

BUILDING PERMITS PROCESS, PROBLEMS AND FISCAL IMPLICATIONS

INTRODUCTION

Single-family home construction and remodeling require a permit prior to start of construction. Issuing permits is under the authority of the Planning and Building Department (“Building Department”) of the appropriate local government (city or county). This report will focus on two distinct but important issues:

- A. The permit process can provide protection for the home builder/remodeler and minimize problems.
- B. The permit process has fiscal implications for the county and cities due to the recent reduction in permit fee revenues a result of fewer housing starts.

METHOD

Many public officials and organizations were interviewed and their web sites reviewed as part of this report. Please refer to APPENDIX A for a detailed list. The 2006-2007 Grand Jury investigated some of these same issues but did not publish a report. As part of the current Jury’s investigation, all information gathered by the previous Jury has been independently verified. Pertinent internet web sites were also consulted.

NARRATIVE

A. THE PERMIT PROCESS – CAUTIONS FOR THE APPLICANT – CAVEAT EMPTOR (BUYER BEWARE)

Three current civil court cases reveal problems that can occur if a property owner is not experienced in construction, is not adequately informed, or is not diligent during the building or remodeling process. While these examples are based on actual cases, which are public record, the names have been changed for our purposes.

Case #1: (No permit, unlicensed contractor, no written contract):

John and Mary agreed with Bob Builder that Bob would remodel their home. The job was to convert a garage into another room, and included framing, roofing, painting, and other related work. Bob told John he has been a builder for a long time. After the job was complete, the rains came and the roof leaked damaging much of the interior finishes and furniture. John and Mary also noticed that the walls moved when doors were opened and closed. Gradually, the wall movement worsened. John and Mary feared the roof would collapse and decided to complain to the Building Department because they could not get satisfaction from Bob. They were told by the Building Department there was no record of their remodel. A building inspector came to the house and condemned it as unfit for occupancy. Bob was not a licensed contractor and he had not obtained a building permit. John and Mary sued Bob claiming their verbal agreement was illegal and fraudulent. John and Mary have little hope of recovering damages because Bob has limited financial resources, is not licensed nor insured. Bob's defense is that he agreed to be employed by John as a construction worker. He has threatened to countersue and file a lien on the property. John and Mary have mounting legal fees, penalties from the Building Department and the cost of repairing the defective construction. The case is still pending in the courts.

Case #2: (No permit; unlicensed contractor):

Joe decided to build a new house. He diligently checked out material costs at the local lumber and hardware stores, asking many questions about quantities needed and alternate materials that could be used. He talked to several construction workers asking what they would charge for the

type work he needed done, including electrical, plumbing and framing. Mark was a painting subcontractor—at least that’s what the sign on his pickup claimed. Joe agreed to pay Mark \$2,000 monthly plus costs of materials and labor. Mark agreed to act as Joe’s contractor and control the entire construction process. Mark hired workers as the job required and Joe paid them the amounts that Mark told him. The house was completed and Mark presented Joe with his final bill. Joe refused to pay because he was not happy with the quality of the work and the total cost of the project. Joe had already paid several thousand dollars over the estimates initially discussed. Joe had assumed these were fixed amounts but Mark disagreed. Mark sued and filed a lien on Joe’s house. In the pre-trial process it was revealed that Mark did not have a contractor’s license and the verbal contract was illegal based on case details. In addition, no permit had been obtained for the project. Just before trial, the parties settled out of court. In addition to the stress and aggravation of the entire situation, Joe now has to deal with the cost of penalties and fines. In addition to the fines imposed by the Building Department for not having a permit, Joe has to bring the various defects up to code.

Case #3: (Permit obtained; licensed contractors; written contract):

Henry and Jane planned to build a large hillside home and contracted with an architect to develop the plans. Once the plans were complete, Henry contracted with a soil analysis firm to perform required soil tests. Laboratory reports from the soil analysis showed acceptable soil conditions and called for minimum foundation specifications.

A well-advertised and licensed general contractor was selected to build the house. The total construction contract was \$500,000. The house was completed and Henry and Jane moved in. Shortly thereafter moisture appeared on most of the walls and the floors began to buckle. An earthquake struck in the area and the house and slope slid several inches. Henry had already started a lawsuit because of the moisture and problems with the floors. He sued the architect, the contractor, and the soil analysis firm. The trial court awarded Henry and Jane damages of \$1,800,000 against the three defendants. Even with a permit and written contracts, Henry and Jane suffered great emotional anxiety and inconvenience. However because they had the necessary documents, with their jury award, they were able to recover the cost of resolving all the building problems. Final settlement is still pending.

Examples of Civil lawsuits Involving Construction and Remodeling Problems:

Approximately fifty civil cases have been initiated in San Luis Obispo (SLO) County since January 2006 involving new home construction, remodeling problems, the lack of permit or written contract where the builder was the owner. Other cases involving claims such as breach of contract, unpaid debts, and incomplete work amount to four times this number. The claim amounts in the most germane fifty cases range up to \$1,800,000. Each of these plaintiffs has certainly learned the full meaning of the ancient Latin phrase, *Caveat Emptor*, Buyer Beware. Although the number of cases may seem small, the total estimated dollar amount of the damages is in excess of \$15,000,000.

Some non-established contractors and subcontractors (those new in the business) meet the pressures of competition by presenting bids at reduced prices. To meet the low bids these contractors may hire inexperienced and, in some cases, undocumented workers. Also some contractors may not obtain proper workers' compensation, business insurance, and the statutorily required operating permits.

The Permit Process for Owner/Builders:

An owner/builder is a property owner who acts as his or her own general contractor, builds or improves the property, obtains his or her own building permits and does the work themselves or through their own employees. An owner/builder assumes responsibility for the overall job which may include, but is not limited to, taxes, insurance, and other liabilities. It is best to hire a licensed contractor who is legally qualified to do the work.

The permit application process requires that the applicant present a set of plans for the project to the County's Building Department (unincorporated areas) or to the city having jurisdiction. Any owner/builder that applies for a permit is required to sign an application form that states the applicant has read the cautionary form attached to the application. However, the permit staff does not verify the form has been read. This form summarizes the responsibilities and risks of the owner/builder. Also, the County's Building Department does not provide informational brochures to those seeking owner/builder permits.

The Contractors State License Board (CSLB) provides Building Departments with brochures describing the legal and financial risks associated with owner/builder permits. Owner/builders should obtain and read these brochures. Paso Robles Planning and Building Department provides these brochures to owner/builder's seeking permits

The SLO County Planning and Building Department has an extensive and informative web site that includes cautionary information. The public has access to a "public information computer" located in the public research area of the permit issuing office. When the applicant obtains the required permit they are then authorized either to do the work themselves or hire contractors.

Once the construction begins, building inspectors verify that the work meets the California Building Code as well as all Municipal Codes at various stages of construction. Generally, a building inspector will review up to eight stages of the construction process. If a particular stage is unacceptable to the inspector, a correction notice is posted addressing the deficiency. If corrective action is not taken, the inspector "red tags" the project, which stops the project and it may not continue until the deficiency has been corrected. Upon satisfactory completion of the project and all required inspections, an occupancy permit can be issued.

The owner/builder may believe that a building permit is "just red tape" and only adds cost and delay to the project. It is, of course, true that the permit process requires additional time, effort, and perhaps, significant cost. Having built or remodeled a home with the proper permits and associated building protocols, the value of the home could increase and possible legal or financial issues could be avoided when attempting to sell.

Property owners may mistakenly believe the contractors or the building inspectors are responsible for a quality-built home or remodel. These beliefs may be false and could prove costly for the property owner. The County (and city) building officials are responsible for:

1. Reviewing requests and issuing permits for all construction,
2. Checking building plans,

3. Conducting on-site inspections,
4. Referring the permit application for other agency review, and
5. Issuing the final permit and certificate of occupancy.

The inspector's job is to check for code compliance with adopted minimum standards. These checks are not to ensure the quality of construction.

Problem Avoidance:

Problems and risks, both legal and financial, are minimized by taking the following precautionary steps before and during construction.

- ***Use written contracts.*** Problems may occur if the contracts are not in writing. The use of competitive bidding often provides the advantage of making the contract more clearly defined since the competitors need to know in advance what is expected of them if they are to be awarded the contract. Reputable contractors generally will specify just what their obligations are for the project.
- ***Hire licensed contractors.*** For the property owner's protection, the CSLB recommends using only licensed contractors. If an owner uses a licensed contractor and has a complaint, the CSLB has the authority to investigate the complaint. By law, anyone who contracts or bids for a construction project valued at \$500 or more (total labor and materials) must be licensed by the CSLB. Project owners may not be aware that certain trades are regulated and require licensed contractors to do the work. Check out every contractor being considered by getting references.
- ***Contact CSLB*** either by phone at (800) 321-2752 or by utilizing the CSLB web site (<http://www.cslb.ca.gov>). The information requested from CSLB should include: contractor license status, workers' compensation insurance status and any disciplinary actions and any civil judgments against the contractor.
- ***Obtain an owner/builder permit.*** While it is legal for a homeowner to act as an

owner/builder, the CSLB recommends that, “unless the property owner is very experienced in construction, it is best he hire a legitimate licensed expert”. Property owners acting as owner/builder should be aware that contractors may encourage them to obtain an owner/builder permit. According to the CSLB, this is generally because the contractor is not licensed or does not possess the required workers’ compensation insurance for his employees. If the project owner signs the permit he could be responsible for the taxes, insurance, and liability exposure.

- ***Avoid mechanics liens.*** Anyone who helps improve one’s property, but is not paid, may record a mechanics lien against the property. Even if the contractor is paid in full, unpaid subcontractors, suppliers and laborers who help to improve a property may record mechanics liens and sue in court to foreclose the lien. Generally, a property with an unresolved lien cannot produce a marketable title of sale. A property owner could be forced to pay twice for the work performed or have a court officer sell the home to pay the lien. A building owner can protect himself from unwarranted liens by carefully selecting contractors and responsibly managing the construction project. This is done by investigating the prime contractor before signing a contract. All trades should provide a lien release, as should each supplier of building materials. The property owner should obtain a lien release from the contractor or sub-contractor who performs the work prior to making final payment.

B. FISCAL IMPACT OF REDUCED PERMIT & PROPERTY TAX REVENUES

The collapse of the sub-prime loan market has resulted in a growing problem of reduced permit revenues, slumping property taxes, vacant houses, depressed property values, tighter credit, and a need to cut services to close government budget gaps. What was, for several years, a booming housing construction market in San Luis Obispo County has now given way to a large drop in new home construction, home prices, and sales volume.

In our sample cities the fall in housing starts has been similar to the national average (approximately 50%). Building permits issued for single-family homes in Fiscal Year (FY) 2006-2007 decreased 55% in San Luis Obispo County, 49% in Atascadero and 75% in Paso Robles. Fewer building permits issued from these cities translate into reduced property taxes and permit revenues. Reduced property tax revenues adversely impact general fund revenues and lower permit revenues affect the operating budgets of planning and building departments and other agencies.

The impact of reduced revenues from building permit fees is far-reaching. Local schools, for example, have taken a large hit to their operating budgets. School fees are assessed separately and are not part of the permit fee. Development impact fees (impact fees) represent approximately 50% of the combined permit and impact fee cost for new single family homes. Impact fees provide funds for roads and bridges, parks, storm drains, open spaces, fire protection, law enforcement, libraries and other government services.

The San Luis Obispo County Board of Supervisors is aware of this serious budget deficit. As stated in the FY 07/08 County final budget introduction:

- “Fee Revenues derived from land use related activities (e.g. building permits) have declined significantly. As a result, the General Fund contribution to the Planning and Building Department will increase almost \$3 million next year - a 79% increase over the current year - simply to maintain a ‘*status quo*’ budget.”
- “In recent years, property taxes - the County’s main source of discretionary revenue - have benefited from the housing boom. We are now seeing a slower rate of growth and, for the first time in years, annual increases in this key revenue source may fall below 10%. Additionally, property transfer tax receipts have declined substantially, reflecting decreased activity in the real estate market.”

New funding for capital and maintenance projects within the County will decline dramatically in FY07/08 (by approximately \$12 million) as money available in previous years for these items has been redirected to pay existing operational costs. It should be further noted that, because the time required from start to completion of any construction process, the issuing authority must be

adequately staffed to perform the requisite code inspections regardless of any revenue decreases from the lack of new permit applications.

The table below shows falling building permit activity and the resultant dollar impacts on planning and building department budgets, impact fees, and schools.

BUILDING PERMIT ACTIVITY AND FEE IMPACTS							
Agency	Building Permit Activity (Single-Family)			Average Permit Fee ('06-'07)	Total Lost Revenue ('06-'07)	Lost Impact Fees ('06-'07)	Lost School Fees ('06-'07)
	'04-'05	'05-'06	'06-'07				
SLO County	1101	1037	570	\$12,203	\$5,689,801	\$2,906,389	\$4,255,771
Atascadero	359	306	151	\$22,837	\$3,539,735	\$1,982,252	\$859,248
Paso Robles	287	181	45	\$42,314	\$5,754,704	\$2,819,805	\$879,104

Note: Losses shown in this table may be off-set by other permit revenues for the same period.

Other permit revenues include: multi-family units, commercial/public, residential and commercial additions and alterations, grading, demolition, and others. Single family building permits issued for FY 2006 - 2007 represented only

- 20% of all permits issued in SLO County
- 18% of all permits issued in Atascadero
- 7% of all permits issued in Paso Robles

Single family building permit activity in Paso Robles is lower by 66% and 75% respectively in FY 05-06 and FY 06-07. As reserve funds accumulated by these various agencies are reduced because of consecutive years of falling permit revenues, operations budgets may be impacted and planned capital projects funded by impact fees may be eliminated, delayed, or reduced in scope. School fees in San Luis Obispo County have also taken a substantial financial hit in FY 2006-2007 due to reduced permit activity. (See table above.)

Falling permit revenues from lack of new home construction will continue to have adverse affects on building departments and other agencies. The 2008 forecast is for slower growth and continued risks to the economy from housing and credit markets.

Permit Fee Determination SLO County, Paso Robles, Atascadero

San Luis Obispo County Planning and Building Department calculates permit fees based on a pre-set schedule that is not directly related to the department's operating costs. As a result, the San Luis Obispo County Supervisors allocate general funds to make up for any costs in the Planning and Building Department's budget not covered by annual revenues. San Luis Obispo County has allocated general funds to cover 50%+ of the budget of the Planning and Building Department for fiscal year 2007-2008. During this same period the number of single family residents permits processed has decreased 55% but the number of employees in the Department has remained stable.

In contrast, the Paso Robles Building Division uses a "cost recovery" system that establishes the cost of each permit based on the current cost of operations. In effect, this system has the department "pay its own way."

The Atascadero Planning and Building Department uses a different cost recovery method to calculate permit fees. Calculations are based on average yearly permit activity. Atascadero Planning and Building Department also uses contract labor for the time consuming plan check items such as building plan checks and engineering code compliance. This enables the department to maintain a consistent headcount of about 12 people and cut back on contract labor when permit activity slows.

The difference in the approach by the County compared to Atascadero and Paso Robles is clear by comparing average permit fees. The county average permit fees in FY 06-07 for single family homes was only \$12,203 resulting in total lost revenue of \$5,689,801. The county makes up this revenue shortfall from the general fund (see table above.).

Remodels, Additions and Alterations

Permit activity for re-models, additions, and alterations, was down only slightly in recent years. In Atascadero permits issued for remodel activity were down from 40 in F/Y 2005-2006 to 34 in F/Y 2006-2007. In San Luis Obispo County, residential additions and alterations were down from 551 in F/Y 05-06 to 538 in F/Y 06-07.

The revenue received from owner/builder remodeling, additions and alterations permits represents approximately 7% of the revenues received from new home construction. The average permit fee for remodels in Atascadero was \$1,534 in F/Y 2006-2007 compared to \$22,837 for new home permit fees.

Because remodels/additions/alterations permits issued remained about the same, the revenue difference was insignificant. Therefore, for the three agencies reviewed from F/Y 06-07, revenue impacts from remodels/additions/alterations permits were not calculated for this report.

Performing Construction/Remodeling Without Permits

Based upon our review of legal cases dealing with construction issues, more remodeling projects are performed without obtaining a permit when compared to new home construction. While our review did not attempt to quantify lost revenue from work being performed without permits, revenues are being lost because of non-permitted work. Two of the three actual case studies presented above identified projects that were done without permits. Issued permits also trigger the actions of the appraisal and tax departments. Thus, when work is done without a permit, the tax revenue will be impacted.

Perhaps Building Department Inspectors could be more diligent in spotting, reviewing and reporting projects that are being done without permits. This could be achieved if the inspectors' used hand-held computer to access data rather than using printed or oral instructions. As building inspectors are assigned to inspect a specific property, they could observe home sites in the area that may indicate construction is about to begin e.g. building materials stacked in the driveway or yard. Inspectors could enter the address into the computer and determine, real time,

if a permit had been obtained for that address/project. The Paso Robles Code Enforcement Division does look for un-permitted work being performed when inspecting other properties.

FINDINGS

1. The County Building and Planning Department does not adequately inform property owners obtaining an Owner/Builder permit about the construction quality, legal and financial risks associated with these permits.
2. The County and cities may derive financial benefit by adopting procedures that discover non-permitted work and calculate the impact on permit fees and taxes. The Paso Robles Code Enforcement Division is currently checking for un-permitted work being performed
3. We were informed by a County Planning and Building official during fact check that beginning in fiscal year 2008-2009, permit fees will be based on a “cost recovery” system related directly to the department’s operation budget.

RECOMMENDATIONS

1. The County Planning and Building Departments should include a CSLB pamphlet on the legal and financial risks associated with Owner/Builder permits in every property owners permit package. (Finding #1)
2. The County and Cities should evaluate the financial benefit of identifying non-permitted work and its impact on permit fees and taxes. (Finding #2)

REQUIRED RESPONSES

Responses to the recommendations are required from the following:

- Recommendation 1 –
 - San Luis Obispo County Board of Supervisors
 - San Luis Obispo County Planning and Building Department
- Recommendations #2 –
 - San Luis Obispo County Board of Supervisors
 - San Luis Obispo County Planning and Building Department
 - Atascadero Planning and Building Department
 - Atascadero Board of Supervisors

All responses shall be submitted to the Presiding Judge at the San Luis Obispo Superior Court by **October 28, 2008**. Please provide a copy to the Grand Jury as well. The mailing addresses for delivery are:

Presiding Judge	Grand Jury
Presiding Judge Martin Tangeman Superior Court of California 1035 Palm, Room 385 San Luis Obispo, CA 93408	San Luis Obispo County Grand Jury P.O. Box 4910 San Luis Obispo, CA 93403

APPENDIX A

INDIVIDUALS, SOURCES AND ORGANIZATIONS CONSULTED

- A. This report utilized portions of the 2006-2007 Grand Jury's investigation of the same general topic. Independent investigations were conducted to verify the data used in this report.
- B. Actual San Luis Obispo (SLO) County civil cases filed in Superior Court of San Luis Obispo were reviewed to identify the issues that property owners may encounter.
- C. San Luis Obispo County, Atascadero and Paso Robles Building and Planning websites were used to gather permit and budget data.
- D. Interviews were conducted with planning and building officials from San Luis Obispo County, Atascadero and Paso Robles.
- E. CSLB web site summary review (<http://www.cslb.ca.gov>)
- F. The CSLB protects consumers by licensing and regulating California's construction industry. There are more than 310,000 licensed contractors in the state, in 43 different licensing classifications. The CSLB also investigates more than 20,000 complaints filed each year against both licensed and unlicensed contractors.
- G. The California Building Officials (CALBO) website (<http://www.calbo.org/>) was reviewed for consumer protection information. CALBO is a non-profit corporation dedicated to promoting public health and safety in building construction through responsible legislation, education and building code development.
- H. The San Luis Obispo 2007-2008 budget was consulted for data and the cited quotation.