one of these residences from our analysis because the department suspended the sale to the occupant and stopped repair work on the residence. We also reviewed 10 additional residences selected by random sample.

## CHAPTER I

### THE STATE MADE ERRORS IN DETERMINING SOME SALES PRICES OF SINGLE FAMILY RESIDENCES

The California Department of Transportation (Caltrans) with the assistance of the Department of Housing and Community Development (HCD) followed statutory requirements in the sale of surplus residential property by offering to sell single family residences according to procedures established by law. However, the HCD made at least three errors in calculating affordable prices and determining selling prices for the 34 single family residences we reviewed. As a result, the two departments overcharged three purchasers a total of \$23,196. We found nine other discrepancies, ranging from \$500 to \$1,901, but we were unable to confirm that they were errors because the records of both Caltrans and the HCD were incomplete. Caltrans also followed statutory procedures in selling multiple family residences to housing-related entities at reasonable prices.\*

#### Caltrans Followed Statutory Procedures in Selling Single Family Residences

Caltrans followed statutory procedures in selling single family residences by offering to sell residences first to former owners

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\*The worksheet used for calculating the reasonable price is shown in Appendix B.

who were occupants, next to occupants, and then to housing-related entities.

We reviewed 47 of the 125 single family residences that were surplus residential property along the proposed State Highway Route 2. Caltrans sold one residence at fair market value to its occupant, who was the former owner, and offered to sell the remaining 46 residences to their occupants. As of March 13, 1985, Caltrans had sold 34 of the residences for \$1,121,129 and was in the process of selling another 2 residences to their occupants. Caltrans scheduled one residence for sale to the public because it was vacant and no longer used as a residence and offered the remaining 9 unsold residences to public and private housing-related entities.

In selling all properties at less than fair market value, Caltrans required purchasers to sign a standard agreement authorizing Caltrans and the HCD to repurchase the property, should the purchaser decide to sell, and to make the property available to low or moderate income households. In signing this agreement, the purchaser also consented not to make substantial improvements that would materially add to the value of the property without the written consent of Caltrans.

The HCD Made Some Errors in  
Calculating Affordable Sales Prices

The HCD made 3 errors in calculating the affordable sales prices for a sample of 34 residences that we reviewed. As a result of these errors, the two departments overcharged 3 purchasers a total of \$23,196. The total sales price for these residences was \$1,121,129. We identified 9 additional discrepancies in the HCD's calculations, but we could not confirm that these were errors because the departments did not always keep complete records to support their calculations of sales prices.

In selling single family residences to occupants, the HCD, under an interagency agreement with Caltrans, established procedures to sell residences at affordable prices. Government Code Section 54237(b) requires that residences be offered at an affordable price that is not less than the State's original acquisition price unless the acquisition price was greater than the current fair market value. For any residence to be sold at Caltrans' acquisition cost, the HCD estimated the State's share of settlement costs and added them to the acquisition price. Caltrans would then receive, in full, the acquisition cost of the property. According to the Chief of the HCD's Rehabilitation and Housing Assistance Section, the standard estimate to be used in determining settlement costs was \$3,000.

State law prescribes that the methods used to calculate affordable sales prices must be in accordance with two different



regulations of the federal Department of Housing and Urban Development. Each regulation uses a different percentage of adjusted income to determine the maximum monthly housing payments: for lower income households, the maximum monthly housing payment is 30 percent of the adjusted income; for other households, the maximum monthly housing payment is 35 percent of the adjusted income.

Two of the errors we identified in our sample occurred because the HCD used the incorrect method to calculate affordable sales prices. In determining the affordable sales prices of houses for two lower income households, the HCD used the method for calculating affordable sales prices for nonlower income households. As a result, the departments required these two households to pay a higher monthly housing payment than the law requires. Based on a maximum monthly payment of 30 percent, the departments overcharged one purchaser, who paid \$31,596 for the residence, by \$4,896; they overcharged another purchaser, who paid \$28,598 for the residence, by \$2,431.

The HCD made a third error in calculating the sales price for a residence because it used an incorrect acquisition price for that residence. The parcel of land that includes the residence originally consisted of two lots, which Caltrans acquired for \$49,405. Caltrans later divided the original parcel into two parcels, and assigned the parcel containing the residence a value of \$31,805. However, in determining the sales price of this parcel, HCD staff used the acquisition price of both parcels--\$49,405--instead of the assigned

value. Since the calculated affordable sales price for the purchase was less than the acquisition price of \$49,405, the HCD, following Government Code Section 54237(b), sold the residence to the purchaser for \$53,850, which included the erroneous acquisition price and estimated settlement costs. The correct affordable sales price, however, was \$37,981, which is \$15,869 less than the amount charged by the HCD. The purchaser is therefore making substantially higher monthly mortgage payments than the law requires.

#### Other Discrepancies in Sales Price Calculations

In addition to the three errors just discussed, we found nine additional discrepancies in our sample of 34 single family residences offered for sale. However, because the two departments did not always maintain complete records of how they determined the final sales prices, we could not confirm why our calculations differed from theirs. Using the methods prescribed by the HCD, we calculated the affordable sales prices and determined the sales prices that the departments should have charged purchasers. One purchaser paid \$500 more than we calculated, and eight purchasers paid \$500 to \$1,901 less than the prices we calculated, a total of \$6,813. For eight of the nine cases, selling prices were based on Caltrans' acquisition costs.

According to the HCD's former program manager responsible for the sale of the residences on route 2, the discrepancies we identified may have occurred because the HCD's estimated settlement costs were

either higher or lower than the \$3,000 generally used. Also, according to the Chief of the Relocation Assistance and Housing Branch of Caltrans, the sales prices may have been calculated to take into account actual, rather than estimated, settlement costs. However, Caltrans did not have any written procedures to support this method of calculation, and it did not keep records to document that this method was, in fact, used.

The HCD and Caltrans Did Not Always  
Indicate That Sales Price  
Calculations Were Reviewed

Although the HCD's program manager was to review all sales price calculations, we could not find evidence of such a review in most of the sales we reviewed. The HCD forwarded the affordable sales price calculations to Caltrans before completing the sales. It was Caltrans' policy to review the calculations, but Caltrans' staff made no record of their review in 14 of the 34 sales that we examined. The Chief of Caltrans' Relocation Assistance and Housing Branch was unsure why Caltrans' staff did not detect the errors. If Caltrans had thoroughly reviewed the calculations, it may have prevented some of the HCD's calculation errors.

The State Followed Statutory Requirements  
in Selling Multiple Family Residences

Caltrans solicited interest from private and public housing entities to purchase and repair surplus residential property containing multiple family residences. Caltrans offered 88 parcels of surplus residential property containing multiple family residences to the only respondent, a nonprofit community development corporation that formed five nonprofit limited-equity housing cooperatives to take title to the properties. Caltrans sold 79 of the parcels to these five housing cooperatives.

We reviewed the reasonable price calculations for two of the five sales of multiple family residences to the housing cooperatives. These two sales included 49 parcels of land containing 164 residential units. We found that Caltrans and the HCD correctly calculated the final reasonable sales prices for the two sales. However, because the final reasonable sales prices that Caltrans calculated were always lower than Caltrans' acquisition costs, Caltrans sold all the multiple family residences for their acquisition costs.

Caltrans also followed statutory requirements by requiring the housing cooperatives to repair the residences and operate them as limited-equity housing cooperatives for persons and families of low and moderate income. In addition, Caltrans used a purchase agreement that required the housing cooperatives to charge occupants a rent or monthly carrying charge that did not exceed an affordable rent.

## CHAPTER II

### THE STATE PAID FOR SOME REPAIRS THAT CONTRACTORS DID NOT COMPLETELY PERFORM

The California Department of Transportation (Caltrans) with the assistance of the Department of Housing and Community Development (HCD) followed statutory procedures in arranging for the repair of single family residences, enabling the homeowners to comply with requirements imposed by lenders. However, contractors hired by the departments to perform repairs did not perform all repairs that the contracts required. We inspected 19 residences and found that contractors did not perform the work required under contract in 10 residences and did not meet contract specifications in 16 residences. Of the \$470,733 that Caltrans spent for repair work on these 19 residences, Caltrans provided \$35,192 to contractors who either did not perform work or performed work incompletely.

As of May 1, 1985, Caltrans had spent \$2,407,830 repairing 89 of the 95 single family residences that it had sold. The cost of repairs averaged \$27,054 per residence and ranged from \$6,768 to \$65,548.

The State Followed Statutory  
Procedures in Arranging for Repairs  
of Single Family Residences

Caltrans and the HCD followed statutory procedures in arranging for the repair of single family residences, enabling the homeowners to obtain government-insured mortgages. To ensure that buyers obtained financing, Caltrans and the HCD used three different types of mortgage insurance programs offered by the federal Department of Housing and Urban Development (HUD): the 203(k), 203(b), and 235 programs. To meet the HUD's mortgage insurance rehabilitation standards for all three programs, Caltrans and the HCD identified repairs that the residences needed and supervised the repair work to ensure that contractors met the repair standards. Government Code Section 54237(b) requires Caltrans to provide the repairs that lenders and government housing assistance programs require for the single family residences.

We reviewed 19 single family residences and found that Caltrans and the HCD identified needed repairs on the residences and selected contractors to make the repairs. While Caltrans provided all of the funds for the repair work, it deposited with lenders the funds to repair residences under the 203(k) program. The lenders released the funds to contractors only after the HCD verified the completion of the repairs on these residences. All homeowners in our sample who purchased their homes through private lenders received mortgages from lenders and obtained mortgage insurance through one of the HUD mortgage insurance programs.

Caltrans Paid for Some Repairs  
That Contractors Did Not Perform

Caltrans provided \$470,733 to repair the 19 residences we reviewed. However, \$7,500 of this total was paid for repair work that contractors did not perform. We hired consultants to inspect 9 residences of homeowners who complained about the repair of their homes and 10 other randomly selected residences. The inspections disclosed that contractors did not make all required repairs in 6 of the 9 residences whose owners previously complained about repairs to their residences and in 4 of the 10 other residences we randomly selected for review.

Caltrans administered the repair of the homes financed under the 203(b) and 235 programs, both of which required that repairs be completed before Caltrans sold the residences. Caltrans hired private contractors to do the repair work. The HCD administered the sales of residences under the 203(k) program, which allowed for the repair of the residences after they were sold. This program allowed buyers to enter into contracts with private contractors for the repairs that the HCD had identified. The costs of the repair work were covered by funds that Caltrans deposited into the escrow accounts for the sales of residences.

We hired consultants from a private building inspection service and from the Office of the State Architect to inspect the contractors' work on 19 single family residences sold by Caltrans and

repaired under the administration of Caltrans and the HCD. The consultants inspected the residences of 9 owners who, in response to a questionnaire sent to them by their state Assemblymember, complained about the incompleteness of the repairs. In 6 of the 9 residences, the consultants found that contractors did not perform all work required by their contracts. Of the \$248,841 that Caltrans provided to repair the 9 residences, \$5,450 was paid for work that contractors did not perform. For example, the consultants found that Caltrans provided contractors \$120 for a light fixture that the contractor did not replace. In addition, Caltrans provided contractors \$1,820 to weatherstrip doors and windows in two residences. However, the contractors did not perform these tasks.

The consultants found that the contractors did not perform all tasks required by their contract in four of the ten residences that we randomly selected. Caltrans provided \$221,892 to repair these residences; \$2,050 of that total was paid for work that contractors did not perform. In one project, Caltrans provided contractors \$150 to install a solid core door. In another project, contractors received \$500 to install two combination doors. In both cases, the contractors did not install the doors specified by the contracts.

According to a rehabilitation specialist at the HCD and a senior right-of-way agent at Caltrans, inspectors for these departments reviewed the repair work while it was being done and approved its completion. Caltrans supervised the repair work for 7 of the



residences that our consultants inspected, and the HCD monitored the remaining 12 residences. The results of our inspections indicate, however, that neither department ensured that contractors performed the repairs required by the contracts. Of the \$7,500 paid to contractors for work they did not perform, \$1,040 was paid to contractors monitored by Caltrans, and \$6,460 was paid to contractors monitored by the HCD.

Contractors Did Not Complete All Work  
To Meet Contract Requirements

Our consultants' inspections revealed that, in addition to not completing all of the repair work required, the contractors did not perform all work according to standards and codes. Of the \$470,733 that Caltrans provided to repair the residences, \$27,692 covered repair work that did not meet contract requirements, local building codes, or the standards of the two administering departments, Caltrans and the HCD.

In eight of the nine residences whose homeowners complained about repairs, our consultants found repairs that did not meet contract requirements. The contracts required that all repairs conform either to construction standards set by the local building codes or by the HUD. Such standards generally specify the materials and the methods that contractors should use to perform the repairs. We found, however, that \$23,317 of the \$248,841 Caltrans provided contractors for repairs covered work that did not meet local building codes or HUD construction standards.

For six of the nine residences, Caltrans provided contractors \$13,955 for work on foundations and structural supports. In all six residences, however, the contractors did not complete the repairs to meet contract requirements. For example, our consultants identified two residences in which the contractors notched or cut the bottom edges of several beams while repairing floors. The building code for the City of Los Angeles states, however, that beams may be cut only on the top edges. The consultants pointed out that the cuts and notches damaged the beams and weakened the floor support. In two other residences, the contractors did not nail the floor posts and beams as the building code required. According to the consultants, this failure created unstable floors in the residences. In another residence, a contractor repaired the stairway from the first story to the second, but several steps varied in height by over one-quarter inch. The building code allows a maximum variation of one-quarter inch between steps. According to the consultants, the differences in height are a safety hazard because they could cause a person to fall.

In eight of the ten residences we randomly selected for review, the consultants found that some of the contractors' repairs did not meet local building codes or HUD construction standards. Caltrans provided a total of \$221,892 for work on these residences; \$4,375 went toward work that contractors did not perform according to contract requirements. The consultants found that the repaired porch steps in one residence varied in height by over one-quarter inch and that, in another residence, the contractor did not nail the posts to beams that

provided support for the floors. The consultants observed that both conditions were unsafe and violated local building codes.

The repair contracts specified all repair work to be performed and the appropriate standards for each repair. The contracts required that the repairs conform to the HUD's rehabilitation standards, to the building code for the City of Los Angeles, and to the construction standards of the supervising department. However, we determined that contractors were paid \$27,692 for work that did not meet contract requirements. Of this total, \$17,533 went to contractors supervised by the HCD, and \$10,159 went to contractors supervised by Caltrans. According to an HCD rehabilitation specialist, the HCD inspectors did not verify that the repairs conformed to the building code since city inspectors also reviewed the construction work to ensure compliance with the code. A senior right-of-way agent for Caltrans also stated that its inspectors occasionally consulted city inspectors about the repairs. It appears that both departments relied on city inspectors to review repairs covered by the building code and, as a result, did not thoroughly inspect some repairs.

#### The Departments' Files Lack Evidence of Inspections

Neither the HCD nor Caltrans maintained complete records to show that it conducted the required inspections of the repairs to the 19 residences in our sample. Both the HUD's mortgage insurance programs and the repair contracts required the HCD to inspect and

verify the completion of repairs made to single family residences. Through an agreement with the HUD, the HCD agreed to inspect the residences repaired under the 203(k) program and to complete an inspection report verifying the completion of repairs. The HCD was then to forward the report to lenders. The purpose of the inspection report was to confirm that the HCD had inspected the construction repairs, agreed to the completeness of the work, and authorized the lender to release payment to the contractor.

Caltrans, which supervised the residences repaired under the HUD 203(b) and 235 mortgage insurance programs, followed different procedures to disburse payments to contractors. According to a Caltrans construction engineer, Caltrans either paid contractors monthly based on the number of repairs they completed or paid contractors only after they completed all of the repairs when the contracts were for less than \$25,000. The construction engineer stated that Caltrans was to verify the completion of these repairs during regular visits to the construction sites and record their completion on schedules maintained for each project.

In our review of the HCD's files, we found that the HCD did not maintain records to show that the HCD conducted the required inspections of the construction work. We could locate files for only 10 of the 12 residences supervised by the HCD. In these 10 files, we could not find records of 15 of 23 inspections that the HUD required the HCD to make. A rehabilitation specialist for the HCD stated that

inspectors performed and reported on the inspections but may have misplaced copies of the reports. He further stated that the HCD inspectors allowed the contractors to vary from contract specifications without documenting the changes. In addition, we could not find all inspection reports for a sample of projects at one of the lenders used by the HCD for obtaining loans to purchase single family residences.

In our review of Caltrans' files, we found that Caltrans also did not maintain records to show that it conducted required inspections. According to the Chief of the Construction Branch for Caltrans' Los Angeles district office, Caltrans' policy generally requires inspectors to make periodic inspections while repair work is underway.

Caltrans had files for six of the seven residences that it supervised. In the six files that we located, we found evidence of inspections in only five of the files. An inspector for the unit assigned by Caltrans to inspect one of the residences in our sample explained that his unit inspected the repair work during periodic visits to the construction site. A construction engineer stated, however, that Caltrans' staff may have misplaced some of the records of these inspections. He further stated that some repair items may have been deleted or changed from specifications on an informal basis without documentation.

## Homeowners' Recourse

According to staff at Caltrans and the HCD, homeowners of the single family residences have several options available when contractors do not perform required repairs or do not perform repairs completely. A senior right-of-way agent for Caltrans' Los Angeles district office stated that homeowners should report deficiencies to his department. Caltrans would then take the responsibility for resolving any complaints about the contractors. A rehabilitation specialist for the HCD stated that homeowners should first contact the contractors and attempt to resolve any complaints with them. If the homeowners are unable to resolve the complaints with the contractor, the homeowners should formally inform the HCD in writing, and the HCD would then attempt to resolve the complaints directly with the contractor.

**CHAPTER III**  
**THE DEPARTMENT OF HOUSING  
AND COMMUNITY DEVELOPMENT  
HAS INADEQUATE RECORDKEEPING PRACTICES**

The Department of Housing and Community Development (HCD) lacked records verifying that it informed homeowners that they could object to the contractor selected by the HCD. In addition, the HCD did not maintain adequate records of contractors' delays in completing repairs and of the fines that the HCD assessed for the delays. In ten of the projects we reviewed, contractors failed to meet completion dates by one day to 141 days. Although the HCD could have assessed fines of \$16,600 for five of the delays, it assessed fines of only \$3,400.

In addition to the inadequate recordkeeping practices we discussed in the preceding chapters, the HCD has had numerous other recordkeeping problems. For example, we could not find complete evidence that the HCD notified homeowners that they could reject contractors selected by the HCD. We reviewed 22 repair projects monitored by the HCD. According to an HCD rehabilitation specialist, all of the homeowners authorized the HCD to act as their agent in the repair process. As agent, the HCD was responsible for supervising the selection of qualified contractors and overseeing the performance of work as the construction contracts required. However, we found evidence in only one of the 22 projects that the HCD formally notified homeowners that they could object to the contractor selected by the HCD to carry out the repair work.

A rehabilitation specialist for the HCD stated that the HCD informed the homeowners by letter of their right to reject the contractor that the HCD selected. The rehabilitation specialist explained, however, that the HCD's staff may have misplaced copies of these letters.

In addition, the HCD did not maintain adequate records of construction delays by contractors. We reviewed 12 repair projects to evaluate the promptness of contractors in completing repair work. In 10 of these cases, contractors failed to meet contractual completion dates by one to 141 days. The State's construction contract stipulates that the State is to assess fines of \$50 a day for any delays beyond the stated completion date unless the contractor notifies the State in writing of the causes for the delay or the State determines that an extension of time is justified. However, we could not find any records in the HCD's files describing the reasons for the delays nor any correspondence from the contractors justifying the delays. Furthermore, the HCD did not assess all penalties that the contract allowed for the delays. The HCD assessed a total of \$3,400 in fines for five of the ten delays; however, under the terms of the contract, it could have assessed an additional \$13,200. The HCD could not provide any records of fines assessed for the remaining five delays.

According to an HCD rehabilitation specialist, the HCD did not enforce contract provisions requiring formal notification of construction delays because the HCD usually learned of the delays



during its periodic inspections of construction sites. According to the rehabilitation specialist, the HCD negotiated the fines that contractors would pay for the delays but only documented the negotiations with one contractor.

The State needs records of the HCD's administration of the repair process to demonstrate that the HCD acted properly in its role as an agent for homeowners in fulfilling statutory procedures to repair residences. Since the HCD did not keep adequate records to demonstrate that it notified homeowners of the contractors selected to make repairs, that contractor delays in completing projects were justified, or that appropriate fines were assessed, the State has no assurance that the HCD acted properly as the homeowners' agent during the repair process. In our opinion, keeping such records would have allowed the State to better respond to the complaints that it has received from the homeowners regarding the manner in which Caltrans and the HCD have administered the repairs to residences.

## CHAPTER IV

### CONCLUSION AND RECOMMENDATIONS

Although the Department of Transportation and the Department of Housing and Community Development followed statutory procedures in the sale and repair of surplus residential property along the proposed State Highway Route 2 in the City of Los Angeles, the departments did not completely fulfill their responsibilities or keep complete records of their administration of the sale and repair processes. If Caltrans had more extensively reviewed the work of the HCD, Caltrans may have prevented some of the conditions we identified. The two departments were supposed to inspect the repair work for single family residences to verify that contractors completed all work required by contract, but we found that the contractors did not complete all work. In addition, the State's lack of complete records documenting how sales prices were determined gives little assurance that the State treated all purchasers equitably. Finally, the absence of complete records documenting that the State inspected repair work and verified the completeness of the work before authorizing release of funds gives little assurance that the State acted properly in administering the repair process.

#### RECOMMENDATIONS

To correct the inconsistencies in the sales of single family residences, the Department of Transportation should review all sales of single family residences to identify any errors in calculating

affordable sales prices. Then, in conjunction with the federal Department of Housing and Urban Development, the Department of Transportation should determine whether it should renegotiate those sales prices. If so, it should adjust the sales prices to the correct amounts, refund excess payments made by purchasers who were overcharged, and collect additional amounts from purchasers who may have been undercharged, if feasible.

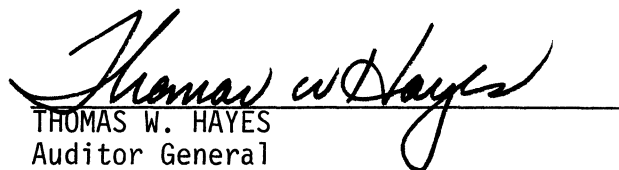
To correct the condition of the repairs in our sample of 19 residences, the Department of Transportation and the Department of Housing and Community Development should do the following:

- If legally possible, compel contractors to complete all repairs required by contract. The departments should also ensure that all repairs made meet contract specifications.
- Determine the recourse available for homeowners not satisfied with the contractors' repairs, and inform all homeowners for whom the departments monitored the repair process of actions that homeowners could take to rectify their situation. The departments should assist homeowners in their actions.
- If the State should again sell and repair residences under the requirements of Government Code Section 54235 et seq., it should establish procedures to keep adequate records of

the sale and repair process. At the minimum, the State should develop written procedures for determining and documenting final affordable sales prices, including the settlement costs that are to be added to acquisition costs. It should also document supervisory review of affordable sales price calculations, inspections of repair work, any changes to contract specifications for repairs, and notification to homeowners of their ability to reject contractors selected for them.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

Date: September 9, 1985

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GLOSSARY OF TERMS

The following definitions come from state statutes or federal procedures manuals.

<u>Term</u>	<u>Definition</u>
Acquisition Price	The price the Department of Transportation paid when it acquired the property.
Affordable Price	For a purchaser from a lower income household, the price of residential property for which the purchaser's monthly payments will not exceed that portion of the purchasing household's adjusted income, as determined in accordance with the regulations of the federal Department of Housing and Urban Development issued pursuant to Section 8 of the United States Housing Act of 1937. For a purchaser other than a lower income household, the price for which the purchaser's monthly payments will not exceed that portion of the purchasing household's adjusted income, as determined in accordance with the regulations of the federal Department of Housing and Urban Development issued pursuant to Section 235 of the National Housing Act.
Affordable Rent	For a person or family of low or moderate income, rent for residential property that is not more than the percentage of the adjusted income of the person or family as permitted under regulations of the federal Department of Housing and Urban Development issued pursuant to Section 8 of the United States Housing Act of 1937; this rent must not exceed the market rental value for comparable property. For a person or family other than a person or family of low or moderate income, rent for residential property that is not more than 25 percent of the occupant household's gross monthly income.

Term	Definition
Area Median Income	Median household income adjusted for family size as determined for the Standard Metropolitan Statistical Area in accordance with the regulations of the federal Department of Housing and Urban Development issued pursuant to Section 235 of the National Housing Act.
Fair Market Value	The highest price that would be agreed to by a seller willing but not needing or obligated to sell and a buyer willing but not needing or obligated to buy, each party dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.
Limited-Equity Housing Cooperatives	Corporations that are organized as nonprofit public benefit corporations or that hold title to real property as the beneficiary or a trust providing for distribution for public or charitable purposes upon termination of the trust. The purchase and sale of interest in the cooperative is limited to a transfer value determined by the cooperative's articles of incorporation or bylaws. The corporate equity, the excess of the fair market value of real property over the transfer value of membership interests less outstanding encumbrances, shall not be used for distribution to members but for the benefit or expansion of the corporation or for the public benefit of charitable purposes.
Lower Income Household	Persons and families whose income does not exceed the qualifying limits for lower income families as established and amended from time to time pursuant to Section 8 of the United States Housing Act of 1937.

Term	Definition
Persons and Families of Low or Moderate Income	Persons and families whose income does not exceed 120 percent of area median income adjusted for family size by the Department of Housing and Community Development in accordance with adjustment factors adopted and amended from time to time by the federal Department of Housing and Urban Development pursuant to Section 8 of the United States Housing Act of 1937.
Reasonable Price	That price best suited to economically feasible use of the property as decent, safe, and sanitary housing at affordable rents and affordable prices for persons and families of low or moderate income.
Settlement Costs	Those expenses incidental to the acquisition of property or the refinancing of mortgages. They include charges for certifying, guaranteeing, insuring, and abstracting titles to real estate; charges for preparing, notarizing, and recording conveyancy and financing instruments; and charges for appraisal, service, and financing.
Single Family Residence	A real property improvement used, or intended to be used, as a dwelling unit for one family.
Surplus Residential Property	Land and structures owned by a state agency and determined to be no longer necessary for that agency's use and developed as single family or multiple family housing. (This does not include property being held by the agency for the purpose of exchange.)

**WORKSHEET FOR CALCULATING  
THE FINAL REASONABLE SALES PRICE\***

	District 07	County LA	Route 2	Post Mile	No
I. Anticipated Gross Monthly Housing Payment Income					\$ _____
II. Less Vacancy and Collection Loss (2%)					\$ _____
III. Adjusted Gross Monthly Income (I minus II)					\$ _____
IV. Less Monthly Operating Costs to be Paid by Housing Entity or Tenant =					
A. Utilities					\$ _____
B. Fire/Hazard Insurance					\$ _____
C. Real Estate Taxes					\$ _____
D. Management					\$ _____
E. Normal Maintenance					\$ _____
F. Reserves for Replacement					\$ _____
G. Other (Specify) _____					\$ _____
Estimated Total Operating Costs (IV)					\$ _____
V. Net Income Available to Service Debt (III minus IV)					\$ _____
VI. Best Available Mortgage/Trust Deed Terms					
A. _____ Down Payment					
B. _____ Years					
C. _____ Interest Rate					
VII. Affordable Mortgage/Trust Deed (Calculated on Basis of V and VI)					\$ _____
VIII. Down Payment					\$ _____
IX. Affordable Total Development Cost (VII and VIII)					\$ _____

\*This worksheet was used by Caltrans and the HCD to calculate sales prices for multiple family residences.



X. Estimated Cost of Rehabilitation Work \$ \_\_\_\_\_

Specify nature of work: Anticipated cost of Rehabilitation Contract plus Contingency. Reserve to perform repairs required to meet housing quality standards and local code.

XI. Estimated General Development Costs

A. Interest on Construction Loans \$ \_\_\_\_\_

B. Financing Fees \$ \_\_\_\_\_

C. Site Inspection Fees \$ \_\_\_\_\_

D. Relocation Costs \$ \_\_\_\_\_

E. Consultant Costs \$ \_\_\_\_\_

F. Legal Costs \$ \_\_\_\_\_

G. Cost Certification Audit Fee \$ \_\_\_\_\_

H. Supplemental Management Fee \$ \_\_\_\_\_

I. Titling and Recording \$ \_\_\_\_\_

Hazard Insurance \$ \_\_\_\_\_

C,E & F combined \$ \_\_\_\_\_

Total Estimated General Development Costs (XI) \$ \_\_\_\_\_

XII. Total Rehabilitation and General Development Costs (Total X plus XI) \$ \_\_\_\_\_

XIII. Estimated Reasonable Sales Price (Total IX minus XII) \$ \_\_\_\_\_

XIV. Caltrans Original Acquisition Price \$ \_\_\_\_\_

XV. Final Reasonable Sales Price \$ \_\_\_\_\_  
(XIII or XIV, whichever is greater, plus closing costs to be paid by BUYER through the Final Reasonable Sales Price in the amount of \$ \_\_\_\_\_)

Indicate basis for each estimated amount (except V).

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps