



**U.S. Department of the Interior
Office of Inspector General**

ADVISORY LETTER

**MANAGEMENT ISSUES RELATED TO
THE COLLECTION OF DELINQUENT LOANS
AND PROPERTY TAXES BY THE DEPARTMENT
OF HAWAIIAN HOME LANDS**

**REPORT NO. 01-I-211
FEBRUARY 2001**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
CARIBBEAN REGION
ROOM 207, FEDERAL BUILDING
ST. THOMAS, VIRGIN ISLANDS 00802



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ADVISORY LETTER

Raymond C. Soon, Chairman
Hawaiian Homes Commission
P.O. Box 1879
Honolulu, Hawaii 96805

Subject: Management Issues Related to the Collection of Delinquent Loans and Property Taxes by the Department of Hawaiian Home Lands (No. 01-I-211)

Dear Chairman Soon:

During our followup audit (Report No. 00-I-500, issued in June 2000) on the status of recommendations contained in our March 1992 audit report on the Hawaiian Homes Commission, we identified opportunities for management to improve controls related to the collection of delinquent loans and property taxes. These issues are discussed in the paragraphs that follow.

DELINQUENT LOANS

Although the Administrative Rules of the Department of Hawaiian Home Lands (DHHL) contained general provisions regarding actions to be taken on delinquent loans, such actions were usually not taken because DHHL did not have detailed operating procedures to guide its employees and/or have sufficient staff assigned to collection efforts. This contributed, as of June 30, 1999, to 609 DHHL loans with outstanding balances totaling \$22.1 million that were delinquent an average of 26 months. In addition, DHHL was at risk of losing loan advances totaling \$1.4 million that were paid to lenders on behalf of delinquent borrowers. Also, we noted that DHHL may have lost \$9,134 because of overpayments made on behalf of lessees.

Section 214(b)(4) of the Hawaiian Homes Commission Act states that DHHL "may permit and approve loans made to lessees by government agencies or private lending institutions, where the department assures the payment of such loans; provided that upon receipt of notice of default in the payment of such assured loans, the department may, upon failure of the lessee to cure the default within sixty days, cancel the lease and pay the outstanding balance in full." Section 214(b)(5) of the Act states that DHHL "may secure, pledge, or otherwise guarantee the repayment of moneys borrowed by the department from government agencies or private lending institutions and pay the interim interest or advances required for loans." In addition, Title 10, Chapter 3, Section 47(i), of DHHL's Administrative Rules states,

"Whenever a borrower is delinquent with loan repayments, the department may demand that the borrower assign wages in part or all moneys due or to become due to such borrower by reason of any agreement or contract to which the borrower is a party, to the department to assure repayment of the loan." Further, Section 47(j) of the Administrative Rules states, "Whenever a borrower is more than one hundred twenty days delinquent on loan repayments, the department may start garnishment proceedings in accordance with the applicable statute, or start cancellation proceedings as authorized under the act."

Direct Loans

As of June 30, 1999, DHHL had 1,546 outstanding direct loans totaling \$50.1 million, of which 609 loans (39 percent) were delinquent for more than 60 days, as shown in Table 1. The average length of delinquency for these 609 loans was about 26 months.

Table 1. Summary of Loans Delinquent More Than 60 Days

<u>Number of Delinquent Loans</u>	<u>Number of Days Past Due</u>	<u>Total Amount Delinquent</u>
59	Over 60 days	\$2,205,545
33	Over 90 days	1,199,377
<u>517</u>	Over 120 days	<u>18,730,795</u>
<u>609</u>		<u>\$22,135,717</u>

We judgmentally selected for review 31 delinquent direct loans totaling \$1.9 million and found that none of the contracts for the loans in the sample included provisions for garnishment of wages. For example:

- In January 1996, DHHL learned that a lessee had died in December 1995. At the time of her death, the lessee had an outstanding direct loan totaling about \$36,498, of which \$2,541 had been delinquent for 8 months. In March 1996, DHHL contacted the lessee's designated successor to notify her that successorship documents were being prepared for her review and approval and to request that she submit a copy of the lessee's death certificate. The Commission approved the designation of successorship in April 1996. In December 1996 (12 months after the lessee's death), DHHL notified the successor of the loan delinquency (now totaling \$6,326) by a letter that also stated that the delinquency "is in direct violation of the terms agreed upon in your loan contract" and that "failure to make your monthly payments . . . is a violation of the Rules and Regulations of the Department and the conditions of your lease." Further, the letter asked the successor to "please call [a mortgage specialist] of the Loan Services Branch . . . within (10) working days from the date of this letter to discuss your account and if needed, schedule a conference. Failure to resolve your delinquency will result in a Contested Case hearing to determine why your lease should not be cancelled." In January 1997 (shortly after the delinquency notice was sent), the successor paid \$460 on the loan. DHHL subsequently issued three more notices to the successor, in July 1997, November 1997, and June 1998, concerning the loan delinquency. However,

DHHL had not taken any action to garnish the successor's wages, and as of June 30, 1999, the loan was 45 months delinquent in the amount of \$15,330.

DHHL's Mortgage Loan Specialists told us that sometimes they did not have the time to follow up on delinquent loans because they were also responsible for processing loan applications. The Administrator of the Homestead Services Division stated that the goal of DHHL was not to put the lessees out of their homes and that he instructed his staff to work very closely with the lessees to pay their delinquent loans. He further said, however, that because of a staff shortage in his division, the collection of delinquent loans had been adversely affected.

We also found that DHHL may have lost \$9,134 because of overpayments involving two loans as follows:

- In February 1993, DHHL entered into an agreement with a lessee to guarantee a Small Business Administration (SBA) loan granted to the lessee. The case file disclosed that in June 1993, SBA was notified that DHHL would guarantee the maximum amount of \$58,700. However, when the lessee defaulted on the loan, DHHL paid SBA \$64,052, which, according to a DHHL accountant, included accrued interest. In our opinion, the \$64,052 payment by DHHL represented an overpayment to SBA of \$5,352 (\$64,052 minus \$58,700).

- In another instance, although a lease was canceled in November 1997, DHHL did not have the home appraised until February 1999. The lessee accepted the appraisal in August 1999, at which time DHHL paid the lessee \$6,890 (the appraised value of \$60,500 minus the outstanding balance of a direct loan and property taxes totaling \$53,610 as of November 1997). The lessee continued to live in the home at no cost until October 1999. In our opinion, the lessee should have been paid only \$3,108 (\$60,500 minus the outstanding balance of a direct loan and property taxes totaling \$57,392 as of February 1999, when the appraisal was completed). DHHL's Fiscal Management Officer stated that DHHL had subsequently established procedures to be used when the sale of a home occurs. However, those procedures would not have addressed the circumstances of this case.

Loan Guarantees

As of June 30, 1999, DHHL had made loan advances of approximately \$1.5 million for 115 Hawaiian Home Land lessees who were delinquent on their loan guarantees and had routinely made loan advances on delinquent loan guarantees without requiring that lessees enter into repayment agreements with DHHL. For example, DHHL did not bill a lessee for an SBA loan guarantee totaling \$52,822, including accrued interest, that had been in default for a period of 22 months. The case file disclosed that DHHL paid off the SBA loan in August 1997 without requiring the lessee to enter into an installment payment plan to repay DHHL. We found that in at least five other instances, DHHL had fully paid off defaulted SBA loan guarantees totaling \$133,618 without requiring the lessees to enter into repayment agreements.

The Fiscal Management Officer stated that his staff had been instructed by the Homestead Services Division not to send out billing statements to the lessees but that he did not know why no action had been taken by the Division. He also stated that the Division was aware that lessees were not being billed for defaulted loan guarantees because his staff prepared monthly reports to the Division regarding the status of the defaulted loans. The accountant responsible for preparing the billing statements told us that he had been instructed by the Division not to mail out billing statements to the lessees because the terms of the loans had not been determined by the Division. The accountant told us, however, that he believed the delinquent lessees should have been billed and suggested that the lack of billings may have been an oversight on the part of the Division because of other responsibilities. When we inquired of the Division's Administrator why bills had not been sent, he stated that he was not aware of the reasons and would need to review the case files to determine the reasons for the bills not being sent.

We suggest that DHHL develop and implement specific procedures to institute garnishment of wages and repayment agreements to liquidate delinquent debts, as provided in DHHL regulations.

DELINQUENT REAL PROPERTY TAXES

DHHL needs to develop procedures to monitor the status of property tax payments by lessees and to recover from lessees tax payments made by DHHL on their behalf. As of May 25, 1999, the Commission, although not legally liable for payment of real property taxes, had made a commitment to pay about \$1 million for delinquent real property taxes owed by lessees.

Section 208(7) of the Hawaiian Homes Commission Act states, "The lessee shall pay all taxes assessed upon the tract [of land] and improvements thereon. The department may pay such taxes and have a lien therefor as provided by section 216 of this Act." In addition, Section 210 states:

Whenever the department has reason to believe that any condition enumerated in section 208 . . . has been violated, the department shall give due notice and afford opportunity for a hearing to the lessee . . . If upon such hearing the department finds that the lessee has violated any conditions . . . the department may declare the lessee's interest in the tract to be forfeited and the lease in respect thereto canceled.

On May 25, 1999, the Commission authorized DHHL to (1) make, from the Hawaiian Homes General Loan Fund, advance payment of delinquent real property taxes of \$1,039,290 owed by Hawaiian homestead lessees to the County of Hawaii as of November 30, 1994 and to the City and County of Honolulu as of March 31, 1999 and (2) pursue repayment of the amounts advanced on behalf of the lessees in accordance with the procedures described in the "Delinquent Real Property Tax Action Plan." The Executive Assistant to the Commission's Chairman stated that DHHL had developed a plan to notify the lessees of delinquent real property taxes and that, according to the plan, the lessees had 30 days to

resolve the delinquency by paying the amount in full or by contacting DHHL to work out a repayment plan. Lessees who arranged for repayment within the 30-day period would be assessed a 6 percent interest rate.

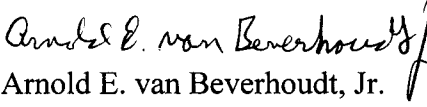
The Chairman's Executive Assistant also stated that DHHL would make advance payment on all outstanding property tax accounts after the 30-day period and that once the advance was made, those lessees who had not arranged for repayment would be notified that an advance was made on their behalf and be charged at a 10 percent interest rate. The Commission's Chairman stated that DHHL agreed to pay delinquent property taxes of more than \$500 and that the counties had been informed by DHHL that the advance payment was a "one time deal." The Chairman added that although DHHL had no legal responsibility to pay for property taxes, DHHL agreed to pay the delinquent property taxes to stay on "good terms" with the local governments. He also stated that under the conditions of the leases, the lessees were responsible for paying property taxes and that DHHL did not have procedures to determine whether lessees paid the taxes. In October 1999, DHHL paid delinquent real property taxes of \$512,904 for 228 Hawaiian Home Land lessees and had agreed to pay an additional estimated \$408,539 for another 196 lessees.

We suggest that DHHL develop and implement procedures to monitor the payment of real property taxes by Hawaiian Home Land lessees and take prompt action to ensure that lessees either pay the taxes or make arrangements with DHHL to repay advance payments made on their behalf.

Since this letter does not contain any recommendations, a response is not requested.

This advisory letter will be listed in our semiannual report to the Congress, as required by Section 5(a) of the Inspector General Act (5 U.S.C. app. 3)

Sincerely,


Arnold E. van Beverhoudt, Jr.
Audit Manager for Insular Areas

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