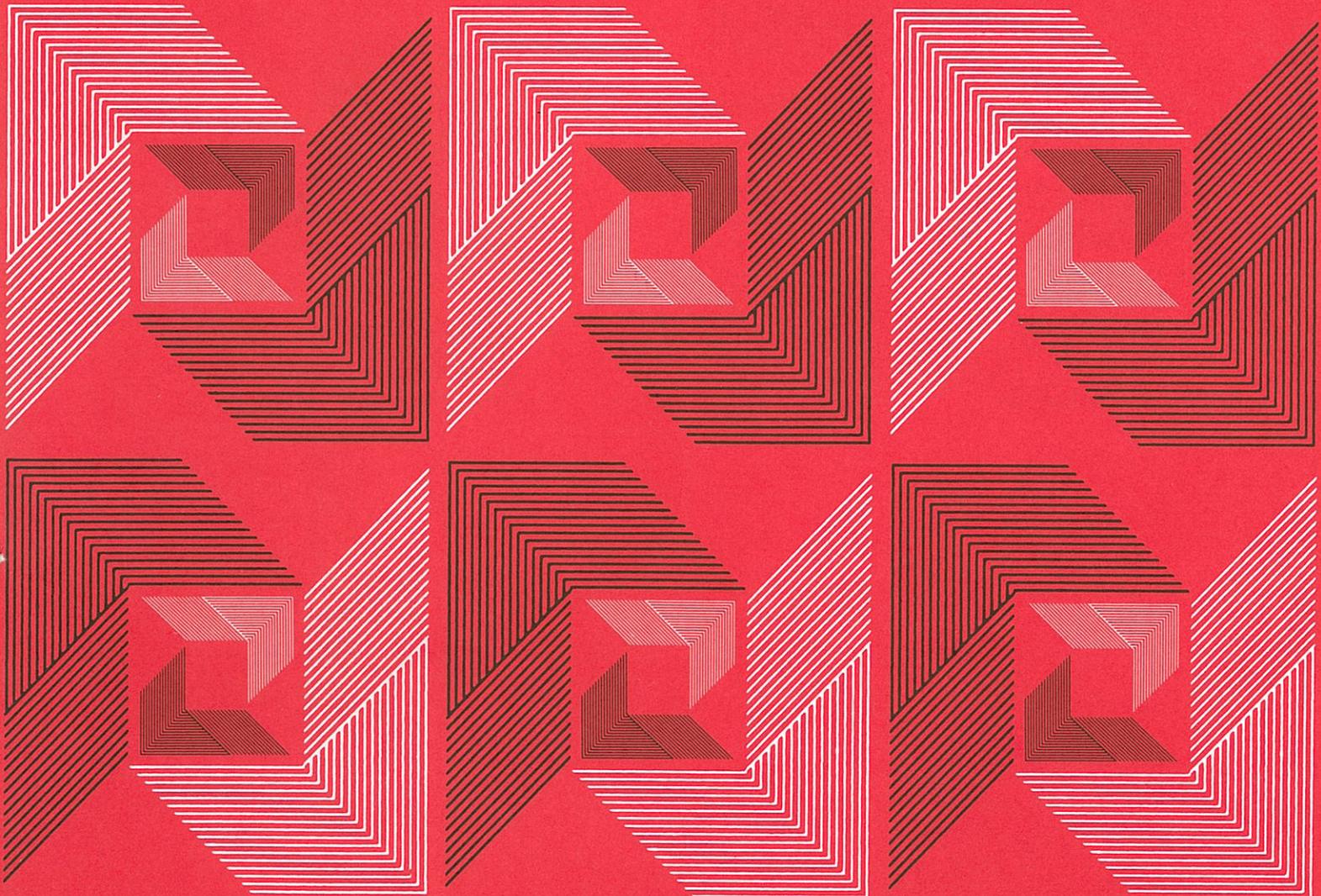


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FEBRUARY 1982

MANAGEMENT AUDIT OF THE LEASEHOLD TO FEE CONVERSION PROGRAM OF THE HAWAII HOUSING AUTHORITY

A REPORT TO THE GOVERNOR AND THE LEGISLATURE OF THE STATE OF HAWAII



SUBMITTED BY THE LEGISLATIVE AUDITOR OF THE STATE OF HAWAII

THE OFFICE OF THE LEGISLATIVE AUDITOR

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1. Conducting examinations and tests of state agencies' planning, programming, and budgeting processes to determine the quality of these processes and thus the pertinence of the actions requested of the legislature by these agencies.
2. Conducting examinations and tests of state agencies' implementation processes to determine whether the laws, policies, and programs of the State are being carried out in an effective, efficient, and economical manner.
3. Conducting systematic and periodic examinations of all financial statements prepared by and for all state and county agencies to attest to their substantial accuracy and reliability.
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**A Report to the Governor and the Legislature
of the State of Hawaii**

**Submitted by the
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FOREWORD

In enacting the Hawaii Land Reform Law in 1967, the Legislature sought to provide for the right of lessees to purchase the fee simple title to their residential leaseholds through use of the State's powers of eminent domain. The dispersion of residential fee simple lots to as many people as possible was viewed as vital to the economy and welfare of the State.

As the law has far reaching social and economic implications for the many thousands of residential leaseholders in the State, the Office of the Auditor performed a management audit to assess the effectiveness with which the Hawaii Housing Authority has implemented the leasehold to fee conversion program established by the Hawaii Land Reform Law. This report contains our findings and recommendations concerning the Authority's planning for the implementation of the law, its management of the leasehold to fee conversion process, its organization and general management for the delivery of program services, and its conduct of the program's financial affairs.

We wish to acknowledge the cooperation and assistance extended to our staff by the Hawaii Housing Authority and the Department of the Attorney General during the conduct of the audit.

Clinton T. Tanimura
Legislative Auditor
State of Hawaii

February 1982

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Chapter 1

INTRODUCTION

This is a report on our management audit of the Hawaii Housing Authority's (HHA) implementation of the leasehold to fee conversion program established under Chapter 516, Hawaii Revised Statutes. The program was created 15 years ago by Act 307, the Hawaii Land Reform Act of 1967. Since then, there have been numerous indications that the program has not met with original expectations. The law has been subject to continuous scrutiny and attention and numerous legislative amendments have been enacted. The primary purposes of these amendments have been to broaden the applicability of the law and to promote implementation.

The audit of the program was conducted pursuant to Section 23-4, HRS, which authorizes the Legislative Auditor to conduct post audits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions. This particular program was audited because it had not previously been subjected to an external, legislative audit and because it is a program affecting the vital economic interests of potentially thousands of lessees.

Objectives of the Audit

The objectives of this audit were to:

1. Assess the efficiency and the effectiveness with which the HHA has

administered the leasehold to fee conversion program created under Chapter 516, HRS.

2. Determine the legality and propriety of expenditures and receipts relating to the leasehold to fee conversion program, the adequacy of financial accounting and internal control systems, and of the operating procedures for the funds established to implement the program.

3. Make recommendations, where appropriate, to improve the management and implementation of the leasehold to fee conversion program.

Scope of the Report

The audit focused on the management and financial practices of the HHA with respect to the leasehold to fee conversion program. Our examination of these practices focused on the Authority's current practices during the fiscal year 1980-81 although prior years were included to obtain proper historical perspective and understanding of the program.

Organization of the Report

This report is comprised of six chapters:

Chapter 1 is this introduction.

Chapter 2 provides some background information on the organization and programs of the HHA and the land reform law.

Chapter 3 presents our findings and recommendations concerning planning for implementation of the land reform law.

Chapter 4 presents our findings and recommendations concerning management of the leasehold to fee conversion process.

Chapter 5 presents our findings and recommendations concerning the organization

and operations of the HHA for the land reform program.

Chapter 6, the concluding chapter, presents our findings and recommendations concerning financial management of the land reform program.

The Appendix contains the response to our report of the Hawaii Housing Authority.

Chapter 2

BACKGROUND

This chapter provides some background information on the organization and programs of the Hawaii Housing Authority (HHA). The Authority's responsibilities for the leasehold to fee conversion program and the provisions of the land reform law are also described.

The Hawaii Housing Authority

The HHA was established in 1935 by the Territorial Legislature as a public corporate body. It operated as a separate agency until 1959. In 1959, the Hawaii State Government Reorganization Act placed the HHA under the Department of Social Services and Housing (DSSH) for administrative purposes.

The HHA has broad powers to accomplish its primary purpose of providing adequate housing for the people of Hawaii.¹ These powers include, among others, the authority to acquire real property by various means, to sell, lease, rent, and develop real property, to issue bonds, and to provide financial assistance for housing to needy residents.

The HHA programs. When first created, the HHA was responsible for providing safe and sanitary housing for those with low incomes. It was authorized to clear slums and build and operate low cost public housing projects.

In the years following, the HHA responded to wartime needs by providing temporary, emergency low rent housing for defense workers

and their families. In the mid-1960's, the HHA's services widened to include housing for teachers, the elderly, and moderate income families. By the 1970's, significant new legislation further broadened the HHA's duties. The Omnibus Housing Law of 1970 emphasized housing development and the creation of new housing, the Housing Loans and Mortgage Act of 1979 provided Hula Mae mortgage funds at below market interest rates, and the Land Reform Act of 1967 created the leasehold to fee conversion program. The purpose of the Land Reform Act is to give the lessees of residential leaseholds the opportunity to purchase their lots in fee simple through use of the State's power of eminent domain.

The HHA organization. The responsibilities and powers of the HHA are vested in eight commissioners. They have a statutory duty to enforce and ensure compliance with all laws, regulations, and contracts pertaining to the HHA. Six commissioners, one from each of the counties and two at-large members, are appointed by the Governor with the advice and consent of the Senate. Two are ex-officio voting members. They are the director of the DSSH and the Governor's special assistant on housing. The commission selects a chairman and a vice-chairman from among its members. An executive director is appointed by the commission to administer the programs and the daily operations of the HHA.

1. Chapter 356, HRS.

According to the latest official organization chart, the executive director is served by two staff units and four branches.² Each of these reports directly to the office of the executive director. The first staff office is a planning, program development, and evaluation services office; the second staff office is a finance and administrative services office. The four branches and their duties are as follows:

- The housing development and construction branch administers and coordinates real property development and construction.
- The housing management branch is responsible for managing and maintaining all housing projects under the HHA.
- The occupancy services branch provides rental, sales, and counseling services for all housing units under the HHA.
- The land reform branch is responsible for implementing the leasehold to fee conversion program.

The land reform branch is headed by a land reform administrator. The exact number of additional personnel has varied from time to time. The staff includes a program specialist, three program technicians, a clerk-stenographer, and a clerk-typist. In addition to these, the HHA has hired appraisers and attorneys as needed to carry out the purposes of the law.

Program expenditures. The Legislature created a fee simple residential revolving fund (Section 516-44, HRS). All funds appropriated for the leasehold conversion program and all moneys received and collected by the HHA for the program are required to be deposited in the revolving fund. The proceeds in the fund are to be used first to pay the principal and interest on bonds or other indebtedness issued by the HHA or by the State, and then for the expenses of the HHA in administering the law.

The HHA draws on three main sources of funding for the land reform program:

- (1) earnings from the fee simple revolving fund,
- (2) general fund appropriations from the Legislature, and
- (3) assessments collected from lessees who apply for conversion. Personal services expenditures account for almost all of the program costs.

In addition to current legislative appropriations, the HHA was appropriated \$1.3 million in general funds in 1975 to finance the acquisition of a tract to test the constitutionality of the law. However, the fee title to the lots in the tract selected for the test case was sold by the lessor to the lessees under a negotiated settlement, so the funds have remained in the fee simple revolving fund. The HHA also has an estimated \$2 million in deposits from lessees applying for conversion.

Expenditures for the program in fiscal year 1980-81 were \$294,150. This is a poor indicator of the scope and impact of the program as it is insignificant in comparison with the many millions in private loans and mortgages used to purchase the fee simple interest in converted lots.

The Land Reform Law

The impetus for the enactment of the Hawaii Land Reform Law has been in the concentration of landownership in Hawaii. This unique pattern of landownership and control had its origins in the ancient land system of the native Hawaiians. Ownership rights were vested in the monarchy until the Great Mahele of 1848. In the Mahele, some 30,000 acres were distributed to commoners, but 1,500,000 acres were set aside for the chiefs, 1,000,000 acres for the king, and 1,500,000 acres for the government.³

2. See *Updated Position Organization Charts, Department of Social Services and Housing, State of Hawaii, 1980*. Prepared by Management and Budget Services Staff, Administrative Services Office, Department of Social Services and Housing, State of Hawaii, as of June 30, 1980.

3. Chinen, Jon J., *The Great Mahele, Hawaii's Land Division of 1848*, University of Hawaii Press, 1958, p. 5.

The subsequent development of plantation agriculture served further to encourage the concentration of landownership and control. Plantations purchased and leased public lands as well as many of the smaller parcels awarded to tenants in the Great Mahele.

This pattern of ownership had not changed by the 1960's except to see even greater consolidation. A 1967 study showed that the state and federal governments owned 48.5 percent of the total land area in Hawaii, 72 major landowners owned 47 percent, and all remaining private landowners owned less than 5 percent of the land in Hawaii.⁴

As land prices rose and residential fee simple lots became increasingly scarce, the control of land became the subject of legislative concern. The Legislature found that the scarcity of fee simple land, combined with the desire for homeownership had inflated prices of both fee simple and leasehold residential lots. The dispersion of ownership of fee simple land to as many people as possible at a fair and reasonable price was viewed as vital to the economy and welfare of the State. Amidst much controversy, some of which remains unresolved to this day, the Legislature passed what is commonly called the Hawaii Land Reform Act of 1967, which is codified, together with subsequent amendments, as Chapter 516, HRS.

Some significant provisions of Chapter 516, HRS. There are four parts to Chapter 516, HRS. The first part includes general provisions, such as, definitions of terms and a list of the HHA's administrative duties. The second part provides for the HHA to exercise the power of eminent domain to acquire the fee title to residential leasehold lots and delineates certain aspects of that process. Part three protects the rights of lessees and limits the lease rentals that may be charged in negotiating extensions to residential leases. The fourth part states the legislative findings and purposes of the Act. This report focuses primarily on those provisions in the law pertaining to the leasehold to fee conversion process.

1. *Responsibilities of the HHA.* The HHA was designated as the agency responsible for implementing Chapter 516, HRS. The purpose of the law is to alleviate the conditions arising from the shortage of fee simple land by doing the following:

"... providing for the right of any person who is a lessee under a long-term lease of residential land in the State to purchase at a fair and reasonable price the fee simple title to such land, by providing for the condemnation of the fee simple title to such land and the payment of just compensation therefor by the State through the use of the power of eminent domain and by providing for the public financing of such purchase and such condemnation and payment through the issuance of bonds, the expenditure of general revenue funds, and the use of private funds which are at the disposal of the State."⁵

To this end, the law requires the HHA to encourage the fee ownership of residential lots and to carry out its responsibilities in an efficient manner so that sales prices and rentals of residential leaseholds may be fixed at the lowest possible rates.

The law assigns the HHA some general duties and powers. It is to adopt rules to carry out the purposes of the law. It may appoint and remove such administrative, technical, and clerical staff as may be required. Appraisers may also be retained as needed. The HHA is authorized to establish and assess fees, conduct investigations, require such information as may be needed of lessees and lessors, make and execute contracts, mortgages, and other instruments and do all things necessary to carry out its powers under the law. Most importantly, the HHA is authorized to acquire by eminent domain proceedings all necessary property interests.

2. *The leasehold to fee conversion process.* The law applies to all residential lease-

4. Legislative Reference Bureau, State of Hawaii, *Public Land Policy in Hawaii: Major Landowners*. Report No. 3, 1967, p. 13.

5. Section 516-83 (b), HRS.

holds with leases of 20 years or more. Excluded are Hawaiian home lands and lands held by the federal government. The HHA may designate all or a portion of a development tract for acquisition once 25 or more lessees, or lessees of more than 50 percent of the residential leaseholds within the development, whichever is less, apply to the HHA to purchase the leased fee interests in their lots.

After lessees have filed their applications with the HHA, the HHA must request the lessees and lessor to negotiate the just compensation to be paid for acquiring the leased fee interest. If no agreement is reached, lessees and lessor are to submit their final offers and related documents to the HHA. The HHA may use this information to determine the lessees' financial ability to purchase their respective lots prior to instituting condemnation proceedings.

Section 516-24, HRS, requires that the compensation to be paid upon condemnation be the "owner's basis." The "owner's basis" is defined as the fair market value, determined by any method normally used by qualified appraisers. The law requires that the fair market value be established to provide the owner with just compensation for his interests. At the same time, every interest and equity of the lessee in

establishing that market value must be taken into consideration.

Within 12 months after the HHA designates lots for acquisition, it must either acquire the lots through the voluntary action of the parties involved or institute condemnation proceedings. Should it not do so within this 12-month period, the HHA is to reimburse the lessor for any actual out-of-pocket expenses that the owner may have incurred as a result of the designation.

Once the designated lots are acquired, the HHA is to sell the lots in fee simple to those lessees who have applied to the HHA and who have qualified for such purchase. The law restricts purchasers to lessees who intend to reside on the lots they wish to purchase, who have legal title to the residential structures on the lots, and who are financially able to purchase the lot. Also, they may not own other fee simple property within the county and reasonably near to their places of business.

Although the HHA may also lease back to residents the lots that it acquires, the law says that it shall be the policy of the HHA to encourage fee ownership. For those who are unable to obtain funds from private lenders at reasonable rates, the HHA may provide loans up to 90 percent of the purchase price.

Chapter 3

PLANNING FOR THE LEASEHOLD TO FEE CONVERSION PROGRAM

In Chapters 4, 5, and 6, we report that the leasehold to fee conversion program has been hampered by organizational and operational difficulties. The problems enumerated in those chapters are to a large degree attributable to the Hawaii Housing Authority's (HHA) neglect to plan for the implementation of the program. In this chapter we describe that neglect.

Summary of Findings

The HHA's failure to plan for the implementation of the land reform law may be characterized as one of utter neglect. It has done little to gather data and formulate strategies to achieve the objectives of the statute. For years, it asserted that the law was unworkable because of the constitutional and funding issues that the law raised. The consequence has been numerous managerial and operational problems in administering the law.

The Problems

The land reform law has been on the books for nearly fifteen years. However, since its initial enactment in 1967 to the late 1970's, the leasehold to fee conversion program was largely dormant. Very little activity transpired. Only in very recent years has the HHA begun actively to implement the program. Requests for

designation of development tracts for condemnation by the HHA have intensified in the last few years, and the HHA's first suit to condemn a development tract under the land reform law was filed in September 1979.

As described in Chapters 4, 5, and 6, the HHA was not prepared to cope with the surge of requests for designation of development tracts for condemnation. It had not developed a coherent program to meet the demands for conversion of leaseholds to fee simple and to ease the way for lessees desiring to purchase the fee interest in their leasehold lots. The HHA had prepared no information booklet or fact sheet to clearly outline the steps required to be followed by lessees in the conversion. It had failed to develop the criteria by which lessees were to be judged as to their qualifications to purchase the leased fee. It had also failed to establish the method by which the "commitment value" (that is, the value at which lessees are required to prove themselves able to purchase the fee title to their respective leasehold lots) was to be established and the factors that the HHA considered necessary or desirable to take into account in the appraisal of any lot.

Not only had the HHA failed to establish clear procedures to be followed and criteria to be used in the conversion program, but it had also failed to organize itself in a way so as to enable the program to be administered efficiently. Responsibilities for the program had

not been clarified and structural confusion and staffing shortcomings had been allowed to persist. Finally, a comprehensible system of putting together budgetary requests, of managing the funds received or collected by the HHA in the leasehold to fee conversion program, and of allocating costs to lessees had not been prepared.

The result has been confusion and frustration on the part of lessees, delays in conversion from leasehold to fee simple, and added costs to lessees.

Planning Neglect

The difficulties enumerated in Chapters 4, 5, and 6 endure to this day. These difficulties have arisen and they persist because the HHA had neglected to plan for the implementation of the program.

The HHA's neglect to plan is evidenced by the following. Since the enactment of the land reform law, the HHA has not collected even the most basic data necessary for a successful and efficient implementation of the program. It has not collected such data as the number of residential leaseholds on Oahu, where they are located, when the fixed rental periods expire, the socio-economic backgrounds of lessees, etc. Such basic data would have at least given the HHA some advance warnings as to when the crunch would come for requests for designation of development tracts and would have enabled the HHA to consider what would need to be done, what procedures would need to be devised, what criteria would need to be developed, etc., to meet the demands. Lacking the basic data, however, the HHA could not anticipate the program demands and needs.

The HHA was so deficient in planning for implementation that there is scarcely any document that gives any hint as to what the HHA intended to do and was doing in implementing the leasehold to fee conversion program. The documentation on the program has been limited to the following. *First*, the HHA adopted

rules shortly after the enactment of the land reform law in 1967. The rules, however, were incomplete on initial adoption and have remained incomplete ever since. Further, the rules have not been updated as the law and circumstances changed over the years. Chapter 4 enumerates these failings in detail.

Second, the leasehold to fee conversion program has been mentioned in the HHA's annual reports. The commentary in these reports, however, has been limited mainly to figures purporting to show the number of leasehold to fee conversions during the reported year. These figures have been presented without a meaningful context, making it impossible to evaluate their significance. For instance, there has been no report on the total number of leaseholds in the state, the number of leaseholders desiring conversion, etc. Moreover, figures reported by the HHA have often been misleading. For example, the HHA reported in 1979 that 1036 lots had been converted in 1979.¹ In 1980, it reported that 1612 lots had been converted in FY 1979-80.² These figures provide no basis for determining whether any progress had been made from one year to another, since one report apparently covered a calendar year while the other report covered a fiscal year.

Third, a description of the leasehold to fee conversion program is contained in the HHA's 1980 State Housing Plan. However, the description is brief with a one-page tabular summary of the program. While it lists some major issues, there is no indication of how the HHA plans to address the issues or what its plans are for the future.

1. Hawaii Housing Authority, *Annual Report, July 1, 1978-June 30, 1979*, p. 18.

2. Hawaii Housing Authority, *Annual Report, July 1, 1979-June 30, 1980*, p. 11.

Defense Against Neglect

At the time of the initial enactment of the land reform law, it was recognized that the law raised serious constitutional issues: (1) whether the taking authorized by the law constituted taking for a "public use," and (2) whether that provision of the law making it applicable to leases existing at the time of the enactment of the law constituted an "impairment of the obligation of contracts." Then, in the early years of the law's existence, the issue of funding for the program arose.

These issues have been used by the HHA to shield it from its neglect to plan for the implementation of the leasehold to fee conversion program. The HHA professed that these issues posed formidable (if not insurmountable) obstacles to the implementation of the program and that unless the issues were resolved, nothing could be done to implement the program. It then sat back and failed to deliberate on how the law might be implemented.

Neither the constitutional nor the funding issues should have been cause for abstaining from planning for the implementation of the conversion program. Pending resolution of these issues, the HHA could have begun to assemble the necessary data and to formulate procedures and devise methodology and strategies for the implementation of the law. But, the HHA did none of these things. Indeed, the whole approach of the HHA with respect to the leasehold to fee conversion program, was one of lack of enthusiasm.

If not planning for the implementation of the program, it would seem that the HHA could have at least exerted some meaningful efforts toward a quick resolution of the issues it claimed were stymying program implementation. But even here, the HHA demonstrated a decided lack of initiative.

Constitutional issues. The constitutional issues, for instance, were allowed by the HHA to

drag on for years. These constitutional issues could, of course, be resolved only by the courts, and the courts could rule on the issues only if the HHA proceeded to actually condemn or threaten to condemn a tract of land so as to cause a case or controversy to arise. That is to say, the initiative lay with the HHA if the constitutionality of the land reform law were to be tested.

Over the years, the HHA kept talking about the need for a "test case" to resolve the constitutional questions. However, it did not vigorously pursue this need. In 1975, the Legislature appropriated \$1.3 million to finance the condemnation of a tract of land to test the constitutionality of the law. The test was never made as the lessor and lessees of the tract targeted for the test case negotiated a settlement on the sale of the fee title to the lots included in the tract. Except for this one effort, no further efforts were made to test the validity of the law until 1979. By then, pressures by lessees for conversion reached a level where the HHA could no longer fail to act to implement the conversion program.³

The funding issue. The funding issue, too, was one which the HHA could have addressed, but did not. That funds had to be available for purchasing the tracts to be condemned by the HHA was understood from the outset.

3. In 1979, under a threat of condemnation of a development tract owned by it, the Trustees of Bishop Estate filed suit in the United States District Court to enjoin enforcement of the land reform law. The Trustees alleged, among other things, that the taking authorized by the law was not for a "public use" and that the law's application to leases existing at the time of the initial enactment of the law violated the impairment of contracts clause of the Federal Constitution. The District Court affirmed the basic constitutionality of the law, although it voided those provisions relating to mandatory arbitration and those provisions limiting the determination of just compensation to those methods set forth in the law. The invalidated provisions of the law have since been amended by the Legislature. The court's affirmation of the basic constitutionality of the law is now on appeal to the United States Court of Appeals.

Originally, these purchases were to be financed through the sale of revenue bonds. The bonds were to be retired through the revenues collected by the HHA from lessees who purchase the fee title to their lots. However, the market was not receptive to these revenue bonds. In 1971, the Legislature authorized the issuance of \$5 million in general obligation bonds to finance the acquisition of fee titles. The bonds were never issued as the State bond counsel questioned the constitutionality of the use to which the bond proceeds were to be put.

In light of the above, the HHA considered the matter of financing the purchase of leased fees to be insoluble. It gave no thought as to how the financing problem might be resolved. Instead of developing alternatives, the HHA took the position that the land reform law was unworkable. For years, the HHA testified before the Legislature that the program was being held in abeyance since the lack of funds made the law unworkable.

It required legislative initiative and legislative prodding to resolve the funding problem. In 1974, the Legislature passed a resolution directing the HHA to investigate the legal possibility of using private financing to implement the land reform law. Prodded by this resolution, the HHA secured a deputy attorney general's opinion in September 1974 that private funds obtained from individual lessees who desire to purchase the fee to their lots may be used by the HHA to pay lessors for the fee title. Further, in 1975, the Legislature amended the land reform law to allow the HHA to condemn only those lots in a development tract for which it has qualified buyers. Under this amendment, the HHA does not have to have funds on hand to acquire all lots in a tract designated for condemnation. Lessees wishing to purchase the fee to their respective lots can be required to be ready with their own private financing, and, upon condemnation, title can pass immediately from the HHA to the qualified buyers and the buyers can immediately pay for their lots, which payment can then be forwarded to the lessor.

Conclusion

The lack of planning has been detrimental to the administration of the leasehold to fee conversion program. However, there is no luxury of time for the HHA to retrace its steps to the beginning so that planning in its full sense can take place for the implementation of the land reform program. There are today numerous condemnation actions pending in the court, and attention must be devoted to these cases. However, we believe that certain basic planning actions must be undertaken if the confusion and difficulties that now surround the program are to be alleviated. Some specific actions required of the HHA are enumerated in the chapters that follow. In addition to those actions, we think the HHA needs to develop a composite picture of residential leaseholds in Hawaii, sharpen its objectives for the program and develop strategies and timetable for the achievement of these objectives. Some of the specific actions that we recommend in Chapters 4, 5, and 6 will need to be taken in light of HHA's overall approach to the land reform program.⁴

4. The HHA's failure to plan is evident not only with respect to the leasehold to fee conversion program under Chapter 516, HRS, but also with respect to the leasehold rental renegotiation provisions of Chapter 519, HRS. The purpose of Chapter 519 is to assure lessees the right to have leasehold rents set at reasonable levels. It provides for renegotiation of rentals not more frequently than once every 15 years and for lease rents not to exceed four percent of the "owner's basis." It states that the HHA shall provide for arbitration of disagreements in such renegotiations.

In 1975, the Bishop Estate trustees challenged the constitutionality of Chapter 519. In June 1978, Hawaii's First Circuit Court upheld the validity of the law. The case is now on appeal to the Hawaii Supreme Court.

Although the constitutionality of Chapter 519 is still under challenge, there is a need for the HHA to act on this chapter. The land reform branch has received requests from lessees for assistance under Chapter 519. More recently, there was a formal request from a lessees' attorney requesting arbitration under Chapter 519. However, the HHA has been unprepared to work with the law. It has formulated no plans for implementing Chapter 519. It thus has no policies, procedures or even administrative rules for Chapter 519.

Recommendations

We recommend that the HHA undertake the development of statistical data on leaseholds in Hawaii; sharpen its objectives for the lease-

hold to fee conversion program; develop strategies and timetable for the achievement of the objectives; and formulate and clarify policies, criteria, procedures, and rules as recommended in Chapters 4, 5, and 6.

MANAGEMENT OF THE
LEASEHOLD TO FEE CONVERSION PROGRAM

Chapter 4

MANAGEMENT OF THE LEASEHOLD TO FEE CONVERSION PROCESS

The Hawaii Housing Authority's (HHA) administrative responsibilities have remained essentially unchanged throughout the many amendments that have been made to the original Land Reform Act. Among its basic duties under the law are: (1) to disseminate information to lessees in order that the law and the HHA's program might be understood, (2) to assist lessees to effect conversion of their leasehold property to fee simple ownership, and (3) to establish an efficient and effective process by which its power of eminent domain might be exercised under Chapter 516, HRS. In this chapter, we examine how well the HHA has fulfilled these responsibilities for managing the conversion program.

Summary of Findings

We find that the HHA has generally failed to carry out its statutory responsibility to effectuate the leasehold to fee conversion program. It has not aggressively implemented the program for the benefit of lessees. Specifically:

1. The HHA has failed to disseminate information to lessees concerning the land reform law, the procedures necessary to effectuate conversions, and the kind and amount of assistance that the lessees may expect to receive from the HHA.
2. The HHA has failed to clarify how the HHA and the lessees are to interact in the

various stages of the conversion process. For the most part, lessees have been left to fend for themselves in the preliminary and the price negotiation stages of the process. The actual condemnation stages are marked by conflicts between the HHA and the lessees.

3. The HHA *Rule* on the land reform program lacks clarity and is incomplete.

4. The HHA has failed to develop criteria for critical components of the land reform program. It has not developed criteria for qualifying lessees for the purchase of the fee title to their respective lots, for determining how and when appraisals of the value of the leased fee interests are to be made, and for setting the value at which lessees are required to qualify financially for purchasing the fee title to their lots. The result is frequent arbitrary decisions by the HHA.

Overview of the Conversion Process

We describe here the current leasehold to fee conversion process as background information for the reader. It is appropriate to note here that merely to describe the conversion process is no easy task due to the absence of any explicit narrative from the HHA on the progressive steps leading to condemnation and acquisition. The following summary of the process was pieced together from a review of HHA correspondence, memoranda and rules, interviews with the HHA

staff, state and private attorneys, and lessee organizations. The steps described below are those that are generally followed, although exceptions have occurred in the past.

Figure 4.1 provides a graphic summary of the process. Each of the steps is described more fully below.

1. *Lessee association.* Lessees in a particular area who are interested in conversion are advised by the HHA to form an association. Generally, an attorney is retained by the association at this time to assist and advise the group throughout the conversion process.

2. *Request and application.* The process is initiated when 25 or more lessees, or more than 50 percent of the lessees in a particular tract, submit to the HHA a formal *Request for Designation of Development Tract*. At about the same time, each lessee in the tract wishing to purchase the leased fee interest submits an *Application to Purchase the Leased Fee Interest Under HRS Chapter 516*.

3. *Preliminary determination.* Within 90 days, the HHA must review the request for designation to determine whether the tract qualifies for designation. The HHA staff makes a preliminary determination of the feasibility of designation and makes its recommendation to the HHA commission.

4. *Resolution for proposed designation.* Based on a favorable recommendation, the commission will adopt a *Resolution for Proposed Designation* and authorize the HHA to schedule a public hearing on the matter.

5. *Public hearing.* A public hearing is held after notices are sent to interested parties and published in the appropriate papers. The hearing affords an opportunity to those interested to present testimony for or against eventual designation.

6. *Resolution for finding an effectuation of public purposes of Chapter 516, HRS, and*

request for negotiation. After considering testimony presented at the hearing, the commission adopts a second resolution finding that public purposes will be effectuated by acquiring the tract. This resolution also formally authorizes the HHA to request lessees' and lessors' representatives to negotiate.

7. *Request to negotiate.* The executive director sends letters to lessees and lessors requesting that they negotiate the just compensation to be paid for purchasing the leased fee interest. Sometimes actual negotiations precede this formal request. On occasions, negotiations begin at the initial stages before this request to negotiate and continue throughout the conversion process. At other times, no negotiation takes place despite this request.

8. *The negotiation period.* The law provides 60 days for negotiations; however, the HHA has allowed extensions upon the request of both of the parties involved.

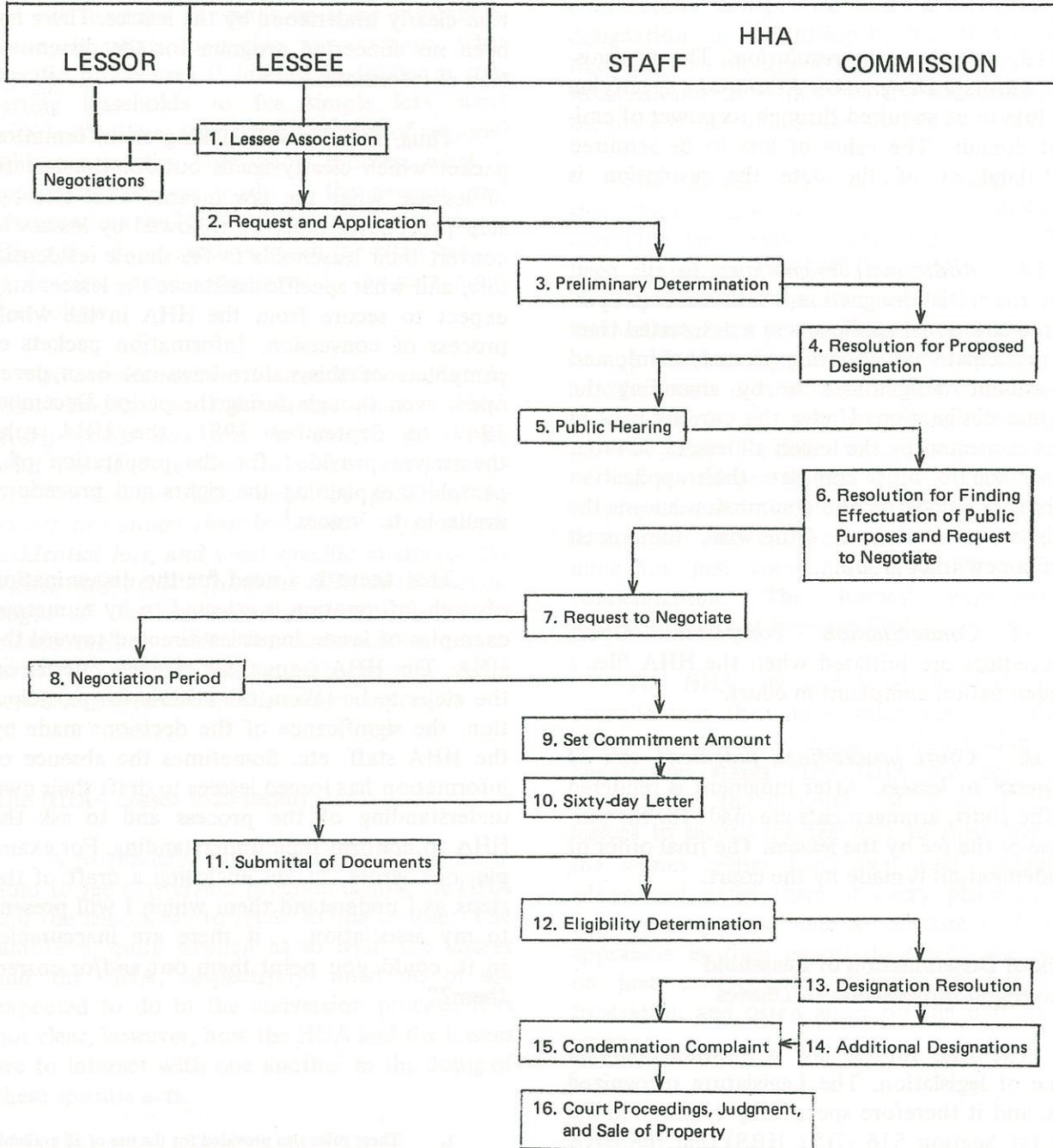
9. *Setting of commitment amounts.* Should negotiations fail, the HHA sets "commitment amounts," that is, it establishes a value for each lot in the tract for which it has an application to purchase. The HHA uses the commitment amounts to qualify lessees as potential purchasers by requiring each lessee to submit documents proving that the lessee has the financial ability to purchase his lot at the commitment amount.

10. *Sixty-day letter (formerly thirty-day letter).* The HHA mails to each applicant a request for the following materials: (1) a current financial statement, (2) evidence of financial ability to purchase at the commitment amount, and (3) a \$500 deposit.

11. *Submittal of documents.* Applicants must submit documents within 60 days and in a form satisfactory to the HHA; otherwise, they are disqualified. In many instances, the submittals are reviewed and logged in by the lessees' attorneys prior to their submission to the HHA.

Figure 4.1

The Leasehold to Fee Conversion Process



12. *Eligibility determination.* The HHA reviews materials submitted by applicants to determine their eligibility under the law and whether they are financially qualified. At this time title reports are ordered by the HHA for all lots for which it has qualified applicants.

13. *Designation resolution.* The commission adopts a *Designation Resolution* specifying the lots to be acquired through its power of eminent domain. The value of lots to be acquired are fixed as of the date the resolution is adopted.

14. *Additional designations.* In the past, after the initial designation, the commission permitted additional applicants in a designated tract to participate by adopting second, third, and subsequent designations or by amending the original designation. Under the current rule, in cases contested by the lessor, all lessees, in order to participate, must complete their application within 90 days after the commission adopts the designation resolution. Otherwise, they must form a new tract group.

15. *Condemnation complaint.* Court proceedings are initiated when the HHA files a condemnation complaint in court.

16. *Court proceedings, judgment, sale of property to lessees.* After judgment is rendered by the court, arrangements are made for the purchase of the fee by the lessees. The final order of condemnation is made by the court.

Lack of Dissemination of Leasehold Conversion Information to Lessees

The land reform law is a rather complex piece of legislation. The Legislature recognized this, and it therefore specifically required in the law (at Section 516–7(5), HRS) that the HHA shall disseminate information to lessees and assist them in understanding the law. An understanding of the law by the lessees was deemed necessary for its effective implementation.

The HHA has not fulfilled this expectation of the law. Aside from sporadic attendance at lessee association meetings and general verbal explanations of the law at such meetings by the HHA staff, the HHA has done little to make the law and the HHA's approach to its implementation clearly understood by the lessees. There has been no concerted program for the dissemination of information.

Thus, there is still lacking an information packet which clearly spells out, for the benefit of lessees, what the law means, what step-by-step procedures must be followed by lessees to convert their leaseholds to fee simple residential lots, and what specific assistance the lessees may expect to secure from the HHA in the whole process of conversion. Information packets or pamphlets of this nature have not been developed, even though during the period December 1967 to September 1981, the HHA rules themselves provided for the preparation of a pamphlet explaining the rights and procedures available to lessees.¹

That there is a need for the dissemination of such information is attested to by numerous examples of lessee inquiries directed toward the HHA. The HHA frequently receives queries on the steps to be taken, the criteria for participation, the significance of the decisions made by the HHA staff, etc. Sometimes the absence of information has forced lessees to draft their own understanding of the process and to ask the HHA to confirm their understanding. For example, one wrote, "I am enclosing a draft of the steps as I understand them which I will present to my association . . . if there are inaccuracies in it, could you point them out and/or correct them?"

1. These rules also provided for the use of all available news media to apprise lessees of their rights and the procedures available for conversion. The rules were amended in September 1981. The amended rules no longer provide for the use of all available media and the preparation of a pamphlet to inform lessees of their rights and the procedures available for conversion from leasehold to fee simple.

The lack of program information has been frustrating to the lessees. It has led to delays and added costs to the lessees.

This lack of information dissemination to lessees is due in part to the fact that the HHA has yet to make decisions on some substantive issues. It needs to decide, for instance, what specific procedures it intends to follow in converting leaseholds to fee simple lots, what criteria it will use in making a variety of required decisions in the conversion process, what it expects the lessees to do in the process, and what services the HHA will extend to the lessees. These and other matters which the HHA has yet to decide upon are discussed in the paragraphs that follow.

Recommendation. We recommend that the HHA develop an information packet which clearly spells out for the benefit of lessees what the land reform law means, the step-by-step procedures that must be followed by lessees to convert their leaseholds to fee simple residential lots, and what specific assistance the lessees may expect from the HHA in the various stages of the conversion process. The packet should include such other information as will assist the lessees in understanding the law and in converting their leaseholds to fee simple lots.

The HHA-Lessee Interaction

A particularly thorny problem in the leasehold to fee conversion program is how the HHA and the lessees are to relate to one another. The statute is quite explicit as to what the lessees and the HHA, respectively, must do or are expected to do in the conversion process. It is not clear, however, how the HHA and the lessees are to interact with one another in the doing of these specific acts.

The problem is of significance especially at three points in the conversion process: (1) the initial stage before the filing of a request for designation of a tract for acquisition by the

HHA; (2) the negotiation stage; and (3) the trial of the condemnation action.

At both the pre-request-for-designation stage and the negotiation stage, the lessees are the principal actors. They must initiate the entire conversion process and file a request for designation for acquisition by the HHA of that tract of land on which their leasehold lots are situated; and they must do the negotiating for the price to be paid for the lessor's fee title.

The land reform law provides that the HHA shall "render assistance to lessees . . . in order that [the law] may be understood and effectively implemented."² This provision plus the law's specification that the authority may assess and collect from lessees fees to cover the costs of appraisal, survey, and attorney's fees as well as other costs incurred by the HHA in administering the law,³ have prompted lessees to perceive that the HHA would be an advocate of and would act as the agent of the lessees in preparing for the filing of their request for designation and in the negotiations to determine the just compensation to be paid on condemnation. The lessees' expectations, however, have not been fulfilled.

The HHA, by and large, has taken the attitude that the lessees must fend for themselves in the pre-request-for-designation and negotiation stages. The HHA has constantly suggested at the inception of every effort by lessees to secure the fee title to their lots that the lessees secure their own legal counsel to advise and assist them at every phase of the conversion process and to procure their own appraisers in their negotiations with the lessor on just compensation. The result has been frustration and often anger on the part of the lessees.

2. See Section 516-7(5), HRS.

3. See Sections 516-30, 516-32, and 516-33.5, HRS.

The lessees' frustration and anger are understandable. Given the provisions of the law, they have felt betrayed. It has been difficult for the lessees to understand why they need to incur the added expense of their own attorney and appraiser, particularly when they are required to pay also for the costs of the attorneys and appraisers whom the HHA needs to hire at the later stages of the conversion process.

The lessees' frustration and anger carry through to the condemnation phase of the conversion process. Invariably, the lessees are named as defendants along with the lessor in the condemnation suit brought by the HHA to acquire the lessor's fee title to the lots included in the designated development tract. By naming the lessees as defendants, the HHA indicates that the lessees may have an interest in the suit adverse to that of the HHA. This necessitates, of course, that the lessees be represented by their own counsel if they wish their views to be heard at the condemnation trial. Indeed, it appears that it is the standing practice of the HHA to recommend to the lessees that they secure their own private counsel for the condemnation trial. It is difficult for the lessees to understand why or when they need to acquire private counsel in a condemnation suit. After all, the suit to condemn is presumably brought by the HHA for the benefit of the lessees.

The above problems exist because the HHA has not made it clear to the lessees why and under what circumstances the lessees need to secure counsel of their own and the extent to which the HHA can and will render assistance to the lessees in any of the conversion phases. The HHA has not clarified these matters because the HHA itself is unclear about them.

The HHA has not developed philosophies and approaches to the conversion of leaseholds to fee simple residential lots. It has not developed the criteria for lessee qualification to purchase the fee, for performing appraisals and for other purposes as described below. Without the development of its philosophies and approaches and the formulation of needed

criteria, the HHA cannot communicate to the lessees what the lessees might expect of the HHA.

It is clear that under the statute, the HHA must do all that is reasonable to assist the lessees in the accomplishment of the conversion of leaseholds to fee simple residential lots. It is equally clear, however, that there will be instances where the HHA and the lessees will not see eye-to-eye on various matters. The price to be paid on condemnation is an example. In such events, the lessees should be free to seek advice and counsel independent of the HHA. However, the need to seek outside advice and counsel and the need for lessees to incur additional costs attendant thereto, could probably be minimized if the HHA's philosophies, strategies, and criteria were communicated and understood by the lessees.

The apparent need for the lessees to secure their own counsel for the purpose of the condemnation trial is not the only relationship problem that arises at the trial stage. The handling of the condemnation case also raises problems of interaction. Lessees have complained that the HHA fails to keep them informed about how the HHA intends to try the condemnation case. Lessees are particularly critical about the lack of information about the price that the HHA plans to propose as just compensation at the trial. This lack of information has led to confrontations between the lessees and the HHA in the past.

In a particular case, the price that the HHA intended to propose as just compensation was discovered by the lessees during pretrial questioning just shortly before the trial date. The price turned out to be much higher than what the lessees expected. The lessees filed a motion in court to exclude the HHA's expert witness, who recommended the proposed price, from testifying in court. The lessees cited as grounds for the motion, among others, that the expert lacked experience in appraising residential leased fee interest and that the expert's economic assumptions were unreasonable. This

case was eventually settled out of court when the lessees could not secure the HHA's support for the lessees' motion.

Recommendations. We recommend that the HHA clarify its role vis-a-vis the role of the lessees in the various stages of the leasehold to fee conversion process. In this effort, the HHA should:

1. Insure that the lessees are provided with as much assistance as is reasonable in the preparation stage of the conversion process, including the filing of applications for designation of tracts of land for acquisition by the HHA and qualifying lessees to purchase the fee title to their individual lots. All efforts should be made to minimize the need for lessees to resort to legal counsel of their own for assistance at this preparatory stage.

2. Establish criteria as recommended later in this chapter.

3. Provide a mechanism whereby the HHA and the lessees may coordinate their strategies and efforts in the trial of a condemnation suit.

Inadequate Rule

Currently, the HHA's *Rule* is about the only official source of information on the HHA's policies and procedures concerning the land reform program. The *Rule* was first adopted as *Rule 10* in December 1967, shortly after the law's initial enactment. The *Rule* was amended in 1968, 1970, 1975, 1977, and 1981. The 1968, 1970, 1975, and 1977 amendments were made to reflect changes in the law. The 1981 amendment was made not only to reflect changes in the law, but also to comply with Act 215, SLH 1979. Act 215 (Section 91.5, HRS) was enacted to require the rules of all governmental agencies to conform in format and substance to certain requirements. As amended in 1981, *Rule 10* is now Chapter 540 of Title 17 of the state rules.

As being just about the only official source of information on the land reform program, the *Rule* should always be kept up-to-date, and it should be as clear and complete as possible. The *Rule*, however, has not always been kept up-to-date; and the *Rule* as it now stands is neither clear nor complete as it should be.

Slowness in updating *Rule*. There have been rather continuous changes in both the law and the HHA's operations over the years. However, the *Rule* has not been updated as frequently as it should have been to keep up with the changes. The HHA amended the *Rule* on its own initiative only four times since 1967. The revisions it made in 1981 were made only because Act 215, SLH 1979, required that the HHA's rules, along with the rules of other agencies, be amended to conform to the substantive and format requirements of the Act.

Between 1977 and 1981 no changes were made in the *Rule* even though significant legislation had been passed and public interest in conversions had escalated during that period. The changes in the law had expanded the applicability of the law. For example, Act 140, SLH 1978; Act 227, SLH 1979; and Act 39, SLH 1980, all expanded the law by including within the scope of the law leases with terms shorter than those originally covered; non-residents, owners of duplexes, and purchasers of leaseholds under agreements of sale also became eligible to participate in the leasehold conversion program. Yet, during this period, the HHA failed to amend the *Rule* and to thus publicize the changes; it continued, rather, to distribute its outdated *Rule*.

Need for clarity. The *Rule* as it now exists is not clear in the following respects. Much of the information is not presented in a logical order. Thus, a reading of the *Rule* provides little information as to the order in which various events occur. For example, Section 17-540-16, *Application by Lessees*, describes the documents to be submitted by applicants upon request by the HHA. In practice, this request is made before the HHA adopts a resolution designating

the tract of land in question for acquisition. Yet, in the *Rule*, the provisions concerning this request for documents are placed after the section on designation and the section on the consequences of nonpurchase and the submission of costs by the lessor. The application section specifies that all documents must be submitted within 60 days; yet, by the placement of the provision relating to requests for documents, the reader is hard pressed to know when the request would be made by the HHA in the conversion process. Lessees have often complained that they have no forewarning of the request for documents and that they have difficulty getting all the required documents together within the time specified.

For another example, the *Rule* mentions appraisal services. Although the lessees are liable for the costs of appraisal services, the placement of the provisions on appraisal services in the *Rule* gives the lessees no information as to the time or times during the conversion process such services might be required.

Rule incomplete. The *Rule* is incomplete in several ways. It omits the delineation of important criteria, such as criteria for determining commitment amounts (the price at which lessees must qualify to purchase their respective lots), the criteria for appraising the market value of the fee interest in the lots to be condemned, and the criteria for determining which lessees are qualified to purchase the fee to their leasehold lots. These omissions are discussed in detail in the next section of this chapter.

The *Rule* is also incomplete in other ways. It does not include provisions with respect to all of the steps necessary in the conversion process. For instance, there are at least three resolutions that the HHA commissioners must adopt before any condemnation action may be filed: (1) resolution proposing designation of a tract of land for acquisition; (2) resolution finding that acquisition of the tract effectuates the public purpose of Chapter 516, HRS, and requesting the lessor and the lessees to negotiate the just compensation to be paid to acquire the fee title

to the development tract; and (3) resolution designating the tract for acquisition. The rule, however, contains provisions only with respect to the third of these resolutions—the designation resolution. The first two resolutions are not treated in the *Rule*, although they are important resolutions. The *Rule* says nothing about how or when these resolutions are to be adopted.

The *Rule* is also incomplete in that the beginning and the ending of the various steps in the conversion process are not sufficiently spelled out to guide the lessees. For example, a 60-day period is provided by law for negotiations between the lessees and the lessor to reach an agreement on the value of the lots to be condemned, but it is not clear when this 60-day period starts or what signals the end of the period. The problem is particularly acute when the HHA delays sending out its request to the lessees and lessor to negotiate. Normally, the HHA sends out its request soon after the public hearing and the adoption of the resolution finding public purpose. However, in at least one instance, the HHA delayed sending the request to negotiate for some 3 1/2 months after the resolution was adopted. In this case, when the 60-day period was to commence and end was not made clear.

The time limits within which various actions must take place are noticeably absent with respect to those actions which the HHA must undertake. There is, for instance, no timetable for when the HHA must hold a public hearing, determine the results of the public hearing, adopt resolutions, start and end the commitment amount process, determine financial qualifications, or designate a development tract after financial qualification.

With no time limits, the HHA tends to delay its actions. Some of these delays are inexcusable. For example, the commission authorized a public hearing on March 16, 1979, but it was not held until August 29, 1979, more than 5 months later. In another case, the public hearing was held about 3 1/2 months after it was authorized by the commission, and the

resolution finding public purpose was not adopted until some 6 1/2 months after the public hearing. There is no reason for delays of such duration, when the actions required to be taken are primarily formalities not requiring much administrative effort or any significant preparation. Without time limits for the HHA actions, lessees have no way of knowing when to press the HHA. It is clear that the lessees pay the consequences of time lags. Delays postpone the designation date which is the date at which compensation is set.

Other omissions in the *Rule* include provisions relating to the purchase by the lessees of the fee title to their respective lots from the HHA after the condemnation action is completed. There is nothing in the *Rule* about how the final purchase by the lessees is to be done, and who is responsible for ensuring and coordinating the closing of the purchase.

The HHA states that omissions or the lack of detail in the *Rule* are necessary to facilitate "administrative flexibility." While there is a need for a reasonable amount of such discretionary power, the matters omitted in the *Rule* are of such substantive nature that their omission is not in the best interests of the public. Without proper rules covering these matters, the public is without protection against administrative inconsistency and arbitrary decisionmaking.

Recommendation. We recommend that the HHA review its Rule and revise the same to make it as complete and understandable to the lessees as possible. Criteria of the kind described in the latter part of this chapter, provisions concerning those steps in the conversion process which are not now in the Rule, and provisions establishing deadlines for actions by the HHA should be developed and included in the Rule.

Lack of Criteria

We have stated that the absence of criteria concerning some important matters constitutes a

major omission in the current *Rule*. Matters for which criteria are lacking include determining commitment value, appraising the market value of the leased fee, and determining the qualification of lessees to purchase the leased fee to their lots.

Lessee qualification. Section 516-33, HRS, sets forth certain requirements which must be met for a lessee⁴ to be eligible to purchase the fee to the residential leasehold lot condemned by the HHA. Among the requirements are: (1) non-ownership in fee simple of lands suitable for residential purposes within the county and in or reasonably near the place of business of the lessee; and (2) submittal of a letter of credit, certificate of deposit, proof of funds, or approved application from a lending institution demonstrating that the lessee will be able to promptly pay to the HHA for the leased fee interest in the lessee's residential leasehold lot.

Clearly, these statutory provisions require amplification, but the HHA has not developed criteria which might clarify these provisions.

For instance, when does one "own in fee simple lands suitable for residential purposes?" Does one "own" land when the individual is a member of a partnership or joint venture which has made an investment in a fee simple residential lot? Does one "own" land if the individual is a beneficiary, sole or otherwise, of a land trust? What if the individual is a trustee of land consisting of a fee simple residential lot, and the spouse is the sole beneficiary of the trust? These questions and others have arisen in the past to which ad hoc replies have been given by the HHA. For the equitable treatment of all persons, criteria need to be established clearly defining "ownership" of fee simple land.

4. The term "lessee" is used here in the broadest possible sense to include all those who by virtue of having a legal or equitable interest in a residential structure situated on the applicable leased lot, is eligible to be a purchaser of the fee interest in the lot. As such, it includes (as the statute at Section 516-33(3) provides) purchasers of a leasehold under an agreement of sale.

The statutory provisions on financial qualification also need to be amplified. Particularly troublesome is the term, "proof of funds." The HHA's instruction on this matter has not been illuminating. Its standard instruction has been as follows: "Please be advised that a Verification of Deposit must have the names of the depository and be verified by said depository. Furthermore, any evidence of ability must be in the form approved by the Hawaii Housing Authority." No explanation is given as to what the HHA will accept as a depository or what particular form will be acceptable to the HHA.

Moreover, the HHA has not been consistent in its approach to determining the adequacy of the "proof of funds" submitted to it. In some instances, the HHA has allowed applicants to include certain assets such as gold and silver and stock certificates which fluctuate in value while at the same time it has attempted to disqualify applicants who were a few dollars short in available cash.

Lessees have frequently sought to secure clarification from the HHA on the criteria it uses to determine the adequacy of the proof of funds and the kinds of information, documents, and assets the HHA will accept as proof. Such efforts have been to no avail. In the absence of such criteria and delineation of acceptable proof, lessees, afraid of possible disqualification, have resorted to private legal counsel for assistance. One lessee organization felt compelled to seek a court injunction against the HHA to prevent it from disqualifying some of its members.

Appraising value. Determining the value of the fee interest in the leasehold lots constitutes the cornerstone of the conversion process. Value is determined generally by appraisals. The land reform law permits the HHA to appoint one or more appraisers when necessary and to assess reasonable fees of lessees for their use.

Appraisal services are costly. Since such costs are borne by the lessees, appraisers should be used and appraisals should be made

judiciously. However, the HHA has yet to decide when and how appraisals are to be done and how the results of appraisals are to be used.

Appraisals are generally done at three points in the conversion process. The first occurs at an early stage when the HHA requests the lessees and the lessor to negotiate the compensation to be paid for the lots to be condemned. At this point, the lessees are usually advised by the HHA to retain their own appraiser. The lessees may then contract for an MAI appraisal (i.e., an appraisal made by Member, American Institute of Real Estate Appraisers).

The second appraisal occurs when negotiations fail and the HHA attempts to set a commitment amount for the lots to be condemned. This is the price which the HHA uses to determine whether an applicant qualifies financially to participate in the conversion. In setting the commitment amount, the HHA usually retains an appraiser on a consulting basis. The appraiser makes a recommendation on the leased fee value on the basis of spot samples—not on the basis of a full appraisal. Generally, the HHA does not utilize the appraisal made by the appraiser hired by the lessees at the negotiation stage.

The third appraisal takes place just before the condemnation suit goes to trial. At this time, the HHA contracts out for a complete lot-by-lot MAI appraisal. Often, lessees, fearing that the appraisal figures of the HHA-hired appraiser might not be in their best interest, have felt impelled to secure their own lot-by-lot appraisal.

It appears that the system followed today in the appraisal of the lots to be condemned is wasteful and costly to the lessees. A full-fledged appraisal is done at the beginning and another is done at the trial stage of the condemnation suit, with a mini-appraisal in-between for the purpose of setting the commitment amount. If the allegations of the HHA are taken as true, the first of these appraisals done at the time of

negotiation is of doubtful validity. The mini-appraisal, which consists largely of "eye-balling" the value of the leased fee interest, is also of limited use. The reports on these mini-appraisals are brief two or three page reports, which, other than providing prices for selected sample lots, give no information of value. The reports contain no data on the assumptions made, approaches used, or market data on comparable sales. The results of such mini-appraisals are often rejected in establishing a commitment value. Then, at the time of the condemnation trial, both the HHA and the lessees secure their own respective lot-by-lot, full appraisal.

Moreover, each appraisal is an independent act and none is related to any of the others. Different parties contract for the different appraisals and different appraisers are used in each. There is no reason why the appraisals could not be related to each other; there is no reason why each subsequent appraisal could not be built upon each preceding appraisal when properly done. Thus, there is no reason for not setting commitment amounts on the basis of an appraisal properly done at the negotiation stage and for the final appraisal to be an update of the first appraisal.

Three independent, unrelated appraisals, two of which are often of doubtful validity, are done in large part because the HHA has not determined the policies and criteria in this area. The reasons given by the HHA in the past for not utilizing the appraisal done at the negotiation stage in determining the commitment value has been that the appraisal made by the lessees' appraiser was too low or that the lessees' appraiser failed to consider factors which the HHA believed were essential in making the appraisal. Lessees, however, have countered that despite repeated inquiries, the HHA has never clarified what appraisal firms and what appraisal methodology would be acceptable to the HHA.

With full and clear standards and guides governing appraisals, the waste and unnecessary

cost now being incurred by lessees in the making of appraisals can be minimized. Further, with clear standards, the HHA might assume a more active role in the conduct of appraisals at the negotiation stage. This would be in keeping with the basic mandate of the statute that the HHA furnish assistance to lessees in order that the land reform law might be effectively implemented.

Setting commitment amounts. The law requires the HHA to determine the financial ability of lessees to purchase the leased fee interest to be acquired by condemnation. This is required to be done before actual condemnation. To determine whether the various lessees will qualify financially to purchase the fee to their lots, some value must be attached to the leased fee interest, even though the actual value may not be determined until later at the condemnation trial. The value so set is referred to as the commitment amount.

To be effective, of course, the commitment amount must be as close to the final actual value as possible. Thus, the setting of the commitment amount is an important process. Yet, there are, at present, no clear rules and consistent procedures for determining the commitment amount. The value currently is set in a variety of ways, most of which have no apparent rational basis. There is little assurance that the value of the leased fee interest now being set for any lot has any reasonable relationship to the value that may be determined on condemnation. In one recent condemnation case, for instance, the condemnation price proposed by the HHA shortly before trial was nearly \$2 per square foot (or \$20,000 per lot) more than the commitment amount it had set earlier.

A realistic commitment amount is best derived by a proper appraisal. Yet, today, the commitment amount is not based on such appraisal. It is not set, for instance, on the basis of the appraisal done at the negotiation stage (assuming that this appraisal is reasonable and properly done). Rather, it is set arbitrarily on the basis of "gut feeling" at best.

Sometimes the value is based on the recommendation of the HHA's consultant appraiser who "eye-balls" the value of the leased fee interest. However, at other times it is determined by a formula or on the basis of some other factors. For example, at a June 1980 meeting, the commissioners of the HHA disregarded the recommendations of its staff and the HHA's consultant appraiser, and followed the recommendation of the lessees' attorney and set the commitment value for five tracts from a base of 120 percent of the appraisal made by the lessees' appraiser. At another meeting, the commission set the commitment amount at 50 percent of the "tax assessed valuation raised to 100%."

This arbitrary method of determining commitment amounts and the unrealistic values that are thereby produced lead to friction between the HHA and the lessees. In the case cited above where the HHA proposed a condemnation amount shortly before trial which was nearly \$2 per square foot more than the commitment amount it had set earlier, the lessees filed a motion in court to exclude the testimony of the expert upon whose recommendation the HHA's proposal had been made. Such confrontation should hardly be necessary when presumably both the HHA and the lessees are

seeking the most favorable, though realistic, price for the leased fee interest of the lessor.

Recommendations

We recommend that the HHA immediately establish criteria for the following:

1. *The circumstances under which a lessee would be considered to own in fee simple land suitable for residential purposes as to disqualify such lessee from becoming a purchaser of the fee title to his leasehold residential lot.*

2. *The proof that would constitute adequate "proof of funds" as to qualify a lessee to purchase the fee title to his leasehold residential lot.*

3. *When and how appraisals are to be made for purposes of determining commitment amounts and the price to be paid to the lessor on condemnation. In establishing this last criteria, some thought should be given to the interrelationship of the values established for lessor-lessee negotiations on the compensation to be paid, the commitment amount, and the final price to be paid to the lessor upon final condemnation.*

Chapter 5

THE ORGANIZATION AND OPERATIONS OF THE HAWAII HOUSING AUTHORITY

The organizational structure of an agency is supposed to facilitate the work of the agency and assist it in meeting its program objective with economy and efficiency. An organizational structure is based on several management principles. Among these are a clear delineation of functions and responsibilities, definite lines and centers of authority, and appropriately differentiated and assigned tasks and workload. In this chapter, the administrative structure and the operations of the Hawaii Housing Authority (HHA) for the land reform program are reviewed.

Summary of Findings

We find that the HHA's administrative structure and work processes are deficient as follows:

1. The organization and functions of the units are inaccurately and poorly defined.
2. There is confusion as to the respective responsibilities of the land reform administrator and the assistant executive director for the land reform program.
3. The land reform branch has not planned for the staffing needs of the land reform program; there are frequent turnovers in staff and vacancies are left unfilled for long periods of time and some of the jobs are not appropriately described or classified.

4. The work of the land reform branch is poorly managed and supervised.

Organizational Structure Inaccurately Depicted

Under the Governor's Administrative Directive 1978-4, each agency of the State is required to have detailed organization charts, position organization charts, and functional statements that depict its functional units, identify the kind and number of personnel, and explain the objectives and responsibilities of the units. The purpose of the directive is to promote sound management by defining objectives, maintaining clear lines of command, and maximizing the use of resources. The directive requires that the charts and statements be evaluated and updated at least annually.

Despite the Governor's directive, the HHA's organization charts are outdated and inaccurate. They do not reflect the organization that exists in fact. The discrepancies between what is shown on the formal charts and statements and what in fact exists are as follows.

The assistant executive director (AED) position. The HHA's formal organization charts show the land reform administrator (LRA) reporting directly to the executive director. In actual operations, there is an AED between the LRA and the executive director.

The AED position has been in existence for some time. The position is recognized in the bylaws of the HHA, and the HHA annual reports have listed someone in this position for the past ten years. It is not, however, shown on the organization charts and there is no position description defining the responsibilities or authority vested in the position. The individual serving as the AED is the Public Housing Administrator VII, a position shown officially on the organization's charts as being in the office of the executive director. However, he has no actual responsibility for public housing programs and his authority over the land reform branch is unclear. For a time, beginning in 1980, the LRA reported to the AED instead of the executive director. Since July 1981, it appears that the AED has taken over direct operational responsibility for the land reform branch, and the LRA has been assigned to a special land reform project.

Planning, program development, and evaluation services office. The organization charts and functional statements of the HHA show the presence of a planning, program development, and evaluation services office. The charts and the statements indicate that this is a support service unit which reports directly to the executive director of the HHA. This office is ostensibly one which provides overall planning, program development, evaluation, and research services to all programs of the HHA.

In fact, this office is nonfunctional. It has no staff. Planning and research at the HHA is carried on not by this support service unit, but by a staff of four exempt personnel who are a part of the executive director's personal staff. The four are not shown on the HHA organization charts and they perform such planning, development, and research functions that the executive director requires. They perform no work for the land reform program.

Land reform branch personnel. Between 1969 and 1979, the LRA was the only employee for the land reform branch. Since that time, the HHA has established six other positions consisting of: one land reform program specialist,

three land reform program technicians, one clerk-stenographer, and one clerk-typist. None of these positions is reflected in existing HHA organization charts.

The program specialist and technicians are contract employees exempt from civil service, and the clerical positions are temporary civil service positions. The Governor's directives require even temporary positions to be shown on organization charts if they (1) establish new functions, or delete or consolidate existing functions, or (2) create a new supervisory level. However, it has been the HHA's position that the addition of the new staff did not constitute a functional change or create a new supervisory level, and that therefore, it was not required to reflect any of these new positions in its formal organizational documents.

In our opinion, the addition of six branch staff significantly changed the actual functioning of the land reform program and should have been reflected in the HHA's position organization charts. This increase in staff from one to seven changed the scope of the program and increased the need for financial and other operating resources as well as management and supervision not previously required.

This is seen in the position descriptions for the program specialist and the technicians. They are described as providing specialized services to lessees and lessors, including not only processing and reviewing submissions from lessees but also providing technical, analytic, and legal assistance. These personnel provide new services to lessees that would not have been possible with a single program administrator.

***Recommendation.** We recommend that the organization charts and functional statements of the HHA be updated to reflect positions and functions as they actually exist within the HHA.*

Confusion in Roles at the Top

Presently, there is some confusion as to who is responsible for administering the land reform program.

Ever since the position of LRA was established some years ago, the LRA reported directly to the executive director. The position description even now states that he "serves under the general direction of the Executive Director of the Hawaii Housing Authority and is responsible for administering the State Land Reform program . . . [He] plans, coordinates, directs, and supervises the activities of the Land Reform program"

On November 26, 1980, the executive director rather abruptly issued a memorandum to administrators and staff stating that effective December 1, 1980, the LRA would report directly to the AED who, in turn, would report to the executive director. Before the issuance of this memorandum, the AED was not actively involved in the land reform program. The memorandum was issued without forewarning, and no clarification was given as to the respective roles and responsibilities of the AED and the LRA for the program.

In view of the LRA's previous full authority for all of the program's activities including all financial affairs and external dealings with the public, such a move needed more explanation and preparation. There being none, however, the result was, both internally and externally, confusion and anxiety over the new level of administration. Within the HHA, support staff in legal and personnel units did not understand clearly the difference in responsibility between the two administrative positions and expressed uncertainty over the procedures to follow in their working relations with the land reform branch. Confusion was even greater within the land reform branch. The program staff expressed uncertainty over the permanence of the change and its impact on the program.

Externally, lessees and their attorneys expressed confusion over the two administrative positions and concern about the impact on the management of the program. They saw the reorganization as a sudden move that served only to delay matters in an already slow and plodding program. Instead of facilitating public

services, the additional level of reporting was viewed as another bureaucratic layer for approvals and paperwork. The AED's own explanation of his role in the land reform program was not helpful. He described the LRA as responsible for the day-to-day operation and himself as responsible for improving the program and reviewing financial reports.

The situation became more confused when, in June 1981, the executive director assigned the AED direct operational responsibility for the land reform branch, removing the LRA from the branch and assigning him to a special land reform project. This move, effective July 1981, again caught both the internal staff and the external clientele by surprise. Although this move was announced as temporary for 60 to 90 days, it has been in effect for six months and appears to be extending indefinitely into 1982.

Recommendation. We recommend that the HHA immediately take formal steps to clarify the roles of the LRA and the AED and amend the position descriptions for the two positions as appropriate.

Deficiencies in Staffing the Land Reform Program

As stated above, the land reform program was for sometime staffed by a single employee—the LRA. Gradually, in the last two or three years six other positions have been added to the land reform branch. The deficiencies and problems in staffing for the land reform program are described in this section.

Lack of planning. The HHA has not properly defined its staffing needs and planned for staffing the land reform program. Even as public pressures for conversions have intensified, resulting in an increase in day-to-day workload, the program scope remains undefined and the work and specific tasks needed to run the land reform branch remain unanalyzed. The HHA appears uncertain about the number of positions it needs and when and whether it should fill

vacancies that occur. This uncertainty and lack of direction have been demoralizing to the staff of the land reform branch. Planning deficiencies are in a large measure responsible for these personnel problems.

Turnovers. There is a high rate of staff turnover in the land reform branch. A part of the reason for this staff turnover is the temporary status of the positions. The specialist and technician positions are exempt from civil service provisions and are filled by contracts; the clerical positions are designated as temporary, although under the civil service program.

According to interviews with the HHA personnel, some of the former staff left their jobs for more secure employment. It is reported that the HHA hesitates to establish permanent positions because of the uncertain constitutional status of the program.

However, the functions performed by these positions, particularly the clerical ones, are needed daily and continuously. The present turnover severely limits the branch's ability to serve the public. According to the position descriptions, the clerks, in addition to such tasks as filing, document reproduction, compilation of data, typing, and document review, are required to answer telephone and in-person inquiries and provide routine program information. In their absence, the technicians have been assigned to perform the clerks' duties along with their own.

It is appropriate for the HHA to review the temporary status of at least the clerical positions to determine if permanent positions might be established. These positions are so basic to the operations of almost any program that the concern for their future placement, if and when the program ends, must be weighed against the clear need for a reasonably stable clerical staff.

Unfilled vacancies. Generally, offices with small staff feel the impact of staff shortages to a greater extent than those with large staff who can be reassigned as needed. The land reform branch, having a small staff, becomes severely

disabled whenever there is a vacancy. Despite this, positions have been left unfilled for long periods of time. For example, as of December 1981, the program specialist position had been vacant since February 1981, the clerk-stenographer position since May 1981, and one technician position had been vacant since September 1981. One other technician was on leave. This left only one technician and one clerk to serve the general public.

The HHA appears hesitant about filling vacancies in certain positions, although they had previously been justified as urgently needed. This is illustrated by the program specialist position.

This position was described at the time of the request for the position as a responsible and technically demanding position, equivalent to a civil service classification of SR 26. The holder of the position is supposed to provide specialized services to lessees and lessors including tasks related to dissemination of information, negotiation, arbitration, land acquisition and disposition activities, administrative duties for land reform funds and instruments, and community outreach. Qualification requirements for the position are highly professional, demanding a college degree, a Hawaii real estate broker's license, and at least ten years of "professional experience in Hawaii real estate sale, appraisal, and financing with extensive experience in residential leasehold property."

The required qualifications, particularly appraisal expertise, appear to be just those needed by the land reform branch. Yet, the HHA has not filled the vacancy. The HHA is not seeking a program specialist at present and there seems to be no intended date for reactivation of the position.

Jobs not appropriately described or classified. There are three program technician positions at the branch. Although they all have the same title, one has a different job description and is classified as an SR 15 while the other

two are SR 13's. There is some question as to whether there is sufficient justification for classifying the third position differently from the other two.

All three technicians are responsible for "technical" services to the LRA, but the description of the third position includes the additional task (not found in the descriptions of the other two positions) of "support services coordinator and supervisor." This would indicate a supervisory function somewhat like that of an office manager. However, the HHA states that the position is not that of an office manager or supervisor. It states that the employee that filled the third position was a "lead" person and functioned as such because of the person's senior status in the branch rather than any formal duties or responsibilities associated with the position.

If what the HHA states is true, then there appears to be no reason for classifying the third position any differently than the other two positions. They should all be classified the same and their position descriptions should all be the same.

On the other hand, if the employee in the third position actually supervises, as the position description indicates, then it would seem that there is further reason for the HHA to amend its organization charts and functional statements to reflect this supervisory level. As stated above, the Governor's administrative directive requires an agency to redo its organization charts and functional statements, even in the case of temporary hires, if such hiring has the effect of creating a new supervisory level. It may well be that the HHA explains the third position in the way that it does only because it chooses, for reasons of its own, not to change its organization charts to reflect the supervisory level created by the third technician's position. In this connection, it is pertinent to note that the two SR 13 technicians acknowledge that they were trained by the senior technician and that they looked to that person for help whenever problems arose.

Recommendations. We recommend that the HHA:

1. *Undertake a comprehensive review of its staffing needs for the land reform program. It should develop a staffing pattern and program which minimizes frequent turnover in staff and fill vacancies as quickly as they occur. Consideration should be given to making permanent at least the clerical staff positions.*

2. *Review the job descriptions and classifications of the technician positions in the land reform branch.*

Poor Management and Supervision of Operations

The land reform branch is the center of the HHA's land reform program operations. Aside from litigation proceedings, the branch provides all of the services that the State provides to the public and coordinates conversion activities.

Daily, the branch receives and responds to all inquiries on land reform and reviews all designation requests and purchase applications from lessees. It collects from many individual applicants various documents required to support their requests for conversion. It reviews all submissions and attempts to keep track of the progress of each conversion effort.

The land reform branch is poorly organized and ill-equipped to manage this workload. Specifically, the branch has no guidelines to assist staff in its work, has no system for data management, either for record maintenance or tract management and has a poor reporting system.

No staff guidelines or direction. For the most part, branch employees receive little guidance and direction; they are left to manage on their own. There are no work manuals or written instructions for even the most basic tasks. Further, there is no training program for the staff. The branch staff works only with

copies of the land reform law and the program's administrative rules. As already stated, the rules fail to illuminate many important processes and procedural details.

The result is that there is no consistency in the rendering of services to the public. Work is assigned to each technician by tracts and each does whatever appears necessary to the technician. There is no defined workload and no performance expectations.

Poor data management. The land reform branch handles a vast amount of information daily. There is however, no internal procedure for the uniform filing and recording of these information. The present system for handling land reform information and records is disorganized and uncoordinated. There are as many filing systems in the branch as there are technicians.

Generally, under the present system, correspondence and documents for a particular tract are routed to the technician assigned to that tract. The technician creates a "tract" file for these documents. The internal organization of a "tract" file often differs from that of another, and not all "tract" files contain the same documents. Each technician divides up the tract files and files documents and correspondence according to the technician's own preferences and needs; some files have separate sections for certain steps of the process while others do not.

The general files for the branch, i.e., documents not specific to a tract, have also received little management attention. Again, the technicians are left to create these files as they deem necessary or as time permits. Many files overlap by subject, and some significant subjects are placed collectively in "miscellaneous" files and are hard to locate.

Further difficulty is created by the absence of a systematic arrangement of the files. The "tract" files are placed in filing cabinets in no particular order or scheme, not even in a simple alphabetical order.

Poor tract management. Generally, the land reform conversion process takes at least two years. It passes through many varying steps from preparation for designation to actual condemnation. Again, each technician devises individually the means of monitoring and controlling tract progress. Some tract files are organized, recorded, and monitored by methods established by the lessees' attorney.

The present individualized filing and tract management systems jeopardizes operations whenever the employment of a technician terminates. When that happens, much time must be spent deciphering that technician's unique filing system to locate documents for particular lessees or to find the records of a tract's status. This not only delays the processing of conversion of particular tracts but also limits the ability of the staff to provide consistent and continuous service to lessees.

Poor reporting and program/monitoring. At present, the HHA has no system for reviewing performance and program operations, and since its inception, the program has received no management review. Reports by the LRA, as a consequence, have been sporadic.

There was one attempt to institute a monitoring mechanism, but this attempt fell far short of establishing a meaningful review system. This attempt occurred in 1981, when a lead technician (who has since left the HHA) issued a series of monthly reports entitled, *Land Reform Branch Monthly Status Report*. The reports continued through June 1981 and apparently none has been issued since. The usefulness of these monthly reports was minimal.

The reports consisted of a list of all "active" tracts with columns for some of the various steps in the conversion process, such as petition, public hearing, designation, suit filed, trial set, etc. Apparently for each step completed for a particular tract a date or an X was supposed to have been inserted. It appears that the information for some of the tracts was incomplete, since dates or X's were entered inconsistently in the columns.

There was one other attempt at monitoring work in the land reform branch. This was the *Land Reform Status Chart* which used to be posted in the office. According to the branch staff, however, this chart was not updated regularly and was not always current.

For management and oversight purposes, some monitoring mechanism is necessary. Information should be readily available on what tracts are in the process of conversion, how many lessees are involved in each tract, the steps completed, the steps yet to be taken, the number of lessees who have qualified to purchase the fee title to their lots, etc. Only by periodic and consistent reporting of such data can management know what the workload is and how well the program is progressing.

Recommendations

We recommend that the HHA:

1. *Develop work manuals and written instructions to guide the work of the staff of the land reform branch.*
2. *Establish a uniform filing system for the filing of documents for the land reform program.*
3. *Establish a uniform system for monitoring the progress of conversion of each tract of land.*
4. *Establish a system for reporting on the progress of the land reform program as a whole.*

Chapter 6

FINANCIAL MANAGEMENT OF THE LAND REFORM PROGRAM

This chapter contains our findings concerning the Hawaii Housing Authority's (HHA) fiscal management and accounting practices for the land reform program. We examine the funding status for the program and the controls exercised by the HHA on the funds and expenditures of the program.

Summary of Findings

We find that fiscal management of the land reform program is grossly lacking. Our specific findings are:

1. The HHA has yet to define what administrative costs of the land reform program are to be borne by the lessees. In the absence of such definition, lessees are being charged arbitrarily for such administrative costs.
2. The HHA has substantial excess funds on hand, which allows it to operate without proper planning or budgeting.
3. The HHA's budget requests to the Legislature are without any basis in fact and present inaccurate and misleading information.
4. Accounting and fiscal controls over the program are inadequate. The HHA fails to exercise proper controls over the deposits made by lessees and makes purchases without proper purchase orders.

Program Funding

Funding intent. The land reform program is intended to be self supporting. To this end, the Legislature authorized the HHA to recover from the lessees its costs of administering the program as well as the costs incurred on condemnation for acquiring the fee title to leasehold lots. The Legislature established a fee simple residential revolving fund into which all moneys received or collected by the HHA under the program are required to be deposited.

To assist the HHA in acquiring the fee title to lots in a leasehold residential tract, the Legislature initially authorized the HHA to issue revenue bonds. It was intended, in keeping with the concept that the program shall be self-supporting, that the principal and interest on these bonds would be paid for from the amounts collected by the HHA from lessees exercising their rights to purchase the fee title to their individual lots. The Legislature authorized the HHA to include in the purchase price for the individual lots the costs of the interest on the revenue bonds. These revenue bonds proved to be unsaleable and thus were never issued.

The Legislature then amended the law to authorize the HHA to issue general obligation bonds on the basis that this form of financing would be more accessible and feasible since general obligation bonds have the full faith and credit of the State behind them. It was the

Table 6.1
Program Receipts and Expenditures

<i>Year Ended June 30</i>	<i>Program Receipts</i>				<i>Less (Plus)</i>		
	<i>General Fund Appropriations</i>	<i>Charges To Lessees</i>	<i>Interest Earned</i>	<i>Total Available</i>	<i>Program Expenditures</i>	<i>Lapses And Transfers</i>	<i>Balance Available</i>
1976	\$1,324,765	\$ 13,500	\$ 40,513	\$1,378,778	\$ 36,962	\$ [47]	\$1,341,863
1977	26,098		71,185	97,283	31,081	1,354	1,406,711
1978	26,820	1,500	92,400	120,720	43,372	[8,301]	1,492,360
1979	57,517		123,603	181,120	59,770	6,581	1,607,129
1980	59,477	12,875	184,549	256,901	135,040	1,764	1,727,226
1981	63,078	6,270	202,221	271,569	294,150	843	1,703,802

intent, as in the case of revenue bonds, that if they were issued, the principal and interest on these general obligation bonds would be paid for from the amounts collected by the HHA from lessees purchasing the fee title to their individual lots.

These general obligation bonds also were not issued. They were not issued because the bond counsel would not approve their issuance on the ground that he doubted the constitutionality of the use to which the proceeds of the bonds would be put.

Funding sources. The land reform program has been funded thus far from three sources: legislative appropriations, interest income, and collections from lessees. The following briefly explains these fund sources.

Although the intent of the law from its inception has been that the land reform program would be self-supporting, in the early years of the program there were no leasehold conversions and thus no program revenues from which the costs of administering the program could be paid. The Legislature, therefore, annually appropriated funds to cover the costs of administration that were being incurred despite the lack of conversions. The primary administrative cost that was being incurred was the personal services cost of the land reform administrator.

In recent years, conversion processes have been taking place, and the HHA has been collecting charges from lessees to cover its costs of administering the land reform program. Nevertheless, the Legislature has been continuing to make annual general fund appropriations to the program on the request of the HHA.¹ Table 6.1 shows the amount of the legislative appropriations for the years 1976 to 1981.

In addition to the annual appropriations to cover some administration costs, the Legislature in 1975 appropriated \$1.3 million to finance the condemnation of a tract for the purpose of testing the constitutionality of the land reform law. This sum was never expended since the fee title to the lots included in the tract which had

1. The practice of requesting general fund appropriations has continued even after the program format changed to allow the HHA to condemn and acquire only those lots in a development tract for which it has qualified purchasers. This change in the law made it unnecessary for the HHA to have any substantial funds on hand to finance the acquisition of the tract. Lessees could now be required to have financing arranged and the moneys for the lease fee interest to their individual lots ready and on hand at the time of the acquisition of the lots in the tract by the HHA. Then upon acquisition by the HHA, the lessees could be required to pay for the fee interests to their individual lots, which moneys could then be turned over by the HHA immediately to the lessor. Such an arrangement was not possible before the change in the law. Before the change, the HHA was required to take all lots in a tract whether or not there were some lessees who chose not to purchase the fee to their individual lots. In such cases, the HHA needed to have some funds on hand to pay for the fee interest to lots for which it had no lessee-purchasers.

been selected for the test case was disposed of to the lessees under a settlement negotiated with the lessor. The money, however, was never returned to the general fund and has been sitting in the fee simple residential revolving fund.

Interest is the second source of funding for the land reform program. As shown in Table 6.1, the amount of interest collected in recent years has been substantial. The interest received thus far has been almost exclusively interest earned on the \$1.3 million that the Legislature appropriated in 1975 for the purpose of testing the constitutionality of the law. Worth noting is the fact that the amount of interest received each year from 1976 to 1980 has consistently been substantially greater than the expenditures for the year. This appears to suggest that there was no continuing need for annual legislative appropriations to pay for the administrative costs of the program.²

The third source of funding has been the amounts collected from lessees to defray the program's administrative costs.

The three sources of funding have provided more than ample funds for program operations. The HHA has had a comfortable cushion for program operations for years. This condition has provided no incentive to the HHA to plan and budget its finances for the program and to institute a self-supporting system of finances as called for by the land reform law. The remainder of this chapter deals with this problem.

Need for a Definition of the Costs to be Assessed Lessees

The intent of the law is for the administrative costs of the program (as well as the HHA's costs of acquiring the fee title to the leasehold lots in a development tract) to be paid for by the lessees. The HHA, however, has not as yet defined fully what administrative costs of the program should rightfully be passed on to the lessees.

The administrative costs of the land reform program can be viewed in terms of direct and indirect costs. Direct costs include the costs of the salaries of personnel assigned to the program and the costs of appraisal, survey, title search and the like attributable directly to the program. Indirect costs include the costs of vacation, holiday, sick leave, and other fringe benefits of employees in the land reform program and the costs of the use of HHA's general equipment and supplies.

The costs of the program may also be viewed in terms of the costs attributable to individual tracts (such as the costs of surveying and appraisal of the lots included in the individual tracts) and costs which are not attributable solely to individual tracts (such as the costs of personnel).

Despite the varying ways in which program costs may be broken down, for years, no accounting was ever made by any defined cost categories. Accounting was done for the program as a whole without any breakdown by type of service or by development tract. It was only during FY 1979-80 that the HHA finance office began classifying expenditures by type. In FY 1980-81, the new director of the HHA sought to institute further detailed accounting for the program. In October 1981, the HHA developed a single page statement on accounting procedures for the land reform program. These procedures provide the first written procedures and assign greater responsibility to the finance officer for the program's financial activities.

These improvements, however, still fall short of fully defining what costs are to be passed on to the lessees, and how costs common to various tracts and to various lessees in a single tract are to be pro rated among the tracts and the lessees. In the absence of the definition of costs to be borne by the lessees, the HHA has

2. Provided, of course, that the \$1.3 million appropriated in 1975 continued to be left in the fee simple residential revolving fund to earn interest. See text discussion *infra* on the propriety of retaining the \$1.3 million in the revolving fund.

been charging lessees for costs in an arbitrary manner.

Assessments for the HHA's administrative costs were first made in 1976. Those charged were lessees of a 30-lot development tract that ultimately reached a negotiated settlement with the lessor. The HHA charged each lessee \$500 for its services. The HHA provided the following breakdown for the use of the \$500.

\$ 22.50	-	escrow fee
25.00	-	title search
202.50	-	appraisal
100.00	-	HHA's costs
<u>150.00</u>	-	negotiator's charge
<u>\$500.00</u>		

The HHA gave no supporting documentation to justify the \$100 "HHA's costs."

In subsequent years, other lessees have been charged for the "HHA's costs" when they converted their lots to fee simple either through negotiated condemnation or direct sales from lessors. The fees charged in these years were, however, either \$25 or \$50 (not \$100) for each lessee. Again, there was no justification for either amount. The amount was arbitrarily determined and assessed by the branch administrator without any formal financial verification or further management review.

The HHA intends to increase its assessments of lessees. For development tracts now in process, the HHA has instructed the staff of the land reform branch to increase its efforts to identify costs attributable to specific tracts by recording expenditures for items such as appraisals, title reports, public hearing and mailing costs. These records have recently been used to charge lessees, who withdrew their applications, their pro rata share of the tract expenses up to time of their withdrawals. Many of these recent charges were greater than charges previously made to lessees who had completed the entire conversion process.

In addition, the revised administrative rules allow the HHA to assess a minimum of \$100 per lessee for withdrawal regardless of the actual administrative costs incurred. This \$100 is not based on any actual cost figures or any defined need.

Recommendations. We recommend that the HHA take immediate steps to:

1. *Define what costs of the land reform program are to be borne by the lessees, and what costs, if any, are to be subsidized by the state. In this connection, although the statute appears to provide for the recovery of all administrative costs from the lessees, there may well be valid reasons for the State to pay for certain costs. In this regard, we suggest that a thorough review be made by the HHA of indirect costs and the costs of the HHA personnel assigned to the land reform program and other costs not attributable solely to particular development tracts.*

2. *Develop accounting procedures that support and implement the definitions.*

Disposition of Excess Funds

The HHA has been administering the land reform program for many years with substantial amounts of excess cash. This cash is in the fee simple residential revolving fund, and the HHA has been drawing on it freely and at will for whatever purpose it has deemed appropriate.

The revolving fund is not subject to budgetary controls normally present in the State's appropriation and allotment procedures. Funds in the revolving fund do not lapse, and the money is available to the HHA without legislative review or budgetary or other constraints. The HHA finance office monitors the use of the fund only to the extent of certifying the availability of money for purchase orders. Since the fund has more than enough money, such certification has been a mere formality.

As of June 30, 1981, the revolving fund had over \$1.7 million in it, of which \$1.3 million is the appropriation made by the Legislature in 1975 for the purpose of acquiring a development tract to test the constitutionality of the land reform law. In FY 1979–80 the interest earned on the amount in the fund was \$184,549 and in FY 1980–81, it was \$202,221. Most of the interest was earned on the \$1.3 million.

Allowing administrators discretion to draw from this fund for whatever they might consider to be allowable program expenditures leaves the fund vulnerable to misuse. For example, in 1980 a \$3,000 cost of printing 600 copies of a draft of the State Housing Plan was charged to the revolving fund.³ The use of the fund for this purpose was clearly in violation of Section 516–44, HRS, which provides that the fund can be used only for the costs of bonds and necessary expenses of the authority in administering the land reform law. This amount has yet to be reimbursed to this fund.

At this time, the HHA has no plans for the use of the \$1.7 million remaining in the fund. Except for deposits collected from lessees, it appears that the balance of \$1.7 million is not needed by the HHA for use in the land reform program.

***Recommendation.** We recommend that the Legislature require the HHA to return to the state general fund, all funds currently in the fee simple revolving fund (except the deposits it has collected from lessees) which are not reasonably programmed for use and are no longer needed to finance the acquisition of development tracts or to pay for the costs of administering the land reform program.*

Problems Associated with HHA Requests for General Fund Appropriations

There are several problems with the current process whereby the HHA requests and receives annual general fund appropriations for the land

reform program: (1) in violation of Section 516–44, HRS, the appropriation is not deposited into the fee simple revolving fund; (2) there is no justification for the amounts requested; and (3) the HHA has consistently provided the Legislature with misinformation and a distorted picture of program revenues and expenditures.

Appropriations not deposited into fee simple revolving fund. Section 516–44 says specifically that all funds appropriated for the purposes of the land reform law and all moneys received and collected by the HHA under the law shall be deposited in the revolving fund. Yet, the HHA has deposited into the revolving fund only the first two appropriations made in FY 1969–70 and FY 1970–71. In all subsequent years, the amounts appropriated have not been put into the revolving fund, but left in the state general fund.

Perhaps the reason for not placing the general fund appropriations into the revolving fund is that the HHA gains by it. Nonplacement in the revolving fund saves the fund from being charged with the fringe benefit costs of the staff in the land reform branch. Generally, when salaries are paid from the general fund, the fringe benefit costs of the employees receiving the salaries are also paid out of the general fund via a separate general fund appropriation. If salaries are paid from the revolving fund, the fringe benefit costs must also be paid from the revolving fund. In FY 1980–81, the HHA charged salaries of \$60,435 to the state general fund and the associated fringe benefit costs were also charged to the general fund. The revolving fund was charged a total of only \$22,763 for the remaining salary costs and \$4,196 for fringe benefits.

No basis for budget amounts requested. The HHA has no budget or budgeting process that justifies its continuing requests for general

3. *Fee Simple Residential Revolving Fund; Statement of Revenues, Expenses and Retained Earnings for the Twelve Months Ended June 30, 1981 and 1980.*

fund appropriations. It does not plan or project expenditures in any meaningful way since it is undecided as to what kinds of expenditures should rightfully be subsidized by the State.

There is no explanation of the planned uses for the amounts requested and the appropriations are not used for any specific program expenses. For example, the request for \$57,888 shown for FY 1980-81 in the executive budget request was presumably for the salary of the land reform administrator and a single position count is shown. Yet, the HHA used the appropriation to pay for all seven of the staffs' salaries to the extent possible. When the money ran out, salary expenses were then taken from the fee simple revolving fund. About two-thirds of the salary costs were charged to the state general fund and one-third to the fee simple revolving fund without any clear policy on why the State is funding one particular portion and not the other nor why lessees are also being charged for administrative costs.

Inaccuracies in budget requests. The budget for the land reform program presented to the Legislature provides an incomplete, distorted, and inaccurate picture of the program. It bears no relationship to actual expenses or planned expenditures. Thus it does not serve any of the functions of a budget such as ensuring the best use of resources, controlling program costs and expenditures, and ensuring accountability for financial management of a program.

1. **Program activities misrepresented.** In its 1981-83 budget presentation, the HHA reported that it performed a number of functions and supplied man-hour data for these functions.⁴ For example, it reported that it assisted lessees to form tract groups, negotiated with lessors, and processed condemnation actions. Yet not all of these functions were actually performed and certainly the man-hour data were pure fiction as the program only recently began to record some of this information.

2. **Program expenditures not accurately reported.** Each agency is required by law to

display in its budget requests its actual program, including the means of financing for all its personnel. This requirement has been totally disregarded by the HHA. It shows neither its actual program costs nor reflects accurately the means of financing. This has been true historically as well as currently.

Table 6.2 compares the HHA's representation to the Legislature in 1981 on what it spent on the program in 1979-80 with what it really spent. Note the differences. *First*, the HHA reported 1 position count and total operating costs of \$55,437; in actuality, it had 7 employees in the branch and total operating costs of \$135,040. *Second*, it reported financing only from the general fund in the amount of \$55,437 even though it actually used \$57,713 plus another \$77,327 that it drew from the fee simple revolving fund. *Finally*, it reported capital expenditures of \$500,000 for land acquisition, funded through \$500,000 in general obligation funds, which never occurred. This last item was explained by the HHA as a carry over from an erroneous estimate made in 1976. It is difficult to believe, but the HHA has allowed this erroneous data to be shown in each of its budget requests since 1976.

The HHA's report on revenues has similarly been inaccurate. Budgets prior to FY 1979-80 failed to report any earnings or collections from lessees, even though the HHA had earned interest and had collected charges from lessees. (See Table 6.1.) For FY 1979-80, the HHA reported revenues of \$141,000, when it actually received \$184,549 in interest on moneys in the fee simple revolving fund and had collected \$12,875 in charges from lessees.

The HHA states that in addition to the regular state budget process, it also has an internal budgeting process; however, the latter appears to be no better than the former. Again,

4. *The Multi-Year Program and Financial Plan and Executive Budget for the Period 1981-87, Budget Period: 1981-83, Vol. II, December 1980, p. 1166.*

Table 6.2

Comparison Between Expenditures Reported
To the Legislature and Actual Expenditures

	Report on Program* Expenditure to Legislature 1979-80	Actual Expenditure 1979-80
Position count	1	7
Total operating costs	\$ 55,437	\$ 135,040
Means of financing		
General fund	\$ 55,437	\$ 57,713
Fee simple revolving fund		\$ 77,327
Capital investment expenditure		
Land acquisition	\$ 500,000	0
Means of financing		
General obligation bonds	\$ 500,000	0

*Source: Multi-year Program and Financial Plan and Executive Budget for the Period 1981-1987, v. 2, December 1980, p. 1165.

there is no correspondence between the budget and actual expenditures. For FY 1980-81, the internal land reform budget showed planned expenditures of \$331,653. Actual expenditures were \$294,150. Even then, it is difficult to tell whether all of the \$294,150 should have been spent.

It is evident that the HHA has no budgeting system for the land reform program. Expenses have been incurred and funds have been used essentially on an as needed basis, and legislative appropriations have been requested with no real idea as to how moneys are to be spent. The availability of the various sources of funds has allowed the HHA to spend without being limited to any particular plan or budget and the public is left with no assurance that all the expenditures are indeed necessary for the program.

It is essential that the HHA develop a sound budgeting system. It is also essential that all excess funds in the fee simple revolving fund be returned to the state general fund as recommended earlier to discourage the HHA from spending money without proper expenditure plans.

Recommendations. We recommend the following:

1. *The HHA develop a financial planning and budgeting system to guide its expenditures.*
2. *The HHA present accurate information on expenditures, sources of funding and program activities in its budget requests to the Legislature.*

Need for Greater Financial Control

Financial management for the land reform program has generally been lax. The HHA administrators have paid little attention to fiscal policy or procedures. Until recently, the finance office was minimally involved with the program, primarily keeping accounting records for the branch and preparing its payroll.

The land reform administrator has exercised most of the management control over land reform program funds. Although the executive director gives final approval for purchase orders, payment of invoices, and execution of contracts, his involvement in the

past has generally been a formality. The administrator has determined what expenditures are necessary, the fees to be charged and how the deposits are to be managed. A review of the HHA's present practices in managing lessee deposits as well as the branch's day-to-day operations in such matters as purchase orders shows the need for a major overhaul in the management of program finances.

Management of lessee deposits. The law allows the HHA to collect a deposit of up to \$500 from each lessee who applies to purchase the fee title to his leasehold lot. The deposit is to be used to pay for the costs of appraisal and surveys and for attorneys' fees incurred by the HHA in the conversion process, with the remainder to be applied towards the purchase of the fee interest.

1. No policy on fiduciary responsibility. The HHA administrators appear to be divided as to HHA's fiduciary responsibility for the deposits. Two administrators say that the HHA has no fiduciary responsibility for the funds, while the executive director says that the HHA has a fiduciary responsibility to preserve the principal and to ensure that it is invested responsibly for the benefit of the lessee. Despite this difference in opinion, in an apparent concession to lessees, and even though the law does not require it, the HHA has placed each lessee's deposit in individual savings accounts at financial institutions with itself as trustee.

The purpose of benefiting the lessees is worthy, but we believe that this practice of depositing each lessee's deposit in a separate and individual account for the lessee should be discontinued immediately. *First*, this practice violates the law which requires that all deposits by lessees be placed in the fee simple revolving fund. *Second*, the practice is not the most financially advantageous. There is approximately \$2 million in deposits sitting in individual savings accounts of \$500 each, earning minimal interest, when collectively in the fee simple revolving fund the money could be generating much greater return through proper investments

by the director of finance. Since money in the fund is used ultimately to pay for services for lessees, all lessees would benefit from the higher returns.

2. No accounting control over deposits. No one at the HHA knows the exact amount of money that the HHA has on hand as deposits from lessees. Our estimate of \$2 million is based on the records kept on development tracts in the conversion process which show that over 4,000 lessees have paid their deposits.

The land reform branch receives deposits directly from lessees or from their attorneys. Branch technicians have been instructed to deposit the funds upon receipt into individual lessee accounts at financial institutions. Each technician collects the deposits for the tracts for which the technician is responsible, often allowing the deposits to accumulate for a week before depositing them. Until December 1981, this process occurred outside the HHA's normal financial accounting procedures; the finance office did not record the deposits and had no idea of the location or amount of lessee deposits. Thus, neither the branch nor the finance office knows how much is on deposit with the financial institutions.

The branch staff maintains a checklist of deposits within each tract file but this information is not maintained in the aggregate. Passbooks for each account are kept not at HHA but are held by the financial institutions.

The branch has made no effort to verify the amounts deposited at the financial institutions. Quarterly statements sent by these institutions to the branch are not reviewed for accuracy. Occasionally, branch staff will review tract files to determine the number of lessees who have deposits with the HHA but these are never verified against the statements from the financial institutions.

Further breakdown of control is created by the HHA's instructions to the financial institutions that they send quarterly statements

of the savings accounts to the HHA and the annual IRS 1099 reports directly to the lessees. However, the HHA has no procedures for ensuring that all 1099's are in fact sent out and that they are sent to the proper lessees. A review of the records has shown numerous problems with the handling of the 1099's.

In the case of one tract with over 450 savings accounts, we found that in December 1980 the financial institution mailed 310 IRS 1099 statements to the HHA and the balance directly to the lessees. Of those sent to the HHA, the same Social Security number was on 198 statements and another Social Security number was on 67 statements; 4 statements showed no social security number at all. Some statements showed both lessees' names and Social Security numbers, while others showed no name other than the HHA as trustee.

The HHA has shown little interest in following up and correcting these errors. The annual IRS 1099 statements are needed by depositors to report their interest earnings for income tax purposes. At present, many depositors remain unaware of their earnings since they do not receive the 1099's.

We pursued the above problem statements with the financial institution concerned. It attributed the errors to a "conversion of data processing systems" during 1980. The institution said that it was correcting the errors as the errors are brought to its attention.

After we informed the institution of the errors in the issuance of the 1980 IRS 1099's, it has begun to review all of the HHA accounts for lessees in an effort to find and make necessary corrections and to ensure that proper 1099 statements are issued for 1981.

The problem identified above with respect to the 1099 statements would be alleviated if individual deposit accounts were eliminated and all deposits placed in the revolving fund. Any interest earned while in the revolving fund would be credited to the HHA for use in defraying the costs of conversion. An accounting could be had with each individual lessee on the

use of the deposits and the interests earned on them upon the conclusion of the conversion process or upon lessee's withdrawal as a purchaser before the conclusion of the conversion process.

Purchase order practices need corrections. Because of its comfortable financial situation, the land reform branch has been able to ignore normal purchase order system controls. Purchase orders are often prepared after the services have been rendered and invoices already received by the HHA. The preparation of purchase orders is then only another formality to conform with the requirement that all invoices be accompanied by an approved purchase order for payment to be released.

Such practices defeat the purpose of a purchase order system which is to control costs and limit expenses to planned expenditures.

Recommendations

We recommend as follows:

- 1. All deposits received from lessees be deposited into the fee simple revolving fund, and all interests earned on the deposits be credited to the fund, rather than to the individual lessees.*
- 2. There be an accounting to the lessee upon the conclusion of a conversion process (whether it concludes on condemnation or a negotiated settlement), or at the time of the lessee's withdrawal as a purchaser, on the use of the lessee's deposit and any interest earned thereon.*
- 3. The HHA institute a control system over the deposits made by lessees of such nature as to enable the HHA to know at any given moment, the amount of deposits made in the aggregate and by tracts, together with the names of every depositor.*
- 4. The HHA comply with State purchase order procedures that require purchase orders to be prepared and approved prior to the ordering of goods and services.*

COMMENTS ON AGENCY RESPONSE

The Agency's response to the comments on the draft EIS is as follows: The Agency has reviewed the comments and has determined that the EIS is adequate to support the proposed action. The Agency has also determined that the EIS is in compliance with the requirements of the National Environmental Policy Act (NEPA) and the Executive Order on the Review of Government Operations.

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APPENDIX

RESPONSE OF THE AFFECTED AGENCY

The Agency has reviewed the comments on the draft EIS and has determined that the EIS is adequate to support the proposed action. The Agency has also determined that the EIS is in compliance with the requirements of the National Environmental Policy Act (NEPA) and the Executive Order on the Review of Government Operations.

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COMMENTS ON AGENCY RESPONSE

On January 26, 1982, copies of a preliminary draft of this audit report were transmitted to the Governor, the presiding officers of the Legislature, and the Chairman of the Commission of the Hawaii Housing Authority. As is our practice, we asked the Commission, as head of the agency, to provide us with its comments on the recommendations contained in the audit report.

A copy of the transmittal letter to the Commission is included here as Attachment 1. The response from the Commission, by letter dated February 9, 1982, is included as Attachment 2.

General Observations on the Response

While most of the Commission's comments on the specific recommendations in the audit show general agreement with these recommendations, the letter from the Commission says that it believes that a number of our findings are misrepresentations and fail to take into account federal and state court rulings and Chapter 101, HRS. Nothing in our report contravenes federal and state court rulings or Chapter 101, HRS, which deals with eminent domain. We believe that the Commission's perception of the audit as full of misrepresentations reflects a misreading of the audit report and a reluctance to face and deal with the issues brought out in the audit report.

For example, although the audit report specifically pointed to the meaninglessness of using undefined figures on number of lots converted without any context for relating these figures to program efforts, the Commission defends the HHA's operations and again points to the same numbers as evidence of its accomplishments. As described in the audit report, this was one of the failings in the HHA's annual reports. The figures provide little information for evaluating whether progress has been made. Moreover, HHA's data in support of its so-called accomplishments do not reveal whether conversions were the result of HHA's meaningful intervention rather than private initiative.

In its general comments on Chapter 4, the Commission says that it understands its role as that of implementing the law in a fair and equitable manner. However, the audit report had noted that this understanding has yet to be conveyed to lessees who are left in the dark as to what they might expect from the HHA. As the law says clearly that the HHA is to render assistance to lessees, the audit report recommends that the HHA clarify its role and how it plans to interact with lessees at each stage of the conversion process; it does not recommend that the HHA act as an advocate.

Similarly, the HHA chose to ignore the specific problems giving rise to the recommendations in Chapter 4. It denies any problems with the rules even though there are specific omissions in the rules. As a result, the rules do not provide to the public the information that it needs on the conversion process. The Commission also denies the need for criteria, saying these are already in the law. The law does provide some general criteria for eligibility in the leasehold conversion program, however, the HHA has been unclear and inconsistent in its day-to-day application of these general criteria. It needs to formulate specific policies and standards to guide the daily decisions made by the land reform staff. Finally, we do not suggest any formula for determining value as the law did previously. Instead, we recommend that the HHA establish criteria for determining when and how appraisals are to be made in its program, what factors are to be considered in making appraisals,

define the interrelationships among the various values established during the conversion process, coordinate all stages as much as possible to eliminate the present costs of delay and overlapping efforts, and lastly, to explain these clearly to the lessees.

Finally, our focus in Chapter 6 was on the serious problems in the HHA's fiscal management practices, including the numerous and continuing inaccuracies in its budget presentations to the Legislature. Rather than dealing with these major problems, the Commission takes issue with a table that it says implies something that it should not have.

In many of its responses to the specific recommendations, the Commission says that it intends to review the recommendations and to seek guidance from the Legislature. While such legislative direction and assistance is clearly desirable, we wish to stress that most of the problems discussed in the audit report are directly under the HHA's management responsibility and within its power to correct. Therefore, we urge the Commission that in its review of the recommendations, it seek to undertake improvements in its program expeditiously so that all lessees in the State may benefit.

HHA's Response to the Recommendations

In addition to HHA's February 9, 1982 letter, HHA also submitted responses to the specific recommendations made in our report. HHA's responses to the recommendations were written on a copy of our preliminary report, and they are reproduced in their entirety as follows:

Chapter 3 – Planning for the Leasehold to Fee Conversion Program

To our recommendations, which appear on page 11 of this report, that the HHA gather the basic information necessary for sound planning, and develop plans, policies and procedures for the implementation of the program, the HHA responds:

“The Authority will review this matter and where appropriate, implement your recommendation with guidance from the Legislature.”

Chapter 4 – Management of the Leasehold to Fee Conversion Process

To our recommendation, which appears on page 17, left column of this report, that the HHA develop a clear and comprehensive information packet on the program to assist lessees, the HHA responds:

“The Authority has provided an informational packet which includes a question and answer pamphlet prepared by the Legislative Reference Bureau (Attachment 1).¹ This pamphlet at times is disregarded by the lessees' representative and not provided to the lessees. The Authority will, however, review this matter and make appropriate changes.”

1. This attachment is not reprinted in this report, but is available for inspection in the Office of the Legislative Auditor.

To our recommendations, which appear on page 19, left column of this report, that the HHA clarify its role in the fee conversion process and its relationship to the lessees and develop procedures for coordinating their condemnation efforts; that the HHA provide to lessees the appropriate assistance, the HHA responds:

“The Authority concurs in general with this recommendation, except for the coordinated strategies and efforts in the trial stage which is governed by Chapter 101, HRS. The Authority will seek an opinion from the Attorney General on coordinating strategies and efforts in the trial stage. The Authority believes the Legislature may need to clarify this issue.”

To our recommendation, which appears on page 21, left column of this report, that the HHA revise its rule to make it complete and understandable, the HHA responds:

“The Authority concurs with the basic intent of this recommendation and will review and take appropriate action.”

To our recommendations, which appear on page 24, right column of this report, that the HHA establish criteria for (1) ownership of fee simple residential land, (2) “proof of funds,” and (3) the making of appraisals, the HHA responds:

“1. The Authority concurs with this recommendation and will take appropriate action.

“2. The Authority will review and clarify.

“3. The Authority believes that any attempt to utilize a formula for appraisals will be declared unconstitutional. We will review, however, the interrelationship of values for negotiations and commitment amounts. No consideration will be given to determine final prices on condemnation since this is solely for a court to determine.”

Our comment with respect to item 3 is that our report does not propose that a “formula” for appraisals be established by law but that HHA should develop strategies and methodology of appraising for the purpose of advocating a price. Of course, final prices are matters for court determination.

Chapter 5 – The Organization and Operations of the Hawaii Housing Authority

To our recommendation, which appears on page 26, right column of this report, that the HHA’s organization charts and functional statements be updated, the HHA responds:

“The Authority’s organizational charts and functional statements are currently under review and near finalization for submission to the DSSH’s personnel section for review and comment. Following that review, they will then be submitted to Budget and Finance, and the Governor for approval, thereafter to the Department of Personnel Services.”

To our recommendations, which appear on page 27, right column of this report, that the HHA clarify the roles of the top administrators for the program, the HHA responds:

“The assignment of the Assistant Executive Director on December 1, 1980 was for the purpose of assisting in the review of the land reform branch on its procedures and operations. The Authority will take formal steps to amend the position descriptions for the two positions as appropriate.”

To our recommendations, which appear on page 29, right column of this report, that the HHA, (1) “undertake a comprehensive review of its staffing needs” for the program, and (2) “review the job descriptions and classifications of the technician positions,” the HHA responds:

“1. The Authority has undertaken a review of its staffing needs which should be completed in the next 90 days.

“2. The Authority concurs with this recommendation.”

To our recommendations, which appear on page 31, right column of this report, that the HHA (1) “Develop work manuals and written instructions,” (2) “establish a uniform filing system,” (3) “establish a uniform system for monitoring the progress of conversion,” and (4) “Establish a system for reporting on the progress of the land reform program,” the HHA responds:

“1. On July 1, 1981, the Land Reform Administrator was assigned the task of developing work manuals and written instructions to guide the work of the staff of the land reform branch. A first draft has been completed and is in the process of review and finalization.

“2. The Authority concurs with this recommendation and a uniform filing system has been established. A written procedure will be incorporated in the work manual.

“3. A system for uniform monitoring has been established and is currently under review for updating. (Refer to Attachment 2.)²

“4. The Authority has completed a status review on January 21, 1982 and will incorporate in its annual report the progress of the land reform program as a whole in a more detailed manner.”

2. This attachment is identical to Exhibit B (referenced in HHA's February 9, 1982 letter), which is reprinted in this section of the report.

Chapter 6 – Financial Management of the Land Reform Program

To our recommendations, which appear on page 36, right column of this report, that the HHA take immediate steps to: (1) "Define what costs of the land reform program are to be borne by the lessees" and (2) "Develop accounting procedures that support and implement the definitions," the HHA responds:

"1. The Authority implemented on July 1, 1981 a determination that all costs except those involving constitutional questions shall be borne by the lessees. On July 1, 1981 costs were segregated by direct cost (tract related) and indirect (administrative, non-tract related) in detailed categories (i.e., legal, appraisal, advertising, etc.). The Authority, however, will review this determination and adopt a formal policy if necessary with regard to costs to be borne by the lessees.

"2. On July 1, 1981, the Authority established a system that accounts for direct and indirect costs (through a timekeeping system) which is able to provide data on a unit level. The Authority will review this procedure and adopt a policy if necessary."

To our recommendation, which appears on page 37, left column of this report, that "the Legislature require the HHA to return to the state general fund, all funds currently in the fee simple revolving fund," the HHA responds:

"The Authority does not concur with this recommendation due to the 7,470 lots now in various stages of the conversion process. However, the Authority will consult with the Director of Budget and Finance, the Governor, and the Legislature on this recommendation."

Our comment is that the bulk of the \$1.7 million currently in the fee simple revolving fund was derived from a \$1.3 million appropriation made by the Legislature in 1975 for the specific purpose of acquiring a development tract to test the constitutionality of the land reform law. Since the appropriation was never used for the specific legislative purpose and there are no plans for such use, we maintain that funds which are no longer needed to finance the acquisition of development tracts or to pay for the costs of administering the land reform program should be returned to the state general fund.

To our recommendations, which appear on page 39, right column of this report, that (1) "The HHA develop a financial planning and budgeting system" and (2) "The HHA present accurate information on expenditures, sources of funding and program activities in its budget requests to the Legislature," the HHA responds:

"1. The Authority concurs with this recommendation. On July 1, 1981, the Authority implemented a cash flow system to forecast needs. In addition an internal budgeting system was established on July 1, 1980 for this branch which brings it in line with other Authority branches and sections. This budgeting accounts for both the general and special fund needs.

"2. We believe this recommendation should be reworded to state 'HHA present *detailed* information on expenditures.' Based on the word *detailed*, the Authority concurs with this recommendation and will present more detailed information in the next executive budget submission to the Legislature.

Our comment on item 2, is that while more *detailed* information on expenditures is desirable, the information should also be accurate, and we maintain, as documented in our report, that HHA has not provided the Legislature with accurate information.

To our recommendations, which appear on page 41, right column of this report, that (1) All deposits "be deposited to the fee simple revolving fund and all interest earned on the deposits be credited to the fund," (2) There be an accounting made to the lessee, (3) "The HHA institute a control system over the deposits," and (4) "The HHA comply with State purchase order procedures," the HHA responds:

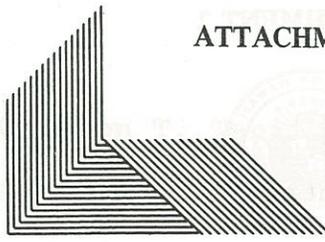
"1. The Authority will request an opinion of the Attorney General as the current process does not impose a fiduciary responsibility on the Authority. If the recommendation is implemented, the Authority believes a fiduciary responsibility may be imposed upon the Authority. This recommendation may require legislative action.

"2&3. If Recommendation No. 1 is implemented, we concur with Recommendations No. 2 and No. 3. The approximate cost recently obtained from a CPA firm to implement Recommendations No. 2 and No. 3 is \$130,000 to \$150,000, not including equipment and ongoing personnel costs.

"4. The Authority concurs with this recommendation. The existing purchasing system was established in 1975. Section 2.100 of the purchasing manual requires purchase orders to be executed prior to the ordering of goods and services. The land reform branch is required to execute purchase orders in accordance with this section."

ATTACHMENT 1

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
465 S. KING STREET, RM. 500
HONOLULU, HAWAII 96813
(808) 548-2450



CLINTON T. TANIMURA
AUDITOR
RALPH W. KONDO
DEPUTY AUDITOR

January 26, 1982

COPY

Mr. Wayne Takahashi
Chairman of the Commission
Hawaii Housing Authority
1002 North School Street
Honolulu, Hawaii 96817

Dear Mr. Takahashi:

Enclosed are 12 copies, numbered 4 through 15, of our preliminary report on the *Management Audit of the Leasehold to Fee Conversion Program of the Hawaii Housing Authority*. Copies of this preliminary report have also been transmitted to the Governor and the presiding officers of the Legislature, and to Mr. Franklin Y. K. Sunn, Director of the Department of Social Services and Housing.

Since the report is not in final form and changes may possibly be made to it, access to this report should be restricted to the Commissioners and those staff members whom you might wish to call upon to assist you in the review of the report. Public release of the report will be made solely by our office and only after the report is published in its final form and submitted to the Legislature.

The report contains a number of recommendations. If you have any comments on the recommendations, we ask that you submit them in writing to our office by February 9, 1982, for inclusion in the final report.

We appreciate the assistance and cooperation extended by the Authority to my staff.

Sincerely,

Clinton T. Tanimura
Legislative Auditor

Enclosures

cc: Mr. Paul Tom, Executive Director
Hawaii Housing Authority

ATTACHMENT 2

GEORGE R. ARIYOSHI
GOVERNOR



PAUL A. TOM
EXECUTIVE DIRECTOR

STATE OF HAWAII
DEPARTMENT OF SOCIAL SERVICES AND HOUSING
HAWAII HOUSING AUTHORITY
P. O. BOX 17907
HONOLULU, HAWAII 96817

IN REPLY REFER

TO: 82:LR/517

February 9, 1982

RECEIVED

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OFF. OF THE AUDITOR
STATE OF HAWAII

The Honorable Clinton T. Tanimura
Office of the Legislative Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

This will acknowledge your letter of January 26, 1982 and copies of your Preliminary Report on the Management Audit of the Leasehold to Fee Conversion Program of the Hawaii Housing Authority.

Enclosed is copy No. 1 of your preliminary report with the Authority's comments to the recommendations contained in your report.

The following are the Authority's comments on a number of your summary of findings:

1. Chapter 3 - Summary of Findings (Pg. 3-1)

The Authority's review of factual accomplishments does not support your findings, especially the characterization "utter neglect." Enclosed as Exhibit "A" is a schedule for the Fiscal Years 1976-80 showing a total of 3,481 lots converted for that period. In addition Exhibit "B", attached, Status Report of December 31, 1981, reflects the total number of tracts in the various stages of the conversion process: 54 tracts totaling 7,470 lots. Based on these accomplishments and with constitutional questions still pending before the court, the Authority can hardly be described as failing to plan for the implementation of the Land Reform law.

2. Chapter 4 - In General

The Authority's review of this chapter notes a continual inference that the Authority should be the lessees' advocate in the leasehold to fee conversion process. As an example, on page 4-8, paragraph 2, "...have prompted lessees to perceive that HHA would be an advocate of and would act as an agent of the lessees..." Based on current statutes, the Authority is unable to find by inference or otherwise that the Authority should act as an advocate for the lessees.

The Authority understands its role as that of implementing and administering the law as adopted by the Legislature in a fair and equitable manner. The Authority believes that if it is the intent and policy of the Legislature that the Authority act as an advocate, then the law should be amended to clearly denote that assignment and responsibility.

3. Chapter 4 - Summary of Findings (Pg. 4-1)

a. Your finding, "The HHA rule on the land reform program lacks clarity and is incomplete." The most recent rule adopted by the Authority was revised and prepared in conjunction with the Attorney General's office. It was suggested by the Attorney General's office that the rule be kept simple to avoid constitutional challenges.

b. Your finding for determining criteria is not based on fact and ignores the law enacted by the Legislature which sets out qualifying requirements.

c. Your finding for determining value is contrary to the recent federal court decision which struck down as unconstitutional any attempted formula by legislation or by rule to determine fair market value.

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4. Chapter 6 - Table 6.2 (Pg. 6-11)

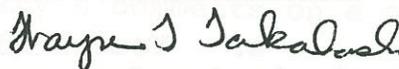
This table implies that the Authority should have reflected seven position counts. However, in accordance with Budget and Finance's June 17, 1980 memorandum for preparation of the executive budget, the following is quoted:

"Position Counts - Enter the position counts of authorized positions funded by the means of financing... These position counts should not include part-time, project funded, temporary or other positions not permanently authorized."

In closing, the Authority believes a number of your Summary of Findings and related statements to be misrepresentative of the facts and fails, for example, to take into account Federal and State court rulings or Chapter 101, HRS, on the eminent domain process.

We thank you for the opportunity to comment on your report.

Sincerely,



WAYNE T. TAKAHASHI
Chairman

Enclosures

cc: Governor George R. Ariyoshi
Director, Franklin Y. K. Sunn, DSSH
Executive Director, Paul A. Tom, HHA

LAND REFORM CONVERSIONS BY FISCAL YEARS

<u>Fiscal Year 1976-1977</u>	<u>Fiscal Year 1977-1978</u>	<u>Fiscal Year 1978-1979</u>	<u>Fiscal Year 1979-1980</u>
Niu Valley 178	Niu-Peninsula- Niu Valley 55	Makakilo 150	Waialae-Kahala 786
Robinson Heights 145	Makakilo 822	Harbor View 229	Leeward Estates 572
	Puulena 30	Crestview/ Seaview 60	Crestview/ Seaview 150
			Olomana 103
			Wahiawa Park 210
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TOTALS 323	907	439	1,812

Total lots converted from July 1, 1976 to June 30, 1980 = 3,481

DEC 31 1981

LAND REFORM BRANCH

Monthly Status Report

Tract Name	Petition	Public Hearing	Designation	Litigation		Voluntary	Involuntary	No. of Applicants	Total Lots	Lots Not Participating
				Suit Filed	Trial Set					
Aikahi Park	X	12/18/80	12/18/81				X	124 (D)	283	159
Aina Lunalilo	X	X	X	3/21/80			X	57 (D)	80	23
Aina Koa Subd.	4/81	6/23/81					X	20	29	9
Awakea Tract	X	X	6/26/81				X	44 (D)	137	93
Crown Haiku	10/81	12/9/81					X	24	39	15
Dune Circle	X	X	X	5/7/80	6/82		X	23 (D)	40	17
Enchanted Hills	X	X	X	8/81			X	24 (D)	43	19
Enchanted Lakes	2/81	6/16/81					X	833	1,665	832
Ewa Lani Homes	X	X	2/27/81 5/15/81	3/13/81			X	78 (D)	124	46
Hahaione Valley	X	X	X	9/23/80	10/04/82		X	227 (D)	565	338
Haiku Park	10/81	12/9/81					X	53	113	60
Haiku Plantations	12/81						X	29	194	165
Haiku Village	X	X	X	8/81			X	76 (D)	234	158
Halawa Hills	X	X	X	8/81			X	218 (D)	438	220
Halawa Valley	X	X	X	8/81			X	138 (D)	252	114
Kaaawa	X	3/6/80					X	141	222	81

EXHIBIT "B"

Monthly Status Report

Tract Name	Petition	Public Hearing	Designation	Litigation		Voluntary	Involuntary	No. of Applicants	Total Lots	Lots Not Participating
				Suit Filed	Trial Set					
Kahala Beach	X	X	X	1/30/81	9/20/82		X	85 (D)	151	66
Kahala Sub. Ext.	X	X	X	1/30/80	(Settled)		X	76 (D)	164	88
Kahanahou Circle	X	X	X	4/30/80	7/12/82		X	45 (D)	81	36
Kahauloa-Keawaiki (Kona)	12/81						X	10	17	7
Kai Nani-Waialae Beach	X	X	X	8/81			X	32 (D)	49	17
Kaiholu Subdivision	X	7/9/80				X		14	14	0
Kaimalino Subdivision	2/81	5/21/81				X		78	115	37
Kainalu Park	X	11/20/80				X		11	11	0
Kalaheo Subdivision	X	X	8/27/81			X		86 (D)	600	514
Kalaheo Hillside Sub.	X	9/30/80	9/18/81			X		217 (D)	511	294
Kalama Valley	X	2/22/79					X	167	813	646
Kamiloiki Valley	X	X	X	12/19/80	3/22/82		X	257 (D)	515	258
Kaonohi Ridge	X	X	X	3/27/81	10/04/82		X	188 (D)	293	105
Keapuka	X	7/12/79				X		323	616	293
Koko Head	X	X	X	5/7/80; 7/25/80			X	465 (D)	749	284
Kuulei II	X	X					X	59	259	106
Kuulei Tract	X	7/5/79	9/18/81			X	94 (D)			
Laie/Hauula	X	1/31/79					X	113	346	233

Monthly Status Report

Tract Name	Petition	Public Hearing	Designation	Litigation		Voluntary	Involuntary	No. of Applicants	Total Lots	Lots Not Participating
				Suit Filed	Trial Set					
Lunalilo Marina	X	2/22/79					X	30	163	133
Lunalilo Park	X	X	X	10/24/80	7/26/82		X	438 (D)	688	250
Manoa Acres	X	X	X	1/9/80	2/22/82		X	42 (D)	42	0
Mariner's Ridge & Cove	X	X	X	2/2/81	5/24/82		X	266 (D)	839	573
Maunalua Beach	X	X	X	10/14/80	11/01/82		X	80 (D)	135	55
Maunalua Triangle	X	X	X	3/4/81	4/26/82		X	257 (D)	495	238
Maunawili	X	X	X	7/18/80	9/06/82		X	96 (D)	257	161
Niu Peninsula/Valley II	X	12/4/79; 2/10/81	X	10/16/81		X		41 (D)	112	71
Parish Estate	X	X	7/24/81	11/13/81			X	25 (D)	49	24
Parish 007 Tract	5/81						X	16	25	9
Pikoiloa	X	8/30/78				X		233	729	496
Pohakupu/Kukanono	X	3/10/80				X		140	391	251
Puohala Village	2/81	8/26/81				X		131	296	165
Spinnaker Isle	X	X	6/26/81				X	47 (D)	92	45
Waialae Iki Ridge	X	4/2/81					X	360	624	264
Waialae-Isenberg	X	X	X	8/28/80	(Settled)		X	36 (D)	127	91
Waialae Nui Ridge	X	X	X	7/81	10/18/82		X	311 (D)	469	158

Monthly Status Report

Tract	Petition	Public Hearing	Designation	Litigation		Voluntary	Involuntary	No. of Applications	Total Lots	Lots Not Participating
				Suit File	Trial Set					
Waialae Nui Valley	X	X	X	3/27/81	6/14/82		X	218 (D)	262	44
Waiau View Estate	X	2/27/80					X	123	468	345
West Marina	X	X	X	10/06/80	9/06/82		X	151 (D)	275	124
							TOTALS	<u>7,470</u>	<u>16,300</u>	<u>8,830</u>

Tract Status:

1. Tracts not designated 21 (2,908 lots)
2. Designated 33 (4,562 lots)
3. Awaiting trial 24 (3,797 lots)
4. Voluntary tracts 6 (550 lots)
5. Complaints to be filed 3 (215 lots)

Total lots (participating) - 7,470
 Total lots (non-participating) - 8,830
 TOTAL 16,300

(D) indicates the number of lots actually designated to date.