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United States General Accounting Office

GAO

Briefing Report to The Honorable Jim  
Bates

April 1986

# PUBLIC HOUSING

## San Diego Housing Commission's Acquiring/Equipping Its Office Facility



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April 4, 1986

The Honorable Jim Bates  
House of Representatives

Dear Mr. Bates:

This briefing report responds to your October 7, 1985, request and subsequent oral discussions with us regarding the San Diego Housing Commission's use of Department of Housing and Urban Development (HUD) funds for an office facility, equipment, and furnishings. You requested that we assess the legality of the Commission's use of HUD's Section 8 housing assistance funds for the facility acquisition; identify possible alternative facilities that were available at the time to determine whether the Commission obtained the best possible deal; and provide you with our observations on the Housing Commission's policies and practices for acquiring and equipping the facility. In a subsequent letter, dated February 7, 1986, and co-signed by Congressman Henry Gonzalez, you also expressed concern about whether interest rates charged by the Commission in the transaction may have been too low and whether Commission officers should be elected. This report summarizes the results of our March 7, 1986, briefing to you on these issues.

We conducted our inquiry primarily at the Housing Commission's offices in San Diego, California. We also met with and obtained information from officials of the Department of Housing and Urban Development, its Los Angeles Field Office, and its San Francisco Regional and Regional Inspector General Offices. As agreed with you, we did not request official agency comments on this briefing report, although the views of Commission officials are incorporated where appropriate. We performed our work during January and February 1986.

We found no violations of Federal law in the use of HUD Section 8 administrative reserve funds in acquiring, renovating, and furnishing the Commission's office facility. However, a class-action suit challenging, in part, the propriety of the expenditures under state and local law has recently been filed in the Superior Court of California against the City of San Diego, the Housing Commission, and private parties.

We were unable to compare the cost of the selected office facility with alternative facilities. Such a comparison was not practicable because we were not able to identify alternative facilities that closely matched the Commission's requirements; final prices for alternatives would have been subject to negotiations; and renovations, if any, might have been required for alternative facilities and their costs are unknown.

Since the alternative facilities identified did not closely match the selected facility, numerous assumptions and value judgments would be required to compare them with the selected site.

We identified a number of questionable practices in the Housing Commission's acquisition and furnishing of its office facility, however. We found that the Commission did not have clear and complete documentation supporting its acquisition and renovation of the facility or showing that the San Diego Housing Authority clearly understood or approved the transactions in advance. We also found that the Commission did not follow its procurement policy in purchasing office furniture and exercise equipment. We believe that more prudent practices should have been employed in these public business transactions because of their unusual and complex nature.

Details on these and the other matters you requested that we examine are discussed in the body of the report.

We are sending copies of this briefing report to Congressman Gonzalez immediately. Unless you or Congressman Gonzalez publicly announce its contents earlier, we plan no further distribution of this briefing report until 30 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

*George E. Grant*

George E. Grant  
Regional Manager

OBSERVATIONS ON THE SAN DIEGO HOUSING COMMISSION'S  
ACQUISITION, RENOVATION AND FURNISHING OF ITS OFFICE FACILITY

BACKGROUND

The San Diego Housing Authority, comprised of the City Council of San Diego and chaired by the Mayor, administers federal, state, and local housing programs through the San Diego Housing Commission. It has delegated authority for administering housing programs to the Commission, while maintaining approval authority over the Commission's programs, projects, and activities involving the expenditure of funds. The Commission is composed of seven members appointed by the Mayor and an Executive Director who heads a staff of 120. The Commission's fiscal year 1985 operating budget was \$23,000,000.

In 1980, the Commission began to study the feasibility of acquiring a central facility that would be large enough to accommodate both its office and maintenance activities. In 1982, assisted by a major real estate broker, the Commission identified and attempted to purchase a 53,000-square-foot facility at 1625 Newton Avenue, San Diego, California. The Commission's attempt to purchase the building was unsuccessful because, according to the Commission's Executive Director, it was unable to reach agreement with the building's owner on terms for the sale.

On April 9, 1984, private investors placed a \$5,000 deposit in an escrow account to obtain an option to purchase the Newton Avenue facility. On April 27, 1984, the Commission and the private investors entered into a partnership agreement; the private investors deposited an additional \$20,000 and the Commission deposited \$25,000 into the escrow account.

On June 29, 1984, when escrow closed, the Commission purchased the land for \$1 million and loaned the investors \$1.5 million to purchase the building at an interest rate of 10 percent for the first 5 years and 11 percent until an option is exercised or up to 55 years. The \$2.5 million used by the Commission to finance the partnership was surplus administrative funds from HUD's housing assistance payment program (Section 8).

At the close of escrow, the private investors' \$25,000 deposit was returned and the John Burnham Company, a realty company of which one of the investors is president, received \$125,000 in commissions from the sale of the property.

The Commission leases the land to the private investors for \$100,000 per year. The investors lease 34,608 square feet of office space and 2,688 square feet of warehouse and maintenance space to the Commission for \$221,000 per year, excluding

operating expenses such as utilities, insurance, and property taxes. The Commission has a 55-year, fixed-rent lease on the building. In addition, the private investors lease the remaining 16,000 square feet to a private firm. The building is managed by the John Burnham Company for a fee.

Under the land lease agreement, the Commission has the first option to purchase the private investors' interest in the office warehouse facility in the eighth, tenth, and every fifth year thereafter. If the Commission does not exercise its option, the private investors have the right to exercise their option to purchase the Commission's interest in the tenth and every fifth year thereafter. When the option is exercised, each party participates equally in the appreciated property value. The investors must repay their loan when the option is exercised. If neither party exercises its option, the private investors' loan may be extended until the next option period, although it may not exceed 55 years. At the expiration of the 55-year lease, the building becomes Commission property, free and clear of the investors' interest.

The Commission spent \$691,000 to renovate the office/warehouse facility.

#### LEGALITY OF COMMISSION'S USE OF FEDERAL FUNDS

HUD's regulations authorize payments from the Section 8 Housing and Urban Development Act reserve fund for regular administrative costs or other housing related costs. Chapter 8-2, paragraph d of HUD Handbook 7420.7 provides that reserve funds shall be used only after year-end settlement for the cost of the ongoing administration of the Section 8 program or for other housing purposes consistent with state or local law. The reserve funds were used by the Commission after year-end settlement to acquire and furnish office space to house the Commission. HUD determined, and we have no basis to disagree, that the Commission's use of the funds for acquisition of the facility was housing related and therefore proper. The propriety of the expenditure under state and local law, however, is a question currently being addressed in the Superior Court of California in a class-action suit filed February 18, 1986, against the City of San Diego, the San Diego Housing Commission, and the private participants involved in the loan transaction (Case No. 558542). We therefore did not examine whether the expenditure was consistent with state or local law.

#### MEANINGFUL COST COMPARISONS OF SELECTED FACILITY WITH ALTERNATIVE FACILITIES COULD NOT BE MADE

The Housing Commission had several specific requirements for its facility, including contiguous offices and maintenance

space, adequate parking for staff and clients, and proximity to the downtown area in order to be accessible to its clientele. We asked real estate experts in government and industry to help us compile a list of possible alternative facilities available at that time. After examining the list, it was evident that none of the alternatives closely matched the Commission's requirements, especially the requirement for contiguous office and warehouse/maintenance space. Also, the extent and costs of renovation that may have been required for alternative facilities could not be readily determined. Furthermore, the cost of such facilities was not reasonably determinable because final costs would most likely have been subject to negotiations. We therefore concluded that any cost comparisons would not be meaningful because of the numerous assumptions and value judgments that would be required.

QUESTIONABLE COMMISSION  
PRACTICES IN ACQUIRING AND  
EQUIPPING ITS FACILITY

We believe the Housing Commission's practices should have included obtaining clear understanding and approval by the approving authorities of the facility acquisition and renovation strategies and costs prior to consumation of the transactions; sufficiently documenting the transactions to assure an adequate audit trail; and adhering to Commission purchasing policies for office furnishings and exercise equipment. The Commission's actions in acquiring, renovating and furnishing the facility were inconsistent with each of these principles, however, and were therefore questionable.

Facility acquisition and renovation  
practices were questionable

The San Diego Municipal Code requires Commission projects or programs involving the expenditure of funds to be previously approved by the Housing Authority. In September 1982, the Housing Authority gave the Commission general authority to purchase an office facility using surplus Section 8 administrative funds. In December 1982, the Authority gave the Commission further general authorization, specifying the Newton Avenue property. Subsequently, on April 27, 1984, without further Authority approval, the Commission entered into a purchase/leaseback partnership with the private investors and deposited \$25,000 into escrow to secure the Newton Avenue facility. Two months later, on June 25, 1984, the Housing Authority authorized the partnership. The details of the partnership, including loan provisions and lease buy-out options, were not specifically authorized by the Housing Authority prior to the execution of the contract.

On June 29, 1984, escrow closed and the investors took title to the building and the Commission took title to the

land. In February 1986, during our review, the Executive Director of the Commission sought explicit Housing Commission approval of the loan to the investors. The approval is still pending.

The Executive Director agreed that the details of the transaction should have been, but were not, incorporated in some manner into the Housing Authority's resolutions. He stated, however, that the Housing Authority members were aware of the transaction details. We believe that prudent business practices would have required specific advance approval and documentation of the partnership arrangement between the Commission and the private investors.

The Housing Commission entered into contracts to renovate the facility in September 1984. The original estimate was \$479,000, but the costs have subsequently increased to \$691,000 due in part, the Executive Director told us, to the unforeseen need to replace, rather than repair, the building's air conditioning system.

Although the Housing Authority should have approved the expenditure of Commission funds, we found no documentation approving these expenditures. The Executive Director told us there was no direct approval of the renovation by the Authority or the Commission but that the actions taken were sufficient and that these bodies understood what was being done. The Executive Director told us, however, that the Housing Authority provided general approval for the expenditures through approval of the Commission's overall operating budget, which included funds in a discretionary account. Expenditures from this discretionary account, which include surplus Section 8 administrative funds as well as funds from other revenue-generating sources (such as Commission real estate leasing arrangements), do not require approval from either the Commission or Housing Authority, according to the Executive Director. The Executive Director told us that the facility's renovation costs were paid from the discretionary account.

Subsequent to our discussion of this matter in February 1986 with the Executive Director, he submitted a proposal to the Commission recommending, in part, adoption of a "preliminary final budget" to cover original and escalating costs for the renovation. (Renovation work on the facility was nearly completed on the building, and the Commission occupied it, in December 1984. A Commission housing analyst told us, however, that work is continuing on the air conditioning system and that the final costs are not yet known.)

We believe that it would have been sound practice for the Commission to have obtained approval for the renovation expenditures in advance of entering into contracts for the work. The Commission was unable to provide us documentation



confirming that the Housing Authority was aware of or had previously approved the original or escalating renovation costs.

Commission procurement policy not followed

The Executive Director did not follow Commission procurement policy when he purchased office furniture and exercise equipment. The Commission's procurement policy for purchases and contracts in excess of \$5,000 states that the Executive Director shall invite formal bids by (1) advertising in at least one newspaper or general publication and/or (2) posting bid invitations in public places. The policy also provides that a tabulation of bids received should be retained. If an award is made without competition based on one of the policy exceptions, a formal report, together with a certification or statement justifying the lack of competition, shall be prepared and retained as part of the Commission's permanent records.

The Executive Director purchased a desk and wall unit for his office for \$7,000 and exercise equipment for \$6,000 for employee use. He acknowledged that this was done without advertising for bids and without keeping a written tabulation of the quotes he received from three suppliers. He also failed to prepare a written statement justifying the lack of competition.

The Executive Director agreed that he did not follow Commission procurement policy and procedures when purchasing the office furniture and exercise equipment. He stated, however, that these purchases were competitive even though he did not retain adequate records. In addition, he does not believe that advertising and bidding were necessary because the equipment consisted of individual items which, if purchased separately, would not be subject to the advertising and bidding requirements. We believe, however, that the office furniture and exercise equipment each constituted a separate purchase in excess of \$5,000 and were, therefore, subject to the advertising requirement. During our inquiry, the Executive Director of the Commission requested that the Commission clarify the procurement policy with respect to what constitutes a single-item purchase.

REASONS FOR BELOW-MARKET INTEREST RATES NOT DOCUMENTED

With respect to the interest rates charged by the Commission for the \$1.5 million loan, the Executive Director of the Commission agreed that a below-market interest rate was charged. Real estate and financial experts informed us that the interest rate charged was 3 to 4 percent below market. The Executive Director commented that the transaction must be evaluated in its entirety and that it is inappropriate to

consider only a single item such as the interest rate. His position is that the interest rate was traded off against other considerations less favorable to the investors. In addition, he stated that circumstances and conditions in the marketplace need to be taken into account and factors such as the availability of suitable buildings, lease expiration dates, and urgency of need for additional space need to be considered. However, as mentioned on page 6, there was not adequate documentation to determine how these factors were weighed in arriving at the final arrangements, or whether the interest rates were reasonable when considering all factors.

#### HOUSING COMMISSION OFFICERS COULD BE ELECTED

Under the Housing Authorities Law of California (California Health and Safety Code 34000 et. seq.), a governing body may, as the City Council of San Diego has done, declare its members to be the Housing Authority. This governing body may in turn, by ordinance, create a housing commission, as was done in San Diego, to act in both an advisory and an administrative capacity. Under California law, the number of housing commission members, their terms of office, their qualifications, and the method of their appointment and removal shall be provided by ordinance. Under the San Diego City ordinance, the seven Housing Commission members are appointed by the mayor and approved by the City Council. According to legal counsel for the Housing Commission, the City Council could amend the ordinance and require election of Housing Commission members. Because, consistent with state and local law, the Commission members' selection is at the discretion of the City Council, we are taking no further position on this matter.

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