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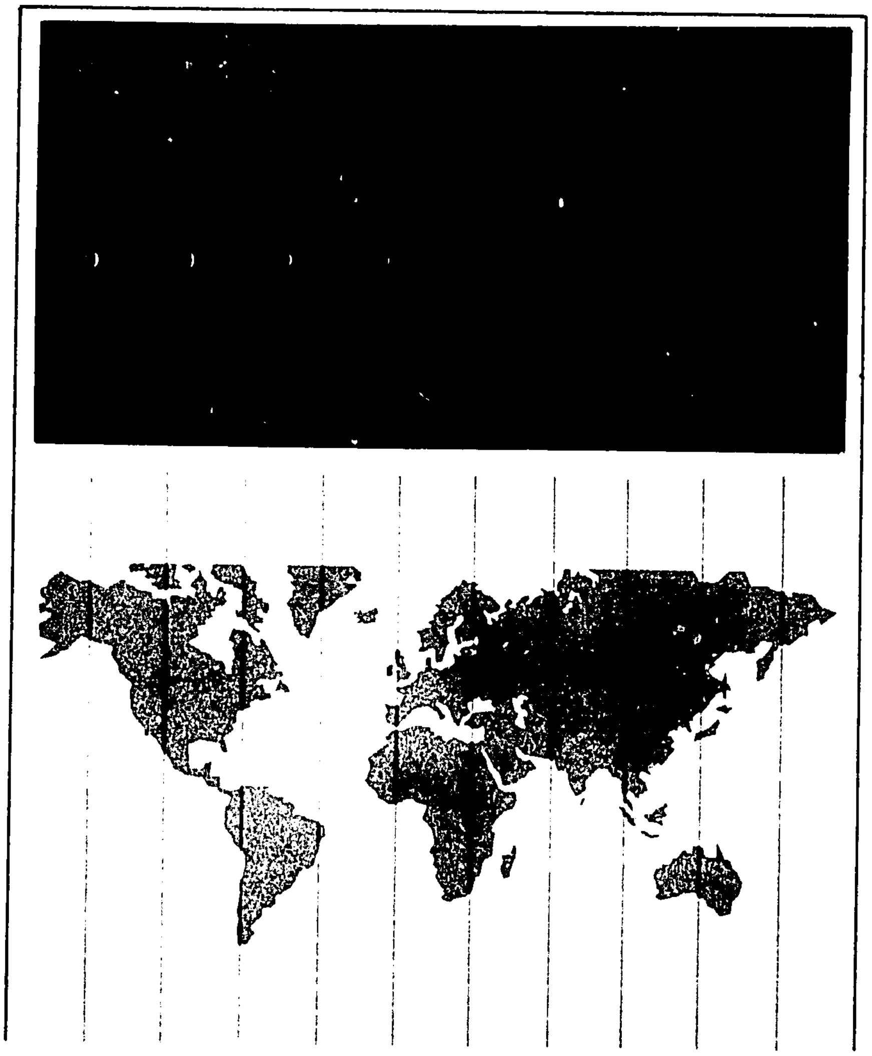

Regional Inspector General for Audit
NAIROBI

HOUSING GUARANTY LOAN PROJECT 664-HG-003

CAISSE NATIONALE D'EPARGNE LOGEMENT

TUNISIA

Audit Report No. 3-664-81-10

May 26, 1981

HOUSING GUARANTY LOAN PROJECT 664-HG-003

Caisse Nationale d'Epargne Logement (CNEL)

TUNISIA

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EXECUTIVE SUMMARY

Introduction

Tunisia was the first country on the African continent to witness the application of AID Housing Guaranty (HG) loan resources (1966). To date, five HG loans have been authorized for a total resource transfer of about $60 million. Of this amount, almost $35 million had been disbursed at the end of CY 1980 under the terms of four loan contracts between various private and Government of Tunisia (GOT) borrowers and several AID-guaranteed U.S. lenders. The GOT, in turn, has in each instance executed a co-guaranty agreement with AID covering AID against all but the most remote risks of loss.

The Tunisia HG program very much reflects the evolution of this AID program worldwide. Beginning with a privately sponsored, middle-income project in Tunis, it has, since that first shelter sector intervention, benefited Tunisian families of progressively lower income strata. It has also expanded geographically from Tunis to secondary cities on the coast and, most recently, under a proposed $50 million HG project not yet implemented, to smaller interior urban centers. The latest implemented HG project was 664-HG-003 ($20 million), which included a slum area upgrading component. This subproject was also assisted by about $600,000 in grant funds under an AID/Washington centrally funded IIPUP (Integrated Improvement Project for the Urban Poor) activity. These funds were designed to finance technical advisory services, health and social services, employment generation and credit facilities in the HG-loan-assisted Tunis slum area targeted for upgrading. Since 1977, management of HG project activities in Tunisia has been the responsibility of the Regional Housing & Urban Development Office of AID's Near East Bureau (RHUDO/NE) located in Tunis, Tunisia.

Scope

AID's Inspector General (formerly Auditor General) function has exercised regular oversight of HG activities in Tunisia through audit visits at 24 to 30 month intervals over the past several years. The latest such report (No. 3-664-79-01, dated October 19, 1978) issued by the Area Auditor General for Africa (now Regional Inspector General for Audit, Nairobi) focused mainly on HG projects 664-HG-002 and 003. The latter project had only recently gotten underway at the time of our prior audit. Our previous report contained six recommendations which had been closed for some time prior to our field visit to Tunisia during January and February, 1981.

The focus of the present review was to update the information contained in our previous report -- concentrating mainly on project 664-HG-003 and the activities and development of the Tunisian Housing Bank, Caisse Nationala d'Epargne Logement (CNEL) -- an institution slated to play a major role in the implementation of the next large HG project. At the same time we have attempted to look ahead and relate HG project experiences under the multi-component 003 project to activities proposed, albeit not yet implemented, under follow-on project 664-HG-004, the first tranche ($25 million) of which was authorized in 1979.

We examined books and records, made site visits, and interviewed AID and GOT officials and private Tunisian citizens to the extent deemed necessary in the conduct of our review. At various points during our stay in Tunisia, and as our field work progressed, we prepared preliminary finding statements (Record of Audit Findings) for the information or action of responsible AID officials. These statements were discussed at some length with officials of RHUDO/NE and USAID/Tunisia prior to our departure. At our request, written comments on our preliminary finding statements were jointly submitted by these two entities, and were drawn upon as we deemed necessary and appropriate in the preparation of this report.

Findings, Conclusions and Recommendations

AID Housing Guaranty Loan project 664-HG-003, in our opinion, has been a qualified success. It has achieved its construction goals, although not without certain inefficiencies and opportunity costs that prevented these goals from being exceeded. At the same time, it has been quite successful in benefiting below-median-income Tunisian families in real need of HG loan assistance.

For its part, the GOT does appear to be moving in the direction of restricting shelter subsidies to those income strata of its population in most need of them. Nevertheless, the degree of subsidization remains such that shelter sector institutions must continue to rely heavily on GOT capital inputs, including external financing arrangements, if they are not to become decapitalized by the effects of these subsidies. This trend can be reversed, in our view, through the mobilization of local capital resources for housing finance purposes. To its credit, the GOT is studying a "free savings" approach to housing finance which could accomplish this objective and greatly diminish, or eliminate altogether, the need for external financing of its housing programs.

Responsible AID housing officials have worked hard at fostering a dialogue with the GOT on housing policy matters in the face of official reticence and occasional non-cooperation. However, it is our opinion that RHUDO/NE has not done all that it could or should have done to adequately monitor the physical construction or financial management aspects of project 664-HG-003. AID housing officials have not adequately emphasized to GOT housing institutions the importance which AID housing policy attaches to cost recovery and portfolio management. Finally, they have not verified GOT compliance with certain provisions of the project Implementation Agreement as regards the end-use of HG loan financed housing units. Nor have they monitored the level of publicity accorded to, and beneficiaries' of HG financed housing awareness of, USG contributions to the Tunisian shelter sector. Our observations of project managers' implementation practices leads us to conclude that greater emphasis has been accorded to the planning and negotiation of future HG project than to implementation of project 664-HG-003. It would be our hope that the nature of the AID-GOT relationship in the shelter sector could be modified to such an extent that adherence to the terms and conditions of international financing and administrative agreements and AID shelter policy objectives could be ensured independently of future HG loan financing considerations, and in consonance with the needs of the Tunisian shelter sector (pages 38-48).

Substantial opportunity costs were incurred in the production of expendable core housing units because over one-third the number built were enlarged in size beyond what was approved by AID. Additionally, significant deficiencies were found in core unit construction techniques, subproject siting, and community facilities. GOT local authorities and construction supervisory personnel appear to exercise no control over unauthorized unit extensions The GOT has not provided planned community facilities as agreed to (pages 4-12).

AID's periodic financial reports on the Housing Guaranty Program do not accurately reflect the status of project 664-HG-003. This is because the AID W-239 report shows HG loan funds authorized for this activity as fully disbursed when, in fact, only about 78% of the funds had actually reached the ultimate GOT borrowing institutions. The remainder of HG loan funds ($4.5 million) lay in three separate escrow accounts whose terms and conditions varied considerably one from another. In two of these cases, arrangements made for the release of escrowed funds were found to be satisfactory; in the third case, however, these arrangements appeared to conflict with provisions of the project Implementation Agreement. Additionally, the GOT borrowing institution under the core housing project component, CNEL, had overvalued the dollar amount of mortgages presented to AID thus far, and has yet to account for 14% of the HG loan funds disbursed under this project component. CNEL had also underestimated the extent of home loan repayment delinquency and should consequently strengthen its portfolio management practices (pages 13-34).

Interviews with randomly selected residents of core units revealed that a substantial number of these dwellings at certain project sites had been rented. Speculative use of HG loan financed dwellings is prohibited in the CNEL sales agreement. Furthermore, our talks with project residents revealed that almost all core unit dwellers we interviewed were unaware of U.S. Government participation in this effort to address their shelter needs. A review of documentation under the second $10 million tranche of this HG project disclosed that the terms of AID's project authorization had been exceeded as regards the length of the grace period granted for the repayment of loan principal (pages 34-38).

This report contains a total of eleven recommendations designed to assist RHUDO/NE, in coordination with USAID/Tunisia, to address the deficiencies described in the body of this report. As a result of actions already taken, two recommendations have been closed. In certain instances, our recommendations are directed at the correction of what appear to be system deficiencies revealed during the course of our review. By directing the attention of responsible AID and GOT officials to these areas, we believe that the process of implementing a proposed follow-on HG loan project will be facilitated, and chances for that project's success enhanced.

We have been requested by AID's Office of Housing (DS/H), which requested and was provided an opportunity to review the draft report, to include the following comments at this point in the report, to which we have appended our responses as deemed necessary.

> "(A) DS/H believes that project 664-HG-003, Tunisia is a good project of which AID, the Government of the United States, and the Government of Tunisia should be proud and that the management of the project by RHUDO/NE has been sound and rigorous."

We have stated that, with certain qualifications, this project has been a success. We cannot agree, however, that project management has been "sound and rigorous" for reasons described at some length in the body of the report.

> "(B) The audit report which alleges deficiencies in the project and the management of it has little discussion of the purposes, as stated in the description of the project when it was approved, that set management objectives. Allocations for shelter programs reaching the urban poor are being increased; slum upgrading has been accepted by the Government of Tunisia as an alternative to clearance; and through greater emphasis on lower cost projects, the Government has moved toward matching shelter options to the financial resources of occupants and reduced the relative magnitude of subsidies in its shelter programs. Specifically, almost 3000 units affordable by families at the 15th percentile of the urban income distribution are nearing completion and upgrading is underway of one of Tunis' largest slums with over 4000 families. Substantial employment resulted from the project's construction activities. In all it is estimated that about 40,000 people have directly benefited from the program. Final project costs are very close to original estimates."

Project objectives are mentioned in the Background section and fully discussed in the final section of this report together with a number of related policy issues. We therefore consider our treatment of this area to be adequate.

"(C) The audit report credits the project with being quite successful in benefiting below median income Tunisian families in real need of HG loan assistance and credits AID housing officials for working hard at fostering a dialogue with the Government of Tunisia on housing policy. The report then qualifies the success because goals were not exceeded (emphasis added). To be sure, further shifts to lower cost programming, further reductions in interest rate subsidies, and further development of savings systems appears to be desireable from our view point; but for AID to do more than help introduce these ideas is unrealistic and not appropriate to its role."

We believe this project should be termed a "qualified success" for a number of reasons, including the one mentioned above. From a reading of this report it will also become apparent that AID's efforts at fostering a dialogue with the GOT have met with something less than success.

"(D) The report laments, as an illustration of mismanagement that 500 of the units in one part of the country (about one sixth of the total) were built with two rooms instead of one. The report's analysis of the opportunity cost is faulty and its finding that this is a serious variance is weak. It passes over lightly that those units were built nevertheless within original cost estimates and that those costs were even lower than some of the units in other parts of the country. In fact, AID was concerned about the opportunity missed to reduce costs even further on those units, but more importantly, to have insisted on building more units than originally agreed would have been unjustified and would only raise GOT questions as to RHUDO seriousness and as such could have jeopardized the dialogue with the Government on substantive issues."

If our analysis of opportunity cost was weak, we would have expected the auditees to supply an alternative analysis. However, they have not done so. In fact, RHUDO/NE is at this moment pressing the GOT to identify sites and begin construction on an additional 180 core units to absorb HG loan funds left over after construction of the original 7 project sites ended. This surplus was seen almost three years ago as likely to occur and noted in our prior report, but no action was taken to avert the present situation described in detail in the body of this report.

"(E) The report alleges that RHUDO/NE has not done all that it could or should have done to adequately monitor the project and verify compliance with agreements, yet most, if not all, of the construction and financial deficiencies noted were identified and documented by RHUDO staff and their consultants prior to the audit. The seriousness of those deficiencies has been overstated in the report. The photographs at the end of this report, DS/H believes, show a good project, and the photos should be recaptioned. These are very low cost projects that actually deliver quite a lot for the money."

The report states that RHUDO/NE staff located in Tunis did not visit the five project sites located outside the capital city for more than two and one-half years. Moreover, after a consultant visited the sites and submitted a report describing the deficiencies that we too found and verified, 15 months passed before RHUDO staff made site visits; and then, we believe, only because of our draft report findings and site visit results. We further believe that the captions included in the photographic exhibits are accurate. If DS/H felt a need to recaption the photos, then alternative texts should have been supplied for our consideration. However, no alternative captions were offered.

"(F) The auditors characterize the Tunisians as non-cooperative and unresponsive to the terms and conditions of international agreements. What they note, however, are problems in reporting and detail some of which may arise from weakness in Tunisian information systems. The report has not demonstrated any reticence in working toward the basic purposes of the program, in meeting anticipated outputs, or discussing AID shelter policy objectives."

In contrast to these assertions, the report text notes that the HG loan borrower never responded to RHUDO's letter of 1980 regarding project construction deficiencies identified by RHUDO consultants; the GOT National Building Society has refused to submit an oft-requested evaluation of its participation in this project, accounting for one-half ($10 million) of the total loan funds; and the HG loan Borrower refused us access to its books and records relating to funds on deposit with an escrow account in the Bahamas until pressure was brought to bear on this matter by AID and Embassy officials, with a delay of two months intervening before access was finally granted. Finally, RHUDO/NE was actually discouraged from bringing a DS/H consultant and eminent American urbanologist to Tunisia by Tunisian authorities when it was disclosed he had been commissioned to carry out a study of AID HG Program impact on the Tunisia shelter sector. We respectfully submit our view that cooperation and responsiveness do not always characterize the AID-GOT relationship in HG Program matters.

"(G) Finally, the allegation that AID officials have evidenced what appears to be greater concern for the planning and negotiation of future HG projects than for adequate implementation of project 664-HG-003 is outrageous and totally unsubstantiated. The project and management of it are good and should be credited as such."

We believe our conclusion on this score is adequately substantiated. In fact, we feel it will be evident to the reader as he/she reads the auditees' comments interspersed throughout the report.

Finally, we would point out that the receipt of the foregoing comments from the Office of Housing has been significant from an audit point of view. They confirm our impressions formed over the past 18 months and several prior HG project reviews that inadequate attention is being paid to project implementation by HG Program officials who appear more interested in future project development. Our concerns on this score have been expressed in prior reports, but always rebutted by RHUDO officials. With these comments, however, we are able to determine the origin of this resistance to be those responsible for the direction of the worldwide HG Program itself. We believe this attitude constitutes a serious system deficiency in this important AID resource transfer program, and should be a matter of some concern to top level AID management officials.

BACKGROUND

The Republic of Tunisia

Tunisia is a relatively small, Louisiana-size country wedged into the pinnacle of North Africa by its larger neighbors, Algeria and Libya. Its lengthy Mediterranean coastline faces Sardinia to the north and Sicily to the east. It has been the recipient of substantial U.S. Government assistance -- especially food assistance -- for almost 25 years. Over the next five years, however, this assistance is scheduled to phase out due to Tunisia's relatively good development record over the past quarter-century.

Some 6.5 million people inhabit this once agricultural and pastoral country. As a result of GOT urban-focused development efforts over the last two decades, however, it is now estimated that more than half the total population lives in urban centers, and especially in the capital city, Tunis, and other coastal population centers in the east. (See map of Tunisia at Exhibit A). Although this last statement, drawn from RHUDO files, remains valid, the auditees wish to note as well that:

> "...over the past several years there has been a distinct shift to the rural areas in GOT development efforts with USAID, RHUDO, and World Bank assistance especially aimed at rural areas such as the Central Tunisia Development Project, HG-004, etc."

The Shelter Sector

The GOT accords substantial priority and budgetary inputs to the shelter sector. As the government contemplates the priorities and breadth of its next (6th) five-year economic Plan, it seems likely that the GOT's role in the field of housing finance will alter somewhat from that of earlier Plans. As late as the 4th Plan, the GOT provided subsidies for the construction and maintenance of high-cost houses. At about the same time, however, it created a new financial institution -- a National Housing Savings Bank, known as the Caisse Nationale d'Epargne Logement (CNEL), whose thrust was to serve lower income strata of the population at reduced GOT subsidies.

With the increased cost of shelter production and construction financing, including external borrowing, it seems clear that GOT shelter sector policy-makers realize that resources other than those provided by the government can and should be tapped to support and expand housing initiatives. It has been quite amply demonstrated that the propensity of Tunisians -- even those with modest incomes -- to save, borrow and sacrifice for the purpose of owning their own homes is quite high. Thus, if the opportunity were available to these people to make savings deposits as and when they felt appropriate, probably greater private resources ("mattress money") could be mobilized for the purpose of shelter production, and reliance on GOT and external financing lessened.

On the technical side, despite the rising cost of conventional construction methods, Tunisians appear to prefer solidly built traditional structures. Thus, it is not unusual to find a modest one-room core (expandable) unit that, at the end of one year, has been transformed into a five or six-room dwelling of possibly two stories. This is an indication of family wealth -- as opposed to income -- that often stems from the sale of a wife's dowry jewels. Also, intra-family lending for the purpose of home purchase or extension is commonplace and usually interest-free. Thus, it is clear that once access to a serviced plot of land is made possible, the resources for acquisition of the property are available to families of apparently very modest means. Furthermore, self-built or locally contracted home construction or extension quite often turns out to be of a higher quality than that offered by GOT institutions, and less costly as well.

In all cases, the responsibility for infrastructure works -- roads, drains, sewerage -- and public facilities lies with the GOT. Planned public facilities normally include health, educational, commercial and religious buildings that are considered by the GOT to round out the needs of an integrated community.

AID Shelter Sector Contributions

To date, AID's contributions to the Tunisia shelter sector through the Agency's Housing Guaranty Program have taken the following form:

-- The financing of 575 middle-income homes in the suburbs of Tunis (Project 664-HG-001, $4,992,178, authorized in 1966) developed by a private U.S. builder.

-- $10 million HG loan funding for a large, lower and lower-middle income area of Tunis known as Ibn Khaldoun (Project 664-HG-002, authorized in 1972). 1,948 units of the proposed 13,000 unit total to be built by the GOT National Building Society (SNIT) were financed by this loan.

-- $20 million was authorized in two separate tranches under loan 664-HG-003 for three sub-projects: (a) to help finish Ibn Khaldoun mentioned immediately above ($10 million); (b) to finance the construction of 1,000 core units ($5 million) on seven sites nationwide under the sponsorship of the GOT's National Housing Savings Bank (CNEL), which is also the GOT borrowing institution for this entire loan package; and (c) $5 million to assist the Municipality of Tunis in upgrading a capital city slum area known as Mellassine through the financing of improved utilities and infrastructure works for the area.

Thus, about $35 million in HG loan funds has been made available to date. In addition, $25 million has been authorized under proposed project 664-HG-004 as a first stage HG loan contribution to the provision of shelter and upgrading of slum areas in certain smaller interior Tunisian towns. HG planners currently envision HG authorizations subsequent to the first $25 million tranche of HG-004, which was authorized in FY 79/80, as follows:

FY	83	84	86	88
Amount	$15	10	15	10 million

The 83/84 authorizations represent the second $25 million for HG-004. The 86/88 authorizations are for projects yet to be designed. Therefore, HG planners have proposed an additional $25 million for yet to be designed projects and $50 million for forseeable future resource transfers.

AID Housing Program Management

The majority of AID's shelter sector resource transfers are authorized in Foreign Assistance Act Sections 221, 222, 223, and 238 which provide for an AID all-risk (except against investor's fraud) full faith and credit guaranty on behalf of the U.S. Government to eligible U.S. investors on loans made in support of AID approved shelter projects in less developed countries. The program is intended to be financially self-sufficient, supporting itself from fee income associated with authorized loan guarantees. The Office of Housing is located within AID's Development Support Bureau (DS/H), and provides policy guidance, program direction and support to six regional field offices worldwide. AID's regional office of housing with program cognizance for Near East Bureau AID housing projects (RHUDO/NE) is located in Tunis, Tunisia and is staffed by four U.S. direct-hire professionals. The responsibility for planning, design and implementation of Housing Guaranty (HG) projects normally lies with the RHUDO. This office has been active in Tunisia since 1977. Over the past several years, the HG program has funded a series of studies dealing with general and specific Tunisia shelter sector topics from which certain information presented in this report has been drawn.

Project 664-HG-003

As noted earlier, under this project AID authorized two loans of $10 million each for three project components: completion of a large urban project in Tunis for lower-income residents of the capital city; the construction of about 1400 units of core or expandable one-room houses at seven project sites in Tunis and other secondary towns along the country's eastern coast; and the provision of infrastructure works in the upgrading of a Tunis slum area known as Mellassine. The project was intended to encourage a shift in Tunisia's shelter policy and to maximize the impact of the GOT's shelter programs aimed at below median income families. Three major objectives were sought:

- Slum upgrading would become an alternative to slum clearance.

- The GOT would move toward lowering the standards of low-income public housing to a level more compatible with the financial resources of its occupants.

- The GOT would make strides in reducing the magnitude of its shelter subsidies, thus permitting GOT resources to be shared among more beneficiaries.

The two loans were provided under the following terms and conditions:

<u>664-HG-003A</u>: $10 million, repayment over 30 years with an initial ten -year grace period as to principal repayment. Interest is at 8.3% per annum plus 0.5% AID fee. The lending institution is Morgan Guaranty Trust Company.

<u>664-HG-003B</u>: $10 million, repayment over 30 years with an initial five-year grace period as to principal repayment. Interest is at 9.875% per annum plus 0.5% AID fee. The lending institutions are E. F. Hutton and Stuart Brothers.

In each case, the GOT has provided AID with its co-guaranty to repay AID for any loss it may incur if, for some reason AID has to honor its guaranty to pay all or a part of the principal and interest owing to these investors because of a default on the part of the Borrower, Caisse Nationale d'Epargne Logement (CNEL), the national housing savings bank, an instrumentality of the GOT Ministry of Finance.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Core Unit Construction

Substantial opportunity costs were incurred in the production of expandable core housing units because over one-third the number built were enlarged in size beyond what was authorized by AID. Additionally, significant deficiencies were found in core unit construction techniques, subproject siting, and community facilities. Finally, GOT local authorities and construction supervisory personnel appear to exercise little if any control over unauthorized unit extensions.

Construction Variances

The results of our prior audit of project 664-HG-003[1/] included the discovery that certain core housing sites visited at that time were being built with two habitable rooms instead of one as planned. Only two of the

1/ Audit Report No. 3-664-79-01, October 1978.

seven total sites were visited during that review because they were the only ones where some of the core units had been occupied at the time. Therefore, it was not possible to quantify the impact of this construction variance. In fact, 500 of the total of 1426 units built under this project component, located on three sites in east-central Tunisia, were built with two rooms instead of one, and with higher boundary walls than planned. The total space variance was estimated to represent a 30% increase.

Misunderstanding -- In response to our previous report, RHUDO/NE advised us that, after a good deal of research, this variance had resulted from certain confusion in the minds of local officials of the GOT National Building Society, responsible for core unit construction, as to what AID had actually approved. They also concluded that, despite this misunderstanding, GOT officials had probably acted in good faith.

Controlling Document Silent -- According to the original AID Project Paper submitted by the Office of Housing (DS/H) to gain AID authorization for this activity, the unit construction was described as follows:

> "The core house itself will be a basic 15-20 m^2 enclosed unit consisting of a kitchen, bathroom and one living/sleeping room set on 80-100 m^2 lots."

While this is clear enough, the project Implementation Agreement, executed between AID and the HG loan Borrower, Caisse Nationale d'Epargne Logement (CNEL), does not mention the size of, or number of rooms in, the core units. The agreement does, however, state the following under Article III, Section 3.03 (c):

> "No construction for the subproject shall be started prior to obtaining the written approval by AID of technical plans, specifications, bid estimates, total costs, sales prices and plan, and construction time-tables."

We were unable to explain how so significant a variance was approved or came about.

Regional Cost Variances -- At the time the projects were being built (1977-1979), however, it was discovered that, for reasons of supply and demand, construction costs in the region where the three project sites in question are located were significantly lower than in other regions where the core housing program was being implemented. Thus, the construction variance did not ultimately affect the total number of units produced under this $5 million project component. Nevertheless, had the units been built to one-room specifications instead of two, a savings of between $700 - $800 per unit could have been realized ($350,000 - $400,000 total). This means that as many as 100 additional units could have been financed by HG loan funds than eventually will be when the program ends.

Conclusion -- An opportunity cost equal to about 8% of the total of HG loan funds made available for this project component has been incurred. However, the time for action has passed and further steps are not appropriate at this time.

Construction Deficiencies

In late 1979, RHUDO/NE commissioned an inspection of the seven core housing project sites by a local architectural and engineering firm. The report on this inspection was submitted in January 1980. Among the report's findings were noted:*

General:

- Leaking roofs.
- Poor quality carpentry and plumbing work.
- Lack of paved roads and storm drains.
- Absence of drainage for rear courtyards.
- Unauthorized unit extensions in some cases extending into public rights of way.

Particular:**

- Lot levels left higher than street levels without provision of access stairs or ramps.
- Exterior wall niches for electric meters not provided.
- W/Cs left unfinished.
- Site located in an isolated salt marsh without provision of community or transport facilities.
- Saline soil conditions causing wall surfaces to crumble and deteriorate.

Construction Inspection -- Core units were built by private contractors under the general supervision of the GOT National Building Society, SNIT (Société Nationale Immobiliere de Tunisie). SNIT placed inspectors at all core housing sites during the construction period to oversee the contractors' work. At the conclusion of this stage, and before the units were delivered for occupancy, a joint inspection was made by various private and public parties concerned with the construction process. If the results of this

* Certain conditions are depicted in photographic Exhibit B to this report.
** Found at one project site only; not generalized.

inspection were favorable, a so-called "provisional acceptance" of the project was granted, and residents were permitted to move in. After one year, a similar "final acceptance" inspection was to occur. The interim between these two inspections permits latent construction defects to be identified and corrected. Until final acceptance has been granted, a certain percentage of the value of the construction contract is retained by SNIT to cover the cost of repairing defects, if the contractor is unable or refuses to do so.

Despite this system, however, the problems noted above were permitted to persist and the units passed for "provisional acceptance" and occupancy. During our own tour of core housing sites we noted many of these conditions which were acknowledged by SNIT and CEEL field personnel who accompanied us. For example, at one site SNIT inspectors pointed out to us how residents were expanding their units in an unauthorized fashion. Asked why this was not brought to residents' attention, SNIT's inspectors stated they were not empowered to curtail these practices which sometimes project into public rights of way. In another instance, we noted that the plaster surfaces of exterior walls of all core units at a southern project site were seriously cracking and deteriorating. We were advised by technical personnel who accompanied us that the condition was owing to high saline content in the soil which is prevalent throughout the area and not confined to the project site. The condition is preventable, we were further advised, by using a richer cement mix or by isolating the walls from the soil by a tar application. The cost of these solutions was estimated to be about $120 in equivalent local currency (about 3% of sales Price), but for some reason none was used to prevent wall deterioration from taking place.

The auditees have provided us with the following comments at this point.

> "It is simply not true that local authorities exercise 'no control' over unauthorized unit extensions. Like most places, in Tunisia the degree of enforcement depends on the locality. RHUDO is aware of several households who say they have had court actions against them because they did not conform to the extension plan proposed by SNIT. On a recent inspection of eight project sites, RHUDO and DS/H staff could find only one project site where extensions seriously encoached upon public space."

RHUDO does not define what it considers to be "serious" encroachments of public space. We believe that most such encoachments result from error, ignorance or misinformation which it is the responsibility of GOT authorities to correct. Under these circumstances the seriousness of the encroachment is probably a matter of happenstance; however, non-enforcement of local ordinances, regardless of the nature of the infraction, cannot be so viewed, in our opinion.

AID Follow-up -- In reviewing the files, we noted that the last field trip by responsible RHUDO/NE housing officials to core housing sites outside the capital city of Tunis took place in November, 1978. Despite the rather bleak description of certain project conditions found in the aforementioned RHUDO-commissioned inspection report submitted in early January, 1980, the only follow-up action we found was a letter from RHUDO/NE to the HG loan borrower, CNEL, regarding the results of the final inspection. No reply was found in the RHUDO project file. During our conversations with CNEL field personnel, we learned that CNEL has little if any relationship with the homeowners or the projects themselves once the units have been sold. In two cases, the senior CNEL officials advised us they had not ever visited the project sites despite their having lived in the vicinity from one to three years.

We have been advised as follows by the auditees, although we believe our comments continue to remain valid.

> "Regarding CNEL relationships with homeowners, RHUDO and DS/H staff on a recent visit to all project sites found that CNEL regional officials appear to know many families by name and were aware of construction complaints which they refer to SNIT for resolution."

Conclusion -- Technical deficiencies in the core housing program have caused homebuyers substantial cost and inconvenience. Furthermore, it seems clear that follow-up by responsible GOT and AID officials has been inadequate under the circumstances described above. If this experience is not to be repeated in future AID Housing Guaranty projects scheduled for implementation in Tunisia, steps will have to be taken to ensure closer supervision of technical aspects of project construction and acceptance by both GOT and AID officials.

Recommendation No. 1

RHUDO/NE, in coordination with USAID/Tunisia, consult with appropriate GOT officials regarding:

(a) strengthened construction supervision practices and the imposition or more stringent controls over the awarding of site acceptances;

(b) establishment of clear lines of reporting and control over unauthorized unit expansions and invasions of public rights of way; and

(c) institution of procedures by which homeowners subjected to unusual hardships or expenses caused by construction or site location deficiencies may seek and obtain compensation from responsible GOT authorities.

The auditees have made the following reply to this recommendation.

"We believe that Recommendation No. 1(a), (b), and (c) are unnecessary since we have been advising GOT on construction, site selection, and follow-up problems and will continue to do so. We agree in principle with the desireability to strengthen construction supervision practices, site acceptance procedures, and control of public rights of way. We have been consulting with GOT officials on these subjects and will continue to do so. With regard to "unauthorized" unit expansions we believe it is more correct to refer to them as individually designed self-help constructions which local authorities have so far condoned. Furthermore, we are not aware of home owners having complained of being subjected to unusual hardships or expenses or having sought compensation from GOT authorities. In any case we feel that both expansion and redress are clearly questions which the GOT would address were they to see them as problems. RHUDO will of course pass valid auditors' and our own observations along to GOT for their consideration, but would be reluctant to propose solutions for things not yet recognized by USAID or the GOT as priority problems. While responsive to the identification of project problems, the GOT has not been typically appreciative of foreign advice on these local implementation/cultural practices and we doubt that consultation at this time would result in serious efforts by GOT to establish guidelines or procedures."

We believe that the auditees' statements further reveal the nature of the AID-GOT relationship in HG Program matters. If RHUDO is "reluctant" to broach subjects which the GOT does not recognize as problem areas, how can a development dialogue take place? We also infer from the above that AID HG Program managers feel they have no responsibility to ensure that the ultimate beneficiaries of AID assistance receive fair value under AID assisted projects. Because we feel these issues run to the core of AID's development work and responsibilities, we must vigorously dissent from RHUDO's views. We have consequently retained the recommendation as drafted.

Recommendation No. 2

RHUDO/NE adopt a site visitation policy which ensures that all HG funded project sites under active construction are visited at least yearly by AID direct-hire project managers.

In reply to this recommendation, we have been advised:

> "As in the case of Recommendation No. 1 we believe that this should not appear as a formal recommendation in the final report because we have in fact been doing it. In any case we do not believe we should commit ourselves to a procedure that required AID direct-hire project managers to make physical inspections on a rigid schedule. Such a procedure would be inconsistent with current DS/H guidelines which admonish RHUDO/staff to minimize involvement in project details, generally relying upon host country systems, institutions and standards for project implementation and using personnel under contract to perform occasional detailed surveillance services when determined necessary by RHUDO. This policy, we believe, reflects overall AID practice for Investment Guaranty and Intermediate Credit Institution type programs."

During the past three years RHUDO staff have visited core housing project sites outside the capital city in Tunisia only twice, and both times in response to critical audit findings. We have not requested a rigid scheduling of visits, merely an annual visitation of all active project sites. If present DS/H guidelines are being followed in RHUDO's site visitation practices, then this would confirm our view that too much time is being devoted to program development at the expense of implementational responsibilities on a worldwide basis, as confirmed in our recent reviews of similar HG projects in Kenya and Botswana. We believe our recommendation calls for a modicum of prudent project monitoring, and is therefore being retained.

<u>Community Facilities</u>

Another area which appears to have lacked adequate attention and application of GOT resources was the provision of community facilities. Of the seven core housing sites visited, we noted one instance where the GOT had expended funds to construct a small, three-room school and a mosque. At other sites, certain facilities were available at a short distance from the project site, although these were not always adequate to meet current demands and those imposed by residents of the core housing project as well.

In the most extreme example, we saw a 150-unit project located in a salt marsh near a fairly small, east-central fishing town. No community facilities of any kind had been provided to the residents of this isolated project who were quite vocal to us in their complaints about project conditions.

<u>GOT Responsibility</u> -- According to the project Implementation Agreement, certain community facilities are clearly identified as GOT project contributions:

> "Section 3.02. <u>Subproject Contributions Which Are the Responsibility of the Government</u>. For the core housing the Government shall cause to be provided as and when needed, suitable community facilities including schools, health centers, mosques, markets, bathing facilities, and recreational areas required for the development of those areas."

Similar language appears at Section 4.02 regarding the large IBn Khaldoun project in Tunis to which AID has thus far contributed $20 million in HG loan funds under projects HG-002 (1972) and 003. To date, however, this site is almost totally lacking in adequate community facilities. The thrust of these sections is reinforced, in our opinion, in a later section of the project Implementation Agreement, as follows:

> "Section 5.01. Due Diligence. The Government (GOT) as appropriate shall cause the subprojects to be carried out through such agencies as set forth herein with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, urban development, public transportation, and utility practices, and shall cause to be provided, as and when needed, the funds, facilities, services, personnel, and other resources required for this purpose."

Conclusion -- From all that we have seen during our recent visit to the AID HG-loan-assisted sites in Tunisia, we would submit that the GOT has generally not lived up to its commitments in providing the necessary community facilities. Nor has it met the test of exercising due diligence, because, in many cases, we were advised that funds had not been allocated to provide these facilities.

Recommendation No. 3

RHUDO/NE, in coordination with USAID/Tunisia, (a) formally advise the GOT that, based on the conclusions of AID commissioned final inspection reports and the results of AID audits, AID concludes that the GOT has not complied with its responsibilities under the project 664-HG-003 Implementation Agreement as regards the provision of necessary community facilities, and especially as regards AID contributions to the large Ibu Khaldoun subproject, and (b) formally request the appropriate GOT authorities to inventory the community facilities needs of those shelter projects assisted under project 664-HG-003 and advise AID when such facilities will be provided.

In reply, the auditees have made the following lengthy comments.

> "We agree that informing the GOT of the need for community facilities in connection with the HG financed projects is useful. We most recently advised the borrower of such deficiencies in our letter of April 3, 1981 after a recent site visit and the

Director of SNIT is very concerned about obtaining financing on a more timely basis. However, we would like to address the thrust of part (a) of the Recommendation. First, RHUDO's interpretation of the language of Section 3.02 and Section 4.02 of the IA is that it is a catchall provision to focus GOT attention to provision of "suitable" community facilities "as and when needed". Section 3.03 and Section 4.03 of the IA state that the subproject workplans shall identify (among other things) the existing and planned community services and facilities programmed for each site. Therefore, unless the GOT has reneged on providing facilities as shown in the subproject workplans, we do not see how AID could reasonably conclude that the GOT has not complied with its responsibilities under the IA. During a recent visit to all core housing sites, RHUDO and DS/H personnel took special note of community facilities and sought views of residents. It is RHUDO's view that these projects are getting services which are consistent with other neighborhoods in the same urban area... RHUDO suggests the following wording:

"<u>Recommendation No. 3</u>

"RHUDO/NE, in coordination with USAID/Tunisia, (a) formally advise the GOT that, based on the conclusions of AID commissioned inspection reports and the results of AID audits, AID concludes that necessary community facilities may be lacking in some projects and (b) formally request the appropriate GOT authorities to inventory the community facilities needs of those shelter projects assisted under project 664-HG-003 and where found deficient advise AID when such facilities will be provided."

In contrast to the thrust of these comments, it would be our view that the prolonged non-provision of community facilities may constitute a material breach of contract on the part of the GOT. While it may still be too early to bring this to the GOT's attention under the core housing component of project 664-HG-003, we believe that the absence of such facilities at the Ibn Khaldoun site in Tunis should not be ignored by AID. The GOT has so far received $20 million in HG loan assistance for this project beginning almost a decade ago. It is therefore our opinion that this particular situation calls for vigorous AID follow-up measures that could have a salutory effect on all AID-assisted shelter projects in Tunisia. For this reason, we are retaining our recommendation largely as drafted.

Project Financial Status

AID's periodic financial reports on the Housing Guaranty Program do not accurately reflect the status of project 664-HG-003. This is because the AID W-239 report shows HG loan funds authorized for this activity as fully disbursed when, in fact, only about 78% of the funds had actually reached the ultimate GOT borrowing institutions. The remainder of HG loan funds ($4.5 million) lay in three separate escrow accounts whose terms and conditions varied considerably one from another.1/ In two of these cases, arrangements made for the release of escrowed funds were found to be satisfactory; in the third case, however, these arrangements appeared to conflict with provisions of the project Implementation Agreement. Additionally, the GOT borrowing institution under the core housing project component, CNEL, had overvalued the dollar amount of mortgages presented to AID thus far, and has yet to account for 14% of the HG loan funds disbursed under this project component. That is, 10%, or $500,000, is on deposit in an escrow account controlled by the Central Bank of Tunisia, and 4% is not yet collateralized by eligible mortgages. CNEL has also underestimated the extent of home loan repayment delinquency and should consequently strengthen its portfolio management practices.

AID Financial Reports

The financial status of the AID Housing Guaranty Program worldwide is reflected in a periodic report published by the Office of Financial Management, Loan Management Division. This report (W-239) entitled: "Financial Summary, Housing, and Other Credit Guaranty Programs", provides the status of disbursements by eligible U.S. lenders under Housing Guaranty loans authorized by AID. The W-239 report dated December 31, 1980 shows the status of loan 664-HG-003 as fully disbursed.

Escrowed Funds Not Reported -- While it is true that the last disbursement by the U.S. lenders under this project took place in late November 1980, it is also noteworthy that at the end of February 1981, about 22% of the $20 million HG loan total had still not reached the ultimate GOT borrowing institutions. (Although the GOT Borrower of record under this project is the national housing bank, CNEL, this institution is in fact a true borrower of only $5 million for the core housing project component. Of the remaining $15 million, the national building society, SNIT, borrowed $10 million to finish the Ibn Khaldoun project, and the Municipality of Tunis was to borrow $5 million for slum

1/ The reader will recall that these are not AID funds but rather commercial loans whose disbursements are governed by the provisions of Loan Agreements between the AID-guaranteed lender and the GOT borrower. Hence, the need for the establishment of escrows in order to avoid losing the lender's funds when the status of project implementation does not justify disbursements as scheduled in the Loan Agreement.

upgrading.) At the time of our audit visit, the status of HG loan funds received by each of the three participating GOT institutions was as follows:

SNIT	$10,000,000	100%
CNEL	4,500,000	90%
Municipality of Tunis	1,031,965	21%
Total	$15,531,965	78%

For reasons explained subsequently in this report, the remainder of project 664-HG-003 loan funds remained in three separate escrow accounts totaling $4,468,035.

At this point the auditees advise:

> "Being the Borrower of Record, we believe that CNEL is in fact the true borrower of the entire $20 million. As auditors know, CNEL has sublending agreements with SNIT and Municipality for "C" unit and Mellassine parts of the loan. CNEL also has mortgage loan agreements with individual sub-borrowers in the core house subproject. However, none of these sublending arrangements, all of which were contemplated in project design, relieve CNEL of any responsibility as the borrower of the full $20 million."

In fact, the "true Borrower" of the $20 million in AID HG loan funds is the GOT Central Bank, the only entity authorized by the GOT to hold foreign exchange. We continue to believe that "Borrower of record" is an apt description, although "Borrower of convenience" would also adequately describe CNEL's role under the project for all but the $5 million core housing sub-project. In contradistinction to RHUDO's assertion, the original Project Paper in fact calls for three separate Borrowers, something obviously changed for the sake of convenience after the project was authorized.

Conclusion — The reader of AID's W-239 report on the status of HG projects worldwide is not fully informed as to the actual status of certain projects because the report does reflect HG loan funds in escrow. We believe that this report should be as accurate as possible and, consequently, we are making the following recommendation.

Recommendation No. 4

> The Office of Financial Management, in coordination with the Office of Housing, amend the format of the W-239 report published periodically by FM/LMD to reflect the status of HG loan funds disbursed by US lenders that remain in escrow accounts.

To this recommendation the auditees have replied:

> "DS/H recommends that this be excluded as a recommendation since how FM/LMD reports HG financial data has little relevance to project implementation. However, as a part of their overall program management, about six months ago, DS/H and FM/LMD began a process to establish a consolidated fiscal agent system. This system which will become effective about June 1, 1981 provides for centralization of new escrow accounting and the reporting of escrow status in the W-239."

Although we are retaining this recommendation in our report, we regard it to have been accepted by DS/H and FM/LMD and, consequently, have annotated our records to show it as "closed" based on the information provided above.

Status of Escrowed Loan Funds

As noted previously, approximately 22% of the $20 million total AID contribution to project 664-HG-003 remained in three separate escrow arrangements at the time of our audit visit to Tunisia. A brief description of each arrangement follows in chronological order of escrow creation.

> Morgan Guaranty Account -- The first escrow opened under the project was established in August 1977 with part of the proceeds of the first HG loan disbursement. The account is located with the Morgan Guaranty Trust Company branch office in Nassau, Bahamas, in the name of CNEL. The principal balance, according to CNEL, at the time of our audit visit was $2,086,450. CNEL advised us they received regular periodic bank statements relative to this escrow account. Despite repeated requests, we were unable to obtain any information on the amount or disposition of interest earnings on these funds from CNEL.1/ The funds are being held for the delayed Mellassine slum upgrading project component under the sponsorship of the Municipality of Tunis.

1/ After a delay of two months, this information was forthcoming but only after strong representations by AID and American Embassy officials to GOT officials.

Funds Held by CNEL -- Another $1,881,585 is being held for the Municipality of Tunis by CNEL in Tunisian dinars. These funds resulted from three HG loan disbursements during 1980. They are not being held in an interest bearing account, rather form part of CNEL's treasury funds where they are reportedly available upon demand.

Central Bank of Tunisia -- Finally, $500,000 was deducted from the last disbursement under the project and deposited into an account maintained by the Central Bank of Tunisia at the Bank of America's New York City branch office. The funds are being held for CNEL's use under the core housing project component. The Central Bank of Tunisia has agreed to pay CNEL the interest earned on these funds when they are released to CNEL by AID.

Differing Arrangements -- We find the existence of three separate escrow arrangements under this project to be quite unusual, especially in the light of the variations noted among these different forms of escrow holdings. The Morgan Guaranty account in the Bahamas represents a standard escrow arrangement involving a neutral third party charged with holding HG loan funds until such time as AID is satisfied that certain conditions have been met that would permit their release. The second form of HG loan fund holding in effect constitutes a "Gentlemen's Escrow" arrangement in that the funds have already been converted from dollars to Tunisian dinars and are being held at no interest. Thus, any leverage offered by holding back dollar disbursements to the GOT has been lost under this arrangement. Lastly, the deposit of $0.5 million to the Central Bank of Tunisia's account with the Bank of America in New York also lacks the impersonality normally associated with formal escrow arrangements in that the GOT has effectively been given the use of the dollar resources, although the disbursement of Tunisian dinars to CNEL has been blocked.

RHUDO/NE Explanation -- In transmitting our preliminary finding statements to RHUDO/NE and USAID/Tunisia, we specifically requested an explanation as to why these different escrow arrangements existed. Their explanation follows:

> "Escrows
>
> HG-003 represents, especially in the upgrading subproject, a pioneering effort in North Africa. RHUDO and Tunisian representatives with the help of consultants made the best estimates possible in developing a financial plan. Particularly for the Mellassine upgrading subproject, however, the timetable initially offered was unrealistically optimistic and led, along with housing construction delays, to the establishment of three separate accounts with distinct characteristics. The first account with Morgan Guaranty Trust was established in CNEL's name in August 1977 when sufficient documentation was not available to justify disbursements from HG-003A.

"After the establishment of the Morgan escrow, AID was informed that the existence of this escrow did not meet normal Tunisian banking practices. In August 1978, before signing the loan Agreement for HG-003B providing for the second tranche of the program, Tunisian representatives insisted upon a letter from AID providing that, in the case of insufficient justification for any disbursement under HG-003B, AID would allow an escrow to be established with the Central Bank of Tunisia (CBT).

"An advance to CNEL, "Gentlemen's Escrow" as described by the Auditors, was agreed to in March 1980 because the Municipality did not have bills from contractors to justify the disbursement. Advances are common practice under the HG program worldwide. Under agreement with RHUDO, funds were disbursed to CNEL to be held until the bills could be presented by the Municipality. The RHUDO judgment at the time was that, as work was progressing well and contracts were already signed, the establishment of a new escrow at the Central Bank was not warranted. We retained some control on the disbursement by disbursing to CNEL rather than directly to the Municipality. Neither the Municipality nor we expected the long delays by the parastatal utilities in submitting their bills.

"The third account was established on November 25, 1980 to hold final payment of $500,000 of the core housing subproject under HG-003B. The Central Bank of Tunisia agreed to hold the funds, pay interest to CNEL, and to disburse the funds on direction by RHUDO. CNEL, in a separate letter agreement, promised to build the additional eligible units and to certify to 25% of construction in place within six months. CNEL representatives expect to meet this deadline.

"This final disbursement was not added to the Morgan escrow per the earlier request of the GOT. The effect of adding funds to CNEL's existing account would have been a direct disbursement. Therefore, the third, separate account was required and was established as agreed when the HG-003B agreements were signed.

"Interest for the use of the money is available to CNEL, the Borrower, on all three blocked accounts. CNEL receives the interest on the Morgan Account and the BCT account and the use of the Municipality funds under the terms of the respective agreements. The agreements signed by AID are silent on the use of interest earned.

"It was and is RHUDO's position that as the Borrower has assumed the risk of varying interest rates, it is therefore entitled to the use of any interest exceeding the requirements for loan servicing. The Borrower is obligated to pay the HG loan whether or not the income from escrow covers these payments, as it did not in the early days of HG-003A."

Auditor's Comments -- It may well be thatonly the Central Bank of Tunisia can legally hold foreign exchange outside of Tunisia in accordance with Tunisian law. However, it would seem to us that other arrangements could have been made more in keeping with the neutrality normally found in escrow arrangements, as exemplified by the terms of the Morgan Guaranty arrangement in the Bahamas. As regards the funds held in dinars by CNEL, although the explanation offered by RHUDO for the first disbursement to this "Gentlemen's Escrow" is quite credible, it is not clear why RHUDO persisted in this informal arrangement after it became apparent that work on the upgrading component was not progressing as well as had been anticipated when this informal arrangement was entered into. Instead, two further disbursements were made into this "Gentlemen's Escrow" four months and eight months after the original March disbursement mentioned in the RHUDO response.

We interrupt this paragraph here to take note of further comments by the auditees.

"...what the auditor describes as a "Gentlemen's Escrow" is an agreement to advance funds to the Borrower w th conditions for accounting for the advance, retaining project manager oversight and which, we reiterate, is common practice in the worldwide HG program. Therefore, the auditor's assertion is patently untrue. Possibly the auditor is confused by his insistence to continue to refer to this as a "Gentlemen's Escrow". We suggest deletion of references to this arrangement, however, if retained in the report (together with our position) we suggest that he refer to it simply as an agreement to advance funds."

We continue to believe that "Gentlemen's Escrow" aptly describes the unique circumstances surrounding these three undocumented disbursements of HG loan funds. The fact that no interest is being earned on these funds while they benefit CNEL and not the Municipality of Tunis, to whom the funds were "advanced" in theory, as the auditees suggest, confirms in our view the somewhat unique and informal nature of this arrangement.

As regards the arrangement with the Central Bank of Tunisia, we see no reason why a true escrow account could not have been established in dollars with any bank of the Central Bank of Tunisia's choosing. Instead the $0.5 million was disbursed into the Central Bank's established account with the Bank of America where it is commingled with other GOT funds.

Interest Benefits -- As to the RHUDO's stated position that CNEL, the HG loan Borrower, is entitled to any interest earnings on these funds, we note that this position is not shared by the Municipality of Tunis which has appealed to the GOT Ministries of Plan and Finance as to its right to these earnings. This is because, in contradistinction to RHUDO's assertion, the Municipality of Tunis has been making interest payments to CNEL on the HG loan funds disbursed for the upgrading component of this project. At the time of our audit visit, a total of five interest and AID fee payments totalling the equivalent of roughly $410,000 had been made to CNEL by the Municipality in accordance with a separate subloan agreement. We also learned that the Municipality had intentionally defaulted on the sixth such payment which fell due at the end of January 1981 to emphasize its concern at the inequity that it perceives these escrow arrangements entail.

Conclusion -- The differing escrow arrangements entered into under project 664-HG-003 had the effect in two cases of forfeiting AID project managers' control over dollar disbursements of HG loan funds from escrows to the GOT borrowing institutions. Furthermore, a lack of AID guidance or conditions as to the disposition of interest earnings derived from these funds has led to an internal dispute between two GOT institutions regarding their rights to these monies. It is consequently our opinion that AID project managers have not exercised adequate controls over HG funds disbursed into escrow.

At this point, however, there is little that can be done to correct this situation (except as noted subsequently). We plan to follow up on this situation in conjunction with the review of HG Program policies, planned by the Regional Inspector General for Audit, AID/Washington with regard to the standardization of, and AID management control over, HG loan funds disbursed into escrow.

Mortgage Valuation and Eligibility of Loan Fees

One of the key determinations that will have to be made before HG loan funds in escrow can be released under the core housing project component has to do with the number of core units needed to absorb as yet unaccounted for HG loan funds. At the time of our visit to Tunisia, however, we were advised by RHUDO/NE that CNEL had yet to coordinate with SNIT in order to acquire a site upon which to build the units needed to absorb the remaining HG loan funds. Obviously, the value of mortgages that will eventually have to be presented to AID as financed by these funds will depend to a certain extent on the sales prices for eligible core housing units. Such sales prices, of course, have yet to be determined. Once these determinations have been made, CNEL can decide on how many units to build. However, as a result of our audit visit, it seems clear that the number of units to be financed by HG loan funds at this point will have to be substantially greater than the number envisaged earlier. This is because we found that CNEL had significantly overestimated the dollar value of core unit mortgages presented to date, as set forth below.

CNEL Mortgage Valuation -- In a letter dated January 9, 1981, CNEL presented AID with a listing of 1319 eligible core housing mortgages with the following valuations:

Number	% of Total	Dinar Value	US$ Value	Exchange Rate
1279	97	1,660,430	4,189,830.94	0.3963
40	3	47,713	117,173.38	0.4072
1319	100	1,708,143	4,307,004.32	0.3966

After examining this letter, we advised RHUDO/NE that in our opinion, CNEL had incorrectly valued the mortgages presented to date which resulted in a significant overvaluation of these mortgages. It would be our position regarding a settling of accounts that an average exchange rate should be used. That is, a rate produced by dividing the total number of dollars disbursed into the TDinars received by CNEL.

According to another statement requested from CNEL in this regard, we noted that CNEL reports the lender's disbursement of $4,398,250 (net of deduction of AID and lenders' fees) which produced for CNEL TD1,810,432.748, or an effective exchange rate of 0.4116 equals US$1.00. When this average rate is applied to the dinar face value of the 1319 CNEL mortgages (TD1,708,143 ÷ 0.4116), the resulting $ value is only $4,150,007 as opposed to the dollar value CNEL has claimed of $4,307,004. The difference is $156,997. As RHUDO had not yet replied to CNEL's 9 Jan 81 letter, there is ample time to advise CNEL that it should use an average exchange rate in computing mortgage values and plan to construct more units accordingly in order to make up the remainder of HG loan funds, which we computed at $698,243.

Accountable HG Loan Funds -- Presented below is the financial status of the core housing project component in accordance with CNEL's January 9, 1981 letter, and as we have recomputed the core unit mortgage values as described immediately above.

		CNEL		Auditors
Core project budget		$5,000,000		$5,000,000
Less: (per CNEL letter of 1/9/81)			(per audit valuation)	
Face Value of 1319 mortgage	$4,307,004		$4,150,007	
Impl. & Coord. Expenses	50,000		50,000	
AID & Lenders' fees	101,750		101,750	
		4,458,754		4,301,757
Unliquidated balance		$ 541,246		$ 698,243

It is clear from this recomputation of mortgage values that CNEL has yet to account for nearly $200,000, that is $198,243 already disbursed, in addition to the $0.5 million in escrow. This means that substantially greater numbers of core units will have to be built than CNEL had anticipated to absorb the as yet unaccounted for HG loan funds, although the exact number still has to be determined.

Eligible Expenses -- The coordination expenses mentioned in the foregoing table are sanctioned in the project Implementation Agreement. However, the same agreement does not mention the eligibility of HG loan fees, as claimed by CNEL. Moreover, Section 1.02 of the Implementation Agreement contains rather rigorous language restricting the use of HG loan funds ". . . exclusively to the goods and services identified in this (Implementation) Agreement." (emphasis added) It would appear from this that project planners had envisaged that the cost of loan fees -- a legitimate financing expense -- would have been factored into the price of the core units, thereby being reflected, in part, in the face value of the mortgages presented for HG loan financing.

At this point, it would seem to us that two recommendations are in order:

Recommendation No. 5

RHUDO/NE, in coordination with USAID/Tunisia, formally advise the HG loan Borrower, CNEL, that (a) the dollar value of eligible core housing mortgages is to be determined using an average loan conversion factor, and (b) CNEL expeditiously propose to AID the number, sales price and location of eligible core units to be built and financed with unused HG loan funds.

In reply, the auditees have noted:

"RHUDO and USAID agree in principle with the concept of average loan conversion factor. However, we have advised CNEL to give us mortgages equal in value to the total dinars that were generated by dollar disbursements to the subproject. We feel that CNEL does not need to concern itself with any exchange rate when accounting for dinars. [We have advised] CNEL that they should submit immediately their proposal for core units to be financed with unused HG loan funds. Our actions already taken seem to be consistent with the auditors intent and we request that Recommendation No. 5 be excluded from the final report."

We believe the auditees have effectively implemented the recommendation. We have consequently annotated our records to show it as "closed". However, we herewith request RHUDO/NE to keep us apprised of CNEL's response to its letter on the matter of accounting for HG loan funds.

Recommendation No. 6

RHUDO/NE, in coordination with USAID/Tunisia, obtain from the Assistant General Counsel for Housing (GC/H) a formal legal interpretation of eligible uses of HG loan funds as defined in the project 664-HG-003 Implementation Agreement Section 1.02 prior to accepting CNEL's claim to reimbursement for fees paid to the lenders and AID as eligible expenses.

The auditees' reply to this recommendation is as follows.

"In addition to our prior comments which noted that HG worldwide practice is being followed in allowing fees to be paid from HG loan proceeds, we call the auditors' attention to Section 5.03 of the Loan Agreements for both HG 003 A and B which mention the amount of the investor commitment fee and say "which fee may be retained by investor from loan proceeds". We have noted the auditors' concern that this eligible expense is not specifically acknowledged in the IA. GC/H has advised RHUDO that it may issue an implementation letter to amend the IA to clarify this point which will be done. RHUDO and USAID see no need to obtain any further legal interpretation from GC/H on this matter and request that this Recommendation be excluded from the final report.

We shall proceed to act on this recommendation when we have received a copy of the proposed implementation letter which admits the eligibility of financing costs under this project. In the interim, we are retaining our recommendation.

Escrow Release Arrangements

The conditions imposed by AID for release of HG loan funds held under the three escrow arrangements described in a previous section differ substantially one from another. As to funds held by CNEL in Tunisian dinars for the account of the Municipality of Tunis ("Gentleman's Escrow") these may be released simply upon presentation to CNEL by the Municipality of adequate documentation justifying such release, without prior AID approval. The same type of justification is required for release of funds held in the Morgan Guaranty escrow account in the Bahamas; i.e., proof that the Municipality has incurred eligible project expenses under the upgrading component of the project. For the Bahamas escrow account, however, AID approval is necessary before these funds can be released. We were unable to explain why AID project managers have abandoned their approval authority over HG loan funds merely because they have been converted into Tunisian dinars. However, assuming that CNEL exercises due diligence in determining the eligibility and accuracy of documentation provided by the Municipality of Tunis for release of escrowed HG loan funds held in local currency, these arrangements should safeguard the integrity of HG loan fund releases under the upgrading component -- especially if AID and CNEL informally consult on this matter, as we expect they would.

Release of Core Housing Escrow -- Quite another matter, however, is the arrangement made for release of funds being held by the Central Bank of Tunisia in dollars in an account in New York. According to the terms of a letter agreement (see Exhibit C) entered into between CNEL and RHUDO, these funds may be released to CNEL by the Central Bank of Tunisia when CNEL has certified to AID that the units to be financed by escrowed HG loan funds have been 25% completed if such state of construction progress occurs within six months of the date of the letter agreement. We have advised RHUDO/NE and USAID/Tunisia of certain reservations we have regarding this arrangement, for the reasons set forth below.

Implementation Agreement Provision -- Quoted below is an excerpt from the project 664-HG-003 Implementation Agreement which has direct bearing on the issue of final disbursement of HG loan funds to CNEL.

> "Section 3.05. Conditions Precedent for Initial and Final Disbursement. No initial disbursement of Investor loan proceeds for the core housing subproject shall be authorized by A.I.D. until CNEL has been advised in writing by A.I.D. that all of the terms and conditions of Section 3.03 (a) and (b) have been met to A.I.D.'s satisfaction. Annex A reserves the sum of $500,000 as a "final disbursement" for this subproject. No such final disbursement shall be authorized by A.I.D. until CNEL has given evidence satisfactory to A.I.D. that all of the terms and conditions of Sections 3.05 and 6.02 have been met and that beneficiaries selected in accordance with the terms hereof are occupying the core houses."
> (emphasis added)

There is no record in RHUDO files to show that this section was ever amended to permit a final disbursement along the lines established in the letter agreement found at Exhibit C. Further, the reader will note in perusing the letter agreement that no mention is made therein of the project Implementation Agreement, much less Section 3.05 quoted above. We remain at a loss to explain how this letter agreement was entered into under these circumstances.

Good Business Practice

Further objections to making a final disbursement to CNEL for anything but eligible core unit mortgages (indicating the units were at least sold and financed, if not occupied) stem from a finding in our previous audit report on this subject (No. 3-664-79-01). In a section captioned "Maximizing the Use of HG Loan Funds," we pointed out the disadvantages of continuing to make construction progress payments to CNEL whose own cash flow and credit resources were more than adequate without this additional funding source. We suggested instead that HG loan funds be used to finance eligible core unit mortgages only. Furthermore, we noted that the results of a small sample of home buyer files had revealed that a certain number of units would be sold for cash while the propensity of Tunisians to save for housing appeared to substantially exceed the normal 1/3 downpayment required by CNEL. That is, CNEL clients were saving more than the minimum 1/3 required in order to qualify for a core unit mortgage loan.

We consequently alerted RHUDO/NE to the possibility that substantial excess HG loan funds could result from these circumstances in connection with our prior audit.

As a result of our latest review, we learned that 1426 units had in fact been built under the AID supported core housing project component, but that mortgage had been required for only 1319 units. That is, 107 units, or 7.5% of the total built, were sold for cash. Additionally, an analysis of the mortgages presented to AID by CNEL revealed that homebuyers had made an average downpayment equal to 39% of the sales price instead of the 33% required.

RHUDO Response to Prior Audit

In order to verify the findings of our prior audit, RHUDO/NE commissioned a study of core unit mortgage financing terms and conditions by an HG Program-funded financial analyst. The results of that review were summarized in RHUDO's formal response to our prior recommendation, paraphrased and quoted as follows:

> The consultant confirms the audit report's finding and recommends that the disbursement procedure be changed to limit CNEL core unit drawdowns to mortgage financing. ". . . to date, the GOT has been unwilling to agree (to amend the Implementation Agreement) as they do not believe that the one example . . . will necessarily be repeated for the other sites." Instead, RHUDO reported that a compromise was reached which would ". . . serve to monitor the situation closely and will permit early decisions to be taken concerning construction disbursements found to be different from mortgage loan requirements. Use of this system of accounting will permit early identification of additional units to be financed or it could result in a reduction in the total amount finally allocated to the core housing sub-project."

It is not clear to us what monitoring provisions were contained in this compromise. Whatever they might have been, it does not appear from the present circumstances that they were implemented. As noted earlier in this section, CNEL had not, at the time of our visit, taken steps to develop additional core housing units with excess HG loan funds, despite having been alerted the possibility of such funds coming into being more than two and one-half years ago.

Based on these considerations, we conveyed to RHUDO/NE once again during our recent audit visit our concerns regarding the inadvisability of making construction progress payments to CNEL, especially in conjunction with the final disbursement of HG loan funds under this project component. We included in our preliminary finding statement a request that RHUDO formally justify its decision to alter the conditions of final disbursement of HG loan funds under this project component. Following are the joint RHUDO/NE - USAID/Tunisia comments to our objections noted above.

> "Regarding the development of the RHUDO-CNEL letter agreement of November 25, 1980, there are three aspects of the events in question which deserve particular attention. The first concerns the formulation of the letter agreements between RHUDO, BCT, and CNEL. It should be noted that at each step in the process which led to these agreements there was full consultation between RHUDO, DS/H, and GC/H. The final letters were explicitly cleared by the Deputy Director of DS/H, the Assistant Director for Operations and the Assistant General Counsel for Housing. Unfortunately the file record does not show these clearances, which were made during a series of telephone calls between Washington and Tunis in late November, 1980. Steps are being taken to make the file record accurate and to secure a memorandum from GC/H which will confirm his agreement and comment upon the legal effects of the letter agreements.
>
> "The second aspect concerns DS/H policies in situations like this, i.e. in situations in which the investor is required to make a disbursement under the loan agreement but the Borrower is unable to meet the requirement of the implementation agreement which will permit him to draw that disbursement. The worldwide practice under the Housing Guaranty program is that release of the funds is not precluded if it can be shown that there is reasonable assurance of necessary progress within an acceptable period of time. Based upon the record in this case, RHUDO's judgment was that the purposes of the project would be furthered by proceeding with a disbursement to BCT, placing additional requirements upon CNEL to be met within a 6 month period and requiring mortgages to be furnished for

the full value of the $500,000 disbursement within 24 months. Furthermore, DS/H policy at the time was to not enter into escrow arrangements which will knowingly last 24-30 months.

"The third aspect of the events concerns the context within which the letter agreements referred to between RHUDO, CNEL, and the BCT were entered into which was as follows: (1) the final disbursement under loan 003B was due to be made in late November 1980; (2) negotiations with CNEL and others in the GOT were actively underway concerning the "free-savings" component of HG-004; (3) CNEL and SNIT had already completed and successfully marketed over 1400 core houses, more than had been estimated in the Implementation Agreement.

"Although CNEL did not have sufficient mortgages to justify disbursement of the final $500,000, RHUDO's view was and is that this was essentially a technical disbursement problem rather than an indication of a project which had failed to substantially meet its intended purposes. Given CNEL and SNIT's record in building and selling over 1400 core houses over 24 to 36 months, their desire to obtain the final disbursement and to see additional houses built, the continuing relationship which RHUDO and CNEL expect to have in HG-004 and the possible effects which a refusal to disburse might have had in this relationship and upon the delicate negotiations which were being undertaken concurrently with the GOT concerning "free-savings", one of AID's major policy objectives, RHUDO and USAID were in agreement that a solution should be found which would allow disbursement of the final $500,000 to finance some 100 to 200 additional houses over 24 months and protect AID's interests at the same time. The letter agreements represent this solution, arrived at after negotiations with CNEL and the BCT.

"With regard to the specific concerns raised by the audit team, RHUDO's comments are as follows:

a) Disbursements to date have been carried out in accordance with Section 3.04 of the IA. Accordingly construction advances have not been made. Because of the reasons cited above (i.e. the success of CNEL and SNIT in constructing and marketing more houses than originally contemplated, an indication of their ability to do the same for the additional units remaining, the bargaining context of the situation, and the rather tight requirements for CNEL and SNIT to actually be underway and 25% complete within six months) it was agreed that the remaining funds could be disbursed at one time in advance of actual completion of units. Given the existing record as well as the continuing relationship which AID and CNEL, indeed the GOT, expect to have over the next 3-5 years, this action was justified.

b) CNEL and SNIT are, we have been informed by CNEL, coordinating the purchase of a site for additional units, although the purchase has not yet been made. RHUDO intends to adhere to the terms of the letter agreements but is unable at this time to estimate whether or not the units will be 25% complete within the (time allotted).

c) RHUDO intends to advise CNEL concerning the mortgage valuation question as discussed previously.

d) With the exception of Section 3.03d, which was, in effect, modified by letter agreements, all other terms and conditions of Sections 3.03 and 6.02 have been fulfilled. As indicated elsewhere, RHUDO has applied a rule of reasonableness with regard to the question of the occupancy of the core houses. In the majority of cases where units have remained unoccupied the new owners have been making improvements to their property. In the normal course of events a small percentage of non-occupation is likely to be encountered.

"RHUDO and USAID do not agree with the statement that CNEL is far from meeting Section 3.05 requirements nor the implied criticism of CNEL's track record under this project and believe this language should be revised. While not free from problems the project has nevertheless substantially fulfilled its purposes."

Auditors' Comments

We do not view the foregoing arguments as valid reasons for disregarding either the provisions of Implementation Agreement Section 3.05 or the recommendations of the HG Program's own financial consultant and our prior audit report to the effect that the use of HG loan funds should be restricted to mortgage financing only. Neither can we accept the assertion that an escrow agreement signed between AID, the Central Bank of Tunisia and CNEL, ipso facto, amends the project 664-HG-003 Implementation Agreement without so much as referring to it, much less the provisions of Section 3.05 thereof, which rigorously restrict the conditions of final HG loan disbursement for core unit financing.

Finally, we are unable to understand why, if it was the intent of AID project managers to amend the Implementation Agreement, they did not specifically do so in conjunction with the execution of the escrow. Authority to make these amendments, we understand, has been delegated to the RHUDO Chief. Such amendment procedures were confirmed with the GOT in April 1979 with the following language contained in a letter amendment to the project Implementation Agreement between RHUDO/NE and CNEL:

> "From previous experience AID understands that the Minister of Plan prefers that Implementation Agreement amendments be resolved by an exchange of letters between AID and CNEL. We will comply with this precedent, but to meet the requirements of Section 10.01 of the Implementation Agreement, a copy of this letter exchange will routinely be sent to the Ministry of Plan."

We found no indication that a copy of the November 25, 1980 agreement covering the final disbursement of HG loan funds for core housing into escrow with the Central Bank of Tunisia was sent to the Ministry of Plan.

In this regard we have been notified (STATE 57913) by DS/H as follows:

> ". . . please be advised that all appropriate DS/H clearances on correspondence with CNEL and BCT (Tunisia Central Bank) have been obtained and these documents are enroute by pouch to Tunisia. GC/H advises that, regarding the use of implementation letters to waive or modify terms or conditions precedent in an Implementation Agreement, delegation of authority from the Director of DS/H to RHUDO/NE dated 3/1/78 gives full legal authority for this kind of action. Further, the specific action taken with respect to this matter was discussed at length with GC/H and Deputy Director DS/H prior to such action being taken."

For the reasons given above, however, we cannot accept the position of the auditees in this matter without a formal legal opinion signed by GC/H. We would also note in passing, that the letter agreement at Exhibit C is nowhere described as an "implementation letter." In fact, in a memorandum dated February 11, 1981 to our office, RHUDO/NE describes this document as an amendment to the Implementation Agreement. It remains our view that this letter agreement contravenes the terms of Section 3.05 of the project 664-HG-003 Implementation Agreement. It also remains our view that, for reasons best known to RHUDO/NE, its purpose was to establish an escrow fund and the terms and conditions under which HG loan funds could be released therefrom, without reference to the project Implementation Agreement.

<u>Timing</u> -- Finally, as noted in the previous section of this report, it seems evident that CNEL will not be in a position by late May 1981 to certify to the completion of 25% of any eligible core housing units, much less the number needed to absorb almost $700,000 in as yet unused HG loan funds.

<u>Conclusions</u> -- It is our opinion that responsible AID and GOT officials did not act in compliance with the provisions of the project 664-HG-003 Implementation Agreement when they entered into an escrow

agreement providing for the release of the remaining undisbursed HG loan funds to CNEL based on the construction progress of eligible core units, rather than against eligible core unit mortgages as implied in Section 3.05 of the Implementation Agreement.

Furthermore, for reasons described in prior reports by this office and an HG Program funded financial consultant, we do not believe that such construction progress payments should be approved by AID and especially not in conjunction with the final disbursement of HG loan funds. Finally, it does not appear that CNEL will be in a position to avail itself of the provisions of the letter agreement that appears at Exhibit C within the time period allotted.

<u>Recommendation No. 7</u>

RHUDO/NE, in conjunction with USAID/Tunisia, (a) determine that the buyers of units to be built with the unused HG loan funds are eligible and that their financing needs are sufficient to absorb the unused HG loan amount before approving disbursement of the final $500,000 from escrow for the core housing subproject, or (b) request a formal legal opinion from the Office of the AID General Counsel that supports the actions it proposes to take in accordance with the escrow agreement found at Exhibit C to this report.

In this regard, we have been advised by DS/H as follows.

"A. DS/H reiterates that the management of project 664-HG-003 by RHUDO/Tunis is excellent and entirely consistent with the practices and procedures of the office. In accordance with a broad delegation of authority from DS/H to the RHUDO. dated May 21, 1979, which reflects DS/H policy to decentralize project design and management, the RHUDO has the authority to negotiate and sign implementation agreements and to amend IA's so long as the amendments are not inconsistent with the relevant project authorization signed by the Regional AA. It has been the practice of RHUDO/Tunis to consult closely with DS/H and GC/H about intended actions which might affect the IA and to assure such actions are consistent with DS/H policy.

"B. DS/H management process is to establish broad principles and guidelines for RHUDO project management leaving considerable discretion to the RHUDO in project implementation, including clarification of and amendments to IA's. Specifically, the changes, amendments, waivers and exceptions to project 003 were accomplished under this management system and therefore entirely in accordance with DS/H and GC/H practices."

To which RHUDO/NE has added:

> "Furthermore, RHUDO cannot see any positive advantage for anyone in not permitting the additional houses to be built nor permitting unused funds to be disbursed. Here again, the Recommendation appears to be inconsistent with the auditors' criticism elsewhere in this draft report regarding the project's not exceeding targets. RHUDO and USAID request that this Recommendation be excluded from the final report. With regard to the possible alternative solution offered by the auditor, RHUDO appreciates his concern, finds the preconditions consistent with what we would normally require and will consider the presale suggestion, although we plan to agree to disbursement from escrow if CNEL meets the conditions established in our letter of November 25, 1980."

There are two concerns in this finding: one substantive, the other procedural. We continue to believe that responsible AID officials should ascertain that the mortgage financing required by CNEL for the number of units it estimates it will have to construct to absorb unused HG loan funds will cover the unused amount and that the buyers will fall within the eligible target group, or they should apply the restrictions contained in the Implementation Agreement concerning the final disbursement of $500,000. The suggestion alluded to by the auditees calls for the pre-sale of these units, even before they are built so that the income of the buyers and their financing needs can be determined, and thereby allow the final disbursement within the spirit, if not the letter, of the Implementation Agreement. The fact that we have made this suggestion -- a rather unusual step for auditors to take -- demonstrates that we wish to assist the auditees to surmount this impasse to the benefit of lower income Tunisian families, but within the terms of the Implementation Agreement. It also demonstrates that we would rather see the homes built than not; thus, we are at a loss to find a basis for the allegation that we would not want to see the units built.

As to the procedural question, we continue to believe that it is not feasible to amend an agreement of international treaty stature without so much as referring to it in the document that purports to execute the amendment. We also fail to see why RHUDO has not, even at this late date, corrected this situation by formally amending the Implementation Agreement under the simplified format it went to some lengths to devise with the GOT to cover contingencies just such as this one. In view of the expressed determination of responsible AID officials to follow the course of action they have set for themselves in this case, however, we have modified our draft recommendation.

Finally, we feel it incumbent upon us to recall at this point that this entire situation could have been avoided had steps been taken since the issuance of our last report to correct the conditions described by us more than two years ago. Further, if CNEL had provided AID officials normal access to information about the nature of its portfolio and the characteristics of its clients, the propensity of Tunisian homebuyers to save in excess of their downpayment requirements would have been disclosed and the project design could have taken this factor into account. However, as noted later in this report, such information is regarded as strictly confidential by CNEL together with such items as annual financial reports, the composition of its mortgage portfolio, and the profiles of its various clientele income groupings. We reiterate that sharing this information is commonplace in the normal course of business between borrowers and creditors. That it is not so in this case provides another insight into the nature of the AID-GOT relationship in the shelter sector of Tunisia.

Portfolio Management

According to the most recent Housing Guaranty Program Annual Report (FY79), issued by DS/H:

> "Important principles of the Housing Guaranty Program are:
>
> (1) maximizing a country's resource investment in shelter and (2) continuously recovering and re-allocating that investment to ensure a more equitable distribution of shelter resources."

Results of Prior Audit --- The final section of our prior report on HG activities in Tunisia dealt with repayment of home loans by purchasers of HG loan financed units. At the time, this consisted of a review of mortgage repayments under the second HG project which financed the construction of several thousand units in a new lower-income suburb of Tunis known as Ibn Khaldoun. Note was taken in our report that 89% of the homebuyers in that project were delinquent to some extent in their loan payments. In response to our report, RHUDO/NE advised us that formal correspondence had been entered into with the National Building Society (SNIT), the GOT borrowing institution under the second HG project, and that follow-up would continue.

Responsiveness Lacking --- As a result of follow-up actions, some information has come to light which has helped to understand the dimensions of SNIT's portfolio management problems. To date, however, RHUDO officials have been unable, despite several written requests to SNIT, to obtain from that institution a satisfactory analysis of its HG-financed mortgage loan portfolio. Consequently, RHUDO/NE officials have no information about the status of homeowner repayments under project 664-HG-003, $10 million of which was sublent to SNIT to complete the Ibn Khaldoun project. In this connection, we were formally advised by RHUDO and USAID/Tunisia as follows:

> "As this section notes, RHUDO has pursued this particular problem with SNIT for several years in an effort to better define the problem and agree on steps which might be taken. SNIT has not been as responsive on this issue as could have been been hoped. Nevertheless a number of facts have emerged concerning SNIT's procedures which have led us to conclude that while SNIT reporting remains deficient and progress has been slow, the actual collection procedures and practices

do not violate the Implementation Agreement. Again, it is woth remembering that SNIT is no longer a financial institution as it was in the early 1970s and that these questions are therefore of considerably less policy importance than they might have been before. Given scarce RHUDO resources it is now our intention to concentrate our efforts as much as possible in working with the institution which, in the housing field, has largely assumed those responsibilities.

"SNIT's procedures for debt collection have been well documented at this point. There are two basic methods, deductions from payroll and direct repayments. Approximately 40% of SNIT repayments come in the form of payroll deductions (although only 19% of 002 beneficiaries). These deductions normally take 4-5 months to reach SNIT, an improvement over earlier years, and are now considered by SNIT to be deferred rather than delinquent payments. In the event of delinquencies by individuals or companies there is an established procedure which involves home visits and court proceedings. SNIT has advised us that arrearages have decreased substantially among project beneficiaries from earlier days both because of increases in real income and because of continuing SNIT pressure on beneficiaries to pay. In actual fact, the 002 project is not in overall arrears due to pre-payments.

"It has not been easy to deal with SNIT on a number of these items, partly because of the general nature of the problem, which involves intra-governmental transfers and partly because SNIT genuinely believes that in the case of the people who were forcibly relocated (a large percentage of the delinquents) it is very difficult to extract even the minimal payments required. Nevertheless progress is being made and considerable RHUDO and SNIT staff time has been devoted to these problems."

Core Unit Portfolio -- In preliminary consultations with officials of the Caisse Nationale d'Epargne Logement (CNEL), the GOT borrowing institution for the core housing component of the 664-HG-003 project, we were advised that home loan repayment arrears in its HG-financed core unit portfolio were "negligible." In testing this assertion, we made a random sampling of 5% of core unit mortgagors from each of the seven core unit project sites under this project component. The data displayed on the following table were supplied by CNEL's financial management division as valid through November 1980.

Number of core unit mortgagors sampled	70
Number delinquent one monthly payment or more	29 (42%)
Number delinquent three pay'ts or more	12 (17%)
Most delinquent case sampled	10 months

In comparing the total amount due each month from the sampled group of 70 mortgagors with the amount in arrears, it was found that the total amount in arrears owned by the sampled group equaled 116% of the amount due from the same group for any one month. While not as serious as SNIT's portfolio delinquency situation, this amount of arrears can hardly be termed "negligible."

In response to these findings, RHUDO/NE advised us as follows:

> ". . . CNEL is now the major housing finance institution in the country and, consistent with RHUDO's institutional objectives, it the institution with which RHUDO fully intends to work extensively over the next several years. CNEL has assured us in the past that the number of delinquent payments is not a serious problem, but RHUDO intends to work with CNEL to establish and maintain a satisfactory level of collections."

Conclusion -- In light of the importance which the Housing Guaranty Program attaches to the subject of cost recovery, we believe that the area of homeowner delinquency analysis and control should not be left for audit attention on a periodic visitation basis only. Consequently, we feel that RHUDO/NE and USAID/Tunisia officials should redouble their efforts to underline the importance that AID HG Program policy attaches to this subject.

Recommendation No. 8

RHUDO/NE, in coordination with USAID/Tunisia, formally request the GOT borrowing institutions under project 664-HG-003 (SNIT and CNEL) that they provide RHUDO/NE with an analysis of HG home loan repayments to date together with a description of the policies and practices employed by each institution to pursue delinquent mortgage loan repayments.

In reply to this recommendation, the auditees have stated the following:

> "RHUDO agrees that good management of mortgage loan portfolio should be encouraged. On the other hand, portfolio management was not emphasized in the design of an agreement covering this policy which had as its major objectives to encourage policy shifts with regard to size and cost of units and improvement of urban slums. We would agree that planning for any project can be improved, but it is unfair to apply resulting new criteria unilaterally and retroactively. We therefore question how successful a formal request for analysis and reports might be, particularly in light of past experience with SNIT on a similar subject. RHUDO plans to continue to share information on this

subject with CNEL and SNIT and to encourage them to refine collection procedures. RHUDO and USAID believe that a recommendation on this matter is inappropriate for the final report but we will welcome auditors' suggestions as to how to maintain a useful dialog with our borrowers on the subject of portfolio management."

AID has every right to request the information sought in our recommendation under the terms of the Implementation Agreement. The auditees in their response appear to anticipate that CNEL will not cooperate in providing the recommended data. To say that good portfolio management was not emphasized in the design of this project when it is a major objective of the HG Program worldwide -- not to mention the precepts of good commercial practice -- calls into question, in our opinion, the continuity of HG program objectives. We continue to believe the recommendation is sound and reasonable, and therefore it has been retained.

Compliance Matters

Interviews with randomly selected residents of core units revealed that a substantial number of these dwellings at certain project sites had been rented by their owners. Speculative use of HG loan financed dwellings is prohibited in the CNEL sales agreement. Furthermore, our talks with project residents revealed that almost all core unit dwellers we interviewed were unaware of U.S. Government participation in this effort to address their shelter needs. Finally, a review of documentation under the second $10 million tranche of this HG loan project disclosed that the terms of AID's project authorization had been exceeded as regards the length of the grace priod granted for repayment of loan principal.

Core Unit Rentals

According to the pro forma sales contract which CNEL used in offering HG loan financed core units, the buyers of these dwellings undertook to purchase their houses for "residential use." This provision is in compliance with certain terms and conditions found in project Implementation Agreement Section 3.03(e): ". . . each beneficiary shall represent in writing at the time of purchase that:

> 1. he intends to occupy the dwelling unit as his place of residence . . ."

Site Visit Results -- Our visits to each core housing site included interviews with local SNIT and CNEL officials as well as with a handfull of project residents selected at random from different parts of each project site. We do not pretend that the results of these talks provide anything more than a general idea of the use to which core units are being put, although we do believe this information to be quite reliable. As regards unit rentals (this term refers to the entire rental of the unit with no owner occupancy), we found that this practice varies considerably from project site to project site. At two sites, we estimated that between one-third to one-half the units financed with HG loan funds had been rented out. At another two sites, this range was from 10% - 30% of the units. At the three remaining sites, less than five percent of the units were estimated to have been let out. As to the amount of rents being paid, we estimated that this varied from twice to three times what the owners of these units are obliged to pay CNEL each month. We found no evidence to suggest that the project sponsor and HG loan borrower, CNEL, had taken any steps to survey the use to which core units were being put, much less to enforce the requirement specifying their residential use only.

Conclusion -- At certain core housing project sites, a substantial number of homebuyers appear to be making speculative instead of residential use of their units. In our opinion, CNEL, the project sponsor and HG loan borrower has not complied with the spirit of the project Implementation Agreement prohibiting speculative use of HG financed units because it has taken no steps to verify homebuyers' use of their units, or enforce the provisions of the sales contract restricting such use.

Recommendation No. 9

RHUDO/NE, in coordination with USAID/Tunisia, formally advise CNEL that a substantial number of core units at certain project sites appear to have been put to speculative use by their owners. Further, request CNEL to propose to RHUDO/NE a plan of action designed to verify the extent of such speculative use and to identify steps that can be taken to enforce sales contract provisions requiring core unit buyers to make residential use of these units.

In reply, we have the following comments from the auditees.

"RHUDO agrees that any information that comes to us about project unit rentals should be shared with CNEL and that we should consult on the implications and remedial procedures if necessary. RHUDO would also make available to CNEL information that becomes available from time to time on how this problem is handled in other countries. However, we believe our dialog with CNEL will be most effective if we are not committed to get some formal proposal from them as is implied in Recommendation No. 9. We are pleased to have the auditors' information and suggestions on this subject, we plan to follow-up with CNEL as best we can, and we request that the Recommendation be deleted from the final report.

Once again, RHUDO/NE appears to anticipate that CNEL will not oblige AID with a plan of action on this subject which AID again is perfectly within its rights to request. We reiterate at this point our comment made at the Tunis Exit Conference at the end of our field work to the effect that it is not within the sole purview of the AID audit function to verify portfolio management practices and proper use of AID HG loan fund benefits. It is as much the responsibility of AID project managers to carry out these verifications and, for this reason, our recommendation has been retained.

Project Publicity

The project 664-HG-003 Implementation Agreement contains the following providions pertaining to project publicity.

> "The Government and CNEL shall give such publicity to the Project as may be appropriate to identify the Project as having been constructed with the cooperation of the Government of the United States of America."

Results of Site Visits -- During our visits to core housing sites we spoke with about 40 residents of HG financed dwelling units. We interviewed only one such resident, however, who demonstrated an awareness of U.S. Government participation in the core housing program. One would assume that if adequate publicity had been accorded this AID shelter program effort, then, at a minimum, the beneficiaries of HG loan financing would be generally aware of AID contributions to their shelter needs.

We were advised by CNEL officials that core housing application blanks and project construction signs both contained the legend "U.S.A.I.D.". The overwhelming majority of core housing residents with whom we spoke, however, were Arabic speakers who were unable to identify the meaning or significance of this English acronym. We were also advised that an inauguration ceremony had been held at only one east-central core housing project site with the U.S. Ambassador in attendance.

Conclusion -- In our opinion, publicity "appropriate to identify the Project as having been constructed with the cooperation of the Government of the United States of America" would have ensured a general awareness on the part of the beneficiaries of AID Housing Guaranty Program financing that the U.S. Government played a significant role in the solution of their shelter problems. We would submit further that additional publicity in this regard would help further good will and understanding between the people and governments of Tunisia and the United States. Consequently, we are making the following recommendation.

Recommendation No. 10

RHUDO/NE, in coordination with USAID/Tunisia, consult with the American Embassy, Tunis, and the GOT borrowing institutions under project 664-HG-003 regarding the desirability of further publicizing and identifying the cooperation of the United States Government in the development of this project.

The auditees have provided us with the following comments on this recommendation.

"RHUDO and USAID have consulted with the American Embassy and USICA about publicizing this project. To date CNEL has provided publicity as requested by AID. We have decided that publicity so far has been satisfactory and we plan to continue our practice of identifying the role of the U.S. Government in connection with important visits or events. Therefore we request that this Recommendation be excluded from the final report."

We have retained the recommendation because we believe that project publicity has not been satisfactory when most of the beneficiaries of AID assistance appear to be unaware of the source of this help.

Exceeding the Terms of Project Authorization

According to the AID authorization document for the second tranche of project 664-HG-003, issued on September 26, 1978, the following terms and conditions, inter alia, were to apply to the second $10 million dollar loan (664-HG-003B).

"Term of Guaranty: The loan shall extend for a period of up to thirty years (30) from the date of disbursement of the first installment of the loan including a grace period on the repayment of principal not to exceed five years (5). The guaranty of the loan shall extend for a period beginning with the first disbursement of the loan and shall continue until such time as the Investor has been paid in full pursuant to the terms of the loan."

Grace Period Doubled -- In reviewing the project documents we discovered that, as a result of an oversight, presumably, the Loan Agreement between the eligible U.S. lenders and the GOT Borrower, CNEL, as well as the attached form of Promissory Note, provided for a ten-year (10) grace period, instead of the five-year period authorized above.

Immediately upon discovering this variance, we cabled the Office of Housing (DS/H, AID/Washington notifying them of this discrepancy. We also took note of the fact that a recent HG project review in Botswana had revealed an identical grace period discrepancy, and suggested that all HG Loan Agreements be reviewed as a result.

Corrective Action Noted -- In response, we have been advised by DS/H and GC/H (STATE 040814) that

> "an Action Memorandum has been sent to the Assistant Administrator/Near East Bureau, AID requesting that the guaranty authorization be amended to provide for a ten (10) year grace period on the repayments of principal . . . . In addition, GC/H is reviewing all authorizations and loan agreements to look for and, if necessary, to correct any similar discrepancies."

Conclusion -- In view of the foregoing response, we are of the opinion that no recommendation is necessary on this matter.

Achievement of Project Objectives

AID Project 664-HG-003 will provide over 3000 shelter units to deserving, lower-income Tunisian families. Certain project implementation deficiencies and misunderstandings have, however, prevented the project from exceeding its shelter production goals. Further, physical implementation of the project has disclosed a number of technical and supervisory weaknesses that should be addressed prior to the implementation of any subsequent HG projects in Tunisia. Greater training and orientation together with adequate physical and financial resources will have to be provided in order for future HG loan financed slum upgrading efforts to be carried out more efficiently and effectively.

As to the project's policy goals described in the Background section of this report and the AID Project Paper:

- The GOT appears to have accepted the concept of slum upgrading as an alternative to slum clearance.

- Although the core housing component of this project was implemented with relative success, the GOT seems reluctant to continue with the construction of any more one-room core units.

- The GOT appears to be increasingly aware that it must better target the beneficiaries of shelter subsidies if it is to employ these resources more effectively and to benefit the income strata really in need of subsidies. Moreover, the subsidies present in the cost of external dollar financing under project 664-HG-003, in our view, remain unacceptably high when compared with the internal return from project beneficiaries. Given the present high cost of AID HG loan financing imposed by conditions in the U.S. financial marketplace, it seems unlikely that this situation will improve much in the foreseeable future.

GOT housing institutions and policy makers have not, in our opinion, been as forthcoming or cooperative as one might reasonably expect under the circumstances, and in view of the magnitude of AID's planned HG loan contributions to the Tunisia shelter sector, as described in the Background section of this report. Certain interest has been evidenced, however, by GOT shelter sector policy makers in launching an experiment in the mobilization of local capital for housing through a "free savings" approach. Given the propensity of Tunisians to save, as noted in earlier sections of this report, this alternative form of home savings and loan operations — as opposed to the "contract system" currently in use — holds out the potential for eliminating the need for further external financing for shelter programs.

As to project management, responsible GOT and AID officials have, in our opinion, demonstrated inconsistency and reluctance to apply adequate financial controls and oversight over project cash flows. We have also noted a lack of compliance with certain stipulations contained in the project 664-HG-003 Implementation Agreement. Finally, the reasons advanced by responsible AID officials for taking or omitting to take certain actions are, in our view, inconsistent with sound management principles.

As noted in the Scope section of this report, audit focus during this review has been directed at the core housing component of this project because of the central role of CNEL as the GOT's primary housing finance institution, core housing project sponsor and HG loan borrower -- a role that will be replicated in the first tranche of follow-on project 664-HG-004.

Ibn Khaldoun

Despite the fact the $10 million of project 664-HG-003's total HG loan amount of $20 million was used to fund the completion of a large capital city project known as Ibn Khaldoun (SNIT Type "C" units), we have relegated it to a secondary plane of importance.

This was also done because, in agreeing to help complete Ibn Khaldoun, AID housing officials continued to apply norms and standards which antedated the AID New Directions shelter mandate -- AID's original contribution of $10 million for this project under loan 664-HG-002 was authorized in 1972. Thus, we believe that AID's second $10 million tranche under HG-003 was in fact a quid pro quo, or inducement offered to the GOT to move further in the direction of c o r e housing and slum upgrading which are funded under the other 664-HG-003 project components. We should also consider the fact that this $10 million loan fuded about the same number of units already built by CNEL under the core housing project component, but for less than half the money used by SNIT to finish Ibn Khaldoun and an adjacent development of similar housing known as H'Rairia. Finally, we have noted that no change in the terms of financing of Ibn Khaldoun units -- 80% of the total financed under this project component -- took place between loan HG-002 and HG-003; that is, all buyers of SNIT-built units in Ibn Khaldoun enjoy interest-free home loans with no downpayment requirement.

A report of final inspection of these units commissioned by RHUDO/NE at about the same time as the inspection of core units, mentioned earlier herein, disclosed a number of construction deficiencies similar to those noted with respect to core units (both built under SNIT's general contractorship). Of greater concern is the continuing lack of adequate community facilities at Ibn Khaldoun -- a development which was begun about one decade ago now and comprising over 12,000 units in all. Finally, SNIT's cost recovery record has been mentioned in an earlier section of this report and continues to give cause for concern. We were advised by one project resident that he stopped making his monthly payments because he wanted to sell his unit at Ibn Khaldoun and planned to pay off his loan with the sales proceeds. He stated that he was unable to sell his unit as quickly as anticipated and that six months passed before he received a collection notice from SNIT. Although AID housing officials formally notified SNIT in 1977 that they were satisfied with SNIT's home loan collection procedures, it would be our view that these procedures continue to require both AID's and SNIT's attention.

Core Housing

The body of this report deals at some length with the record of this project component's implementation. Of greatest concern in this respect is the fact that both CNEL and SNIT official responsible for financing and building these units, respectively, have evidenced great reluctance at continuing to build one-room core units (See EXHIBIT C). This attitude stems from the GOT's view that one-room units are hard to sell. However, during our field trip visits to core housing sites and regional CNEL and SNIT officials, this was not found to be universally true. It does seem apparent that after waiting from two to four years to complete a savings contract that qualifies a CNEL client for a home loan, many savers would prefer to purchase at least a two-room unit, because they regard a one-room unit as unacceptable for traditionally large Tunisian families. Rather than increase the size of the unit, it would be our view that CNEL should provide instead an urbanized lot and perhaps sanitary facilities only with reduced downpayment requirements that would permit buyers to construct their own units to the specifications laid down by GOT authorities and the size their means permit. In an era of spiralling construction costs, this would seem to provide a solution to the problem of continuing to make shelter facilities available to the most needy income groups. Also a consideration in marketing core units, we learned, was the fact that some of the AID HG loan financed projects were sited in close proximity to similar housing offered by the GOT under a highly subsidized program funded by a special tax on employers. Given a choice, prospective buyers will naturally opt for the more subsidized units. Hence, in certain instances, the GOT offered shelter to the same target group in competition with the AID HG loan financed core housing units. This lack of planning and coordination is a matter which will have to be addressed under future HG loan projects planned in Tunisia.

Slum Upgrading

Of the three components under project 664-HG-003, the effort to upgrade living conditions in a capital city slum area known as Mellassine represents the most innovative approach attempted yet in the Tunisian urban sector and a significant departure from the traditional GOT approach of bulldozing squatter settlements. There have been many delays in this project, as reflected in the fact that almost 80% of the HG loan funds ($5 million total) authorized for this component remain in two escrow accounts. Our visit to this area and interviews with AID and GOT officials revealed that residents of Mellassine have received the project with enthusiasm. In view of the fact that this is the first such slum upgrading effort to be attempted in Tunisia, we have concluded that the delays in project implementation have come about because progress is being measured against unrealistically optimistic benchmarks set forth in the AID Project Paper. This observation was also found to be borne out in the reports of different project consultants which we found in the project file.

AID HG loan funds are being used to fund infrastructure upgrading works and the provision of certain utilities and public services. Because of an expected excess of HG loan funds for this project component, AID housing officials have recently agreed to use a portion of these monies to fund the construction of certain community facilities. In our own physical inspection of this project, we noted that one end of the project is situated on very low lying land -- lower perhaps than the level of an adjacent body of water. It was our impression from discussions with technical personnel associated with this project that not all the problems associated with in-fill of this land and its drainage had been completely surveyed and costed out. We passed these impressions on to RHUDO/NE officials who have taken action to have an AID engineer verify these observations and provide them with an opinion.

Grant Funding -- Of special note under this project component is the provision of centrally funded AID grants totalling about $600,000 under an activity known as Integrated Improvement Project for the Urban Poor. These monies are roughly divided into thirds, as follows:

- The provision of health training and social services to Mellassine residents.
- The establishment of a revolving small credit loan fund to finance small business ventures and increase employment generation in the area.

- The provision of an American technical adviser on a resident basis to help coordinate the provision of these services and orientate local personnel as to their purpose and function.

Of these three grant funded subproject elements, the provision of health and community services has been undertaken and successfully so. The small credit program has been delayed because it has not yet been possible to identify and employ the services of Tunisian personnel with sufficient credit experience to enable these operations to get underway. Without such experienced personnel, we were advised, responsible officials believe the program's chances of success are diminished to the point where they should not be undertaken at all, and we would agree.

Technical Advisory Services -- A resident American contract technician employed by Planning and Development Collaborative, Inc. (PADCO) arrived in Tunisia in November 1979 to assist in the Mellassine improvement project. According to this adviser's reports and statements made to us, certain progress has been made in developing the necessary administrative structures and personnel components that will be needed to make Mellassine a viable community. However, this progress has been achieved despite the fact that an inordinately large proportion of his time and efforts (and, consequently, AID grant funds) were taken up in day-to-day dealings with the Municipality of Tunis' bureaucracy in obtaining the necessary approvals for such basic items as office machine and furniture purchases for the Mellassine community center. This "walk through" procedure was made necessary by the fact that the municipal approval process still functions along 19th century management lines that include rigidly compartmentalized areas of responsibility and a reluctance to communicate between different administrative functions to facilitate such necessary procedures as procurement of equipment and supplies.

According to information provided by municipal officials, about $67,000 has been expended thus far for equipment under this project. However, the Municipality of Tunis had yet, at the time of our review, to submit to AID its first billing for reimbursement for these purchases. Also noted was the fact that these items were being procured "off the shelf" with duty and sales taxes included in the purchase price, although the AID-GOT project agreement specifies AID reimbursement of duty-free procurement.

The resident technical adviser, who has a Ph. D. in Social Anthropology, has made timely, detailed reports on his activities on a quarterly basis since his arrival in country. He further advised us that he is preparing a separate monograph on these experiences for publication in the United States. We have discussed this project at some length with the adviser and how the results of his write-up could be used to assist in facilitating the implementation of similar slum upgrading activities envisaged under the follow-on AID loan project 664-HG-004. Consequently, we are making the following recommendation.

Recommendation No. 11

RHUDO/NE, in coordination with USAID/Tunisia, consult with the resident technical adviser under project 912-0007 (IIPUP-Tunisia) to:

(a) obtain timely submission by the Municipality of Tunis of requests for reimbursement under the project;

(b) ensure that such submissions include requests for reimbursement of the duty-free value of items purchased only; and

(c) divulge to appropriate GOT officials at all levels the results of technical advisory services provided in support of the Mellassine improvement project in such a manner as to facilitate similar upgrading activities planned under AID project 664-HG-004.

In response to our final recommendation the auditees have stated:

"As auditors are aware, the resident technical advisor gives us very candid reports and we consult on project progress on almost a daily basis. Since the specific consultations mentioned in Recommendation No. 11 (a) and (b) have been underway for some time we do not see the need for this Recommendation and ask that it be excluded from the final report. With regard to part (c) of the Recommendation we will divulge the results of the technical advisory services, as a normal course in project implementation through timely dissemination of the evaluations and/or the project adviser's final report. In any case we do not see how we could respond to this Recommendation within the limited time frame for audit responses, therefore, we request that it, too, be excluded from the final report."

In retaining this recommendation we feel the auditees have misinterpreted our objective and would note that the requests in parts (a) and (b) are for RHUDO/NE action directly with the Municipality of Tunis, and not the resident American adviser. As to part (c), given the amount of time remaining in the resident adviser's contracted period of stay in Tunisia (October 1981), we feel that ample opportunity exists for him to participate in the divulgence of information on the upgrading experience, while still within the audit report response requirements of the agency.

Project Goals

From the preceding section it seems clear that the GOT's acceptance of slum upgrading as an alternative to slum clearance has been ratified by inclusion of large-scale upgrading activities in a planned follow-on HG loan project designed to benefit several secondary urban centers in the country's interior. As noted earlier in this finding section, however, the GOT's acceptance of core housing under the one-room design concept has not taken hold. In fact, CNEL officials were extremely reluctant to use excess HG loan funds under that project component for continuing construction of this size unit, and have so formally advised RHUDO/NE. Nevertheless, it would appear that SNIT and CNEL will now coordinate to construct sufficient one-room units to absorb the remainder of unused HG loan funds under this project component.

Subsidies -- A great amount of discussion has taken place and been recorded in the project file regarding GOT shelter subsidies. Some of these considerations have already been alluded to in previous sections of this report. It is important to understand in this connection that the role of the GOT in providing housing services in Tunisia is a predominant one, accounting for about 55% of all residential construction. Prior to the mid-70s, the National Building Society (SNIT) acted as both developer and financing agent for the GOT in its shelter efforts. Residents of solidly middle-class housing built by SNIT in earlier years continue to receive an annual subsidy from the GOT ("prime de construction") to help defray their housing expenses. All units built by SNIT under project 664-HG-003 benefited from a GOT price reduction subsidy of about $600. Interest rates on home loans of 10-15 years' duration still range from 0% to 4½% annually. Even this latter rate includes a 1% subsidy to CNEL homebuyers provided by the GOT to CNEL, despite the fact that many of CNEL's clients are clearly middle income families. A recent AID funded shelter sector analysis of Tunisia described this return from home loans (5½% total as opposed to 4% interest paid to savers) as "too narrow for long term capitalization;" and went on to observe: "It seems possible that the CNEL system so favors the ultimate client, the housing purchaser, that it does not permit adequate strengthening of the institution."

Cost of External Financing -- The effect of this policy of subsidization is magnified when one analyzes the cost of external financing. In the case of project 664-HG-003, the average cost of long-term financing to the GOT under this $20 million project was about 9.6% (disregarding the yield effect of loan fees deducted from loan disbursements and paid to the U.S. lenders and AID). It is difficult to gauge the internal return in local currency to be perceived by the GOT under this program because cost recovery mechanisms have not yet been finalized under the slum upgrading component. However, the net effect will undoubtedly see an internal return of something well under 3% in Tunisian dinars against an outflow of 9.6% in hard currency resources to the American lenders. Even if the GOT were to establish 6% as a minimum home loan rate under future HG projects, it is not clear, given present and forseeable conditions in the U.S. financial marketplace, that this spread would narrow appreciably. Thus, the net effect of present GOT subsidy policies is to make the entire shelter sector increasingly dependent on GOT resources to offset the institutional decapitalization which these subsidy policies cause.

Financing Affordability -- While interest rates are an important consideration, they represent only one of three factors which determine the affordability of a home loan and the dwelling unit itself. In addition, the face amount of the loan and its duration are also important variables to consider. Thus, a $4,000 loan's cost at 5½% interest over 15 years is about $33 per month. But it would cost only pennies more per month if the same amount was lent at 9½% over 30 years. Given the relatively high construction standards employed in Tunisia, there is little doubt of the unit's utility equalling or exceeding the term of a 30-year mortgage loan (the limit for such loans set down in the project Implementation Agreement). In our opinion, it is the monthly payment and not the terms of the loan that determines whether or not a unit is marketable in the face of high demand for shelter, as is the case in Tunisia. Furthermore, given the demonstrated propensity of Tunisians to save and sacrifice to own their home, it is doubtful that the average loan term would exceed the present 15-year limit, even if 30-year loans were offered. Thus, we question the GOT's continued maintenance of unrealistically low interest rates and reliance on GOT capital support for housing sector institutions.

"Free" vs. Contract Savings -- In a similar vein, it is difficult to understand why, in view of this penchant for saving, the GOT has delayed so long in experimenting with a "free" approach to savings. At the present time, persons saving for a home with CNEL obligate themselves to save a certain amount per month for from two to five years in order to qualify for a home loan and at the same time to meet a fairly stiff downpayment requirement of 1/3. When the savings contract has been completed, however, these persons are no longer able to continue saving with CNEL, despite the fact that they have developed a regular savings habit and attitude over several years. The topic of "free" savings, in line with the model provided by the U.S. savings and loan industry, has been discussed for some time with GOT officials. An experimental free savings project confined to certain geographic locations of Tunisia only has been made a part of follow-on project 664-HG-004. However, it is not clear at this point when this experiment will get underway because GOT officials have been reluctant to complete negotiations on this issue, which they consider quite sensitive their controlled economy environment, and also because interest rates on HG loans at the present time are running at levels of 14% - 15% due to conditions in the U.S. marketplace. The experiment does, however, hold out the potential for greatly diminished reliance on external or GOT capital financing for shelter through local resource mobilization for housing.

At this point the auditees have offered us further comment.

> "The fact as we see it is that the GOT policy to extend subsidies prevents decapitalization of financial institutions rather than their becoming decapitalized by the effects of the subsidies as is stated in the report. One should not expect a Ministry of Housing nor a GOT construction agency like SNIT to become capitalized in the first place. CNEL, a mortgage bank, has only recently progressed towards a

philosophy of independence from the Central Bank. Otherwise, it has operated, as have other GOT parastatal institutions, as an implementation arm of the Government. The GOT financial system philosophy does not currently aim at capitalization of such institutions. All bank risks are ultimately borne by the Government. The GOT adoption of a free savings approach would require a revolution in this philosophy which has, for ten years, succeeded in financing successful economic growth and in protecting Tunisian citizens from the worst effects of worldwide inflation and interest rates. While stating this, we accept that as Tunisia moves into a world governed by international fiscal policies, etc., the GOT should be moving toward more self-renewing financial institutions. We have been urging the adoptio. of a free savings approach, but we also are respectful of the reluctance of GOT policy-makers to abandon a system which has worked.

"Furthermore in these same discussions the auditor says that a free savings approach to housing finance could greatly diminish or eliminate the need for external financing of its housing programs. We think the auditor may mean GOT budget support rather than external financing."

In response we would note that it is an overall HG Program objective to assist recipient countries to minimize subsidies and attain self-sufficiency in housing finance. The GOT may be coming around to this posture, but very slowly. As to the need for external financing, unless the auditees wish to characterize AID HG loan inputs as "budget support," we believe our description is accurate.

GOT Housing Institutions & Policy -- Not much more than has already been briefly summarized in this report is known about GOT housing institutions or policy formulation. This is due to the confidentiality with which these institutions regard their operations and make policy decisions. To cite some examples of this institutional reticence, we would note that:

- Despite rather extensive dealings with CNEL over the past several years, RHUDO/NE has never been able to obtain certain basic information on CNEL's overall operations considered commonplace to the lender-borrower relationship. There is no record in RHUDO's files of CNEL financial statements, internal reports, or the composition of its home loan portfolio.

- Somewhat surprisingly, CNEL initially refused us access to its books and records (specifically bank statements) as regards the status of HG loan funds deposited in an escrow account with a U.S. bank branch office in the Bahamas.

(Section 8.01 of the project Implementation Agreement specifically provides AID representatives such right of access.) After two months' delay, and only after much pressure had been brought to bear on this issue by AID and Embassy officials, access was finally obtained.

- SNIT has not responded satisfactorily to RHUDO's often repeated requests for a description and analysis of its HG loan financed portfolio arrearages. This despite the fact that RHUDO has gone so far as to provide a detailed format in blank for such a report.

- SNIT has similary failed to respond in any way to RHUDO's often repeated requests for a formal evaluation of its role in the implementation of project 664-HG-003, as specified in the project Implementation Agreement.

- RHUDO was officially discouraged by GOT officials from bringing an American housing expert to Tunisia to perform a case study of HG program impact on the Tunisia shelter sector. These officials regard this as a sensitive area for research at a time when the GOT is formulating its next five-year economic plan.

Conclusions -- AID Housing Guaranty Loan project 664-HG-003, in our opinion, has been a qualified success. It has achieved its construction goals, although not without certain inefficiencies and opportunity costs that prevented these goals from being exceeded. At the same time, it has been quite successful in benefiting below-median-income Tunisian families in real need of HG loan assistance.

For its part, the GOT does appear to be moving in the direction of restricting shelter subsidies to those income strata of its population in most need of them. Nevertheless, the degree of subsidization remains such that shelter sector institutions must continue to rely heavily on GOT capital inputs, including external financing arrangements, if they are not to become decapitalized by the effects of these subsidies. This trend can be reversed, in our view, through the mobilization of local capital resources for housing finance purposes. To its credit, the GOT is studying a "free savings" approach to housing finance which could accomplish this objective and greatly diminish, or eliminate altogether, the need for external financing of its housing programs.

Responsible AID housing officials have worked hard at fostering a dialogue with the GOT on housing policy matters in the face of official reticence and occasional non-cooperation. However, it is our opinion that RHUDO/NE has not done all that it could or should have done to adequately monitor the physical construction or financial management aspects of project 664-HG-003. Further, AID housing officials have not adequately emphasized to GOT housing institutions the importance which AID housing policy attaches to cost recovery and portfolio management. Finally, they have not verified

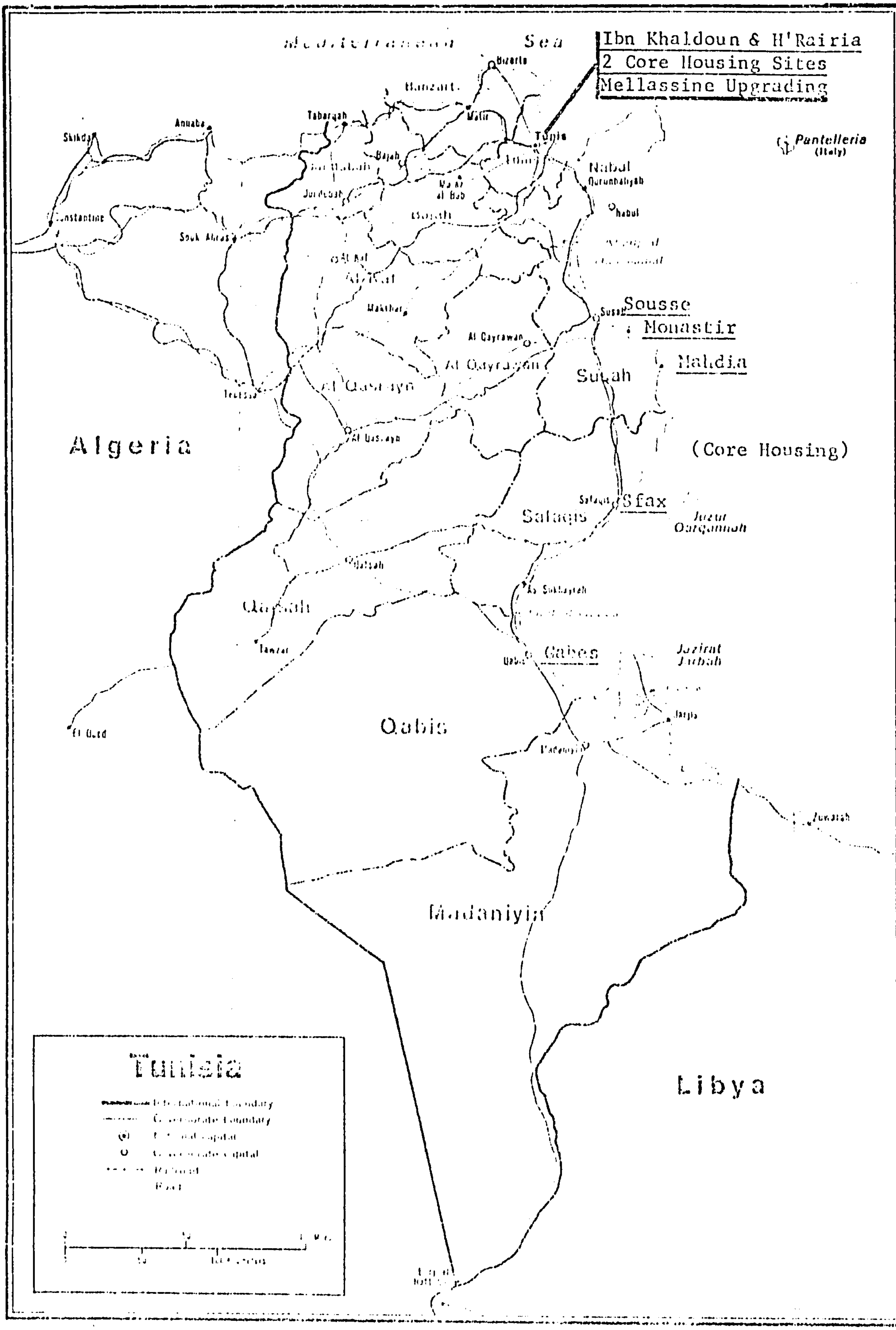
GOT compliance with certain provisions of the project Implementation Agreement as regards the end-use of HG loan financed housing units or the level of publicity accorded to, and beneficiaries' of HG financed housing awareness of, USG contributions to the Tunisian shelter sector. In their responses to our preliminary finding statements responsible AID officials have evidenced what appears to be greater concern for the planning and negotiation of future HG projects than for adequate implementation of project 664-HG-003. It would be our hope that the nature of the AID-GOT relationship in the shelter sector could be modified to such an extent that adherence to the terms and conditions of international financing and administrative agreements and AID shelter policy objectives could be ensured independently of future HG loan financing considerations, and in consonance with the needs of the Tunisian shelter sector.

In response, the auditees have offered us these final thoughts.

> "Re auditor's opinion that RHUDO/NE has not done all that it could or should have done to adequately monitor the physical construction or financial management aspects of the project, ...RHUDO would... point out that a distinguishing feature of HG management, in contrast to typical direct loan and grant management, has been the ability to effectively manage a relatively large portfolio of new and continuing projects with relatively few people (in the case of RHUDO/NE a staff of four direct hires develops and monitors about $50 million in new projects per year in 5 countries). This of course is partly due to some basic differences between HG as opposed to direct AID funded and administered housing project monitoring responsibilities (Egypt for example) in view of U.S.G.' role as guarantor rather than direct financing source, market rather than concessional lending rates, U.S. private investor involvement and role, and the operation of the program using fees charged to users of the guaranty rather than appropriated funds."

In contrast to the views expressed above, we feel that the contents of this report amply support our view that AID project monitoring has been deficient and that attention to project implementation has taken second place to future project planning and negotiation.

EXHIBIT A



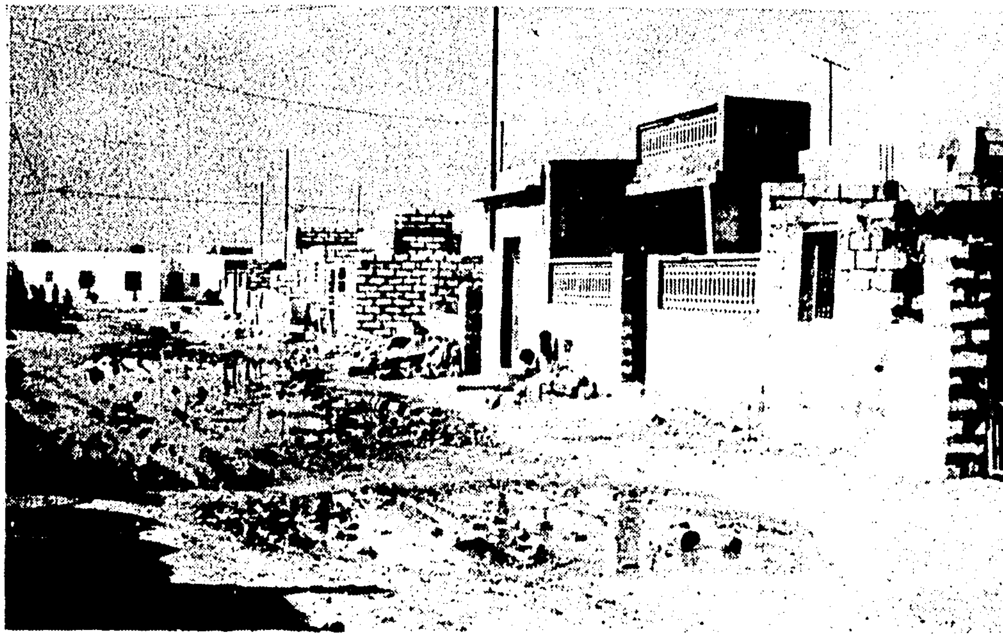
Sea
Ibn Khaldoun & H'Rairia
2 Core Housing Sites
Mellassine Upgrading
Bizerte
Tabarqah
Anuaba
Skikda
Tunis
Pantelleria
(Italy)
Bajah
Nabul
Constantine
Souk Ahras
Al Kaf
Makthar
Sousse
Monastir
Mahdia
Al Qayrawan
Al Qasrayn
Algeria
(Core Housing)
Sfax
Safaqis
Qafsah
Tawzar
Gabes
Qabis
Jarjis
Madaniyin
El Oued
Libya
Tunisia

GABES: The basic one-room core unit. Deterioration to facade is caused by high saline content in soil. No provision was made to counter this easily preventable condition.

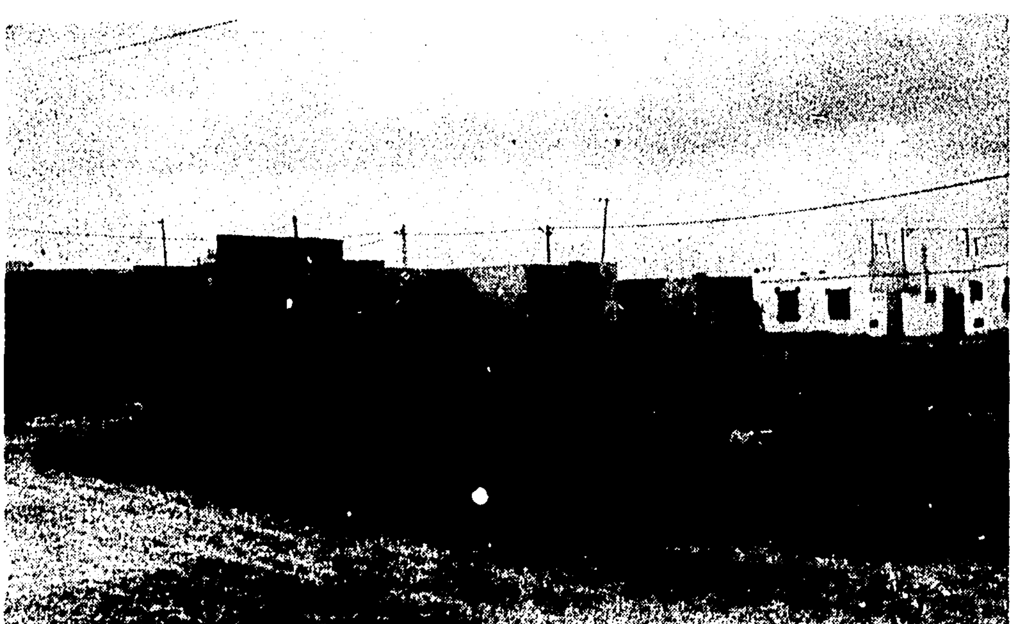
GABES: Many of the units in this project were expanded before homebuyers occupied their dwellings. This multi-story extension exemplifies the rapid improvements being made to the basic core structures provided with HG financing.

SOUSSE: Another example of the pride homeowners take in improving their original structures. Aside from the attractive facade, two rooms and a flagstone courtyard were added to the rear of this home.

MONASTIR: Improvements made by this homebuyer, however, include a front staircase which projects illegally into a public right-of-way.



MAHDIA: The condition of many roads at the seven core housing project sites is exemplified by this scene.



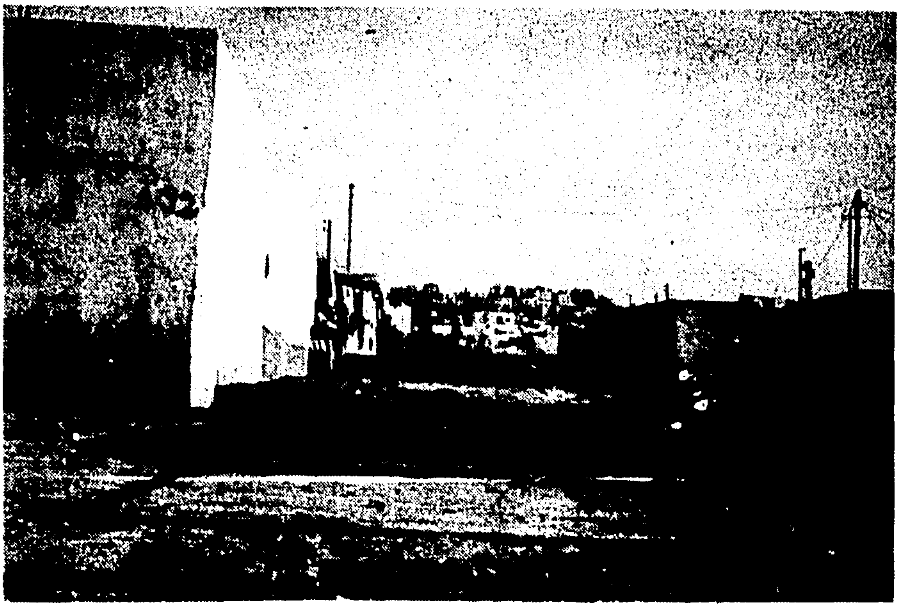
MAHDIA: The as yet unimproved central plaza of this project recently saw one of the bordering core units converted into a small grocery store -- the only community facility available to residents who occupied these units more than two years ago.

MAHDIA:

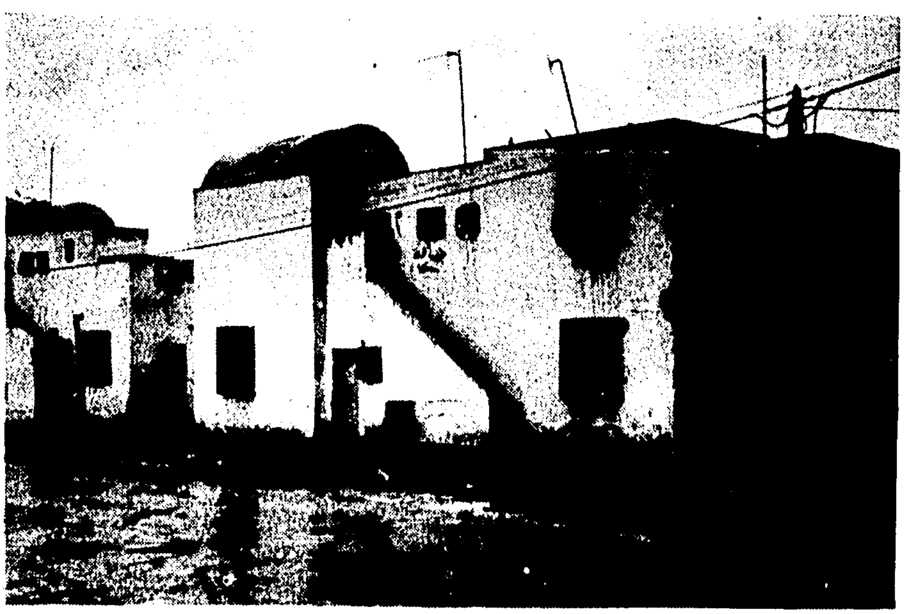
Our previous audit report noted that no provsion was made for drainage at the rear of core units. This condition remained uncorrected, however; and, as a result, this resident (and others) has run a drain pipe under the floor of his unit to sluice water from his kitchen and rear yard onto the street fronting his home.

MELLASSINE (TUNIS):

Seriously delayed at first, infrastructure improvements to this capital city slum area are now nearing completion with work on the area's roads and drains.



MELLASSINE (TUNIS): The low-lying nature of part of this project site bordering a lake may be appreciated from this aspect. The future street level corresponds to the top of the manhole cover, while the adjacent homes lie considerably below.



IBN KHALDOUN (TUNIS): Noteworthy of this example of substantial unit extension and improvement is the tendency of homebuyers to conserve traditional architectural values and designs.

Letter Agreement between AID and CNEL Establishing an Escrow Fund for the Core Housing Project Component

(Retyped by RIG/A/Nairobi for clarity. N.B.: The clearances found at the lower right hand corner of page 2 for DS/H were added after the audit visit to Tunisia.)

NOV. 25, 1980

Mr. Habib Alouini
President Directeur General
Caisse Nationale d'Epargne Logement
Avenue de Londres
Tunis

Subject: Tunisian Housing Guaranty 664-HG-003;
Core Housing Subproject

Dear Mr. Alouini:

We are pleased to be in receipt of your letter dated November 6, 1980 which details accomplishments and requests disbursement of the final 500,000 dollars hold-back for the core housing subproject. Your letter presents a clear summary of the facts.

We regret again that we are not able to accept your proposition, offered again, to finance houses larger than the prototypes agreed upon under the HG-003 housing guaranty loan. We are aware of your desire to provide comfortable housing for Tunisians and believe that you are able to do an admirable job in this respect without our help.

As you know, A.I.D. housing guaranties are offered in part as an incentive to help you expand shelter options to very low-income families. The third housing guaranty, and now the fourth, are designed to finance very minimal experimental shelter alternatives which can be afforded by below-median income families.

We are concerned by your statement that you expect marketing of additional core houses to be difficult and also your statement that an escrow account would permit us to study the possibility of replacing the value of the core units which were sold for cash or a lower mortgage amount. We are not aware that you have any significant inventory of unwanted core houses. On the contrary, we have observed a very strong market, except where similar houses are virtually being given away under government programs such as FOPROLOS. Second, neither you nor we are interested in establishing a blocked account for its own sake. Rather than a commitment to study this question, we would expect that you make a commitment to finance the required minimal houses. Otherwise, there is little rationale for the disbursement.

We are very proud of our successful collaboration with CNEL and respect your past history of success. We appreciate your openness in keeping us informed of your concerns on the implementation of these programs. We look forward to the timely construction of urgently-needed shelter affordable by very low-income families. We, therefore, propose a disbursement procedure as follows:

> La Caisse Nationale d'Epargne Logement (CNEL) will effect transfer of $500,000 of the November 26, 1980 closing to the HG-003 special account established by the Central Bank of Tunisia. The Assistant Director/Near East, Office of Housing will authorize transfer of the funds so held to CNEL after sites, plans, and costs for the additional units to be financed under the core housing subproject have been approved by A.I.D. and when 25 per cent of construction is complete as certified by CNEL. If any funds so held have not yet been disbursed six months from the date of this letter, A.I.D. shall have the right to direct payment of all or a portion of the HG-003 special account funds to such account as A.I.D. may specify for purposes of effecting a prepayment under the Loan Agreement. CNEL will provide evidence of eligible mortgages to A.I.D. as specified in Section 3.03 of the Implementation Agreement within twenty-four months of the date of this letter.

If you accept the paragraph above as our agreement as to the basis for the disbursement, please sign both copies of this letter in English and return one to us along with a signed copy of our agreement with the Central Bank so that we may proceed with the disbursement.

Sincerely yours,

(signed by)

C. Richard Zenger
Assistant Director/Near East
Office of Housing

(signed by)

Habib Alouini
President Directeur General
Caisse Nationale d'Epargne Logement

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