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UNITED STATES GOVERNMENT

Memorandum

001-2-3

TO : AA/LA, Mr. Herman Kleine

DATE: September 25, 1975

FROM : AG, Aubrey F. Mills
GAO-IGA Liaison, Room 547 PP

SUBJECT: IGA Draft Inspection Report "AID Loans to the Caribbean Development Bank," dated September 25, 1975

Attached for action by your office in preparing a coordinated Agency response is the subject draft Inspector General of Foreign Assistance report. Copies of the draft report are also being provided to the addressees below who are asked to provide pertinent comments to your office for use in preparing the Agency response. Comments by addressees should be provided to LA/OPNS with a copy to this office by October 10, 1975.

IGA has requested that AID's comments be to them by October 24. To assure timely submission, your office is requested to provide the comments transmitted by memorandum to the Auditor General by October 22 with appropriate clearances.

If there are any questions regarding this action or I can be of any assistance, I can be reached on 235-9220.

Attachment: a/s

Addressees:

AA/PPC, P. Birnbaum
SER/H, P. Kimm

Information Addressees:

SER/MP, W. Wild
SER/COM, W. Schmeisser
AA/LEG, D. Neill
OPA, C. F. Wheeler
GC, C. L. Gladson
AG/OC, W. Lane
AG/IIS, R. Parker
AG/OAS, P. Cody
AG/AUD, F. Shaver

RECORD COPY

DEPARTMENT OF STATE

Washington, D.C. 20520

Office of the Inspector General
of Foreign Assistance

MEMORANDUM

September 25, 1975

To: AID/AG - Mr. Harry C. Cromer

From: IGA/RPM - Thomas W. Novotny TN

Subject: Draft Inspection Report - AID Loans to the Caribbean Development Bank.

The subject draft is enclosed for coordinated agency comments. Written agency comments received before C.O.B. October 24 will be reflected in our final inspection report.

Enclosure:
As stated

DEPARTMENT OF STATE

Washington, D.C. 20520

Office of the Inspector General
of Foreign Assistance

INSPECTION REPORT (DRAFT)*

AID Loans to the Caribbean Development Bank

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*NOTE: This is a preliminary draft report of an IGA field inspection, prepared to allow appropriate officials to comment on IGA findings. The final inspection report may be revised to reflect comments received and further review of any subject included in the draft report.

1

AID Loans to the Caribbean Development Bank

SUMMARY

Under the authority provided by Subsection 624(d) of the Foreign Assistance Act of 1961, as amended, we reviewed certain activities funded by AID loans 538-L-001, 002 and 003 made to the Caribbean Development Bank (CDB). We inspected the deep water ports for Dominica and St. Lucia and low income housing projects in Dominica and St. Lucia, which were being financed by the CDB with AID loan funds.

Deep Water Ports

The deep water ports have suffered from overly optimistic feasibility studies and analyses. As a result, the current estimated costs are more than double those originally estimated and new capital will have to be raised to complete the ports. The completion date of the Dominica port is two years behind schedule. Due to changes in the financial estimates concerning the Dominica port, the Government of Dominica's ability to repay the CDB the amount borrowed for the project may be affected.

The St. Lucia port project has been delayed but does not appear to have the financial problems of the Dominica project. However, there is some question as to whether the Government of St. Lucia needs the new docking facilities at this time because it is uncertain whether estimates of increased port business will materialize. If the port's new docks are fully utilized, ships may not be able to maneuver in the harbor's turning radius.

We believe these difficulties illustrate the need for more thorough feasibility studies on behalf of CDB.

Low Income Housing

The CDB low income housing program, for which AID provided $6 million in August 1972, has lagged badly. As of May 31, 1975, nearly three years after the loan was made, only $3.5 million had been sub-loaned for six low income housing projects. The remaining $2.5 million is earmarked for projects which have not yet reached the loan agreement stage. We inspected two of the six projects and found them facing serious problems. In the case of the incomplete Dominica project, estimated unit costs are so much higher than planned, due in part to inflation which made the original estimates unrealistic, that it is questionable whether the income of the people who are expected to occupy these homes will rise as fast as the costs of the housing. In St. Lucia the project has not been started because the government has not been able to afford to buy the land in the urban areas on which to locate the houses.

The consultants hired by AID to provide technical assistance reported that the Bank's cost estimates were unrealistically low and that participating countries were incapable of providing the necessary financing of the infrastructure needed for the projects.

We believe the delays and cost overruns encountered in the port and low income housing projects clearly indicate that the cost projections and feasibility studies made by the CDB and subsequently reviewed by AID were not realistic.

We recommend that AID provide for a closer review of technical and economic feasibility studies of future subloans proposed by the CDB and other multilateral development banks.

BACKGROUND

The CDB was established in January 1970 as part of an international effort to provide development resources to the Caribbean area. The United States did not join the CDB but, in order to assist in the area's development it has, through AID, made loans to the CDB at concessional terms. CDB sublends these AID funds to approved borrowers. According to the loan agreements with the CDB, AID must approve all CDB subloans of AID funds of $500,000 or more. AID also provides the CDB with advice on policy and operating procedures and makes periodic evaluations of the CDB's progress.

AID has made three loans to the CDB. In 1970 it made a loan (001) for $10 million, and in 1973, a second loan (003) for $12 million, to the CDB's Special Development Fund. This Fund is the CDB's soft-term window having total resources of $57 million ($22 million from AID, $10 million each from the Governments of Canada, Venezuela, and Great Britain, and $5 million from Trinidad). The CDB relends these funds to the lesser developed member countries of the Caribbean region, including the independent and associated states and the British Crown Colonies.

In 1972 AID had also made a loan of $10.3 million (002) to the Bank's Special Housing Fund. The housing loan provided

$300,000 for financing technical assistance in the housing field, $4 million for a secondary home mortgage market fund and $6 million to construct housing for low income persons.

SCOPE OF INSPECTION

The purpose of our review was to ascertain whether or not the activities financed by AID's loans to the CDB achieved the objectives stated in the original loan proposals, and if not, to determine the reasons and make recommendations to help prevent such situations in the future.

We selected CDB-financed activities in Dominica and St. Lucia for review. We inspected the deep water ports and low income housing projects in each country. The results of our inspection were discussed with appropriate AID officials who expressed agreement with our findings and recommendations.

RESULTS OF INSPECTION

A. Deep Water Ports

If AID's review of the project proposals had been more thorough, the completion of the deep water ports financed by AID funds for Dominica and St. Lucia would not have been unduly delayed by problems which could have been foreseen and overcome.

The difficulties encountered in Dominica and St. Lucia port projects illustrate that the feasibility studies made by the CDB's consultants did not give full consideration to potential problems, including cost increases.

AID loan 001 for $10 million was made to the CDB in December 1970. In June 1972 CDB requested AID to authorize a subloan of $2 million to the Government of Dominica to finance 80 percent of the cost of constructing a deep water port, which was to consist of a 1,000 foot wharf with two major shipping berths, a smaller schooner berth, the reclamation of land in the port area, and related port facilities.

The estimated cost of the project, expressed in Eastern Caribbean dollars (EC$) was EC$5.4 million, equivalent to about 2.7 million U.S. dollars. The CDB had hired a consultant to make a feasibility study of the project prior to requesting AID's approval of the subloan.

Before giving its approval, AID reviewed the project and questioned certain assumptions relating to its economic viability. For example, the local lumber company which was to use the new facilities for exporting lumber had gone into receivership prior to the start of the port project. There was also a question about the future of banana exports, which were to pass through the port facilities, because of the entry of Great Britain (which buys the entire crop) into the Common Market and Great Britain's declining financial position. Further, AID believed that the type of tourist ships which the CDB estimated might call at the port was optimistic. However, AID believed the construction cost estimates were accurate and, even using more conservative estimates of financial return, that the project was economically sound.

Despite the CDB feasibility study which had been made, the cost estimates were, in fact, not adequate. By 1974 revised estimates of the costs of the project had more than doubled even before construction had begun. The project construction contract, signed in 1974, totaled EC$9.2 million (about $4.6 million) even though planned facilities having an estimated cost of about EC $350,000 were eliminated from the project in order to keep costs down.

The government agreed to finance the facilities deleted from loan financing from its own resources, though it later applied to CDB for this funding. In 1974, AID approved an additional subloan of $2,010,000 for the port project from funds provided to the CDB by loan 003. Part of the new loan was to permit the CDB to finance 90 percent rather than 80 percent of the cost of the port.

While inflation in the price of steel and other building materials and higher wages for Dominican workers caused a part of the increase in construction costs (EC$735,000) a poor computation of the cost of the construction contract was also a major and unnecessary contribution to the perceived costs on the part of the Government of Dominica. These cost increases forced the port to be completely redesigned on a smaller scale to save money. The design called for one 500-foot berth and a smaller schooner wharf with curtailed auxiliary buildings.

The most avoidable miscalculation of the amount of funds needed for the project was due to the use by the consultant of an inaccurate exchange rate to convert the foreign exchange component of the construction contract into EC dollars. In converting the amount of U.S. dollars needed to pay for imported goods and services into an equivalent amount of EC dollars, a rate of exchange was used which overvalued the EC dollar. This led to a misunderstanding on the part of the CDB and the Government of Dominica of the EC equivalent cost of the project of an amount in excess of the equivalent of US$600,000.

We did not receive an adequate explanation as to why the Government of Dominica's engineering consultant used an exchange rate of EC$1.78 per US$1 in making the conversion when the current market rate at the time the calculation was made was about EC $2 to US$1. According to AID the consultant obtained the rate from "New York banks". Our inquiry prompted a review by AID and the CDB of this occurence.

Work on the project began in January 1975 and is expected to be completed by August 1976. At the time of our inspection in June 1975, estimated construction costs had increased another $1 million to a new total, estimated at $5.6 million. The additional increase of $1 million was due to the need for additional pilings to complete the ship berths. The original soil tests had indicated that the pilings would meet resistance at a depth of 115 feet into the ocean bottom. In order to save money, the contractor persuaded the engineering firm that the pilings need only to be sunk to a depth of 90 feet. However, when the contractor started to sink his test pilings, he found they sank up to 25 feet further than anticipated and in fact the original feasibility study was accurate. By cutting and welding the existing pilings, the contractor extended them as much as possible, but under the new circumstances, the port cannot be completed on schedule as the new pilings must be ordered six to eight months in advance. Therefore, another long construction delay can be anticipated.

The state of Dominica's banana industry also raised some question as to whether or not the Government of Dominica can repay the loan. The Chief Technical Officer of the government's Port Authority believes that the government will need 10 years to begin debt service, but may not be able to begin repayment of even the interest when the port is operational. The CDB's revised economic study indicates the Government of Dominica can service a loan up to $6 million. However, the repayment of the loan depends in part on cargo handling revenues derived from the export of the banana crop.

An agricultural officer of the CDB said that poor administration and marketing keeps the price of Dominican bananas higher than any others in the Eastern Caribbean and Central American areas and that only a favorable contract (negotiated on a periodic basis) with Great Britain enables Dominica to export bananas to Great Gritain at an inflated price. New tourism could help the government service the debt; however, the government has no commitments from cruise lines to stop at Dominica.

Although the CDB's recent economic study states that repayment is possible, the loan may have to be renegotiated. Since the government is unable at this time to pay for the facilities which were deleted from the loan such as transit sheds, port buildings, and water supply. In addition to the infrastructure facilities, trucks and forklifts all have to be supplied by the government if the port is to be operable and there is no indication how this can be financed unless additional borrowings are made from the CDB. Further, with only one small ship berth, barges probably will still have to be used to load and unload cargo. The main reason for building the port was to eliminate the use of barges and speed up the "turn around time" of visiting cargo ships.

As a result of questions raised by IGA the CDB completed a new feasibility study in July 1975 which projected the total cost at $5,750,000.

St. Lucia

In December 1972, the CDB, with AID's approval, made a subloan of AID loan 001 funds in the amount of $2,787,000 to the Government of St. Lucia to enlarge its deep water port. Although not suffering from some of the problems of the Dominica port, this project is a year behind schedule and has also suffered from cost inflation. The current projection is a 40-week construction cycle to be completed in the spring of 1976.

An eight-month delay of the project ensued when the British consulting firm overseeing the construction would not accept the Venezuelan contracting firm's U.S. construction specifications. In addition, the test pilings were broken in shipment from Venezuela, which added another month's delay. The estimated cost of the project doubled before construction ever began, and to fund the increase AID approved a second subloan in the amount of $2,298,000 (from loan 003). No further subloans are expected to be required because, unlike Dominica, the contractor for the St. Lucia port is responsible for any cost overruns. Last year (1974) the port made a profit of EC$500,000 and the Bank does not consider debt service to be a problem.

The port currently has two berths capable of handling large ships and one schooner dock. The British consultant questioned whether the two additional berths, which will be constructed under this loan, will be fully utilized in the near future because at the time of our inspection existing facilities were adequate for existing needs. It is uncertain whether estimates of increased port business, which were the basis for constructing the new facilities, will in fact materialize. The port authority is planning to hire a new port manager to attract new shipping business.

Beyond this there is another problem with the port. The harbor mouth is too narrow (300 feet) to handle five large ships and would have to be widened to a minimum of 500 feet. Also, no feasibility study could be found which determined whether or not the harbor is large enough to allow five ships to maneuver without difficulty; a large ship should have at least three times its length to turn and the St. Lucia harbor's 1,100-foot turning radius allows for only twice the average ship's length. With a full port-five ships and a full schooner wharf--maneuvering efficiently in the harbor will be difficult. Currently, there are no plans to make the harbor more efficient.

B. Low Income Housing

In connection with the $10.3 housing loan (see p. 4), AID made a grant to the CDB to hire advisors on low cost housing techniques and to provide managerial guidance at the subborrower level to help develop and implement projects.

The use of the $6 million designated for low income housing has been delayed. Through May 31, 1975, about 2-1/2 years after the loan was made, the CDB had executed subloans for housing projects to six Caribbean countries totaling only $3.5 million. Some of these approved subprojects are having problems. The low income housing subprojects in Dominica and St. Lucia, which we inspected, are examples. The remaining $2.5 million has been earmarked for additional subprojects, but these had not yet reached the loan agreement stage. The status of the low income housing projects which we inspected demonstrates that the CDB has made subloans of AID funds without securing firm assurances that the conditions necessary for project completion can be met reasonably in accordance with the original proposals.

1. Dominica

On August 22, 1974, the CDB approved a subloan of $732,000 to the Government of Dominica for the first stage of a low income housing project, to consist of 200 units, and supporting infrastructure within walking distance of the capital. However, the project estimate made in 1973 was inadequate since the funds made available will not be sufficient to complete the 100 houses of the first stage. Completion of the project as planned will require at least another $1 million to complete the second stage of the project (another 100 houses)

At the time of our inspection in June 1975, construction was underway but no units had yet been completed.

The CDB's subloan provided that CDB would loan no more than $2,800 per unit, in order to insure that housing would be built that low income families could afford. Because of delays in the project, during which time cost inflation occurred, the CDB initiated a new cost estimate. As a result there of the CDB, in early 1974, approved a higher per unit loan of $4,500. At the time of our inspection, the estimated cost per unit had risen to $7,000 and, since no units had yet been completed, the unit price may well rise again. No decision has yet been made on how this cost is to be financed.

It is questionable whether the incomes of the people intended to benefit from the loan will rise as rapidly as the cost of the housing. This housing project is not intended to attack the problem of slum housing and may be so limited that the lowest income group will only be slightly affected. A CDB representative will be included in the group that will select tenants to assure that tenant placement will be in accord with the program. It should be noted that the government estimates that it needs 800 units a year to eliminate low cost housing shortages; and while the Government of Dominica has the available land, it does not have the funds to finance 800 units per year.

2. St. Lucia

In 1975, the CDB made a $645,040 subloan to the Government of St. Lucia for low income or urban working class housing. However, there was little progress on the project because the Government of St. Lucia could not afford to buy the land on which the houses are to be built. The current AID-funded project requires a sewage treatment system, which was not planned for at the time of our inspection. Forty-five percent of the population of St. Lucia lives in two major cities; this makes the cost of land too expensive for the government to acquire. The Government of St. Lucia has previously built successful low income housing with non-AID funds in locations away from the urban areas.

3. Technical Assistance

In connection with the housing loan, AID made a grant of $300,000 to the CDB for technical assistance in the low income housing field. AID employed the Foundation for Cooperative Housing (FCH) as a consultant for the low cost housing program; two of FCH's employees were provided to the CDB. In his final report, covering about one year's time, the FCH architectural and planning consultant reported that the CDB's original construction cost estimates were unrealistic; that the participating countries were unable to provide the infrastructure needed for the housing projects; and that their manpower and administration expertise were inadequate to the task. Subsequently, the CDB revised its estimates and increased the amount of funds that it would provide for each housing unit by $1,700 to $4,500.

CONCLUSION

The delays and cost overruns encountered in the port and the low income housing projects clearly indicate that the cost projections and the feasibility studies made by the CDB, and subsequently reviewed by AID, were not realistic. Therefore, the original feasibility studies used as a basis for approving each loan did not anticipate the increased costs of the actual projects.

Although it is not possible to alter the history of these projects, they should serve as examples to the CDB and AID and serve to help the CDB and AID as it plans future loans to multilateral development banks.

Recommendation - That AID provide for a closer review of technical and economic feasibility studies of future subloans proposed by the CDB and other multilateral development banks for AID financing, and impress on these banks and AID loan officers the need for effective planning.

Preliminary Agency Comments - The AID Chief, Caribbean/ North Coast Finance Division, Office of Development Resources, Bureau for Latin America agreed with our findings and recommendation as regards the CDB. He has scheduled an inspection trip, commencing September 22, to deal with the problems IGA has surfaced. The exchange rate question, the piling shortages in the Dominica port, the space problems in the St. Lucia port, and a complete review of low income housing will be included in the review.