

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

# **Audit Report**

## **Virgin Islands Housing Finance Authority Government of the Virgin Islands**



**Report No. 2002-I-0009  
December 2001**





# United States Department of the Interior

## OFFICE OF INSPECTOR GENERAL

Caribbean Region  
Federal Building, Room 207  
St. Thomas, Virgin Islands 00802

December 31, 2001

Mr. Ira Hobson  
Chairperson, Board of Directors  
Virgin Islands Housing Finance Authority  
210-3A Altona - Frostco Building, One Stop  
Charlotte Amalie, Virgin Islands 00802

Subject: Audit Report "Virgin Islands Housing Finance Authority, Government of the Virgin Islands"  
(Report No. 2002-I-9)

Dear Mr. Hobson:

This report presents the results of our audit of the Virgin Islands Housing Finance Authority.

Section 5(a) of the Inspector General Act (5 U.S.C. app. 3) requires the Office of Inspector General to list this report in its semiannual report to the U.S. Congress. In addition, the Office of Inspector General provides audit reports to the Congress.

Please provide a response to this report by January 31, 2002. The response should provide the information requested in Appendix 4 and should be addressed to our Caribbean Regional Office, Federal Building - Room 207, Charlotte Amalie, Virgin Islands 00802.

Sincerely,

Arnold E. van Beverhoudt, Jr.  
Audit Manager, Caribbean Region

cc: Governor of the Virgin Islands  
President, Legislature of the Virgin Islands



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# EXECUTIVE SUMMARY

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## BACKGROUND

The Virgin Islands Housing Finance Authority was established by statute in 1981 and began operations in 1984 as a public corporation and autonomous instrumentality of the Government of the Virgin Islands. The Authority was created to stimulate low and moderate income housing construction and home ownership through the issuance of revenues bonds to obtain funds to be used for low interest mortgage loans to qualified purchasers. The Authority is vested with the power to issue bonds and notes, borrow capital, accept Federal grants, and invest in property and securities to meet its objectives.

The Authority is governed by a 5-member Board of Directors and its Executive Director is appointed by the Board. The Authority has established 28 developments, 19 on St. Thomas and 9 on St. Croix, consisting of 926 residences and housing lots for qualified applicants. The Authority also administered four rental projects on St. Croix that were managed by a private management firm under guidelines established by the U.S. Department of Housing and Urban Development (HUD).

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## OBJECTIVE

The objective of the audit was to determine whether the Virgin Islands Housing Finance Authority (1) used Federal and local funds for their intended home ownership program purposes, (2) ensured that applicants met eligibility requirements for home ownership, (3) ensured that contractors fulfilled their contractual obligations, and (4) generated sufficient revenues to meet its operating expenditures.

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## RESULTS IN BRIEF

The Housing Finance Authority did not (1) always use competitive procurement procedures to select development contractors, (2) always ensure that program participants met eligibility requirements, and (3) not have adequate control over its financial operations. Specifically, we found that:

- The Authority often selected development contractors noncompetitively and without the benefit of invitations for bids or requests for proposals. As a result, there was no assurance that the Authority obtained the best possible prices or the best quality product or service for its affordable housing developments. In addition, because the Legislature directly appropriated funds for contractor claims that were in dispute, the Authority was placed

in the position of having to make questionable payments of as much as \$1.95 million to two development contractors.

- The Housing Finance Authority gave some Authority employees preferential treatment that was not available to members of the general public and did not always ensure that program participants met eligibility requirements. We found that (1) nine Authority employees were given a total of 21 interest-free personal loans totaling \$60,566, (2) two other Authority employees were given lower-than-normal prices and preferential treatment in the purchase of home lots, and (3) at least six housing program participants were given financial assistance although they did not meet eligibility requirements.

- The Authority did not have adequate control over receivables, collections and deposits, and bank accounts and did not generate sufficient revenues to meet operating expenses or fund required infrastructure investments. As a result, the Authority (1) was owed about \$809,500 loaned to two housing communities and \$38,500 in rental charges, (2) did not have current and accurate information on the financial status of the Authority's accounts, and (3) was unable to effectively use bond proceeds totaling \$33.7 million that was available to provide mortgage loans to eligible applicants. We also found that a former member of the Authority's Board of Directors may have violated Virgin Islands conflict of interest laws regarding a legal services contract she had with the Authority.

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## **RECOMMENDATIONS**

We made 11 recommendations to the Virgin Islands Housing Finance Authority and 1 recommendation to the Legislature of the Virgin Islands to address the deficiencies disclosed by the audit.

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## **AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL EVALUATION**

In its response to the draft report, the Housing Finance Authority concurred with 10 of the 11 recommendations addressed to the Authority. However, we did not receive a response to the recommendation addressed to the Legislature. Based on the response received, we consider eight recommendations resolved and implemented, two recommendations resolved but not implemented, and two recommendations unresolved.

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# CONTENTS

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## EXECUTIVE SUMMARY

..... 1

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## INTRODUCTION

Background ..... 5  
Objective and Scope ..... 6  
Prior Audit Coverage ..... 6

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## RESULTS OF AUDIT

Overview ..... 7  
Selection of Development Contractors ..... 7  
Determination of Participant Eligibility ..... 15  
Management of Financial Operations ..... 20

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## RECOMMENDATIONS

..... 26

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## APPENDICES

1. Monetary Impact ..... 29  
2. Prior Audit Reports ..... 30  
3. Response to Draft Report\* ..... 31  
4. Status of Recommendations ..... 43

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\* Redactions were made to Appendix 3 of this report pursuant to the Freedom of Information Act (FOIA) exemption 6, 5 U.S.C. section 552 (b)(6).





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# INTRODUCTION

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## BACKGROUND

The Virgin Islands Housing Finance Authority was established by statute in 1981 and began operations in 1984 as a public corporation and autonomous instrumentality of the Government of the Virgin Islands. The Authority was created to stimulate low and moderate income housing construction and home ownership through the issuance of revenues bonds to obtain funds to be used for low interest mortgage loans to qualified purchasers. The Authority is vested with the power to issue bonds and notes, borrow capital, accept Federal grants, and invest in property and securities to meet its objectives.

In February 1990, the Legislature signed into law the Low and Moderate Income Affordable Housing Act to (1) provide safe, sanitary, aesthetically acceptable, and high quality affordable housing for persons of low and moderate income by stimulating home ownership opportunities; (2) provide Government-owned land and site improvements to reduce the cost of housing sites; (3) encourage investment and development of factory-built housing to reduce construction costs; (4) provide financing for owner-occupied and rental housing developments; (5) offer incentives, including tax exemptions, to encourage the construction of affordable housing; and (6) provide a mechanism for establishing and maintaining a Housing Trust Fund to facilitate the construction of new owner-occupied and rental housing developments, and provide assistance to home buyers and renters.

The Authority is governed by a 5-member Board of Directors comprised of the Commissioner of Housing, Parks, and Recreation; the Director of Management and Budget; and three persons not employed by the Government of the Virgin Islands. The three non-government members are appointed by the Governor with the advice and consent of the Legislature, and serve 2-year terms. The Executive Director of the Authority is appointed by the Board of Directors.

The Authority has established 28 developments, 19 on St. Thomas and 9 on St. Croix, consisting of 926 residences and housing lots for qualified applicants. In addition, the Authority had plans for three additional developments, two on St. Thomas and one on St. John. The Authority also administered four rental projects on St. Croix that were managed by a private management firm under guidelines established by the U.S. Department of Housing and Urban Development (HUD).

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## **OBJECTIVE AND SCOPE**

The objective of the audit was to determine whether the Virgin Islands Housing Finance Authority (1) used Federal and local funds for their intended home ownership program purposes, (2) ensured that applicants met eligibility requirements for home ownership, (3) ensured that contractors fulfilled their contractual obligations, and (4) generated sufficient revenues to meet its operating expenditures. The scope of the audit included a review of the Authority's operations during fiscal years 1999 and 2000 and other periods as appropriate.

To accomplish our audit objective, we interviewed Authority officials and reviewed applicable laws, rules, and regulations; files related to procurement transactions, development contractors, program participants, housing loans, collections and deposits, bank statements, and Authority personnel; and minutes of Board meetings.

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. The "Standards" require that we obtain sufficient, competent, and relevant evidence to afford a reasonable basis for our findings and conclusions.

As part of our audit, we evaluated the internal controls at the Authority to the extent we considered necessary to accomplish the audit objective. Internal control weaknesses were identified in the selection of development contractors, the determination of participant eligibility, and the management of financial operations. These weaknesses are discussed in the Results of Audit section of this report. The recommendations, if implemented, should improve the internal controls in these areas.

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## **PRIOR AUDIT COVERAGE**

The Office of Inspector General has not issued any reports on the Virgin Islands Housing Finance Authority within the past 5 years. However, in 1989 we issued an audit report on the Authority's housing programs (see Appendix 2).

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# RESULTS OF AUDIT

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## OVERVIEW

The Housing Finance Authority (1) did not always use competitive procurement procedures to select development contractors and experienced cost overruns totaling as much as \$2.8 million on two housing developments; (2) did not always ensure that program participants met eligibility requirements and gave some of its employees preferential treatment, including interest-free personal loans totaling \$60,566; and (3) did not have adequate control over receivables, collections, deposits, and bank accounts and did not generate sufficient revenues to meet operating expenses or funds required infrastructure investments. The cost overruns on two developments occurred in part because of the political involvement of the Virgin Islands Legislature. The other deficiencies occurred because the Authority did not always follow established policies and procedures related to competitive procurement and participant eligibility and did not have adequate policies and procedures to ensure that transactions involving employees were handled fairly and that financial operations were properly controlled and accounted for.

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## SELECTION OF DEVELOPMENT CONTRACTORS

Construction contracting is generally governed by the procurement requirements contained in the Virgin Islands Code (31 V.I.C. § 235 and § 236). Specifically, the Code states that the procurement of contractual services are to be based on competitive bids and that notices inviting competitive bids are to be published in newspapers of general circulation within the Virgin Islands. In addition, the Joint Rules and Regulations for the Virgin Islands Affordable Housing Program reiterate the importance of competitive bidding. Despite these requirements, development contractors were often selected noncompetitively, without the benefit of invitations for bids or requests for proposals from interested contractors. As a result, there was no assurance that the Authority obtained the best possible prices or the best quality product or service for its affordable housing developments. In addition, because the Legislature directly appropriated funds for contractor claims that were in dispute, the Authority was placed in the position of having to make questionable payments of as much as \$1.95 million to two development contractors.

### **Contracts Valued at \$14.7 Million Were Awarded Noncompetitively**

As of the end of fiscal year 2000, the Authority had completed 19 projects (home and lot sales) on St. Thomas and 9 projects (primarily home sales) on St. Croix. We randomly selected for review 10 of these 28 projects (5 on St. Thomas and 5 on

St. Croix). However, because Authority personnel could not locate the files related to one development project, we only reviewed the other nine projects in our sample. Although the Authority had a selection committee in place comprised of at least three Authority employees, we found that five of the nine development contractors in our sample had been selected on a sole source basis for contracts valued at a total of \$14.7 million. For example:

- The Authority initiated the Water Bay development project in December 1988 to provide 58 condominium style units to low income families on St. Thomas. However, neither an invitation for bids nor a request for proposals was ever issued for the project. Instead, the Authority's then-Executive Director asked the developer if he was interested in building the project and notified the developer that he could expect to make \$10,000 profit on the sale of each unit built. Although the Authority's Rules and Regulations state that developers must "demonstrate the availability of sufficient financial resources to obtain adequate construction financing to complete the construction of the proposed development or project," the then-Executive Director took the developer to a local bank and offered to cosign a loan, on behalf of the Authority, so that the developer could obtain necessary financing. However, the bank still did not approve the loan request, and the Authority then assisted the developer in obtaining financing at another local bank. An initial contract (called a "Developer Agreement" by the Authority) was executed in December 1988 in the amount of \$3.77 million.

- The Authority also initiated the Work and Rest development project in December 1988 to provide 50 single-family homes to first time, low-income home buyers on St. Croix. Although Authority officials stated that invitations for bids had been issued for this project, the project files did not include any evidence of competitive procurement. In fact, in a 1993 letter to the developer, the Authority's then-Executive Director stated that "in 1989 you begged for this project." An initial Developer Agreement was executed in December 1988 in the amount of \$2.66 million.

- In 1997, the Authority issued an invitation for bids to survey and subdivide parcels 92 and 93 at Estate Solitude, St. Croix. Although three companies submitted bids, only the lowest bidder, at \$16,270, submitted its bid within the specified deadline. However, the bid was rejected because the Authority considered it to be too high. Two years later, in 1999, the

Authority entered into a noncompetitive contract with the company that had been the highest bidder, at \$18,400, in the 1997 solicitation and whose bid had been submitted after the specified deadline. Further, the 1999 contract was for surveying and subdividing only parcel 93 at Estate Solitude at a price of \$20,400, and the contract was later amended to increase the price to \$22,900. If the Authority had accepted the lowest bid in 1997, it would have obtained the survey and subdivision of both parcels 92 and 93 at a price that would have been \$6,630 lower than it ultimately paid for the survey and subdivision of only parcel 93. At the September 26, 2001, exit conference on the preliminary draft of this report, the Authority's Acting Executive Director stated that the 1999 contract required the contractor to "redesign" the subdevelopment in addition to surveying and subdividing the parcel of land.

**St. Thomas Project  
Had a \$1.5 Million Cost  
Overrun**

Although a Developer Agreement for \$3.77 million was executed in December 1988 with the contractor for the Water Bay project on St. Thomas, construction of the 58 condominium style units had not started by September 1989, when Hurricane Hugo struck the Virgin Islands. Therefore, in April 1990, the Authority and the contractor entered into a separate contract for \$580,000 for the development of infrastructure facilities at the Water Bay site. In September 1990, the parties also entered into an Agreement for Infrastructure Subsidy,<sup>1</sup> which provided the \$580,000 to fund the infrastructure facilities and represented the total amount of the contractor's proposed profit of \$10,000 per unit. Therefore, the total contemplated contract price was increased to \$4.35 million, or \$75,000 per unit.

During the construction of the development, the contractor claimed that cost overruns occurred because Executive Order No. 313 had made the building codes stricter after Hurricane Hugo. However, the contractor did not submit any contract change orders to address the claimed cost overruns. Further, the Authority took the position that no additional sums were owed to the contractor. For example:

- In a June 23, 1992 memorandum to the Authority's then-Executive Director, a financial advisor to the Authority stated, "The amount of Authority funds which have to date been expended on Water Bay is unprecedented . . . [The contractor] has received more than \$20,000 per unit in Authority subsidy. Typically, developers on St. Thomas receive no more than

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<sup>1</sup>An "Agreement for Infrastructure Subsidy" is the vehicle used by the Authority to provide funding for affordable housing developers to construct infrastructure facilities. The amount of such infrastructure subsidy results in a reduction in the selling price of the units to eventual home buyers.

\$10,000 per unit in Authority subsidy. If you add in the additional money being contemplated, [the contractor's] per unit subsidy increases to more than \$24,000 per unit."

- In a March 18, 1993 letter to the developer, the Authority stated, "The Board of the Virgin Islands Housing Finance Authority (VIHFA) has considered your company's request for payment of the alleged cost overrun. . . . It is the position of the Board that no additional sums are owing to [the contractor] from VIHFA for the construction of the Project. As you know, the VIHFA has already expended substantial sums in excess of amounts agreed to in its development agreements with [the contractor]."

Despite these statements, the Authority further subsidized the project by paying an additional \$1.05 million for the alleged overruns, which were neither anticipated, negotiated, nor supported by contracts, agreements, or change orders. This included paying almost \$55,000 for warranty work that was the responsibility of the developer and \$639,000 that was funded through special appropriations made by the Virgin Islands Legislature, as follows:

- Act No. 5878, enacted in July 1993, appropriated "\$250,000 to the Virgin Islands Housing Finance Authority to be used for payment to [the contractor] for the Water Bay Project." Although, at the time, the Authority's Board of Directors stated that about \$976,200 in excess of the agreed upon contract price had already been paid to the contractor, the Board supported the appropriation because it represented "the difference between actual construction costs and the payments made" to the contractor.

- Bill No. 21-0232 was passed by the Legislature in August 1996 with an amendment to appropriate "the sum of \$389,000 from the interest on bond proceeds to the Virgin Islands Housing Finance Authority for payment to [the contractor] to complete payment for the construction of the Waterbay project." The then-Governor of the Virgin Islands vetoed the Bill, but the Governor's veto was overridden by the Legislature and the Bill was enacted as Act No. 6117 in September 1996. The Authority's then-Executive Director agreed to payment of the \$389,000 despite disagreeing with the contractor's calculations to arrive at the \$389,000 amount. The Legislative Senator who had lobbied for passage of Bill No. 21-0232 and for the override of the Governor's veto was voted out of the Legislature in

November 1996. By late-1997, the former Senator had become the contractor's legal counsel and in May 1999 negotiated for the payment of the \$389,000 by the Authority, including picking up a check in the amount of \$82,104 payable to himself for legal fees.

Although Act No. 6117 clearly stated that the \$389,000 appropriation was to "complete payment" to the contractor, in December 2000, the Legislature passed Bill No. 23-0274 (signed into law by the Governor in February 2001 as Act No. 6388) to again appropriate funds to the "Virgin Islands Housing Finance Authority for payment of legal claims against the Authority," including \$450,000 to be paid to the contractor of the Water Bay project. In a letter sent to the members of the Legislature in December 2000, prior to the passage of Bill No. 23-0274, the Authority's Executive Director stated, "Although both of these entities [the Water Bay and Work and Rest contractors] have also received Legislative funding in the past, **neither of them has any legitimate or legal claim against the VIHFA at this time.**" (Emphasis in original.) With regard to the Water Bay contractor, the Executive Director further stated:

[The contractor] has been at odds with the Authority since 1990, relative to the construction of the Water Bay Condominiums, and has already received funds from the Legislature (Act No. 6117), which were to have brought this matter to a final conclusion. However, since then, [the contractor] has filed yet another case against the Authority on this same issue. That case has not been heard and no settlement or judgement of any kind has been reached to date."

As of July 2001, the contractor's claim was still in litigation before the Territorial Court of the Virgin Islands, but attempts continued to force the Authority to release the \$450,000 appropriated by Act No. 6388. If this \$450,000 is added to the additional amounts already paid by the Authority, the Authority will have paid a total of \$5.85 million for the Water Bay development, or about \$1.5 million more than the \$4.35 million negotiated construction cost. That represents a construction cost of almost \$101,000 per unit as compared with the \$75,000 per unit negotiated cost for the 58 condominium style apartments. Of the \$1.5 million total cost overrun, \$1.09 million directly resulted from special appropriations enacted by the Legislature.

**St. Croix Project Had a  
\$1.3 Million Cost Overrun**

A Developer Agreement for \$2.66 million was executed in December 1988 with the contractor for the Work and Rest project on St. Croix. However, construction of the single-family homes had not started by September 1989, when Hurricane Hugo struck the Virgin Islands. Therefore, in January 1990, the Authority and the contractor entered into a new Developer Agreement with the price remaining the same. Subsequently, during the period of October 1990 to October 1991, the Authority awarded the contractor a series of Agreements for Infrastructure Subsidy totaling \$508,000. The two parties eventually agreed to the construction of 50 units at an average cost of about \$75,000 each, for a total cost of about \$3.76 million for the proposed 50 units.

During the construction of the development, the contractor claimed that cost overruns occurred primarily because of implementation of the Uniform Building Code (UBC) after Hurricane Hugo. However, the contractor did not submit any contract change orders to address the claimed cost overruns or provide documentation to justify the claimed cost overruns. Further, during the period of March 1993 to June 1994, the Authority disputed all claims made by the contractor. For example:

- In a March 3, 1993 letter to the Authority's then-Executive Director, the Authority's then-attorney stated, "Any cost overrun is legally the sole obligation of the developer."

- In a March 12, 1993 letter to the contractor, the Executive Director stated, "The VIHFA believes that it has over-extended itself in assisting you not only financially but in man hours on this project. Please note that in 1989, you begged for this project. VIHFA tried to advise you to decrease the house size and amenities but you insisted that you could build for \$58,000. At that time, you were offered subsidy of \$3,000 per unit and you accepted. The increase to \$18,000 per unit more than covers Hugo, UBC, etc."

- In a June 2, 1994 letter to the contractor's attorney, the Authority's attorney stated that "the UBC did not apply to the contractor's residential project, nor did VIHFA agree to compensate the developer for any additional costs he alleges he incurred as a result of his alleged compliance. In the event [the contractor] was required by some other agency of Government to comply with the UBC, a written change order should have been negotiated prior to construction to account for any impact on construction costs. No written change order was negotiated or



executed with VIHFA, nor did [the developer] notify VIHFA of any specific changes which were being made to comply with the UBC."

Based on the advice of legal counsel, the Authority's Board of Directors initially opposed any settlement with the contractor that called for additional payments. For example, during a August 1994 meeting of the Board of the Directors, the then-Chairperson stated, "I have difficulty supporting something that [the contractor] has already been compensated for, and that is he has received all the resources set aside from the project. He has not completed his part of the bargain." During the same Board meeting, the Authority's attorney stated that "it is a classic mismanagement of the project [by the contractor] as it progressed."

Despite these objections, the Authority eventually subsidized the project by paying \$1.3 million against alleged cost overruns. When added to the amounts previously paid to the contractor, the construction cost for the 50 single-family homes totaled almost \$5.1 million, or about \$102,000 per unit as compared with the original negotiated cost of about \$75,000 per unit. Included in the additional \$1.3 million paid to the contractor by the Authority was \$855,000 specifically appropriated by the Legislature, as follows:

- Act No. 6031, enacted in October 1994, appropriated \$55,000 for "Payment to [the contractor] for Work at Estate Work and Rest-STX."

- Act No. 6084, enacted in October 1995, appropriated "the sum of \$300,000 from the Interest Revenue Fund established pursuant to Title 33, Section 3026a, Virgin Islands Code, to the Housing Finance Authority for payment to [the contractor] for cost overruns associated with the construction of affordable housing units at Estate Work and Rest on St. Croix." A then-Senator (other than the Senator involved in the Water Bay, St. Thomas project) was instrumental in the passage of this appropriation.

- Act No. 6226, enacted in April 1998, appropriated "a principal amount not to exceed \$200,000 to [the contractor] for costs overrun on construction of the Estate Work and Rest Housing Development."

- Act No. 6388, enacted in February 2001, appropriated "the sum of \$350,000 to the Virgin Islands Housing Finance

Authority for the purpose of providing a final payment satisfying a legal claim against the Authority by [the contractor]." In a letter sent to the members of the Legislature in December 2000, prior to the enactment of Act No. 6388 (Bill No. 23-0274), the Authority's Executive Director stated, "Although both of these entities [the Water Bay and Work and Rest contractors] have also received Legislative funding in the past, **neither of them has any legitimate or legal claim against the VIHFA at this time.**" (Emphasis in original.) With regard to the Work and Rest contractor, the Executive Director further stated:

Relative to the proposed appropriation of \$350,000, for [the contractor], we are unaware of any claim against the Authority, as none has been presented. However, we are aware that he is owed a small balance from a previously approved appropriation (Act No. 6088), for which the funds are on reserve pending drawdown from [the contractor].

Additionally, in an April 2001 letter to the contractor, the Authority's Executive Director pointed out that in July 1994, the contractor and the Authority "agreed to settle [the contractor's] cost overrun dispute at Work & Rest for \$400,000. Of that amount, the Authority would be reimbursed \$50,000 for surveys of encroachment errors at the site. The net amount due [to the contractor is] \$350,000." The Executive Director also stated that, despite this settlement agreement, the contractor was paid \$300,000 in February 1996 (pursuant to Act No. 6084) and an additional \$200,000 in August 1998 (pursuant to Act No. 6226). The Executive Director continued, "In total, [the contractor] was paid \$500,000.00. The previous agreement dated July 26, 1994, was for \$350,000.00. Consequently, [the contractor] was overpaid in the amount of \$150,000.00." The Executive Director concluded, "There is no evidence of any further 'legal claims' against the VIHFA. Therefore, it is our opinion that the \$350,000.00 appropriation approved in Act No. 6388 is not warranted, and amounts to yet another over-payment to [the contractor]." According to an Authority official, the Board of Directors, under pressure from a current Senator, voted to release the \$350,000 to the contractor, with \$50,000 to be refunded to the Authority. The net amount of \$300,000 was released to the contractor in July 2001, resulting in a total cost overrun on the project of about \$1.3 million above the originally negotiated \$3.76 million construction cost.

In our opinion, the actions of the Legislature to intervene on behalf of contractors in business-related disputes with the Housing Finance Authority contributed significantly to the increased cost of affordable housing developments. In the Water Bay, St. Thomas project, the Legislature's special appropriations resulted in increased costs of about \$1.09 million, or almost \$18,800 per unit. In the Work and Rest, St. Croix project, the Legislature's special appropriations resulted in increased costs of about \$855,000, or more than \$17,000 per unit. In both cases, the contractors had begun legal proceedings against the Authority for reimbursement for claimed cost overruns and, in both cases, the Authority was placed in a difficult situation by the special appropriations enacted by the Legislature. In the future, the Legislature should avoid involving itself in legal proceedings between the Authority and contractors and, instead, allow such legal proceedings to run their course. Without legislative involvement, the Authority and the contractors in the two cases cited above may have been able to settle outstanding claims for lower amounts, to the advantage of the Authority and potential low income home owners in the Virgin Islands.

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## **DETERMINATION OF PARTICIPANT ELIGIBILITY**

The Housing Finance Authority did not always ensure that program participants met eligibility requirements and gave some Authority employees preferential treatment that was not available to members of the general public. Specifically, we found that (1) nine Authority employees were given a total of 21 interest-free personal loans totaling \$60,566, (2) two other Authority employees were given lower-than-normal prices and preferential treatment in the purchase of home lots, and (3) at least six housing program participants were given financial assistance although they did not meet eligibility requirements.

### **Authority Employees Were Given Interest-Free Personal Loans Totaling \$60,566**

During the period of December 1992 to July 1999, the Authority granted 21 interest-free personal loans totaling \$60,566 to nine different employees. The loans, which ranged from \$170 to \$20,000, were used by the employees to pay for building plans and blueprints, land surveys, tax liabilities, medical and funeral expenses, vacation travel, computer purchases, and home improvements. Further, the Authority did not begin to fully account for these loans until October 2000. Of the 21 loans, 14 loans with balances totaling \$30,866 were entirely paid off and 7 loans with balances totaling \$29,700 remained outstanding. Six of the outstanding loans with balances totaling \$2,650 were delinquent for periods ranging from 3 months to 6 years. The Authority did not have formal collection procedures and did not pursue legal action to collect on any of the delinquent loans.

Two of the 21 personal loans, totaling \$23,500, were made from the Authority's Special Fund account, which consisted of funds set aside primarily for the Self-Help Program, which was eliminated and merged with the Cistern and Slab Program in 1991. The two loans were as follows:

- In 1994, an employee was granted a loan of \$3,500 from the Self-Help Program for "drawings, plans and specs, survey, and location of bound posts on the lot." The loan was granted although the Self-Help Program had been discontinued 3 years before.

- In 1999, an employee was granted a loan of \$20,000 from the Self-Help Program for "plans, blueprints, etc." The loan was granted although the Self-Help Program had been discontinued 8 years before and the employee had two other loans that were outstanding and delinquent at the time.

The 19 other personal loans were made from the Authority's operating account, which contained funds for the Authority's day-to-day operations. For example:

- In December 1994, the Authority purchased a computer for an employee and had the employee sign a promissory note to repay the funds. The employee repaid the interest free loan in February 1996. The employee also received two other interest-free personal loans, one for \$4,000 granted in 1994 and a second loan for \$4,000 granted in 1996. As of June 2000, these two loans were outstanding and delinquent, and the Authority had not taken any collection action. In June 2000, the Authority's Executive Director wrote a letter to the employee concerning the delinquent loans. The Executive Director stated, "The Authority is due to be audited and we are still facing the possibility of being merged with the other Housing agencies. Your experience as a Fiscal Officer should suggest to you that financial matters such as this need to be cleared from our books as soon as possible, before we are cited for fiscal irresponsibility." The employee started to make payments on the loans in July 2000.

- In June 1995, an employee received an interest free personal loan of \$250. Although the employee never repaid the 1995 loan, he subsequently received two other loans, one for \$175 in 1996 and another for \$175 in 1997. The employee received a fourth personal loan in 1999, this one for \$5,000, although he had not repaid any of the previous loans. The employee resigned from the Authority in December 1999, still

owing the Authority a total of \$4,850 on the four loans. The employee eventually paid off the four loans by November 2000.

- In 1995 and again in 1997, an employee received \$800 "cash advances" for medical and funeral expenses, for a total of \$1,600. The 1997 cash advance was granted although the employee had not made any payments on the 1995 advance. The 1995 cash advance remained delinquent without any collection action being taken by the Authority until April 2000, when the Executive Director wrote to the employee concerning the outstanding loans. The employee paid off the 1997 loan in April 1999 and began making payments on the 1995 loan in June 2000, and eventually also paid them that loan.

- In 1997, an employee received a loan of \$1,500. She retired in March 2000, with a balance of \$750 still outstanding on the loan. As of June 2001, the Authority had not taken any action to collect the outstanding amount. Subsequent to our audit, the employee paid off the loan in September 2001.

The Authority should discontinue the practice of issuing personal loans to employees and take immediate action to collect the balances of outstanding personal loans. In our opinion, the use of Authority funds for the purpose of making personal loans to employees is a misuse of those public funds.

### **Authority Employees Were Allowed to Purchase Home Lots at Below the Normal Selling Prices**

Nine current or former Authority employees purchased homes or home lots or received housing assistance from the Authority. Of the nine employees, two received preferential treatment by being allowed to purchase home lots at prices less than available to the general public. Specifically:

- An employee was allowed to purchase a preconstructed home that was used as a model for homes to be built in a development where the Authority was only selling lots. This was the only case, of the developments included in our review, where a model home was constructed on property designated for lot sales. Although the Authority sold lots in the development to eligible individuals for \$15,000, the employee was allowed to make a \$500 deposit that was applied to the price of the lot. Based on available records, it appears that the \$500 deposit was the only amount paid directly by the employee for the land. The employee also received \$52,000 in assistance from the Federally-funded HOME Program, consisting of a \$42,000 grant and a \$10,000 loan at 1 percent interest. Further, a May 16, 1996 memorandum from the Authority's Director of Federal Programs

to the Home Ownership Director suggests that an attempt was made to conceal the nature of the land purchase transaction. In the memorandum, the Director of Federal Programs stated, "I told [the Executive Director] that, in my opinion, the best way to avoid the situation where someone would be able to draw comparison between the lot price charged to her versus charged to the others is to structure her deal as a package. In other words, give one price which would include the land and the house; this way, no one on the outside would really know how much is apportioned to land versus house."

- An employee purchased a home lot from the Authority in February 1998 at a price of \$12,500, which was the price at which the Authority sold other comparable lots within the development to members of the general public. The employee originally was given a deferred purchase amount<sup>2</sup> on the lot of \$20,000 -- again comparable to the deferred purchase amounts given for other comparable lots within the development. However, in April 2000, the employee was awarded a new deferred purchase amount of \$27,500, which effectively reduced her purchase price for the lot from \$12,500 to only \$5,000. Further, the employee received \$42,000 in assistance from the Federally-funded HOME Program, consisting of a \$30,000 grant and a \$12,000 loan at 1 percent interest.

The Authority should discontinue the practice of giving its employees preferential treatment in the purchase of homes and lots or access to housing-related financial assistance because such action undermines the integrity of the Authority and, in our opinion, is a violation of the Authority's public trust. The Authority's employees should be required to meet the same eligibility requirements and abide by the same policies, procedures, and restrictions that apply to members of the general public.

### **Participants Did Not Always Meet Eligibility Requirements**

The Authority used eligibility ratios established by the U.S. Department of Housing and Urban Development (HUD) for Federal Housing Administration (FHA) insured mortgages, the U.S. Department of Agriculture (USDA) for Rural Development mortgages, and the Veteran Administration (VA) for VA mortgages. The Authority also used an in-house eligibility ratio for land sales. The eligibility ratios measured the percentage of an applicant's gross monthly income devoted to mortgage

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<sup>2</sup>All lots sold by the Authority have a "deferred purchase amount," which is the difference between the selling price and the market value of the property. Lots are sold to the public at prices below market value, with the Authority funding the "deferred purchase amount."

payments (mortgage ratio) and the percentage of gross monthly income devoted to all debt payments (debt ratio). For FHA and Rural Development mortgages, the maximum allowable mortgage ratio was 29 percent and the maximum allowable debt ratio was 41 percent. For VA mortgages and Authority land sales, only the 41 percent debt ratio was used. The Authority also uses Federally-mandated maximum income requirements that varied depending on household size and location of property.

We reviewed the case files for a sample of 50 individuals who received housing assistance from the Authority in order to determine whether they met all eligibility requirements. Of the 50 program participants, 40 met the eligibility requirements, 6 did not meet the eligibility requirements, 3 case files did not contain sufficient income and debt information to determine eligibility, and 1 case file could not be located. For example:

- A participant was allowed to purchase a home lot in December 1994 although he had a debt ratio of 76 percent, which far exceeded the 41 percent maximum allowable debt ratio. The participant's account was frequently delinquent, sometimes by as much as 3 months, and his payment checks were routinely returned by the bank for insufficient funds.

- A participant was allowed to purchase a home lot for \$20,000 although her mortgage ratio was 54 percent, which exceeded the 41 percent maximum allowable debt ratio.

- A participant was allowed to gain higher priority consideration of her application by using the "priority number" assigned to her mother, who was the Authority's Executive Director at the time. It appears that the Authority did not conduct a review of the participant's eligibility, because the case file did not contain any income, savings, or credit history information used to make eligibility determinations. In addition, one of the checks the individual issued to the Authority for the down payment on the purchase of land was returned by the bank for insufficient funds, and the amount of that check was not paid to the Authority until a year later when the final balance on the land purchase price was paid off.

We believe that the Authority should adhere to the eligibility ratios prescribed for Federal mortgage loan programs and for the Authority's own land sales program. In addition, the Authority should ensure that only eligible clients receive assistance because it appears that clients with mortgage and/or debt ratios that

exceeded the prescribed maximum allowable ratios typically became delinquent on their loans.

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## **MANAGEMENT OF FINANCIAL OPERATIONS**

The Housing Finance Authority did not have adequate control over receivables, collections and deposits, and bank accounts and did not generate sufficient revenues to meet operating expenses or fund its required infrastructure investments. As a result, the Authority (1) was owed about \$809,500 loaned to a rental management firm and \$38,500 in rental charges, (2) did not have current and accurate information on the financial status of the Authority's accounts, and (3) was unable to effectively use bond proceeds totaling \$33.7 million that was available to provide mortgage loans to eligible applicants.

### **Two Housing Developments Owed the Authority \$809,505**

In 1998, the Authority loaned \$809,505 from its Federally-funded HOPE3 account to the Profit Hills and Bethlehem Village rental developments for rehabilitation of the units. The loans were made with the approval of HUD, but with the understanding that the funds were to be repaid to the HOPE3 account. However, we found that a repayment schedule had not been established by the Authority because the rental developments did not have surplus funds from which to repay the loans and, as of June 2001, no payments had been made on the loans. The Authority's Comptroller told us that in June 2001 the Authority requested payment in writing and that a substantial payment on the loan was expected soon from the private firm that manages the developments. The Comptroller also stated that the Authority did not request repayment before because the HOPE3 funds had not been urgently needed.

### **Rental Accounts Totaling \$38,500 Were Delinquent**

The Authority had four rental properties that were managed internally: an apartment building in Anna's Retreat, an apartment at Hillside Condominiums, and commercial property in Frenchtown, all on St. Thomas, and a apartment building in Estate Concordia on St. Croix that has since been demolished. The Authority was owed more than \$38,500 in delinquent rental payments from seven tenants in these rental properties. For example:

- A current Authority employee resided in one of the properties and owed the Authority back rental payments totaling \$10,690. During the period of September 1, 1997 (the start date of the lease) to June 25, 2001, the employee made only five payments totaling \$7,750 on the account for accrued rental charges, late fees, and returned check fees totaling \$18,440. The



only collection action initiated by the Authority was a letter sent to the employee in September 1999, and the employee has made no payments on the account since July 2000. The employee has been allowed to continue living in the property although the Authority, in a February 4, 1999 letter, notified the employee and other persons residing in the development that the Authority would be discontinuing the rental housing operations effective December 31, 1999 and that the property had to be vacated by that date. At the time of our review, the employee was the only person residing on the property, as the other individuals had been forced to move out by the Authority.

- A tenant in another Authority property had a delinquent rental balance of \$5,550 since April 2000, and the Authority had not initiated any collection action.

The Authority's Executive Director stated that the only way for the Authority to receive payment on the delinquent accounts was to garnish the tenants' salaries through legal action. However, the Authority had obtained a judgment against only one of the seven delinquent tenants. In our opinion, the Authority should initiate formal collection action against the other six delinquent tenants.

### **Collections and Deposits Were Not Adequately Controlled**

The Authority did not have adequate controls over collections and deposits. We reviewed receipts for 5 months in 1999 and 5 months in 2000 and found that the Authority did not always issue receipts in sequential order. For example, receipt number 531 was issued on June 14, 1999, but receipt number 530 was issued on June 16, 1999, or 2 days later. Receipt number 9381 was issued on August 2, 2000, but receipt number 9380 was not issued until September 2, 2000, or a month later. Additionally, receipt numbers 9401 and 9409 were issued in September 2000, but receipt numbers 9400 and 9408 had not been issued and were still in the receipt book.

We also found that in June 1999 the Authority collected \$250 from three individuals for priority number fees. However, the Authority's accounting division did not have any record that it had received the \$250 for deposit into the Authority's operating account. Because the Authority did not maintain a log of incoming receipts, there was no way to trace the funds.

We also found at least one instance where the Authority issued a receipt for funds that it had not received. In this case, an individual was given a receipt on December 29, 1999 for payment of a \$100 priority number fee. However, the accounting

division could not locate any documentation showing that the money was deposited. Upon our inquiry, we were informed by an Authority employee that the receipt was prepared before the money was received. The client was to have returned at a later time with a money order to actually pay the priority number fee. Although a receipt was issued and a priority number assigned to the individual, the client never returned to make the promised payment. Based on our inquiry, the client's name was to be removed from the Authority's priority applicant list.

In our opinion, the Authority should implement formal procedures to require that receipts are issued in strict numerical sequence and only upon receipt of payment and that collections and deposits are recorded and reconciled on a daily basis.

### **Bank Accounts Were Not Reconciled Timely**

The Authority had a total of 16 active bank accounts (13 for local funds and 3 for Federal funds). We selected for review a random sample of five of the local accounts and also reviewed the three Federal accounts. Although we found that the bank accounts were generally under adequate control (checks were issued for legitimate purposes, were issued in numerical sequence, and were countersigned by two Authority officials), we noted that the bank accounts were not reconciled in a timely manner. Specifically, as of June 2001, none of the 16 accounts had been reconciled since December 1999, or a period of 1 1/2 years. The Authority's Comptroller told us that reconciliations were not performed because the individual who had that responsibility had resigned, and assigning the task to another accounting division employee would pose a conflict with the duties of those employees with regard to processing and accounting for checks written against the accounts. Because the monthly reconciliation of bank accounts is an important element of good internal controls, we believe that, if necessary, the responsibility for reconciling the Authority's bank accounts should be assigned to an employee who does not work in the accounting division. Based on our inquiry, the former employee who used to reconcile the bank accounts was rehired in June 2001 specifically to bring the reconciliations up to date. At the September 26, 2001 exit conference on the preliminary draft of this report, the Authority's Comptroller stated that the bank account reconciliations had been brought up to date through August 2001.

### **Financial Transactions Were Not Recorded Timely**

We also found that, as of June 2001, the Authority had not recorded any financial transactions (primarily revenues and expenditures) to its accounting system for the first 6 months of calendar year 2001. As a result, the Authority's financial

managers did not have basic accounting information necessary to effectively manage the Authority's financial operations. The Comptroller stated that he was always able to keep track of the financial status of the Authority's various bank accounts because he kept close watch over the bank statements. However, the Authority had 16 active bank accounts, making it extremely difficult for one individual to keep track of the Authority's finances on a consistent basis without up-to-date postings to its accounting system. At the September 26, 2001 exit conference on the preliminary draft of this report, the Authority's Comptroller stated that the recording of financial transactions had been brought up to date through August 2001.

### **Revenues Were Not Sufficient to Cover Operating Costs and Fund Infrastructure Investments**

The Housing Authority did not generate sufficient revenues to meet its operating needs or to fund required infrastructure investments. Infrastructure funds were critical to the Authority because they allowed the Authority to finance the construction of roads and other basic infrastructure improvements necessary to make Authority land ready for sale to potential home owners or for construction of housing units by potential developers. However, as of the end of fiscal year 2000, the Authority's infrastructure fund had a balance of only \$230,321 and the Housing Trust Fund established by the Low and Moderate Income Affordable Housing Act had not been funded and had a \$0 balance. Additionally, the Authority's revenues totaled only about \$280,000 in fiscal year 1999 and \$590,000 in fiscal year 2000, while annual payroll costs alone totaled more than \$960,000. As a result, the Authority could not pursue the development of land at Estate Solitude on St. Croix and at Abbey Hill and Estate Fortuna on St. Thomas. To further exacerbate the Authority's financial problems, it owed the Government of the Virgin Islands about \$3 million for prior year payroll costs, the Government Employees Retirement System about \$25,000 for employee retirement contributions, and the Virgin Islands Water and Power Authority about \$257,000 for electrical and potable water service.

Because it did not have funds to make infrastructure improvements for new housing developments, the Authority was unable to effectively use as much as \$33.7 million that had been available through two bond issues for the issuance of mortgage loans to potential home owners. For example:

- In 1995, the Authority issued \$27 million in bonds for low and moderate income housing mortgages. However, the

Authority used only \$6.2 million before the bonds expired and the remaining \$20.8 million had to be refunded to bondholders.

- In 1998, the Authority again issued \$15 million in bonds to finance low-interest mortgage loans to potential low and moderate income homeowners. However, the Authority only used \$2.1 million for its intended purpose and, as of June 2001, the remaining \$12.9 million balance remained available but unused.

One alternative that might be available to the Authority to finance critically-needed infrastructure improvements at proposed housing development sites is to tap some of the smaller accounts (with fiscal year 2000 balances ranging from \$299,870 to \$422,330) that the Authority has set aside for other housing-related purposes. As long as these other accounts are not legally restricted the purposes for which set aside by the Authority, the funds could provide "seed money" to help jump-start proposed housing developments, thus both assisting potential low and moderate homeowners and helping to improve the Authority's recurring revenue stream.

#### Former Authority Board Member May Have Violated Conflict of Interest Laws

On February 5, 1999, an attorney, who was a member of the Authority's Board of Directors at the time, wrote to the Authority's Executive Director stating that she was willing to honor a request of the Board that she provide legal services to the Authority. The attorney agreed to provide the services for a retainer fee of \$7,500 and at an hourly rate of \$175. The retainer fee of \$7,500 was paid to the attorney on February 8, 1999.

Questions soon arose as to whether the Board had actually requested the attorney's services and as to the appropriateness of the contract. On April 16, 1999, the Authority's legal counsel provided a legal opinion in which she concluded that "based on the law and the By-Laws of the Authority, [the attorney] was not authorized to enter into any contractual arrangement with the Authority for the rendering of legal services. Her letter of February 5, 1999 was a fraudulent misrepresentation and consequently, she must return the money to the Authority." The Authority's legal counsel also concluded that "[the attorney's] action violates Section 1102 of Title 3, V.I.C. Chapter 37 (Conflicts of Interest) and is subject to further action as provided in Section 1108."

On April 23, 1999, the Authority's Executive Director wrote to the attorney, requesting that the \$7,500 retainer fee be returned to the Authority. On October 28, 1999, the Executive Director

wrote to the Chairman of the Board of Directors, indicating that several attempts to recover the \$7,500 had been unsuccessful and that the matter had been referred to the Attorney General's Office. At the September 26, 2001 exit meeting on the preliminary draft of this report, the Authority's Acting Executive Director stated that the \$7,500 retainer fee had still not been recovered.

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## RECOMMENDATIONS

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### TO THE VIRGIN ISLANDS HOUSING FINANCE AUTHORITY

We recommend that the Board of Directors of the Virgin Islands Housing Finance Authority require the Executive Director to:

1. Ensure that the competitive procurement procedures contained in the Virgin Islands Code and in-house policies, including the existing contractor evaluation committee, are used for all of the Authority's procurement actions or that the reasons why the competitive procurement procedures were not used are fully documented in the appropriate contract files.
2. Require that affordable housing contractors submit formal change order requests to fully document and justify any claims for cost overruns and that payments to contractors for cost overruns are not released without such documentation.
3. Ensure that only applicants who meet eligibility requirements applicable to Federal and in-house housing programs administered by the Authority are allowed to participate in those programs.
4. Develop comprehensive guidelines for handling applications for housing assistance from Authority employees to ensure that such employees are not given preferential treatment not available to members of the general public. Consideration should also be given to requiring that the two employees discussed in the finding pay the appropriate additional amounts for the land they purchased from the Authority.
5. Immediately discontinue the practice of allowing employees to obtain personal loans from the Authority's accounts.
6. Initiate collection action against all delinquent borrowers and tenants to recover outstanding balances due the Authority.

7. Develop comprehensive guidelines for the cash collection process to ensure that receipts are issued in sequential order and only at the time of collection, receipts are promptly deposited, and that collections and deposits are reconciled on a daily basis and any differences investigated.

8. Assign the task of performing monthly reconciliations of bank accounts to a qualified employee who does not have accounting or custodial responsibilities related to the bank accounts.

9. Take immediate steps to ensure that financial transactions, including revenues and expenditures, are posted to the Authority's accounting system on a regular (at least monthly) basis.

10. Submit a formal request to the Governor of the Virgin Islands for funding to serve as "seed money" to finance infrastructure improvements needed to facilitate the construction of affordable housing developments.

11. Formally followup with the Attorney General to determine the status of the attempts to recover the \$7,500 retainer fee paid to a former Board member and to urge the Attorney General to initiate legal proceedings against the former Board member for recovery of the \$7,500 retainer fee and for possible violation of the conflict of interest laws contained in the Virgin Islands Code.

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**TO THE LEGISLATURE  
OF THE VIRGIN  
ISLANDS**

We also recommend that the Legislature of the Virgin Islands:

12. Discontinue the practice of directly appropriating funds for payment to affordable housing contractors without the input and concurrence of the Authority's Board. In addition, the Legislature should allow the judicial process to work, without legislative involvement, in cases of disputes between the Authority and affordable housing contractors.

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**AUDITEE RESPONSE**

The November 19, 2001 response (Appendix 3) to the draft report from the Virgin Islands Housing Authority expressed concurrence with 10 of the 11 recommendations addressed to the Authority. However, the response expressed nonconcurrence with Recommendation 10. Additionally, we did not receive a response to Recommendation 12 from the Legislature of the Virgin Islands.

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**OFFICE OF  
INSPECTOR  
GENERAL REPLY**

Based on the Authority's response, we consider Recommendations 1, 2, 3, 5, 6, 8, 9, and 11 resolved and implemented; Recommendations 4 and 7 resolved but not implemented; and Recommendation 10 unresolved (see Appendix 4). In addition, because we did not receive a response from the Legislature, we consider Recommendation 12 unresolved (see Appendix 4).

**Recommendation 10.** Nonconcurrence.

**Authority's Response.** The Authority did not concur with the recommendation to "consider the possibility of transferring a portion of the unobligated funds from the Authority's discretionary accounts to the infrastructure fund to serve as 'seed money' to finance infrastructure improvements needed to facilitate the construction of affordable housing developments." However, the Authority did agree that without funding for infrastructure improvements, it could not effectively use bond proceeds that were available to finance loans and grants to potential low income housing home owners. The Authority stated that the Government of the Virgin Islands should provide adequate funding to carry out the affordable housing program.

**Office of Inspector General Reply.** In light of the Authority's response, we have revised Recommendation 10 and request that the Authority consider the revised recommendation (see Appendix 4).

## APPENDIX 1 - MONETARY IMPACT

<b>FINDING AREAS</b>	<u>Funds To Be Put To Better Use*</u>	<u>Unrealized Revenues*</u>	<u>Questioned Costs*</u>
Selection of Development Contractors	\$2,800,000		
Determination of Participant Eligibility	30,866	\$29,700	
Management of Financial Operations	<u>33,700,000</u>	<u>848,250</u>	<u>\$7,500</u>
Total	<u>\$36,530,866</u>	<u>\$877,950</u>	<u>\$7,500</u>

\* Amounts represent local funds.



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## APPENDIX 2 - PRIOR AUDIT REPORTS

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### OFFICE OF INSPECTOR GENERAL REPORT

The October 1989 audit report "Housing Programs, Housing Finance Authority, Government of the Virgin Islands" (No. 90-09) stated that the Authority did not effectively manage its housing programs and account for funds. Specifically, although the Authority had successfully issued bonds of \$22.6 million in 1985, it did not finance planned home mortgages with bond proceeds, and all of the bonds were retired in 1988. The report also stated that the Authority had not implemented sufficient financial and operational controls before the bonds were issued and therefore did not accomplish its housing goals. Also, the Authority lost approximately \$78,000 by issuing the bonds and subsequently retiring them without making use of the bond proceeds. Our current audit also disclosed that bonds of \$27 million issued in 1995 and \$15 million issued in 1997 were not fully utilized.

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## APPENDIX 3 - RESPONSE TO DRAFT REPORT

VIRGIN  
ISLANDS  
HOUSING  
FINANCE  
AUTHORITY



210-3A Altona • Frostco Building, One Stop • P.O. Box 308760 • St. Thomas, VI 00803  
Telephone: (340) 774-4481 • Fax: (340) 775-7913

November 19, 2001

Mr. Arnold E. van Beverhoudt, Jr.  
Audit Manager for Insular Areas  
United States Department of the Interior  
Office of Inspector General  
Insular Area Audits  
Federal Building, Room 207  
St. Thomas, Virgin Islands 00802

**Subject: Draft Audit Report "Virgin Islands Housing Finance Authority"**  
**(Assignment No. V-IN-VIS-001-01-M)**

Dear Mr. van Beverhoudt:

Enclosed please find the Housing Finance Authority's response to the above-mentioned audit. While the audit, for the most part, depicted an accurate picture of the Authority, several of the deficiencies identified were from the period dating back to the Authority's creation and were corrected more than 10 years ago. For example, in the early 1990's the Authority redeveloped its Affordable Housing Developer's Agreement and Housing Development Guidelines to address the problems associated with cost overrun and change orders from developers. In addition, the procurement procedures which the audit stated were bypassed, dated back primarily to the first few developments that the Authority developed in an effort to jump start the affordable housing program.

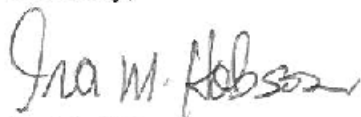
Other parts of the report highlighted areas where the Authority needs to improve upon. It's important to note, however, that all of the deficiencies noted predates the present Interim Executive Director. Nonetheless, for these deficiencies the Authority has initiated or is in the process of initiating the recommended corrective actions.

The Board of Directors appreciates this audit of the Authority and guarantees that the deficiencies noted will be corrected. Should you have any questions concerning this

Arnold E. van Beverhoudt, Jr.  
November 19, 2001  
Page 2

response, please feel free to contact me at (340) 774-0255 or Mr. Clifford Graham, the Interim Executive Director, at (340) 774-4481.

Sincerely,

A handwritten signature in dark ink, appearing to read "Ira M. Hobson". The signature is fluid and cursive, with the first name "Ira" being the most prominent.

Ira M. Hobson  
Chairman, VIHFA Board of Directors

Enclosure

xc: Governor of the U. S. Virgin Islands  
Senate President, Legislature of the Virgin Islands  
VIHFA Board Members  
Interim Executive Director, VIHFA

**VIRGIN ISLANDS  
HOUSING FINANCE AUTHORITY**

**RESPONSE TO**

**V-IN-VIS-001-01-M**

**DRAFT AUDIT REPORT**

**BY**

**U. S. DEPARTMENT OF THE INTERIOR  
OFFICE OF INSPECTOR GENERAL**

**NOVEMBER 19, 2001**

## SELECTION OF DEVELOPMENT CONTRACTORS

### **Use of competitive procurement procedures to select development contractors**

From the inception of the Authority, a mandate was given to the agency to jump start an affordable housing program in the Territory. Unlike other U.S. jurisdictions, the Virgin Islands lacks developers that produce affordable housing as their mainstream. Instead, most developers prefer to construct moderate income custom housing where the profit margins are much greater than the low-end housing. The Executive Director at the time held several meetings with potential developers about the possibility of developing the Authority's property with affordable housing. As a result, developers were chosen to implement and construct the Agency's first set of affordable housing developments.

By the early 1990's, however, the Authority established and followed the Virgin Islands Code, Title 31 and other in-house policies, as they relate to the procurement procedures. All projects were and continue to be advertised in newspapers of general circulation in the Virgin Islands. Bids/proposals are evaluated according to specific written criteria and subsequently contracts are awarded. In the one recent deviation from standard procurement procedures, in 1999, in response to pressures from an elected official, a surveying contract for the design and surveying of Authority's property at Estate Solitude, St. Croix was fast tracked in an attempt to satisfy a mandated deadline; as a result, some provisions of the procurement process were inadvertently bypassed. The contract amount, although higher than the lowest solicitation obtained in 1997, reflected an overall change in the original scope of work to include a complete redesign of the subdivision drawings. This redesign was necessary to maximize the full use of the site.

The Authority concurs with Recommendation No. 1. ("Ensure that competitive procurement procedures contained in the VIC and in-house policies are used for all of the Authority's procurement"). Although the Authority has been in general compliance with these policies for the past 10 years, the Authority will be adding the task of **procurement officer** to a current employee in order to help ensure that these policies are strictly observed. This employee has received some training and will continue to receive training to ensure that all of the Authority's solicitations and purchases follow proper procurement procedures. This employee, Ms. [REDACTED], has commenced her added responsibilities effective November 2, 2001.

### **Project Cost Overruns:**

The cost overruns as identified in the two developments, Waterbay Villas (St. Thomas) and Work and Rest (St. Croix) are unique and rare. Both developers, [REDACTED] and [REDACTED], respectively, resorted to political maneuvering to obtain repeated Legislative appropriations for their baseless claims against the Authority. Once approved by the Legislature, these appropriations were endorsed by the Authority's Board of Directors and subsequently paid to the developers despite the opposition of the legal counsel and Executive Directors at the time.

In 1993, the Authority revamped its Housing Development Guidelines and Affordable Housing Development Agreement to address the problems experienced at these two developments. Within the new Developers Agreement, clear parameters were established relative to a process for contract changes and procedures for resolution of disputes between developers and the Authority. This agreement also established an interest-bearing escrow account of \$2,000.00 from the sale of every unit to be held for a period of one year to ensure that all warranty repairs are completed by the developer.

By the revision of the Affordable Housing Development Agreement, the Authority has already taken the necessary steps, as outlined in Recommendation No. 2. "Affordable housing developers must submit formal change order requests to fully document and justify any claims for cost overruns and payments to contractors for cost overruns are not released without approvals of such documentation." It is apparent that the revisions to the Affordable Housing Developers Agreement have been effective because, since the implementation of the revised Agreement, no developers have claimed cost overruns and no payments have been made for claims not properly documented and approved.

## **DETERMINATION OF PARTICIPANT ELIGIBILITY**

### **Two Employees Purchased Homes/ Lots at Below Normal Selling Prices**

In 1998, an employee was allowed to purchase a home which had been constructed as a prototype for homes to be built by the Authority. This occurred after an interested developer approached VIHFA with a proposal to build affordable homes using an innovative building system. From time to time, the Authority routinely offered serious inquirers the opportunity to construct a model home so that the proposed

building system and construction management approach could be evaluated. The locations of the model homes are driven by ready access to a buildable lot, infrastructure in place, etc. Upon completion of the model home, the unit is sold to a client of the Authority.

In the above-mentioned case, the employee was allowed to purchase the preconstructed home as a turnkey sale transaction. (It should be noted that the employee met all program eligibility and qualification requirements relative to being a V.I. resident, a first-time homebuyer, a duly registered and qualified applicant with a priority number). A review of the Authority's records will show that in the typical transaction involving the sale of a turnkey home (rather than sale of a plot of land), the Authority routinely realized \$5,000 for the land at closing. This was a longstanding administrative decision (dating back to the earliest VIHFA developments) which was required in order to keep the cost of the home affordable to purchasers. In this case, the Authority realized \$5,000 for the land as consistent with all other turnkey home transactions. The employee made a \$500 deposit up-front with the balance (\$4,500) having been paid at closing. (Please refer to closing statement attached).

In another case, an employee contracted to purchase a house plot from the Authority in 1998 for a selling price of \$12,500.00 with a deferred purchase amount of \$20,000.00, as is customary for lot sales transactions in the St. Thomas/St. John district. In seeking construction financing, the employee applied with the USDA - Rural Development. Rural Development subsequently referred the applicant to the Authority's Federal Programs Division for secondary financing to complete the financing package. The Authority recognized that a reduction in the land cost would reduce the amount of subsidy financing which would be required. Given that the land was being purchased from the Authority, the then Executive Directive made a judgement call to restructure the sales terms such that the up-front price was reduced while the deferred purchase amount was increased to \$27,500.00. This was done to minimize the amount of federal assistance that was required while assisting the applicant in making her home ownership dream a reality. The deferred amount acts as a soft second mortgage (duly recorded as a lien against the property) which is fully recoverable by the Authority if the lot is sold at a later date.

With respect to the federal assistance which was received by two employees, the employees were subjected to the same high standard of eligibility determination as in any other cases. A review of the overall pool of federal assistance cases reveals that neither the amount nor the terms of the assistance which was provided to the employee-applicants were unusual or exceptional in any way.

The Authority agrees with Recommendation No. 4 and will develop guidelines for handling applications from the members of the Authority's staff to ensure that employees do not receive any benefits which can be perceived as resulting from preferential treatment. These guidelines will be developed by the Director of Home Ownership, Ms. Lisa Richards, with assistance from the Interim Executive Director and will be in place by early 2002.

### **Participant Eligibility Requirements**

While the Authority has consistently adhered to the eligibility guidelines in its federally-regulated loan programs, there apparently have been some sporadic incidences of deviation from qualification criteria in the lot sales program in the past. In the early history of the program, it was apparently thought that the lot sales program did not need to meet stringent criteria since it was an in-house program and as such, the loans were not governed by federal guidelines. However, since then, the Authority has implemented standardized guidelines to protect the interest of the Authority while still achieving a program which works for the target clientele. The baseline parameters which have been adopted have been modeled after lending industry guidelines whereby the maximum qualifying ratios are 29%/41%.

The Authority acknowledges Recommendation No. 3 and is pleased to report that it has already established guidelines which ensure that only those clients who meet standard qualifying ratios are allowed to participate.

## **MANAGEMENT OF FINANCIAL OPERATIONS**

### **Monies Owed the Authority by Two Housing Developments**

In 1998, the Authority lent \$809,505 from its federally-funded HOPE 3 account to the Profit Hills and Bethlehem Village rental developments for rehabilitation of the units. The Profit Hills and Bethlehem Village projects are both owned by the VIHFA. The loans were made with the approval of HUD, but with the understanding that the funds were to be repaid to the HOPE 3 account. Two loans were made to accomplish rehabilitation of the units.

There has never been any doubt that the funds are loans which must be repaid to the HOPE 3 account. The entire transaction was incorporated into the financial statements for each respective project. The debt owed to VIHFA's HOPE 3 fund is recorded on the books of the respective projects [Reference: Page 3 of Balance Sheet,



Liabilities (Long-term Debts), Acct. No. 2340 ("Loan Payable: HOPE funds")]. The existence of these items on the books of the projects evidences the fact that the loans are recognized and will be repaid.

A formal repayment schedule was not established because the premise of the loans was that each project would repay its respective loan when the financial condition of the respective project became such that the debt service payments could be made either from surplus operating funds or from the proceeds of sales of the units upon conversion to home ownership (as had been planned). Initially, operating surplus funds were reinvested in the project in order to continue the rehabilitation effort. In addition, some surplus funds were also utilized to augment necessary reserves such as those for property insurance. As of this date, the home ownership conversion has not been realized because it is still pending final approval by HUD. In light of the indication that the HUD's decision-making process will be a lengthy one, the decision was made earlier this year to proceed with the request for establishment of a payment schedule commencing as soon as possible; the plan is to utilize the operating surplus as the funding source, to the extent that funds are now available.

### **Delinquent Rental Accounts**

The Housing Finance Authority has not always been diligent in its efforts to collect outstanding rent from our internally managed units and agrees with Recommendation No. 6 - "Initiate collection action against all delinquent borrowers and tenants to recover outstanding balances due the Authority." As such, all delinquent borrowers and tenants have been identified and legal actions have commenced, through the Agency's Legal Counsel, to recoup these outstanding funds. Since the commencement of collection actions, one delinquent tenant has been brought up to date and another has begun payment, by payroll deduction, on the unpaid balance.

### **Collection and Deposits Were Not Adequately Controlled**

The Authority did not always adequately control the collection and deposit process. As revealed in the audit, there were several instances where receipts were written out of sequential order in error. Whenever this error of omission was discovered by the Authority's staff, the overlooked receipt was used as a means of saving the receipt with no consideration of the ramifications of its being issued out of sequential order.

In another incident, an Authority staff member wrote a receipt without first receiving payment. This mistake occurred when a client returned an application to the Authority and was being processed for a priority number when it was discovered that the client

did not have the application fee in the requisite form of payment (check or money order). Given that the employee had already begun writing the receipt, and in light of the fact that the applicant promised to visit a nearby facility to obtain a money order, the receipt was held in abeyance. The client failed to return and, in an administrative oversight, his name was not removed from the Authority's priority applicant list until recently.

The Authority concurs with Recommendation No.7 and will strengthen its collections and deposits process by developing and implementing comprehensive guidelines for the cash collection process. These guidelines will ensure that receipts are issued in sequential numerical order and only at the time of physical collection of money. These guidelines will also ensure that monies collected are promptly deposited with collection and deposits being reconciled on a daily basis.

The Director of Home Ownership, Mrs. Lisa Richards, will spearhead the development of these guidelines with input from the Interim Assistant Executive Director. These guidelines will be implemented by January 2002. In the interim, the Authority's staff has been directed to pay keen attention to the issuance of receipts and to issue receipts in sequential order only when payments are received. Further, in the event that a receipt is overlooked in error, staff has been instructed to void the missed receipt in order to preserve the sequential order.

### **Tardy Reconciliation of Bank Accounts**

The audit found that during the 1½ year period from December 1999 to June 2001, the Authority's 16 active bank accounts were not reconciled in a timely manner. This occurred after the resignation of a key Fiscal Division employee left the division critically short-staffed. Because of the need to maintain the separation of certain key accounting functions, the task of reconciliations could not be assigned to other division employees without causing a potential violation. Although it was thought that the Controller could pick up the task, eventually it was recognized that the assuming of this task along with the other responsibilities of his position was impossible. In June 2001, the Authority rehired a former employee, Mr. [REDACTED], whose responsibilities include, among other tasks, the reconciliation of all bank accounts monthly. Since Mr. [REDACTED] re-employment, all accounts reconciliations have been brought up-to-date.

The Authority concurs with Recommendation No.8, and has accomplished this task. To ensure coverage of this responsibility, an alternate employee, outside of accounting, has been identified and will be trained.

### **Delayed Posting of Financial Transactions**

The Authority did not remain current with its posting of financial records (primarily revenues and expenditures) to the accounting system. This was the direct result of lack of management oversight of this area. The Authority does concur with Recommendation No. 9 and the Interim Executive Director has issued a directive to the Fiscal Division to ensure that postings are done on a weekly basis. Posting to the system will be completed every Friday for the week prior. All postings will be monitored to ensure compliance with the directive.

### **Revenues Insufficient to Cover Operating Cost and Infrastructure Investments**

While it is a fact that the VIHFA did not generate sufficient revenues to meet its operating needs or to fund required infrastructure investments, it should be pointed out that the VIHFA's program has been negatively impacted by the withdrawal of key outside funding sources. When the Housing Finance Authority was created in 1981, it was given a mandate to produce affordable housing for low to moderate income persons. To help make this mandate a reality, the Housing Development Trust Fund was established in 1990 with an initial opening balance of approximately \$1,390,000.00. This fund was the primary source of infrastructure subsidy (\$10,000.00 per unit) that would help defray the cost of construction at each development and enable the units to be sold at affordable prices. The legislation creating the Trust Fund also stipulated that a portion of the annual property taxes of the units developed by the Authority be set aside as a mean of replenishing this fund for future developments.

In recent years, the legislative and executive branches have not provided sufficient appropriations for infrastructure funding as had been customary since the inception of the VIHFA. Further, no funds have been deposited to the Trust Fund account since the initial allocation. The tracking and deposit of the property taxes to the Housing Trust Fund are functions of the central government, primarily the Office of the Lieutenant Governor - Division of the Tax Assessor and the Department of Finance. Because the required portion of the property taxes has never been deposited as prescribed by law, the Trust Fund has had a zero balance since the mid 1990s. As a result, the infrastructure funding required to jump start and subsidize affordable housing developments has not been forthcoming and the Authority's developments have been stalled.

The Authority's annual allocation from the central government averages approximately \$400,000.00 which represents approximately 28% of its overall budget. Funding for the remaining 72% is realized from the sale of land in the Authority's developments and from the collection of miscellaneous fees. The anticipated revenue from the various stalled developments has not been realized; this has contributed to the Authority's operational deficit and underutilization of the Mortgage Revenue Bonds floated in 1995 and 1998.

The Authority disagrees with Recommendation No. 10 - "Consider the possibility of transferring a portion of the unobligated funds from the Authority's discretionary accounts to the infrastructure fund to serve as "seed money" to finance infrastructure improvements needed to facilitate the construction of affordable housing developments". Instead, the Authority believes that the Affordable Housing Program should be funded to help create Home Ownership opportunities throughout the Territory. In the Consolidated Plan developed by the Government of the Virgin Islands for the Territory, "expansion of homeownership economic activities and sustainable neighborhoods through production of new mixed-income/mixed-use neighborhoods" ranked second among the long term objectives and goals for the next five years.

In light of the rising cost of construction in the Territory coupled with the limited purchasing power of our clientele, heavy subsidization of housing costs is essential. As such, funding for the affordable housing program must become a priority of the Government of the Virgin Islands. If infrastructure funding is provided, more units can be built realizing more operating revenue for the Authority. Once the Authority is able to become more consistent in its production of affordable housing developments, eventually more monies will be available for additional infrastructure investments. An added benefit will also be full utilization of any Mortgage Revenue Bonds which may be floated in the future.

### **Interest-free personal loans to Authority employees**

Beginning in the late 1990's, the various Executive Directors of the Authority have given discretionary interest-free loans and self-help loans to employees. These loans ranged from \$170.00 to \$20,000.00 and were issued from the Authority's in-house funds. Of the seven loans outstanding as of the writing of the audit report, three were paid off by early November 2001 and one is scheduled to be paid off by the end of December 2001. Of the remaining three loans, one was granted from the discontinued Self-Help Program and is secured by a First Priority Mortgage on the individual's

property. The last two loans are held by one employee and are presently current and are being paid by payroll deduction.

The practice of providing interest free employee loans was likely an error in judgment by the previous Executive Directors and a policy not endorsed by the present Interim Executive Director. Thus, the Authority strongly agrees with Recommendation No. 5 and has already discontinued the practice of allowing employees to obtain personal loans from the Authority's in-house account. A resolution creating a policy which prohibits the Executive Director from issuing personal loans to employees has been drafted and will be presented to the Authority's Board of Directors at the next scheduled Board meeting. In addition, the present Interim Executive Director has initiated steps to recover the remaining outstanding loans.

### **Conflict of Interest by Former Board Member**

On February 5, 1999, a private citizen member of the Authority's Board of Directors, who was an attorney, wrote to the previous Executive Director offering to provide legal services for the Board of Directors specifically as it related to rendering an opinion on the proposed merger of the three housing agencies. The letter requested a \$7,500.00 retainer fee payable upon approval of the engagement letter. On or about February 8, 2001, the engagement letter was signed by the then Executive Director. On February 8, 2001, the retainer fee was issued to the attorney board member and cashed the following day. Subsequently, the previous Executive Director learned that the board member had not resigned from the Board and was not engaged by the Board to perform legal services as had been represented. Although a letter requesting the return of the \$7,500 retain fee was delivered by a process server, the member never responded. The member's position was eventually declared vacant by virtue of her apparent breach of public trust. The matter was turned over to the Attorney General's Office of the Virgin Islands thereafter. At present, the whereabouts of the former member are unknown and the matter remains unresolved.

The Authority agrees with Recommendation No. 11 and has initiated communications with the Attorney General's Office to follow-up on this matter. On May 20, 1999 and October 25, 2001, formal correspondences were forwarded to the Attorney General's Office with several telephone dialogues transpiring since those dates. At present, the Authority awaits a formal response from the AG relative to the status of this matter.

## APPENDIX 4 - STATUS OF RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1, 2, and 3	Implemented.	No further action is required.
4	Resolved; not implemented.	Provide this office with supporting documentation upon completion of guidelines for handling applications from Authority employees.
5 and 6	Implemented.	No further action is required.
7	Resolved; not implemented.	Provide this office with supporting documentation upon completion of guidelines for handling collections and deposits.
8 and 9	Implemented.	No further action is required.
10	Unresolved.	Consider the revised recommendation and provide a response that includes a plan of action including the target date and title of the official responsible for implementing the recommendation.
11	Implemented.	No further action is required.
12	Unresolved.	Provide a response from the Legislature that includes a plan of action including the target date and title of the official responsible for implementing the recommendations.







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