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

Abandoned Government of the Virgin Islands building at Estate Slob, St. Croix
Office of Inspector General photo

Management of Real Property
Government of the Virgin Islands

Report No. V-IN-VIS-0002-2005 **May 2007**

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Western Region Office
2800 Cottage Way, Suite E-2712
Sacramento, California 95825

May 18, 2007

Honorable John P. de Jongh, Jr.
Governor of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, VI 00802

Re: Final Audit Report *Management of Real Property, Government of the Virgin Islands* (Report No. V-IN-VIS-0002-2005)

Dear Governor de Jongh:

The enclosed report presents the results of our audit of the management of Government-owned real property by the Virgin Islands Department of Property and Procurement (DP&P). The objective of our audit was to determine whether the Government (1) maintained adequate inventory control over real property; (2) maximized the leasing out of excess government-owned property, including timely collection of rental income; and (3) minimized the leasing of private property for government use.

We were encouraged to find up-to-date property inventory records and a system of formal procedures to administer leases. However, we also found that DP&P has not used these procedures to maximize leases of Government-owned property and minimize the need for the Government to lease privately owned property. In effect, both as landlord and procurer of private space for Government agencies, DP&P has not acted in the best interest of the Government of the Virgin Islands. The financial impact of this failure is substantial, with nearly $1 million in rental revenues that can no longer be collected, over $2 million in rental revenues that remain uncollected, and nearly $6 million in revenues that could have been saved or spent more wisely (see Appendix 1).

In one instance, for example, the Government, through DP&P, did not pursue an opportunity to purchase privately owned space being rented to house Government agencies. As a result, the Government, as of September 30, 2005, had paid more than $3 million in lease payments that could have been applied towards the $4.2 million asking price for the property. Although other instances were not as dramatic, such as the failure to encourage payment agreements for seriously delinquent tenants or file proof of Government claims in bankruptcy cases, they collectively point to the need for DP&P to aggressively use and tighten existing lease administration procedures. We also noted that the Department of

Public Works (DPW), despite repeated overtures from DP&P, has not met the mandate of the Legislature (Act No. 6289) to develop cost estimates for repairing and reclaiming abandoned Government property, an essential step in reducing the amount of annual rent paid for Government office space. We made six recommendations, which, if implemented, should significantly improve DP&P's ability to manage real property to the financial benefit of the Government.

In his March 1, 2007 response to our draft report (Appendix 2), the Acting Governor of the Virgin Islands, through the management of DP&P, concurred with all of our recommendations and provided action plans to address each recommendation. As such, we consider Recommendations 1, 2, 3, 4, and 5 to be resolved and implemented and Recommendation 6 to be resolved, but not implemented. The status of the recommendations is shown in Appendix 3.

The legislation, as amended, creating the Office of Inspector General (OIG) requires that we report to the U.S. Congress semiannually on all audit reports issued, the monetary effect of audit findings (Appendix 1), actions taken to implement our audit recommendations, and recommendations that have not been implemented.

Please provide a response to this report by June 22, 2007. The response should provide the information requested in Appendix 3 and be addressed to Mr. Hannibal M. Ware, Field Office Supervisor, Office of Inspector General, Caribbean Field Office, Ron deLugo Federal Building, Room 207, Charlotte Amalie, Virgin Islands 00802. We appreciate the cooperation shown by DP&P staff during our review. If you have any questions regarding the report, you may contact me at (916) 978-5653 or Mr. Ware at (340) 774-8300.

Sincerely,

Michael P. Colombo
Regional Audit Manager

Enclosure

cc: Commissioner, Department of Property and Procurement
Commissioner, Department of Public Works

CONTENTS

INTRODUCTION

RESULTS OF AUDIT

RECOMMENDATIONS

APPENDICES

Acronyms

DP&P .... Department of Property and Procurement
DPW .... Department of Public Works
OIG .... Office of Inspector General
VIC .... Virgin Islands Code

INTRODUCTION

BACKGROUND

DP&P is authorized by the Virgin Islands Code (VIC)[1] to manage and control all real and personal property owned by the Government of the Virgin Islands, including acquisitions, dispositions, commercial leasing, and property distribution. Through its Property Division, DP&P manages Government leasehold contracts and agency requests for office space and is responsible for related real estate management activities, including negotiation; contract preparation; and property inspection, appraisal, and survey.

Recognizing operational problems within DP&P's Property Division on St. Thomas, the Commissioner of Property and Procurement established a property task force in January 2005. The task force was charged with reviewing all of DP&P's business and commercial accounts to ensure that delinquent tenants became current in the rental and legal obligations under their leases. The task force began meeting with tenants to (1) execute payment agreements to liquidate any outstanding balances, (2) renew expired leases, and (3) ensure compliance with requirements for business licenses and liability insurance. These efforts, which were underway when our audit began in May 2005, are still ongoing. At the time of our audit, DP&P's Property Division managed 149 business and commercial leases of Government-owned property to private businesses and 129 active leases of private property for use by Government agencies.

OBJECTIVE AND SCOPE

The objective of our audit was to determine whether the Government (1) maintained adequate inventory control over real property; (2) maximized leasing of excess Government-owned property, including timely collection of rental income; and (3) minimized leasing of private property for Government use. We judgmentally selected and reviewed 39 business and commercial lease agreements and 28 leases for Government office space in effect during fiscal years 2000 through 2005. Our sample was selected based on the length of time contracts and permits were in effect for business and commercial lease agreements, and the dollar amount of Government leases for office space.

[1] 3 VIC § 202(a).

Audit work was performed from May 2005 to October 2006. To accomplish our objective, we interviewed officials and reviewed lease agreements, payment records, and related correspondence at DP&P offices on St. Thomas and St. Croix. We also reviewed related information at the Tax Assessor's Office and the Department of Finance on St. Thomas. In addition, we performed site visits and inspections of businesses leasing property from DP&P and abandoned Government-owned property.

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 we considered necessary under the circumstances. As part of our audit, we evaluated the internal controls related to the management of real property, including leasing, monitoring, and rent collection, to the extent we considered necessary to accomplish the audit objective. Internal control weaknesses identified as a result of our audit are discussed in the Results of Audit section of this report. The recommendations, if implemented, should improve the internal controls in property management.

PRIOR AUDIT COVERAGE

During the past 5 years, we have not issued any audit reports on real property management by the Government of the Virgin Islands. We did note, however, that the two most recent reports, one issued in October 1986 (No. V-TG-VIS-13-85) and the second in July 1991 (No. 91-I-1056), both identified the collection of delinquent rental receivables as a problem.

RESULTS OF AUDIT

OVERVIEW

We found that property inventory records were up-to-date and formal lease administration procedures have been established. However, DP&P has not maximized leases of Government-owned property or minimized leases of private property for Government use. In renting space for Government agencies, DP&P spent nearly $6 million that could have been saved or used more wisely. Deficiencies included leasing privately owned space when suitable Government-owned space was available, failing to follow up on opportunities to purchase privately owned space being rented by Government agencies, and approving leases that exceeded established rental rate limits and included renovation costs for private buildings. We also found that DPW was not compliant with the mandate of the Virgin Islands Legislature in estimating the cost of repairing and renovating abandoned Government properties.

DP&P DEFICIENCIES IN LEASING OUT GOVERNMENT-OWNED PROPERTY

►DP&P Did not Collect Over $1.2 Million in Delinquent Rental Payments

Of the 149 active business and commercial accounts, 96, or 64 percent, were delinquent by more than $1.2 million as of August 31, 2005. Our review of 39 accounts disclosed that DP&P neglected to notify tenants of their delinquent status or evict delinquent tenants. DP&P's Property Manual requires notices be sent to delinquent tenants on the following schedule (Figure 1):

No. of Days Payment Delinquent	Notice Description
After 30 Days	Notice of Default/Delinquency after a tenant misses a rental payment and does not meet with Property Division personnel to discuss remedies
31 to 60 Days	Notice to Cure
61 to 90 Days	Notice to Terminate
After 91 Days	Notice to Vacate, with a filing through the Virgin Islands Department of Justice for adjudication by the courts

Figure 1

Of the 39 accounts reviewed, 22 had no documented evidence of any attempts by DP&P to collect balances that had been outstanding and delinquent for periods of up to 12 years. For example:

- DP&P allowed Family Broadcasting, Inc., to occupy Government property without paying rent for more than 12 years and accumulate an outstanding balance of $94,700 before DP&P sent a letter detailing the history of nonpayment. The tenant signed a payment agreement[2] for $73,508, but then filed for bankruptcy protection. The U.S. District Court for the Virgin Islands notified DP&P that it must file proof of claim by August 11, 2005, to recoup any delinquent rent. DP&P failed to file, and the Government of the Virgin Islands is at risk of not being able to collect any of the money it is owed.

- DP&P allowed Wings Auto Parts to occupy Government-owned property without making rental payments for up to 3½ years and to accumulate an outstanding balance of $35,175. When the tenant filed for bankruptcy protection, the District Court discharged all claims against the owner as of the date of the action. DP&P was unable to recoup any of the outstanding balance, but continued to allow the tenant to occupy the property without paying rent for 3 more years and accumulate $13,180 in additional unpaid rent. DP&P eventually issued a Notice to Vacate, but had not taken any serious eviction action as of the end of our audit.

At the close of our audit, DP&P was in the process of preparing eviction notices for 11 other delinquent tenants.

►DP&P Did Not Collect Nearly $1.9 Million in Additional Rental Income and Related Fees

DP&P also failed to collect nearly $1.9 million in additional rental income and related fees because it did not (1) monitor or bill for tenant sublease activity, (2) use correct rental receivable calculations when entering into payment agreements, (3) implement rental rate increases stipulated by lease agreements, and (4) accurately assess or record late fees (see Figure 2).

[2] A legal document that states an agreed-upon delinquent rent amount and a payment plan to liquidate the debt.

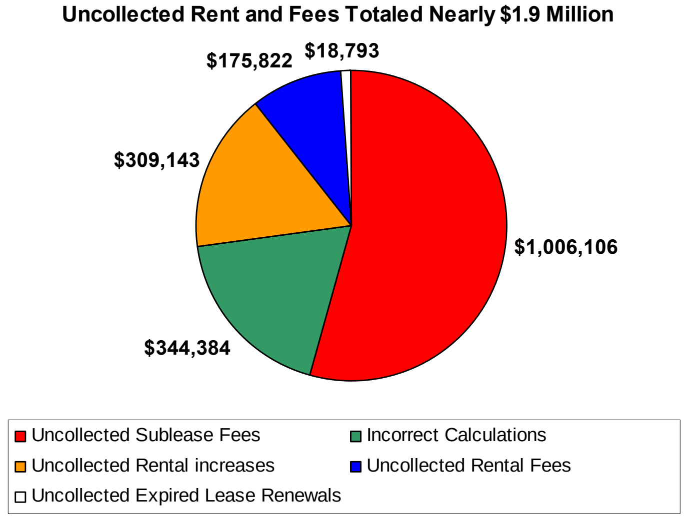

Figure 2

Uncollected Sublease Fees Totaled $1,006,106

DP&P did not adequately monitor or bill for tenant subleasing. With one exception, every lease agreement executed by DP&P allowed tenants to sublease with the understanding that they would pay DP&P a specified percentage of sublease income. We conducted physical inspections of 10 tenants leasing space in the Crown Bay area of St. Thomas, where DP&P is located, and found that 5 tenants were subleasing. We identified $1,006,106 in outstanding sublease fees, with three tenants responsible for the majority of this amount (Figure 3).

Sublease Fee Payments Owed as of September 30, 2005

Tenant	Percentage of Sublease Income Owed To DP&P	Amount
Island Laundries	15 to 25 percent of monthly sublease income	$616,748
MDM Enterprises	10 percent of monthly sublease income for first 10 years of lease; 15 percent for the second 10 years	$300,591
Skif Corporation	10 percent of monthly sublease income for 2003 and 2004 and 15 percent from 2005 onward[a]	$84,568
Total		$1,001,907

Figure 3

[a] We calculated the $84,568 based on the percentages shown. Skif Corporation did not have a sublease provision in its lease until January 2003, when the lease came up for renewal. Had a sublease provision been in place prior to January 2003, Skif would have paid $3.2 million over a 15-year period.

Incorrect Calculations Resulted in Lost Rental Revenues of $344,384

DP&P did not adequately review the terms of lease agreements and coordinate with its Fiscal Division before executing payment agreements with delinquent tenants, resulting in significantly understated tenant delinquencies and the loss of $344,384 in rental income in 5 of the 39 cases reviewed. The most extreme example was the American Furniture account, which comprised $199,697 of the uncollected amount. American Furniture was chronically delinquent with its lease payments, with lapses of up to 19 consecutive months. DP&P made many attempts to collect the outstanding balances and signed two payment agreements; however, both payment agreements had significant computational errors (Figure 4).

American Furniture Payment Agreements			
Description	**Amounts Accepted by DP&P**	**Correct Amounts Per OIG Review**	**Difference Between DP&P and OIG**
First Payment Agreement – May 2002	$26,580[a]	$138,587	-$112,007
Amounts Owed After First Agreement	$154,512	$242,202	-$87,690
Total Delinquent Amount Owned	$181,092	$380,789	-$199,697
Less Payments by American Furniture	-$51,162	-$51,162	$0
Final Payment Agreement – May 2005[b]	$129,930	$329,627[c]	-$199,697

Figure 4

[a] Did not account for outstanding balances prior to September 1998, rental rate increases, or late penalties.
[b] Did not account for increases to the monthly rental rate.
[c] Includes the $112,007 difference carried forward from the first agreement.

Uncollected Rental Increases Resulted in Lost Revenues of $309,143

DP&P did not monitor the terms of each agreement and therefore either did not implement rental increases stipulated in lease agreements or implemented the increases up to 8 years after they were due. As a result, about $309,143 in rental revenue was lost for 9 of the 39 accounts reviewed. Two examples demonstrate:

- DP&P lost rental income of $110,325 on a lease with MDM Enterprises. The March 1991, 20-year lease agreement called for rental increases every 5 years, but DP&P did not notify MDM of the first increase until more than 4 years after it became effective and never notified MDM of the second increase. Although the Fiscal Division added $110,325 to MDM's outstanding balance, DP&P's attorney reversed the entry based on an opinion by the Virgin Islands Attorney General that tenants could not be required to pay retroactive rental increases that they were not told about.

- DP&P lost rental income of $71,618 on a lease with Victor's New Hide Out. The August 1994 lease agreement called for a fixed rate increase in March 1996, along with increases every 5 years, based on changes in the Consumer Price Index starting in September 1999. However, the tenant continued to pay the original monthly lease amount until notified by the Fiscal Division 4 years after the increase was due. The Fiscal Division again added these delinquent amounts to the tenant's outstanding balance, which were also reversed based on the same opinion by the Virgin Islands Attorney General.

Uncollected Late Payment Penalty Fees Resulted in Losses Totaling $175,822

Of the 39 accounts reviewed, 32 had instances where late fees were either not assessed or were incorrectly assessed, resulting in the loss of at least $175,822. Lease agreements generally included provisions for late fees of either 10 percent of any monthly amount more than 10 days late or 1 percent compounded monthly of any amount more than 60 days late. For example, a lease agreement with the V.I. Metal Shop required a 1 percent fee compounded monthly for delinquencies of more than 60 days. Although V.I. Metal Shop was never current on lease payments from October 1984 to September 1989, DP&P did not assess any late fees. After September 1989, DP&P recorded late fees, but did so at 10 percent of the monthly balance, rather than at the specified 1 percent compounded rate. Over the life of this lease, DP&P failed to assess or collect a total of $32,336 in late fees.

►DP&P Did Not Renew Expired Leases or Monitor Compliance With Other Requirements

DP&P did not renew expired lease agreements. Of the 39 accounts reviewed, 23 had expired leases that had not been renewed for periods ranging from 1½ to 23 years. As a result, DP&P did not adjust rental rates to reflect increases in fair market value or in the Consumer Price Index, resulting in additional, undeterminable lost revenues. Although we could not determine the overall lost revenues because of the lack of historical information, we did identify $18,793 in additional rental income that should have been collected for Haulover Marine Inc. The 1-year lease with Haulover Marine, which began on October 1, 1992, continued for 12 years, although the lease was never renewed. On four occasions, Haulover Marine requested approval to enter into a long-term lease agreement, stating that it was willing to negotiate a reasonable rent increase and spend about $40,000 in capital improvements. However, DP&P did not respond, even though a January 1997 property appraisal estimated a fair market monthly rental value of $182 more than Haulover Marine was paying. Had the lease been renewed in 1997 at the recommended rate, DP&P could have realized at least $18,793 in additional income.

DP&P also failed to ensure that tenants maintained current business licenses and liability insurance policies. Of the 39 accounts reviewed, 30 account files did not have evidence of valid business licenses, and 32 did not have evidence of liability insurance. As a result, DP&P could not be certain that its tenants were in good standing in terms of taxes and other business licensing requirements or that it would be held harmless regarding any actions by its tenants.

► DP&P Issued Letters of Good Standing and Lease Renewals to Delinquent Tenants

In addition to its difficulties in lease and associated revenue collection, DP&P issued letters to other Government agencies certifying that some delinquent tenants were actually in good standing regarding their rental payments. In one case, DP&P issued a letter of good standing for a tenant that had not paid rent for 6 years. DP&P also entered into new, long-term lease agreements with delinquent tenants without requiring them to pay past due amounts. For example, DP&P allowed Bakale, Inc., to renegotiate a 20-year lease under a new name of Kent Corporation after Bakale's lease expired in 2003, even though Bakale had a delinquent balance of more than $12,000. DP&P then transferred the balance to Kent Corporation's account, rather than ensuring that the delinquent amount was paid.

DP&P DEFICIENCIES IN LEASING PRIVATELY OWNED SPACE FOR GOVERNMENT USE

In reviewing lease activity related to renting privately owned space for Government use, we identified nearly $6 million in funds that could have been saved or more wisely used. Specifically, DP&P neglected to follow up on opportunities to purchase leased property when the purchase was advantageous to the Government. DP&P also allowed other Government agencies to negotiate leases, some without competitive analysis; and agreed, without due consideration, to renovate space with improvements that would become the property of the lessor. In addition, DP&P allowed other Government agencies to lease private space at rates in excess of limits specified in its own regulations.

►DP&P Failed to Follow Up on Opportunities to Purchase Privately Owned Space Being Leased by the Government

DP&P Paid $2.1 Million to Rent Privately Owned Space When Government Space was Available

As of September 30, 2005, DP&P had paid a private company more than $2.1 million for warehouse space for the Government's Central Stores Division, even though Government-owned space was available. The Central Stores Division had vacated a Government-owned warehouse at Subbase, St. Thomas, in September 1995, when the warehouse was damaged by Hurricane Marilyn, and leased warehouse space owned by Cousins and Sons. The initial rent of $12,000 per month ultimately increased to $24,000 a month. Shortly afterwards, DP&P leased the former Central Stores Division's Subbase warehouse to American Furniture on a month-to-month basis. In May 1997, DP&P tried to terminate the lease and move the Central Stores Division back to the Subbase warehouse. However, when American Furniture would not vacate, DP&P did not pursue eviction action, but instead entered into a 20-year lease with American Furniture with payments of $3,750 per month. As of January 2006, the Government has paid over $2.1 million to rent this facility, while its former facility is effectively used for warehousing and other purposes by American Furniture for lease payments of less than $500,000 for the same period. Cousins and Sons offered to sell the warehouse to the Government for $1.7 million in September 1996, but we found no documented evidence that the Government pursued the offer.

DP&P Paid More Than $3 Million in Rent that Could Have Been Applied to a $4.2 Million Purchase Price

Lost opportunities to purchase privately owned buildings also included the Vitraco Mall on St. Croix owned by Fast Foto, Inc. Fast Foto offered to sell the Mall to the Government in June 1999 for $4.2 million. The offer allowed the Government to purchase the Mall without any capital outlay, cash deposit, or down payment by applying all of the rental payments (except payments related to maintenance costs) as credit towards the purchase price. The Government has seven leases with Fast Foto and as of September 30, 2005, has paid more than $3 million in lease payments, which could have been applied toward the $4.2 million asking price. The Commissioner of Property and Procurement told us that the offer was not pursued because one of the Government agencies did not want to remain in the building because of poor infrastructure, environmental issues, and plans for a new Government complex that were ultimately tabled owing to funding constraints. The Commissioner conceded that, in hindsight, DP&P's failure to pursue the offer "looks bad."

►DP&P Did Not Ensure the Best Rental Rates and Agreed to Renovate Privately Owned Space

In four leases, DP&P did not fulfill its role to procure rental space for Government agencies, instead limiting its responsibility to that of signing completed leases submitted by other Government agencies. The VIC[3] stipulates that only DP&P can procure rental space for the Government. In addition, DP&P's Property Manual requires that DP&P meet with any Government agency requesting office space to discuss specific needs and negotiate with potential landlords, based on a comparability study of space for three similar properties. By approving these four leases after the fact, DP&P could not ensure that the Government received the best price or that proper negotiations were conducted prior to entering into the lease agreements.

Renovation Costs of Privately Owned Buildings Total $859,625

DP&P has committed to spending $859,625 to renovate privately owned buildings, with all improvements becoming the property of the facility owner. This includes improvements to the Office of the Lieutenant Governor for bathroom facilities, flooring, and an elevator, costing $169,625, and to the Bureau of Internal Revenue for roof repairs, electrical work, and flooring, costing $690,000. Both agencies were allowed to commit Government funds to improve privately owned property, although several Government-owned properties that could have been used for office space also needed renovations.

FAILURE OF DPW TO ESTIMATE COSTS TO REPAIR ABANDONED GOVERNMENT PROPERTIES

Recognizing the need to reduce the amount of annual rent paid for office space, the Virgin Islands Legislature passed Act No. 6289 in August 1999 requiring DP&P to present a list of abandoned Government properties to DPW so that DPW could estimate the cost of repairing and renovating the buildings. DP&P submitted the list, which included 7 properties on St. Thomas and 16 properties on St. Croix, to DPW in December 1999.

As of September 2000, DPW had not provided the required repair estimates. After repeated requests for the estimates by the Commissioner of Property and Procurement, the Commissioner of Public Works stated that his staff did not have the time to assist in the matter. As of January 2006, the Commissioner of Property and Procurement had received no further response from DPW, and there has not been any action toward fulfilling the requirement of Act No. 6289. In the meantime, most of the Government properties in question remain abandoned and serve as targets for vandals and homes

[3] 3 VIC § 70.

for squatters. The building shown on the cover of this report and the one shown in Figure 5 are just two examples of abandoned Government property.

Abandoned Government Building at Bonne Esperance, St. Croix. (OIG photo)

Figure 5

RECOMMENDATIONS

TO THE GOVERNOR OF THE VIRGIN ISLANDS

We recommend that the Governor of the Virgin Islands direct the Commissioner of Property and Procurement to:

1. Identify delinquent tenants and pursue collection efforts aggressively by:

    a. Requiring all current lessees with delinquent accounts to make full payment or arrangements for monthly liquidation of delinquent accounts. Tenants who fail to pay delinquent balances should be promptly evicted, with their accounts referred to the Attorney General's Office for collection.

    b. Assessing and collecting subleasing fees for tenants subleasing Government-owed property.

    c. Assessing and collecting late payment penalties on delinquent accounts.

2. Establish and implement a formal lease monitoring system to ensure that (a) expired leases are renewed to reflect current market rates, (b) rate increases specified by lease terms are timely implemented, (c) routine physical inspections of Government-owned lease property are performed and inspection reports prepared to confirm that only authorized tenants and subtenants are on the properties, and (d) liability insurance coverage and business licenses are obtained by lessees and kept current.

3. Require DP&P's Fiscal Division to be notified of rental increases to ensure that official payment records reflect accurate tenant account balances.

4. Require, in accordance with their existing policy, DP&P to negotiate and execute all leases for Government agencies to obtain the most advantageous rental rates for Government office or warehouse space.

5. Contact private property owners who made sales proposals to determine if the offers are still valid and determine whether the Government should purchase the properties.

We also recommend that the Governor direct the Commissioner of Public Works to:

6. Develop, in accordance with Act No. 6289 and forward to DP&P, cost estimates for repairs needed to make abandoned Government-owned property identified by the Commissioner of Property and Procurement usable for Government office or warehouse space.

GOVERNMENT OF THE VIRGIN ISLANDS' RESPONSE AND OIG REPLY

In his March 1, 2007 response to our draft report (Appendix 2), the Acting Governor of the Virgin Islands, through the management of DP&P, concurred with all of our recommendations.

As part of his response, the Acting Governor provided information showing that the DP&P had implemented plans of action to address each recommendation. As such, we consider Recommendations 1, 2, 3, 4, and 5 to be resolved and implemented and Recommendation 6 resolved, but not implemented (Appendix 3).

APPENDIX 1 – MONETARY IMPACT

FINDING AREA	LOST REVENUES	UNCOLLECTED REVENUES	FUNDS TO BE PUT TO BETTER USE
DEFICIENCIES IN LEASING OUT GOVERNMENT-OWNED PROPERTY TOTAL $3,096,423: ($956,825 + $2,139,598)			
Delinquent Accounts Receivable: ($1,242,175)			
Rental Revenue (Recommendation 1)	$73,508	$1,133,492	
Proof of Claim Filing with U.S. District Court (Recommendation 1)	35,175		
Subtotal	$108,683	$1,133,492	
Additional Rental Income and Related Fees: ($1,854,248)			
Uncollected Sublease Fees (Recommendation 1)		1,006,106	
Incorrect Calculations of Rent (Recommendation 2)	344,384		
Uncollected Rental Increases (Recommendation 2)	309,143		
Uncollected Late Payment Penalty Fees (Recommendation 1)	175,822		
Renewal of Expired Leases (Recommendation 2)	18,793		
Subtotal	$848,142	$1,006,106	
DEFICIENCIES IN LEASING PRIVATELY OWNED SPACE FOR GOVERNMENT USE TOTAL $5,959,625 ($5,100,000 + $859,625)			
Lost Opportunities to Purchase Privately Owned Space total $5,100,000			
Leasing Private Space in Lieu of Government Space (Recommendation 4)			$2,100,000
Lease Payments That Could Have Been Applied to Purchase Private Space (Recommendation 5)			3,000,000
Subtotal			$5,100,000
Other ($859,625)			
Renovations on Privately Owned Property (Recommendation 4)			859,625
Subtotal			$859,625
Totals*	**$956,825**	**$2,139,598**	**$5,959,625**

*All amounts represent local funds.

APPENDIX 2 – GOVERNMENT OF THE VIRGIN ISLANDS' RESPONSE

THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE

Charlotte Amalie, V.I. 00802
340-774-0001

March 1, 2007

Via Facsimile: (340) 774-7847

Mr. Hannibal Ware
Field Office Supervisor
Department of Interior
Office of Inspector General
Ron de Lugo Federal Building
Suite 207
St. Thomas, Virgin Islands 00802

Re: Draft Audit Report on Management of Real Property, Government of the Virgin Islands
Assignment No. V-IN-VIS-0002-2005

Dear Mr. Ware:

This letter is in response to the Draft Audit Report submitted by Michael P. Colombo, Regional Audit Manager, of the Office of the Inspector General. The purpose of this audit was to determine whether the Government (1) maintained adequate inventory control over real property; (2) maximized leasing of excess Government-owned property, including timely collection of rental income; and (3) minimized leasing of private property for Government use. This audit was done for business and commercial lease agreements and leases for Government office space in effect during fiscal years 2000 through 2005.

The Department of Property and Procurement ("DP&P") is governed by Title 31, Chapter 23, §201-205 of the Virgin Islands Code, with respect to the management of Government property. In January of 2005, the Department established the Property Task Force to make an assessment of its business and commercial tenant accounts. The task force was charged with reviewing every account, meeting with all tenants, increasing collection activities, liquidating outstanding balances by executing agreements to pay, renewing expired lease agreements, executing agreements where property is being utilized without a lease agreement being negotiated and operating within the mandates of the Virgin Islands Code as the Government's Property Manager. An employee property manual is being developed to better serve the Division of Property and to help encourage efficiency and streamline the internal processes and to address recommendations contained in the audit.

There are six (6) recommendations outlined by the Inspector General, and attached are the Government of the Virgin Islands' identified corrective actions taken to resolve these findings.

Should you have any further questions please do not hesitate to contact Acting Commissioner, Lynn A. Millin at (340) 774-0828.

Sincerely

Gregory R. Francis
Acting Governor

FINDING

DP&P did not collect over $1.2 million in delinquent rental payments, and did not collect nearly $1.9 million in additional rental income and related fees.

Government's Response:

We concur that the Department of Property and Procurement failed to collect monies owed to the Department on leases and subleases; however, we have addressed the issue of our ever increasing delinquencies. Since January of 2006, the Department has aggressively pursued collection on its accounts. Thirty-two (32) notices to quit and for eviction were issued to delinquent tenants between January and March of 2006. As a result of the issuance of eviction notices, the Department was able to collect all outstanding obligations on fourteen (14) out of the Thirty-two (32) accounts. Six (6) Agreements to Pay were issued to tenants after having made a 25% down payment on their outstanding obligations. All these agreements remain current. Seven (7) accounts have been referred to the Department of Justice to file Complaints in the Superior Court for Forcible Entry and Detainer. The Department was able to regain the property from one account, upon determining that the property was abandoned due to the death of the tenant. Two (2) of the tenants have abandoned/not occupying their properties and termination proceedings have been initiated. One (1) tenant upon receiving notification of the eviction submitted a duly executed affidavit stating the property had been surrendered back to the Department; therefore, rent should not have accrued on the account past the pay-off date. The other case has been referred to the Department of Justice. Finally, two (2) properties were successfully evicted without a formal proceeding in Superior Court due to the fact that the properties were occupied by squatters.

In prior years, the Government was not vigilant with inspecting its properties to ensure the agreed upon use and purpose of the lease was being carried out by the tenant. The Department has inspected all of its properties during 2006 and determined where subleasing activities have been taking place. Fees for subleasing activities are determined by the terms of the lease agreement with the Government. The 25th Legislature increased the Government's subleasing fee to 35%. As a result, Property & Procurement wrote to the Department of Justice to resolve the issue as to whether the 35% increase was retroactive, whether it applied to all existing leases despite the agreed upon percentage or only to new leases developed by the Department. The Department has failed to add the additional ten percent (10%) on accounts that are delinquent until the matter is resolved.

SPECIFIC FINDING

DP&P allowed Family Broadcasting, Inc., to occupy Government Property without paying rent for more than 12 years and accumulate an outstanding balance of $94,700 before DP&P sent a letter detailing the history of nonpayment. The tenant signed a payment agreement for $73,508, but then filed for bankruptcy protection. The U.S. District Court for the Virgin Islands notified DP&P that it must file proof of claim by August 11, 2005, to recoup any delinquent rent. DP&P failed to file, and now the Government of the Virgin Islands will not be able to collect any of the money it is owed.

Government's Response:

The Government did not file a timely proof of claim in the Family Broadcasting, Inc. matter. However, the Department did subsequently submit a proof of claim and is currently listed as a debtor that is owed in the Bankruptcy proceeding.

SPECIFIC FINDING

DP&P allowed Wings Auto Parts to occupy Government-owned property without making rental payments for up to 31/2 years and to accumulate an outstanding balance of $35,175. When the tenant filed for bankruptcy protection, the District Court discharged all claims against the owner as of the date of the action. DP&P was unable to recoup any of the outstanding balance, but continued to allow the tenant to occupy the property without paying rent for 3 more years and accumulate $13,180 in addition unpaid rent. DP&P eventually issued a Notice to Vacate, but had not taken any serious eviction action as of the end of our audit.

Government's Response:

We concur. Wings Auto Parts did successfully receive a discharge of debt and remained on the property. The Department has since severed its relationship with Wings Auto Parts and has reclaimed the property back into inventory.

RECOMMENDATION NO. 1

Identify delinquent tenant and pursue collection efforts aggressively by:

a. Requiring all current lessees with delinquent accounts to make full payment or arrangements for monthly liquidation of delinquent accounts. Tenants who fail to pay delinquent balances should be promptly evicted, with their accounts referred to the Attorney General's Office for collection.

b. Assessing and collecting subleasing fees for tenants subletting Government-owned property.
c. Assessing and collecting late payment penalties on delinquent accounts.

Action Plan:

The Department is monitoring its accounts on a monthly basis. We have completed the electronic archiving of our business and commercial accounts, which will enable the Department to assess the CPI increases by setting a timer function that will notify the Fiscal Office as well as the Division of Property that the increase is scheduled to take place in thirty (30) days. The Fiscal Office will be responsible for calculating the increase and generating a notification letter to the tenant of the increase. Additionally, the Department has begun invoicing and now issues a monthly invoice to each tenant. Currently, the Department is also in the process of expanding the perimeters of the invoice to include the current balance, 30 day past due, 60 day past due and 90 past due balances. In order to achieve this goal, the Department reviewed all the account balances so that once the transition in invoicing occurs there will be no errors in the account balances as they will also reflect the late fees that the Department can charge.

The Department has established that all subleasing activities must have a separate file, including the sublease agreement between the tenant and sub-tenant. It is the responsibility of the Fiscal Office to assess the subleasing fee based on the master lease agreement. As of 2005, all newly executed leases include the provision for a 35% subletting fee.

Additionally, the Department created a ticket book that will enable its property inspectors to issue warnings and fines to tenants that are misusing the government's property, subleasing without the Department's consent, allowing the property to fall into disrepair, careless use of hazardous materials and for keeping junked or abandoned vehicles on the leased property.

FINDING

DP&P did not renew expired leases or monitor compliance with other requirements.

Government's Response:

We concur that Property and Procurement failed to re-execute expired lease agreements and the process was void of any process to monitor the tenants' compliance with the Department's established policies and procedures; however, the Department has required its staff to strictly adhere to the policies and procedures that are in place and in a few instances implemented new mandates. The property task force discovered that the Department did in fact need to create a system that would monitor the lease agreements for expiration and renewal, CPI increases, updated documentation on insurance and business licenses, as well as the need for routine but random property inspections.

SPECIFIC FINDING

DP&P did not renew expired lease agreements... The 1-year lease with Haulover Marine, which began on October 1, 1992, continued for 12 years, although the lease was never renewed. On four occasions, Haulover Marine requested approval to enter into a long-term lease agreement.

Government's Response:

The Government has negotiated and executed a lease agreement with Haulover Marine as of April of 2006.

RECOMMENDATION NO. 2

Establish and implement a formal lease monitoring system to ensure that (a) expired leases are renewed to reflect current market rates, (b) rate increases specified by lease terms are timely implemented, (c) routine physical inspections of Government-owned lease property are performed and inspection reports prepared to confirm that only authorized tenants and subtenants are on the properties, and (d) liability insurance coverage and business licenses are obtained by lessees and kept current.

Action Plan:

The Department conducted training for its inspectors to address the target points for inspections and maintaining familiarity with the tenant file. A schedule was developed for property inspections. On Tuesdays and Thursdays, the inspectors are given a list of properties to be inspected. Prior to conducting an inspection, the inspectors are tasked with reviewing the corresponding file to ensure that the inspection yields efficient results and follows up on previous citations to prevent recurrence. The property inspectors are also required to measure the details of the file with the actual physical attributes that are found during the inspection. Monday, Wednesday and Friday are office days for the inspectors to review any files or discuss their findings with the Director or Deputy Commissioner.

The Department updates its internal records annually, with the assistance of the files being monitored electronically. A policy has been established to obtain an appraisal report when generating a new lease agreement to ensure that the Government is getting fair market value for the properties it is leasing.

FINDING

DP&P issued letters of good standing and lease renewals to delinquent tenants

Government's Response:

We concur that the Department of Property and Procurement failed to review its files prior to issuing letters of good standing on behalf of its tenants. As a result, in some cases, this renewed a bad relationship with a delinquent tenant through the execution of a new lease agreement; however, the Department has instituted a policy of reviewing a tenant's request through a task force meeting with the tenant to ensure the Department does not reward a delinquent tenant by renewing a lease or not collecting outstanding rent. The Department acknowledges that there has been a breakdown in communication between the Division of Property and the Fiscal Office. As a result of the poor communication, many accounts have fallen into delinquency and outstanding balances have escalated to unprecedented amounts. This has been rectified and should not recur.

RECOMMENDATION NO. 3

Require DP&P's Fiscal Division to be notified of rental increases to ensure that official payment records reflect accurate tenant account balances.

Action Plan:

The Department established an invoicing system which allows the Government to manage its rental properties more like a business. The invoices are generated by the Fiscal Office, since all payments on accounts must be made to the Fiscal Office. However, the Division of Property is charged with the overall management of the accounts, both offices meet monthly to discuss any problematic accounts and determine whether it is necessary to call the tenant in for a face to face to discuss the outstanding balance, send a notice of delinquency or issue a notice to quit and for eviction. Since the problem centered on poor communication between these two offices within the Department, members of both divisions meet prior to the release of the invoices to ensure each account is properly reconciled with respect to payments. The Department anticipates that the newly developed invoice will be implemented by May 1st, 2007. The invoice will capture current as well as outstanding balances on a 30, 60, 90 day basis. This will allow the Department to keep its collections consistent to avoid trying to collect insurmountable balances that go back years.

FINDING

DP&P deficiencies in leasing privately owned space for Government use.

Government's Response:

We concur that Property and Procurement's process for leasing privately owned office space was deficient and in many instances the Government did not comply with its own policy; however, we have started negotiating all space management leases to ensure that the Government is not being taken advantage of during the commercial leasing process. The Department has been negotiating all leases for Government agencies in the St. Croix district to ensure the best rate for the Government. However, the St. Thomas operation has not been as diligent. Leases are rarely, if ever negotiated in St. Thomas. There are policies in place with respect to how the Department evaluates a potential commercial office or warehouse space and these will be fully implemented throughout the Territory.

RECOMMENDATION NO. 4

Require DP&P to negotiate and execute all leases for Government agencies to obtain the most advantageous rental rates for Government office or warehouse space.

Action Plan:

The Department conducted training with the members of the space management staff to go over its policy for negotiating and executing leases on behalf of Government agencies. The Department also has a ceiling established for rates on office space and warehouse space that is being adhered to now. Inspections were only conducted when requested by an agency with a problem. The Department has four vacancies for property inspectors, upon filling those vacancies, inspections will be conducted routinely on behalf of the Government to ensure the commercial landlord is meeting the guidelines of the Government's space requirements.

The Department is in the process of developing a scope of work to advertise specifications for a Government Complex. A Request for Proposal will be advertised in March of 2007 as a design, build and finance that will be turn keyed over to the Government.

FINDING

DP&P failed to follow up on opportunities to purchase privately owned space being leased by the Government.

Government's Response:

We concur that Property and Procurement was negligent in not acquiring property used by its instrumentalities that was offered for sale; however, the Department has renewed its interest to accept prior offers to purchase buildings that are being leased by Government agencies. The Department acknowledges that is has failed to acquire properties that are used by Government agencies, even when the property owners have offered the properties for sale. The Government has recently acquired the Massac Nursing Home of behalf of the Department of Human Services.

RECOMMENDATION NO. 5

> Contact private property owners who made sales proposals to determine if the offers are still valid and determine whether the Government should purchase the properties.

Action Plan:

Beginning October 1, 2006, the Department renewed its interest in all properties that were offered to the Government for purchase. Discussions have begun with the principals of Fast Foto, Inc. to begin the process of acquiring the Vitracco Mall Building in St. Croix. To date, three appraisal reports have been obtained for the purchase and the Department is trying to obtain the funding to complete the acquisition. Last year the Department met with the Department of Planning and Natural Resources, Virgin Islands Police Department and the owner of Rainbow Plaza to discuss purchasing the property. The intention of the Government in 1998 was to rent Rainbow Plaza with an option to purchase. The purchasing option was omitted from the lease agreement and never provided for contractually. The owners have expressed that they would like to receive income for life from the property; therefore, the Department is considering a Government taking on the basis that the Government has invested over three million dollars into the property.

FINDING

Failure of DPW to estimate costs to repair abandoned Government Properties.

Government's Response:

We concur that Property and Procurement has failed to comply with Act No. 6289; however, the Department has requested funding under a supplemental budget to address identified properties under this Act. A listing has been prepared of all abandoned and derelict Government-owned property. This recommendation relies on the services of the Department of Public Works to develop scopes of work or design draft plans for the rehabilitation of Government-owned property. The Department has requested on several occasions thru the Commissioner of the

Department of Public Works to have its engineering department review and furnish Property & Procurement with a scope of work. To date only a scope of work for the main building in St. Thomas has been done. Currently, the Department has to process a supplemental contract, due to the fact that many critical components were not included in the original scope of work.

RECOMMENDATION NO. 6

Develop, in accordance with Act No. 6289 and forward to DP&P, cost estimates for repairs needed to make abandoned Government-owned property identified by the Commissioner of Property and Procurement usable for Government office or warehouse space.

Action Plan:

The Department has been informed that the Engineering Division at Public Works is short staffed; therefore, we have engaged the services of a private engineer to develop scopes of work and draft plans for Government-owned properties. Act No. 6289 did not provide funding or a source of funding to execute the Act's intention. The Department is requesting additional funding in fiscal year 2008, specifically to carry out the mandates of Act No. 6289.

APPENDIX 3 – STATUS OF AUDIT RECOMMENDATIONS

Finding/ Recommendation Reference	Status	Action Required
1 - 5	Resolved and Implemented.	None.
6	Resolved, Not Implemented.	Provide cost estimates for repairs needed to make abandoned Government-owned property usable for Government office or warehouse space.

Report Fraud, Waste, Abuse and Mismanagement

Fraud, waste, and abuse in government concerns everyone: Office of Inspector General staff, Departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and abuse related to Departmental or Insular area programs and operations. You can report allegations to us in several ways.

By Mail:	U.S. Department of the Interior Office of Inspector General Mail Stop 5341 MIB 1849 C Street, NW Washington, D.C. 20240	
By Phone:	24-Hour Toll Free Washington Metro Area	800-424-5081 703-487-5435
By Fax:	703-487-5402	
By Internet:	www.doioig.gov	

Revised 07/06