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AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011

Audit Report No. 1-525-87-29.  
April 30, 1987

AGENCY FOR INTERNATIONAL DEVELOPMENT

U. S. MAILING ADDRESS:  
RIG/T  
APO MIAMI 34022

OFFICE OF THE REGIONAL INSPECTOR GENERAL  
AMERICAN EMBASSY  
TEGUCIGALPA --- HONDURAS

TELEPHONES:  
32-0044 & 32-0092  
also 32-3120/9, EXT. 293 & 296

April 30, 1987

MEMORANDUM

TO : Acting Director, USAID/Panama, Raymond F. Rifenburg  
Chief, RHJDO/PSA, William T. Gelman

FROM : RIG/A/T, *Coinage N. Gothard*  
Coinage N. Gothard, Jr.

SUBJECT: Audit Report No. 1-525-87-29, Audit of AID-Assisted Shelter Sector Activities in Panama, Projects No. 525-HG-010 and 525-HG-011

This report presents the results of audit of AID-Assisted Shelter Sector Activities in Panama, Projects No. 525-HG-010 and 525-HG-011. The Office of the Regional Inspector General for Audit, Tegucigalpa, Honduras made a program results audit of the Housing Guaranty Program in Panama. Audit objectives were to evaluate program effectiveness and efficiency and compliance with AID regulations and requirements.

The audit disclosed that, while certain aspects of AID's shelter program in Panama had been or promised to be successful, the program did not receive sufficient monitoring by the Regional Housing Office or USAID/Panama. Because of this and deficiencies in the procedures and operations of Panamanian implementing agencies, the program was not effectively managed and implemented. Basic, important implementation requirements and conditions were not met. These implementation problems limited the effectiveness with which program objectives were being achieved.

The audit found a number of deficiencies in the Housing Guaranty Program in Panama: beneficiary selection procedures had not been formalized and included criteria contrary to the letter and spirit of the AID-Government agreements; beneficiary income levels were disregarded; separate accounting to control program financial resources, a condition precedent to initial disbursement, had not been achieved; beneficiary sub-loan repayment delinquency rates threatened program replicability; the large Torrijos-Carter sub-project needed management attention to control prohibited renting/selling practices; home improvement sub-loans were used in many cases to construct new units and the execution of home improvements needed better supervision; and overall Housing Guaranty Program monitoring by the Regional Housing Office and USAID/Panama required substantial improvements.

The seven recommendations included in the audit report are designed to correct the weaknesses and deficiencies disclosed during the course of the audit. Therefore, we have recommended that RHUDO/PSA, in consultation with USAID/Panama, suspend further disbursements of AID-guaranteed housing program loan funds until beneficiary selection criteria are improved; periodically revise the program beneficiary income table, verify applicants' income before granting sub-loans, and ensure that shelter "solutions" are sold only to eligible beneficiaries; obtain evidence that the bank has established and maintained a separate accounting system and an effective system for monitoring sub-loan delinquencies; obtain evidence that the Ministry of Housing has established and implemented a systematic follow-up mechanism to see that housing units are in fact occupied by program beneficiaries; review and approve the implementation procedures for the home improvement program and ensure supervision of this program; and improve monitoring of the Housing Guaranty Program and compliance with an outstanding condition precedent, covenants and requirements.

Both the Regional Housing Office and USAID/Panama provided comments to the draft report of this audit. In response we have made a number of changes. Mission comments are summarized as they pertain to each finding and are included in full as Appendix 3.

Please advise us within 30 days of any additional information relating to actions planned or taken to implement the recommendations. We appreciate the cooperation and courtesy extended to our audit team.

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## EXECUTIVE SUMMARY

AID's Housing Guaranty Program provides U.S. investors with a full-faith U.S. Government all-risk guaranty for loans made to authorized borrowers in less developed countries. Housing Guaranty Project No. 525-HG-010 and a follow-up loan package were to support the concentration of housing resources and selected growth and services centers for low-income Panamanians in rural areas near population centers. The loan package of \$75 million was to be authorized in three equal tranches of \$25 million each (Projects No. 525-HG-011, -012 and -013). Under Projects No. 525-HG-010 and -011 a total of 5,699 housing "solutions" (serviced lots, house shells, houses or apartments) had been delivered as of November 30, 1986, at a cost of \$28.7 million. Also 7,422 home improvement sub-loans had been granted for a total of \$8.3 million.

The Office of the Regional Inspector General for Audit, Tegucigalpa, Honduras made a program results audit of the Housing Guaranty Program in Panama. Audit objectives were to evaluate program effectiveness, efficiency and compliance with AID regulations and requirements. The audit disclosed that, while certain aspects of AID's shelter program in Panama had been or promised to be successful, the program did not receive sufficient monitoring by the Regional Housing Office or USAID/Panama. Because of this and deficiencies in the procedures and operations of Panamanian implementing agencies, the program was not effectively managed and implemented. These implementation problems limited the effectiveness with which program objectives were being achieved.

Overall, the Housing Guaranty Program in Panama had accomplished AID's primary objective of providing or improving over 13,000 units of low-cost housing. The Regional Housing Office encouraged the Government of Panama to pass several policy reform laws, strengthening the financial position of the National Mortgage Bank, motivating institutional changes at the Ministry of Housing and most importantly, providing housing "solutions" for low-income Panamanian families. Summaries of program accomplishments provided by the Regional Housing Office are included as Appendices 1 and 2.

The audit found a number of deficiencies in the Housing Guaranty Program in Panama: beneficiary selection procedures had not been formalized and included criteria contrary to the letter and spirit of the AID-Government agreements; beneficiary income levels were disregarded; separate accounting to control program financial resources, a condition precedent to initial disbursement, had not been achieved; beneficiary sub-loan repayment delinquency rates threatened program replicability; the large Torrijos-Carter sub-project needed management attention to control prohibited renting/selling practices; home improvement sub-loans were used in many cases to construct new units and the execution of home improvements needed better supervision; and overall Housing Guaranty program monitoring by the Regional Housing Office and USAID/Panama required substantial improvements.

AID-guaranteed housing program benefits should be available impartially to all Panamanian citizens whose gross family income falls below the local median. Audit results disclosed that the beneficiary selection criteria employed by the Government of Panama included political party affiliation and inaccurate calculation of family incomes. This occurred because neither the Regional Housing Office nor USAID/Panama had approved or even reviewed Housing Guaranty Program beneficiary selection criteria. In certain instances, persons not otherwise eligible for AID-guaranteed housing program benefits were selected as program beneficiaries. More importantly, however, persons equally deserving of obtaining housing assistance were denied equal access to that benefit because they lacked political support. We recommended suspension of disbursements of loan funds until approved beneficiary selection criteria are established. While the Mission felt that political recommendations were character and need references only, the Inspector General reiterated that the main concern is the inclusion of political affiliation among the formal, stated selection criteria. The Mission also felt that the use of net income criteria was more limited than we had found.

Pertinent provisions of the Housing Guaranty Program agreements having to do with beneficiary eligibility limited participation in the program to families whose gross income fell below the local median. In addition to the previous finding, three other deficiencies prevented this key selection criterion from operating as planned. First, median income levels for the various localities in which the program was to operate were not periodically updated as required. Second, income figures alleged by candidates in their home applications frequently remained unverified by government authorities. And finally, income limits were simply ignored in certain cases and locations. These shortcomings existed because of lax Government program oversight and control. As a result, persons who did not qualify for housing guaranty loan-financed units obtained program benefits while other equally or more deserving applicants await a solution to their housing needs. We recommended revision of the income tables, verification of incomes and assurance that loan recipients met income criteria. The Mission added that a new revision had been recently made and will be repeated periodically. They will reemphasize income limits to the government. The recommendation remains open pending proof that corrective action has been taken.

The implementation agreements required the borrower to maintain adequate books and records. The audit found that the National Mortgage Bank had not maintained separate accounting records to segregate program financial resources. Although the establishment and maintenance of separate accounting records by the bank was a condition precedent to AID's initial disbursement of AID-guaranteed loan funds, the Regional Housing Office did not obtain compliance. The absence of separate accounting for program financial resources denied management timely and reliable information needed for decision making, reporting, and monitoring. We recommended suspension of further disbursements until separate accounts and records are established. The Mission noted that separate accounts had been planned and disbursements have been suspended until they are implemented. The recommendation is considered resolved and will be closed by receipt of evidence of a functioning separate accounting system.

The project implementation agreements required that the implementing agencies carry out the program in conformity with sound financial practices. The audit found that the delinquencies for mortgage sub-loans were excessive. The high rate of delinquencies had been caused by the absence of an effective system for managing and monitoring the AID-guaranteed sub-loan portfolio. This situation, if left uncorrected, could adversely affect the bank's cash flow, jeopardize the recovery of the capital investment needed to replicate low-cost housing "solutions," and thus adversely affect the institution-building objectives of the program. We recommended that the bank improve monitoring of sub-loan delinquencies. The Mission has stressed the need for corrective actions and has conditioned disbursements on improved monitoring. The recommendation is resolved and will be closed by evidence of improved collection efforts and results.

Other findings include the fact that many units at the large Torrijos-Carter housing project near Panama City had been abandoned, rented or sold. These practices are prohibited in the sales agreements signed by each program beneficiary. The home improvement loan program had been less effective than planned because many such loans had been used to build new units "from scratch" despite the fact that HG program financing was often insufficient for this purpose. In addition, supervision provided by cognizant GOP authorities over the use of the construction materials provided was either too lax or non-existent.

Of greatest concern, however, was the fact that RIIJDO/PSA and USAID/Panama had distanced themselves from these implementation deficiencies, many of which they were unaware of until brought to their attention through audit. AID officials in Panama have taken the position that project implementation is exclusively the responsibility of Panamanian officials. We disagree both because pertinent AID Handbook guidance states otherwise and because of the high-profile nature of housing assistance -- especially when it is of the scale of this program in a country so small and politically sensitive to U.S. interests as Panama.

*Office of the Inspector General*

AUDIT  
 OF AID-ASSISTED SHELTER SECTOR  
 ACTIVITIES IN PANAMA  
 PROJECTS NO. 525-HG-010 AND 525-HG-011

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AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
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PART I - INTRODUCTION

A. Background

AID's Housing Guaranty (HG) Program provides eligible U.S. investors with a full faith and credit U.S. Government guaranty against all risks for loans made to authorized borrowers in less developed countries under Sec. 222 and others of the Foreign Assistance Act. The program is managed and implemented by the Office of Housing in AID's Private Enterprise Bureau. Individual country programs are the responsibility of AID's field Missions and the cognizant Regional Housing and Urban Development Office (RHUDO). The RHUDO responsible for this program is located in Panama City and covers the housing programs in Panama and South America (RHUDO/PSA).

Housing Guaranty Project No. 525-HG-010 was signed on November 27, 1979 to support the concentration of housing resources and selected growth and service centers for low-income Panamanians. This approach served to encourage the integrated development of rural areas located near population centers by providing improved infrastructure, transportation and marketing services. Total funding for this project was \$6.8 million, of which \$5.4 million was an AID-financed housing guaranty and \$1.4 million was a host country counterpart contribution. :

Based on AID-financed reports and studies which described the shelter problems in Panama, and the 1979 Torrijos - Carter Panama Canal Treaty, an AID housing guaranty loan package of \$75 million was recommended. The purpose of this loan package was to assist the Government of Panama in a national program to provide shelter and to improve community services for low-income Panamanians. The loan package was to be authorized in three equal tranches of \$25 million each. As a result, Projects No. 525-HG-011, -012 and -013 were developed to implement the program.

The first tranche (Project No. 525-HG-011) was signed on September 12, 1979 to continue providing shelter "solutions" (serviced lots, house shells, houses or apartments) and related services and facilities for low-income families. Total funding for this project was \$30.7 million, of which \$25 million was an AID-guaranteed private sector loan from Riggs National Bank to the Government of Panama (GOP), \$0.2 million AID grant funding, and \$5.5 million a host country counterpart contribution. Institutional objectives in this first tranche focused on strengthening key GOP institutions in the shelter sector so as to improve their capacity to plan, execute and manage housing programs for below-median-income families.

The second tranche (Project No. 525-HG-012) was authorized on August 19, 1983, and represents a continuation of the first. The implementing agencies under these two projects were the Ministry of Planning and Economic Policy (MIPPE), the Ministry of Housing (MIVI), and the National Mortgage Bank (BIN) (Spanish acronyms by which these agencies are known). The third tranche (Project No. 525-HG-013) had been authorized at the time of the audit and was to be implemented through the private sector.

Under Projects No. 525-HG-010 and -011, a total of 5,699 housing "solutions" had been delivered as of November 30, 1986 at a cost of \$28.7 million. Also, 7,422 home improvement sub-loans had been granted for a total of \$8.3 million. AID guaranteed disbursements amounted to \$28.9 million (\$22.3 million for housing "solutions" and \$6.6 million for home improvements), representing about 80 percent of the total investment (the GOP was to absorb the remaining 20 percent). Project No. 525-HG-010 was complete and project No. 525-HG-011 was 98 percent complete at the time of the audit. No disbursements had been made for projects No. 525-HG-012 and -013.

#### B. Audit Objectives and Scope

At the request of the USAID/Panama Director, the Office of the Regional Inspector General for Audit, Tegucigalpa, Honduras, made a program results audit of the Housing Guaranty Program in Panama. The audit included activities from November 27, 1979 through November 30, 1986, and covered \$28.9 million in AID disbursements for Projects No. 525-HG-010 and -011. Audit field work was conducted from October 27, 1986 through February 10, 1987. These activities had not been audited previously.

Audit objectives were to evaluate: (a) the program's effectiveness in achieving planned results, (b) the efficiency with which the program was managed and implemented, and (c) compliance with AID regulations and requirements. To accomplish these objectives, we reviewed program files, records and other pertinent data at USAID/Panama, RHUJO/PSA, MIVI, and BIN. Also, we interviewed Mission, RHUJO/PSA and Government of Panama (GOP) officials and conducted field visits to program sites. Specifically, we selected 9 of the sub-projects (5 under the housing construction mortgage program and 4 under the home improvement program) and reviewed a sample of 320 sub-loan (beneficiary) files (249 home mortgages and 71 home improvement sub-loans) selected at random, and conducted personal interviews with 254 beneficiaries (223 mortgage beneficiaries and 31 home improvement beneficiaries) in 3 provinces in the Republic of Panama. Also, during the survey phase we reviewed a sample of 30 mortgage files and interviewed 12 beneficiaries. Because of the size and stratification of the beneficiary universe, no attempt was made to arrive at statistically valid sampling results. Instead, judgment samples of certain sub-projects were made for the purpose of testing the presence or absence of management controls only.

Of the 23 sub-projects financed under the program (Project No. 525-HG-010 financed 14 housing sub-projects and a home improvement component and Project No. 525-HG-011 financed 9 housing sub-projects and a home

improvement component), the audit team decided to select 2 sub-projects from each project for field visits and interviews with beneficiaries. A third (reserve) sub-project was also selected in each case for a field visit if time permitted. The largest sub-project in each program was selected because it was most likely to be representative. The rest of sub-projects were selected at random. Beneficiaries in each sub-project were randomly selected for file reviews, field visits and interviews. Photos taken at the sub-projects show benefits of the program as well as problem areas (see Exhibit 1).

We audited \$28.9 million in AID-guaranteed loan disbursements and tested \$1.3 million in program expenditures. Internal controls were examined as they related to selection of program beneficiaries, delivery of home improvement construction materials, issuance and delivery of mortgage documents, and collection of sub-loan repayments. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit disclosed that, while certain aspects of AID's shelter program in Panama had been or promised to be successful, the program did not receive sufficient monitoring by RHUDD/PSA or USAID/Panama. Because of this and deficiencies in the procedures and operations of GOP implementing agencies, the program was not effectively managed and implemented. Basic, important implementation requirements and conditions were not met. These implementation problems limited the effectiveness with which program objectives were being achieved.

Overall, the housing guaranty program in Panama had accomplished AID's primary objective of providing or improving over 13,000 units of low-cost housing. RHUDD/PSA had encouraged the GOP to pass several policy reform laws, strengthening the financial position of the National Mortgage Bank (BHN), motivating institutional changes at the Ministry of Housing (MIVI) and most importantly, providing housing "solutions" for low-income Panamanian families. Summaries of program accomplishments provided by RHUDD/PSA are included as Appendix 1 and 2.

The audit found a number of deficiencies in monitoring and managing the housing guaranty program in Panama: beneficiary selection procedures had not been formalized and included criteria contrary to the letter and spirit of the AID-GOP agreements; beneficiary income levels were disregarded; separate accounting to control program financial resources, a condition precedent to initial disbursement, had not been achieved; beneficiary sub-loan repayment delinquency rates threatened program replicability; the large Torrijos-Carter sub-project needed management attention to control prohibited renting/selling practices; home improvement sub-loans were used in many cases to construct new units and the execution of home improvements needed better supervision; and overall HG program monitoring by RHUDD/PSA and USAID/Panama required substantial improvements.

The seven recommendations included in the audit report are designed to correct the weaknesses and deficiencies disclosed during the course of the audit. Therefore, we have recommended that RHUDD/PSA, in consultation with USAID/Panama, suspend further disbursements of AID-guaranteed housing program loan funds until such time as the beneficiary selection criteria are improved; periodically revise the program beneficiary income table, verify applicants' income before granting sub-loans, and ensure that shelter "solutions" are sold only to eligible beneficiaries; obtain evidence that the BHN has established and maintained a separate accounting system and an effective system for monitoring sub-loan delinquencies; obtain evidence that MIVI has established and implemented a systematic follow-up mechanism to see that housing units are in fact occupied by program beneficiaries; review and

approve the implementation procedures for the home improvement program and ensure supervision of this program; and improve monitoring of the housing guaranty program and compliance with an outstanding condition precedent, covenants and requirements.

## A. Findings and Recommendations

### 1. Of Three Criteria Used to Select HG Program Beneficiaries, Two Were Inappropriate

AID-guaranteed housing program benefits should be available impartially to all Panamanian citizens whose gross family income falls below the local median. Audit results disclosed that the beneficiary selection criteria employed by the GOP included political party affiliation and inaccurate calculation of family incomes. This occurred because neither RHUDO/PSA nor USAID/Panama had approved or even reviewed housing guaranty program beneficiary selection criteria. In certain instances, persons not otherwise eligible for AID-guaranteed housing program benefits were selected as program beneficiaries. More importantly, however, persons equally deserving of obtaining housing assistance were not given equal consideration because they lacked political support.

#### Recommendation No. 1

We recommend that the Regional Housing Office, in consultation with USAID/Panama, suspend further disbursements of AID-guaranteed housing program loan funds until such time as the Government of Panama has adopted and AID has approved beneficiary selection criteria in accordance with housing guaranty program gross family median income limits, and which do not discriminate against any prospective candidate for any reason.

#### Discussion

AID-guaranteed housing program benefits should be equally available to all Panamanian citizens whose gross family income falls below the local median without discrimination of any kind.

We found that the selection criteria used by GOP implementing agencies under the housing guaranty program included a political factor and inaccurate calculation of family income. In fact, the audit found that MIVI's internal procedures for the selection of program beneficiaries had never been formalized, and appeared in a draft document neither formally adopted by MIVI and BIN nor sanctioned by AID. (See Exhibit 2.) The document included three factors -- social, economic, and political -- for the selection of beneficiaries. MIVI accepted political recommendations in the process of selecting beneficiaries and likewise applied a net income formula instead of using gross family income. Two key selection criteria factors were thus contrary to the letter and spirit of the Implementation Agreements.

Political Affiliation - Our sample review of 249 mortgage (beneficiary) files at BIN for the housing guaranty program in Panama showed that 13 (5 percent) beneficiaries' folders included political recommendations. Letters of recommendation from senior GOP officials requesting that positive action be taken on behalf of the applicant's request for a sub-loan were found in the files. Internal memoranda by MIVI officials demonstrate that these letters of reference were heeded regardless of

beneficiary income level. Although beneficiaries with political recommendations, with rare exceptions, were indeed eligible to participate in the program, the practice effectively denied equal opportunity to other equally deserving Panamanian families in need of housing.

Income Criterion - The family income (net family income) criterion applied by MIVI was contrary to the income criterion (gross family income) <sup>1/</sup> intended in the implementation agreements, but was nevertheless included in an internal draft procedures manual for the selection of beneficiaries (Manual for the Selection and Adjudication of Mortgage Loans). Even though the implementation agreements did not specifically refer to gross income, RHUDO/PSA officials told us, and we agree, that the intent of such agreements was meant to be gross family income.

Since MIVI and BIN selected beneficiaries based on their net income, families with gross incomes above median income limits were qualified to participate in the program and more needy applicants were not given priority. Fourteen percent or 34 sampled beneficiaries had gross incomes which exceeded median gross family income limits.

The main reason for these deviations was that RHUDO/PSA failed to approve or even review housing guaranty program beneficiary selection criteria. RHUDO/PSA officials directed most of their efforts toward dealing with policy issues and reforms for the housing sector in Panama, concentrating on the institution-building aspects of GOP shelter sector agencies. Important implementation elements, such as the review and approval of program beneficiary selection criteria, were neglected. In fact, RHUDO officials advised us that they had not approved eligibility criteria as they felt this was the responsibility of the GOP. Consequently, beneficiaries not otherwise eligible for AID-guaranteed housing program benefits were selected to obtain housing units.

#### RHUDO/PSA-USAID/Panama Comments

"The audit report states that 'the criteria employed by the GOP in selecting beneficiaries for the Housing Guaranty Program in Panama included political party affiliation and inaccurate calculation of family income.' We have found no evidence to support the allegation that the GOP uses political party affiliation to select beneficiaries. The application forms which are filled out by beneficiaries do not include party affiliation.

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<sup>1/</sup> Gross income represents total family members' income or earnings without deductions of any kind. Net income represents total family members' income or earnings less payroll deductions and installment or monthly payments for consumer goods.

"The report notes that thirteen (5 percent) of beneficiaries' folders included 'political recommendations.' It should be noted that it is not uncommon for an applicant to request recommendations from the representative of their corregimientos, from a government official, or from the parish priest. These recommendations are not necessarily politically motivated. These are character and need references and according to MIVI spokespersons, a person who is recommended must meet the eligibility requirements of the program. Unless ineligible applicants were granted housing loans, we fail to see how deserving Panamanian families were denied equal opportunity.

"With regard to the use of net income versus gross income, this seems to have occurred in one project in the interior which indicates a management problem with one of the ten regional offices of MIVI rather than a deviation from the norm which has been and remains gross family income. USAID believes that action ... planned will resolve this difficulty. USAID/Panama recommends that this recommendation and the discussion related to selection criteria be eliminated."

#### Office of Inspector General Comments

Exhibit 2 to this report and our limited review of beneficiary files provide sufficient evidence that political party affiliation is indeed a consideration in selecting HG program beneficiaries. The fact that recommendations from government officials were found in certain beneficiaries' files, and apparently heeded, is of less concern than the fact that government officials included political party affiliation as one of three proposed selection criteria. It is also a fact that a GOP employee involved in the selection of beneficiaries at the large Torrijos-Carter housing complex near Panama City had to leave her post because she refused to accede to political pressures being applied to the selection process. Since the person in question is currently employed by RIJUDO/PSA, we find it difficult to accept the auditees' response at face value.

As to the use of gross vs. net family income, this criterion was used throughout the program and not confined to just "one project in the interior." Since program managers readily admit, and have even attempted to defend, their lack of participation in reviewing selection criteria and other administrative aspects of this program, we cannot explain how they can now assert that this condition was confined to only one location.

The recommendation will remain open until such time as the GOP issues and RIJUDO/PSA-USAID/Panama approve definitive, non-discriminatory selection criteria in accordance with the letter and spirit of the HG program guidelines and the pertinent project agreements.

## 2. Beneficiary Income Levels Were Disregarded

Pertinent provisions of the HG Program agreements having to do with beneficiary eligibility limited participation in the program to families whose gross income fell below the local median. In addition to the fact that program selection criteria called for net vs. gross family income calculations, as described in the previous finding section, three other deficiencies prevented this key selection criterion from operating as planned. First, median income levels for the various localities in which the program was to operate were not periodically updated as required. Second, income figures alleged by candidates in their home applications frequently remained unverified by GOP authorities. And finally, income limits were simply ignored in certain cases and locations. These shortcomings existed because of lax GOP program oversight and control. As a result, persons who did not qualify for HG-loan-financed units obtained program benefits while other equally or more deserving applicants await a solution to their housing needs.

### Recommendation No. 2

We recommend that the Regional Housing Office, in consultation with USAID/Panama and appropriate Government of Panama officials:

- a) periodically review the accuracy of beneficiary income tables and revise same accordingly;
- b) obtain from cognizant Government of Panama officials evidence that they have taken appropriate measures to ensure that the incomes of candidates for Housing Guaranty-financed units are properly verified; and
- c) obtain further evidence that income limits, once established, are properly disseminated and observed in the beneficiary selection process.

### Discussion

The application of the income criterion was flawed in several ways.

Income Limits - The implementation agreements require that the program beneficiary income table be revised periodically to adjust the monthly family median income limits. Specifically, the agreements require that the program beneficiary income table be adjusted every six months, starting six months from the date of the agreement, on the basis of (a) income distribution variations determined by a formula agreed upon between borrower and AID, and (b) overall financial costs of the Borrower. Implementation Agreements No. 525-HG-010 and -011 were signed on November 27, 1979 and September 12, 1979, respectively. We found that the program beneficiary income table was revised on August 24, 1981 but no further revisions were made. This revision was made in preparation for implementing the housing program in Panama (Projects No. 525-HG-010 and -011). Moreover, the audit found no evidence that RHUDO/PSA had established and implemented procedures to develop median income data to revise periodically the median income limits applied under the program.

RHUDO/PSA stated that the development of statistical data for the periodic revisions of the median income limits was the responsibility of the COP. According to RHUDO/PSA officials, periodic revisions were not conducted because such actions could have resulted in higher income limits due to inflation, thus diluting participation of the lowest family income strata. They further stated that the office lacked the necessary human resources for these revisions.

Although the rationale for requiring adjustments to the program beneficiary eligibility table every six months may be questionable, periodic revisions (annually at least) are necessary to update income levels. The absence of periodic revisions could restrict the number of families who could qualify for sub-loans under the program.

Income Verification - The draft Procedures Manual for the Selection and Adjudication of Mortgage Loans, never formally adopted but nonetheless used jointly by MIVI and BHN, required that all family income reported by applicants be verified. Employers are asked to provide salary certification and self-employed workers are required to produce income tax returns or other duly authenticated documents to verify income.

A random sample of 249 beneficiaries' files at the five sub-projects showed that MIVI did not verify the family income of 33 applicants (13 percent).

MIVI had not verified family income in 33 cases because it had concentrated its evaluation on the social aspects of the applicant and less effort was directed toward the verification of family income. Further, in Mi Dulce Hogar sub-project at David City the lots on which the units were built already belonged to the applicants, and all of them thereby became entitled to participate in the program, regardless of family income.

It is evident that the failure to verify family income could result in granting loans to beneficiaries whose income is insufficient to meet scheduled payments or exceeds established limits. The solution to this problem is the strict enforcement of regulations already in place within MIVI and BHN, with RHUDO/PSA oversight.

Limits Exceeded - The implementation agreements specified that sub-loans will be made only to families whose income falls below the median. Further, the Program Beneficiary Eligibility Table in Annex D of the implementation agreements, as revised, sets forth different levels of median income for Panama City, Colon, other urban, and rural areas. The audit found that 34 (14 percent) of the 249 houses selected at random at five sub-projects <sup>1/</sup> were sold to families who earned more than the

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<sup>1/</sup> The audit team selected five housing sub-projects under the housing construction mortgage program. From these five sub-projects, the audit team selected 249 sub-loan beneficiaries files at BHN for review and conducted field visits and interviews of 223 home occupants.

median family income. Despite the established criteria limiting sub-loans to families earning less than the median income, income level did not serve as a barrier to sub-loan applicants under the program.

To illustrate, of the 25 houses included in the review at the Mi Dulce Hogar sub-project, 14 (56 percent) were sold to families whose reported income exceeded the median income of \$307. Of these 14 families, 6 reported income greater than \$500, and 1 reported income of \$1,000.

From the above statistics, it is evident that the program has not fully fulfilled its goal of improving the housing situation of families earning less than the median income. While the results of a random but limited sample do not necessarily represent the entire universe, the audit findings confirm the presence of serious lapses of internal controls in the selection process in MIVI, and suggests the likelihood that these problems persist throughout the program.

The failure to apply the income level provisions of the implementation agreements can be traced to the relative lack of importance that MIVI assigned to income relative to other factors in the selection process.

If the applicant appeared to qualify for a sub-loan using other indicators, these could override income levels. In the specific case of Mi Dulce Hogar, MIVI felt that applicants qualified for a sub-loan on the basis that they already owned the lots on which the houses were to be built. This problem can be eliminated by reasserting the importance of income level to responsible personnel in MIVI and by RHUDO/PSA's monitoring the selection process to ensure that the income criterion established by the implementation agreements is met.

Failure to abide by income restrictions in qualifying applicants for sub-loans resulted in the project not fully accomplishing its objective of benefiting only families earning less than the median income.

#### RHUDO/PSA-USAID/Panama Comments

"The audit report noted that income tables for eligibility were established in 1979 and revised in 1981. Income tables were also revised in 1986. The audit report should be so noted. In addition, RHUDO has completed a review of income levels for the period 1981-1986 and has determined that no adjustments were necessary other than those noted above; i.e. GDP grew at only about 0.5 percent per year during this period. In the future RHUDO will review annually maximum income levels and advise the GOP if any changes are required. We request that this recommendation be closed.

"While the verification problem noted by the auditors does not seem to be pervasive, the Mission agrees that MIVI should make every effort to verify income of applicants. We will communicate this concern to the Ministry and request MIVI to ensure compliance with established regulations and procedures.

"The problem detected by the auditors of incomes in excess of established targets was concentrated in one of ten regional offices of MIVI. USAID concurs that this is a problem that needs to be corrected and plans to communicate this concern to the Ministry in the same letter which deals with verification of income."

Office of Inspector General Comments

The auditees' assertion that income tables were revised in 1986 constitutes new information for the auditors. Despite the fact that the Exit Conference concluding our fieldwork occurred in early February 1987, this is the first time we have been advised of such a revision. Furthermore, no evidence of such action was provided among the attachments to the comments on the draft report we received. While the recommendation is considered resolved based upon the information provided, it will remain open until we are provided evidence that the income tables were in fact revised last year.

In the past, RHJDO/PSA has requested corrective actions and expressed its concern at program deficiencies on several occasions to GOP program officials without notable results. For this reason, parts b) and c) have been framed in such a way as to ensure that corrective action is in fact taken, and not merely requested.

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### 3. Separate Accounting for HG Program Financial Resources Was Not Established

The implementation agreements required the borrower to maintain adequate books and records. The audit found that the National Mortgage Bank (BHN) had not maintained separate accounting records to segregate program financial resources. Although the establishment and maintenance of separate accounting records by BHN was a condition precedent to initial disbursement of AID-guaranteed loan funds, RHUDO/PSA did not obtain compliance. The absence of separate accounting for program financial resources denied management timely and reliable information needed for decision making, reporting, and monitoring.

#### Recommendation No. 3

We recommend that the Regional Housing Office, in consultation with USAID/Panama obtain evidence that the National Mortgage Bank has established and maintained separate accounting books and records related to AID-guaranteed housing program activities, and suspend further program disbursements until such time as an independent auditing firm certifies that such a system is in place and operating.

#### Discussion

The implementation agreements stated that the borrower was "to maintain or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, books and records relating to the program, to the loan, and to the agreements, adequate to show without limitation, the receipt and use of funds, the relending of funds and the use of goods and services acquired under the loan."

The audit found that the BIN did not maintain separate accounting records to segregate program financial resources. Also, a review of the Chart of Accounts used by the bank showed only two accounts for transactions related to the AID-guaranteed housing program. However, as a result of technical assistance provided by Deloitte, Haskins & Sells, a new automated accounting system was designed, tested and ready to be implemented by BIN. According to BIN officials, implementation of this new system began in January 1987 and will be fully operational by mid-1988. This new accounting system would permit a more complete recording of the transactions, segregation of financial resources, and a better management information system.

The establishment and maintenance of separate accounting records by BHN was a condition precedent to initial disbursement of AID-guaranteed loan funds. However, RHUDO/PSA had never requested BIN to set up separate accounting records. Thus, the requirement was not met because RHUDO/PSA did not adequately seek or ensure compliance.

The absence of separate accounting denied management timely and reliable information needed for decision-making, reporting and monitoring. It also produced undue delays in the completion of our audit field work as

most of the data requested by the audit team was not readily available, taking several days to produce manually. In fact, an analysis of delinquent accounts for the home improvement program could not be made because BHN could not produce a delinquency report for this purpose. Future audits would also be hampered. Further, the absence of these management tools could jeopardize the replicability of the program. Fund utilization could not be managed and monitored separately by BHN and RHUDO/PSA and therefore program benefits could not be extended to additional low-income Panamanian families as envisioned by the program. In fact, the Finance Manager of BHN told us that \$4.5 million of reflows from payments had been budgeted to be reused during 1987 in housing "solutions" for low-income families. However, he could not tell us how much of this amount came from recoveries of the AID-guaranteed sub-loans.

#### RHUDO/PSA-USAIID/Panama Comments

"The audit report notes that 'the BHN did not maintain separate accounting records for the AID guaranteed housing program, a condition precedent to first disbursement contained in Section 5.02.C of the Implementation Agreements No. 525-HG-010 and -011.' Documents in RHUDO files indicate that a plan to establish and maintain separate accounting books and records was accepted for meeting the conditions precedent for Program No. 525-HG-011 .... The BHN submitted the plan for an accounting system but failed to implement the system. USAID has suspended disbursements until the system is implemented and has included a condition for further disbursement under the HG-011 and HG-012 Programs in Implementation Letter Nos. 4 and 7 ... as follows:

A formal statement by BHN with full descriptions of the systems and procedures to be employed during a specific timeframe, to create separate accounts for the mortgage and loan portfolio as well as for recuperations for each Housing Guaranty Program.

Evidence that Loan proceeds, their utilization, and Panama's own resources broken down by sub-programs as well as the recuperation of the investment by sub-program by BHN are being recorded and maintained in separate accounts as mandated by Section 6.01(F) of the Implementation Agreement dated September 12, 1979, modified by Amendment No. 1 dated August 25, 1981.

The Mission requests that based on the action above the recommendation be closed."

#### Office of Inspector General Comments

In our view, RHUDO/PSA cleared this condition precedent prematurely. It should not have done so until the separate accounting system was in fact established, as required. Failing that, RHUDO/PSA should have followed up to verify that the system had in fact been put into place. The audit demonstrated that, not only is the system not in place, but also that MIVI has yet to transfer to the BHN the majority of HG Program loan

files. These were commingled with GOP-financed home loans at MIVI to such an extent that we were never able, during our four-month stay in Panama, to identify the housing guaranty loans (about 13,000 or 31 percent) within the portfolio of approximately 42,000 mortgage loans. For this reason, we believe the condition precedent to disbursement was never met and is far from being met at the present time. Thus, unless the CP is formally waived (which we would advise against if this situation is to be resolved at all expeditiously), no further HG loan disbursements should occur until a separate accounting system has been established and is independently certified to be actually functioning.

#### 4. Many Beneficiaries Were Seriously Delinquent in Their Loan Repayments

The project implementation agreements required that the implementing agencies carry out the program in conformity with sound financial practices. The audit found that the delinquencies for mortgage sub-loans were excessive. The high rate of delinquencies had been caused by the absence of an effective system for managing and monitoring the AID-guaranteed sub-loan portfolio. This situation, if left uncorrected, could adversely affect BHN's cash flow, jeopardize the recovery of the capital investment needed to replicate low-cost housing "solutions," and thus adversely affect the institution-building objectives of the program.

#### Recommendation No. 4

We recommend that the Regional Housing Office, in consultation with USAID/Panama, obtain evidence that the National Mortgage Bank has established and implemented an effective system for managing and monitoring AID-guaranteed housing program sub-loan repayment delinquencies.

#### Discussion

The project implementation agreements provided that the implementing agencies, the BHN and MIVI, were to carry out the program or cause it to be carried out with due diligence and efficiency, in conformity with sound technical, financial, and management practices. Project reflows were to enhance the capacity of the BHN as the financial arm of the GOP for low-income housing. The additional source of investment and capital was to complement the efforts of the BHN in raising additional local resources.

Delinquencies for mortgage sub-loans financed under the Housing Guaranty Program (Projects No. 525-HG-010 and -011) were excessive. As of November 30, 1986, 5,667 sub-loans valued at \$26.5 million were outstanding under the AID financed program (Projects No. 525-HG-010 and -011). Of the 5,667 outstanding sub-loans, 2,526 (45 percent) were in arrears for 90 days or more for a total of \$2 million. Of the 2,526 sub-loans in arrears for more than three months, 513 (20 percent) were delinquent under Project No. 525-HG-010 for a total of \$149,192 and 2,013 (80 percent) were delinquent under Project No. 525-HG-011 for a total of \$1.9 million (refer to Exhibits 3 and 4 for further details). Because these sub-loans had been in effect for relatively short periods of time, the total amount delinquent in relation to the amounts outstanding balances was \$149,192 (only seven percent of \$2,143,813) for Project No. 525-HG-010 and \$1,879,057 (only eight percent of \$24,349,097) for Project No. 525-HG-011.

While the delinquency rate of total amount delinquent in relation to the outstanding balances was not significant, the number of delinquent sub-loans overdue 90 days or over warrants management concern. In several instances the beneficiaries were in arrears for almost five years.

The delinquency situation of the AID-guaranteed mortgage sub-loan portfolio was caused by several factors which contributed to delayed recoveries and growing arrearages. We found that the BHN did not have an appropriate reporting system to manage and monitor recoveries and delinquencies. Although three reports were being produced every month with information related to recoveries and delinquencies, they were of limited use for management. For instance, one report on mortgage sub-loans contained a list of beneficiaries on projects guaranteed by AID or sponsored by other financial institutions, without proper identification of source of funds. Another report for aging accounts showed arrearages for 30 days, 60 days and 90 days or more. However, it was not possible for BHN and other interested parties to manage and monitor delinquencies over 90 days. In fact, the audit found that at Loma Colorado 21 of 60 beneficiaries were in arrears for over a year. Another report on delinquency contained the amounts in arrears for the BHN as a whole, which included the total loan portfolio, without separation by sources of financing. We believe, therefore, these reports were of limited value for managing and monitoring the AID-guaranteed sub-loan portfolio.

Further, collection efforts by the BHN were inadequate to ensure an acceptable level of mortgage sub-loan recoveries and delinquencies. We determined that 68 percent of sub-loan recipients were paying their monthly installment through direct payroll deduction. This system, when properly implemented, would guarantee sub-loan recoveries on a timely basis. However, the system did not work as expected because payroll deductions made by employers were sometimes taking months to reach the Bank. A final factor adversely affecting sub-loan recoveries had to do with poor economic conditions in Panama, resulting in lost jobs for many beneficiaries, who had to stop making payments.

This high delinquency situation, if not properly addressed, could adversely affect BHN's cash flow and jeopardize the recovery of the capital investment needed to replicate low cost housing "solutions." This, in turn, could adversely affect the institution-building objectives of the program.

#### RHJDO/PSA-USAIID/Panama Comments

"USAID became concerned about delinquencies more than a year ago and requested that MIVI and BIN take corrective action. Various memoranda of conversation between the RHJDO, Minister of Housing and the Manager of the BHN cite this problem as early as February 14, 1986. This concern was raised to the level of a condition for disbursement of HG resources in Implementation Letter No. 6, dated July 2, 1986, which stated the following:

USAID is concerned about the intended institutional and financial impacts of the overall HG program, and even though we understand that the physical execution of the project is proceeding well, we feel that disbursements must be linked to improvements in program implementation procedures. We request that

the following issues be addressed to USAID's satisfaction before resources are disbursed under Program 525-HG-012.

2. A recent analysis of the BIN portfolio suggests that arrearages are a problem. The level of delinquent payments, among a series of other problems, is affecting the financial viability of BIN. We believe, that corrective actions are necessary now. In particular, we suggest several changes in procedures: 1) joint selection by BIN and MIVI staff of beneficiaries; 2) issuance of mortgages prior to occupancy of units; and 3) more vigorous collections of payments. We also would like to know what the BIN and MIVI plan to do about arrearages problems in buildings already occupied.

"On February 18, 1987, the implementing institutions responded to this point stating that actions were being taken. After a review of these actions we concluded that adequate progress had not been made. We communicated this decision to the government in Implementation Letter No. 7 which included the following requirement for disbursement to continue:

An analysis of the current level of arrearages, quantified by the number of loans, amount of funds due, number of months overdue, by region, by project and by type of solution. This will be used as base data against which progress can be measured in reducing delinquencies. The base case analysis should also include a review of those projects which have an extraordinarily high rate of delinquency and the special measures which BIN and MIVI plan to take to resolve these problems.

The Mission requests that the recommendation be closed based on actions taken as noted above."

#### Office of Inspector General Comments

When one considers that the Government of Panama is donating HG loan proceeds costing 12% per annum in order to capitalize the BIN, the gravity of this situation becomes more apparent. The recommendation is considered resolved upon issuance of the report. However, in view of the seriousness of the delinquency situation (\$2 million in payment arrearages over 90 days due) and in the light of the GOP's record of inadequate responses in the past, the recommendation will remain open until such time as an adequate response has been forwarded to this office and evidence of an improvement in GOP collection efforts and results has been provided.

5. Numerous Units at the Large Torrijos-Carter Project Had Been Abandoned, Rented or Sold

The Joint Selection and Adjudication Commission, staffed by MIVI and BIN and established under the draft Procedures Manual for the Selection and Adjudication of Mortgage Loans, was entrusted, among other things, with the specific function of overseeing the housing sub-projects to ensure that housing units were being occupied by approved beneficiaries. A sample taken from the Torrijos-Carter Housing Sub-project showed that many housing units were rented, sold, vacant or abandoned. The main reason for this situation was that the Commission was not formally established to oversee the housing sub-projects. Consequently, a systematic follow-up mechanism to visit the sites to ensure that housing units were being occupied by authorized beneficiaries was not established. The lack of such a mechanism might encourage project beneficiaries to continue this selling/renting practice, thus preventing the project from serving its target group.

Recommendation No. 5

We recommend that the Regional Housing Office, in consultation with USAID/Panama, obtain evidence that the Ministry of Housing has established and implemented a systematic follow-up mechanism to ensure that housing units are actually occupied by program beneficiaries.

Discussion

The draft Procedures Manual for the Selection and Adjudication of Mortgage Loans utilized jointly by MIVI and BIN called for the creation of a joint commission between MIVI and BIN for the selection of beneficiaries and the adjudication of mortgage sub-loans. Specifically, the Commission, in coordination with Department chiefs, was to ensure that housing units were being occupied by program beneficiaries. To accomplish this end, the Commission was to make periodic visits to project sites, accompanied by the respective project manager, to ensure that housing units were being occupied by authorized beneficiaries.

The audit found that 6 (9 percent) of the 70 sample beneficiaries interviewed <sup>1/</sup> had rented their houses, 3 (4 percent) had sold the houses, 1 (1 percent) had left the house vacant and 1 (1 percent) owned 2 houses. Although the finding cannot be scientifically extrapolated to the universe of 4,292 housing units in Torrijos-Carter sub-project, the above statistics are indicative of a potential problem that could pervade the entire program.

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<sup>1/</sup> Torrijos-Carter was selected because it is by far the largest of the sub-projects under Project No. 525-HG-010. We randomly selected 80 beneficiaries, reviewed their files at BIN and conducted personal interviews with 70 occupants.

A joint Commission was informally established between MIVI and BIN to oversee the utilization of housing projects. However, we learned that the Commission was not operational, as no follow-up system was in place, and periodic visits were not made to Torrijos-Carter to see that housing units were being occupied by the designated beneficiaries. The Social Department of MIVI blamed scarce staff resources as the basic reason for not visiting Torrijos-Carter. The failure of the Commission to comply with its own implementation and monitoring requirements dulled the effectiveness of the program in achieving its objectives. The absence of periodic follow-up efforts by MIVI/BIN serves as a temptation to project beneficiaries to misuse program resources. Conversely, the implementation of an effective mechanism to verify end-users would deter misuse.

RHDDO/PSA-USAIID/Panama Comments

"The Ministry of Housing does have a mechanism to ensure that housing units are occupied by program beneficiaries at the time of purchase. However, there is no requirement that original beneficiaries occupy the units forever. On the contrary, a considerable amount of movement could and does occur in any housing market. Indeed, a commonly accepted principle exists in housing known as the "filtration process", which describes the phenomenon of how housing, over time, filters down to successively lower income groups. The Mission supports a free and open market system and disagrees with the recommendation that the government restrict occupancy of housing units subsequent to initial occupancy. We recommend that this Finding and Recommendation be eliminated."

Office of Inspector General Comments

The following excerpts are taken from the Sales Agreements of the HG Program on file with participating GOP agencies:

SIXTH: This purchase is subject to the following restrictions with which the purchaser agrees to comply: 1) Neither to transfer nor create a lien against the property, in whole or in part, without prior written authorization of the Bank; . . .

NINTH: The purchaser may not rent the property while it remains mortgaged; except in special cases as it may deem appropriate, the Bank may authorize rental for a limited period, which shall not exceed one (1) year at a time.

The foregoing provisions are contained in all HG Program sales agreements and, in our opinion, they constitute valid restrictions on program beneficiaries' ability to speculate and profit from their AID-guaranteed units, save those cases where sales or rentals are reasonable and warranted. The recommendation will therefore remain open until corrective action is taken and completed.

## 6. Deficiencies Limited the Effectiveness of the Home Improvement Program

The Implementation Agreements established that the home improvement program was to provide sub-loan financing to low-income families to improve existing housing units. MIVI, the implementing agency, was to carry out the program in conformity with sound technical, financial, and management practices. However, MIVI lacked clear implementation procedures and did not provide adequate technical supervision. As a result, home improvement sub-loans were made for ineligible construction, new buildings and poorly built improvements. This absence of supervision hindered the achievement of the program objective: benefiting low-income families with existing housing units in need of improvement or repair.

### Recommendation No. 6

We recommend that the Regional Housing Office, in consultation with USAID/Panama:

- a) review and approve the implementation procedures for carrying out the home improvement program in accordance with the implementation agreements in conjunction with cognizant Government of Panama officials; and
- b) obtain evidence that the Ministry of Housing has established and implemented a supervision plan to ensure proper utilization of construction materials provided under the home improvement program.

### Discussion

The implementation agreements established that the home improvement program was to provide sub-loan financing to low-income families to improve existing housing units, and that MIVI was to carry out the program in conformity with sound technical, financial and management practices. Specifically, Section I.6 of Annex A of Implementation Agreements No. 525-HG-010 and -011 defined shelter improvement loans as "loans to owner/occupants of existing housing to improve, expand or modify his/her home;" and Section 7.04 of Implementation Agreements No.525-HG-010 and -011 provided that: "Execution of the Program. Borrower [MIVI] and Panama will: A. Carry out the Program or cause it to be carried out with due diligence and efficiency, in conformity with sound technical, financial and management practices..." However, the audit found that these loans were used inappropriately because 1) they financed new construction rather than improvements and 2) improvements were badly designed or poorly constructed.

New Units -- Fifteen (48 percent) of the 31 beneficiaries interviewed <sup>1/</sup> had used the improvement sub-loans to build new structures rather than

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<sup>1/</sup> We randomly selected 71 home improvement sub-loans at Arraijan, David, Penonome, and Veracruz, from the universe of 7,422 sub-loans granted under the Home Improvement Program (Projects No. 525-HG-010 and -011). We reviewed the sub-loan files at BHN and conducted personal interviews with 31 sub-loan recipients.

improving, expanding or modifying existing ones. These statistics suggest that many home improvement sub-loans were being used to build new structures rather than improving the existing one. In fact, the director of the home improvement program at MIVI indicated that a large portion of the sub-loans granted were used for the construction of new housing "solutions." Further, an Evaluation Report commissioned by RHUDO/PSA and published by the National Council of Savings Institutions in November 1983, concluded that 59 percent of the 1,200 home improvement sub-loans made to that time were used for building a basic unit, while 27 percent went to home completion. In one case, we found that a beneficiary received a sub-loan to build a house for her mother; instead she built a house at a resort area for herself. Another beneficiary used the construction materials for unknown purposes.

Poor Design and Construction -- In a number of cases, the audit found that house construction exceeded MIVI's basic unit design, or that completed units were defective resulting from poor workmanship and inadequate construction materials, or that construction materials were misused. Specifically, the interviews with 31 home improvement beneficiaries, selected at random 1/, showed the following situations. Eight houses built were larger than the basic unit designed by MIVI, thus the house construction could not be completed with the materials provided. Three houses showed poor workmanship and wasteful use of construction materials: walls were not aligned, a recently constructed concrete wall used a poor mixture of materials and had been blown over by a gust of wind, and concrete beams exceeded design structure as they were larger than needed. A latrine was built alongside one kitchen creating a health problem. Zinc roofing materials delivered to a beneficiary were not of the specified length, thus rain water was leaking through the roof.

The primary reason for the above situations was the absence of clearly defined implementation procedures and the lack of technical supervision to carry out the program. However, the audit could not find evidence that USAID/Panama or RHUDO/PSA considered this the responsibility of the GOP. In implementing the program, MIVI felt that a sub-loan for the construction of a housing unit on an empty lot represented an improvement to the lot and should be allowed under the program. Likewise, MIVI believed that a sub-loan for the replacement of a hut (construction based on mud and straw) was also an allowable program cost. Although the latter situation could be considered as an improvement to an existing housing unit, the former appears to stray wide of the intent of the implementation agreements. On the other hand, problems in the utilization of sub-loans occurred because MIVI did not provide adequate supervision of construction activities. In fact, all beneficiaries interviewed confirmed they had never been visited by MIVI's supervisors or by any other official personnel. MIVI's officials told us the main

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1/ We randomly selected 71 sub-loan (beneficiary) files at BHN for review and conducted personal interviews with 31 beneficiaries located at Arraijan, David, Penonome, and Veracruz.

reasons for not conducting supervisory visits were lack of staff resources and transportation facilities. Since the home improvement program was being implemented all over Panama, MIVI can not exercise adequate supervision unless sufficient staff resources and transportation facilities are provided to the implementing office.

MIVI's failure to abide by the agreements' provisions resulted in the program not fully accomplishing its objective of benefiting low-income families with existing housing units in need of improvement or repair. In fact, the Evaluation Report of November 1983 also concluded that, while the subprogram was meeting a demand for basic units, albeit in an imperfect way, through home improvement, the purpose of the program was not being met. The absence of adequate supervision meant that the program was not providing adequate home improvements to meet the beneficiaries' housing needs. This lack of program supervision could also expose AID and the GOP to criticism because of shoddy construction and the potential for waste and abuse.

#### RHUDO/PSA - USAID/Panama Comments

"The rationale for the Finding and Recommendation is that the auditors apparently believed that home improvement loans should be used to improve existing units, not to build new units on family owned lots.

"While the Implementation Agreement states that home improvement loans are to expand or improve existing structures, many existing structures are so precariously built that a beneficiary must start from scratch and build a new unit. Moreover, this is clearly meant to be part of the program and often reaches the families most in need. This issue was dealt with several years ago at the project design stage. The Project Paper for HG-010 specifically states that loans may be made available to families who own a lot (See Attachment 11).

"We request that the recommendation [6a] be eliminated.

"MIVI has always had at least one architect or engineer to supervise home improvements in every regional office of the Ministry. In addition, the MIVI has recently hired experienced construction supervisors (maestros de obras) in each regional office to provide technical assistance to beneficiaries receiving materials loans. We request that recommendation [6b] be closed."

#### Office of Inspector General Comments

The implementation agreements clearly indicated that home improvement loans were to be used to improve, expand, or modify existing housing. In fact, an Evaluation Report on the Home Improvement Program in Panama dated November 1983 also noted that "previous discussions in the study have brought out the tendency of this Program to become a full-fledged shelter delivery system instead of remaining a shelter upgrading mechanism." Therefore, the position of the OIG is that program documents called for improvement of existing units and not building new units. However, if RHUDO/PSA and USAID/Panama feel that home improvement program

resources should be used to finance new housing "solutions," the agreements should be amended accordingly. The recommendation remains open until implementation activities are in accordance with agreement provisions.

Regarding technical supervision, the program had been lacking this management tool since the beginning of the program. The 1983 Evaluation Report described this deficiency as follows:

Of all the operational phases of the loan process the weakest, in structure at least, was the monitoring phase, or, the follow-up on the loan recipients to verify the intended use of the loan material.

First of all in the Documento de Implementacion no formal mention is made, nor norms established, for this important aspect of building loan process. Secondly, lack of transportation facilities in the Provinces has hampered seriously any follow-up visits to the construction sites after the building materials had been picked up.

It was observed, in general, on the field trip that the houses were overbuilt. Cement beams and columns were more massive - and therefore, more expensive - than their functions required. Similarly, there was a great deal of cement wastage round and about the units. The plaster (cement) wall finishings were frequently much thicker than was necessary. A simple awareness of cost factors, easily instilled through meetings, could reduce materials needs considerably.

The audit confirmed through field interviews with beneficiaries that no supervision was being provided under the home improvement program. Consequently, the recommendation remains open until such time RHUDO/PSA-USAID/Panama obtain evidence from MIVI that a supervision plan has been established and implemented.

## 7. Monitoring of the Housing Guaranty Program in Panama Needed Improvement

AID Handbook 7, Chapter 5 and AID Handbook 3, Chapter 11 define Housing Guaranty (HG) Program monitoring responsibilities. The audit showed that the program had not received adequate monitoring from RHUDO/PSA or USAID/Panama. The basic cause for this deficiency was RHUDO/PSA's (AID's primary implementing and oversight unit) failure to establish and implement an effective monitoring mechanism to oversee program activities. Accordingly, RHUDO/PSA had not obtained compliance with an important condition precedent, covenants, and requirements established in implementation agreements and the effectiveness of the program was diluted.

### Recommendation No. 7

We recommend that the Regional Housing Office, in consultation with USAID/Panama:

- a) establish and implement effective procedures as required by AID Handbooks 3 and 7, to monitor housing guaranty program activities; and
- b) obtain evidence that the Government of Panama has complied with conditions, covenants and requirements established in Housing Guaranty Implementation Agreements.

### Discussion

AID Handbook 3, Chapter 11, Section 11A defines monitoring as the action relevant to AID's observations and tracking of the project environment and its activities. Monitoring enables AID to understand progress being made in implementing the project, and whether or not methods and procedures are in accordance with the terms or conditions of the project agreement and subsidiary documentation. Monitoring requires the timely gathering of information regarding inputs, outputs and actions that are critical to project success, and the comparison of such information with plans and schedules for the purpose of alerting AID and Borrower/Grantee management about potential implementation problems. Further, monitoring is of great importance because AID must assure itself that funds are being disbursed in accordance with statutory requirements and that goods and services financed are utilized effectively to produce intended benefits. AID Handbook 7, Chapter 5 makes it clear that the foregoing monitoring concepts apply to implementation of the HG Program.

Although the Housing Guaranty Program in Panama was effectively providing low-cost housing, it did not receive adequate monitoring from RHUDO/PSA or USAID/Panama. Basic and important implementation requirements had not been met. This occurred because neither RHUDO/PSA nor USAID/Panama established or implemented an effective monitoring mechanism to oversee implementation requirements, and further, RHUDO/PSA did not obtain compliance with an important condition precedent, covenants and requirements established in the implementation agreements.

The lack of effective monitoring is illustrated in various implementation elements of the housing guaranty program as noted in this audit report. The BHN did not maintain separate accounting records for the AID guaranteed housing program, a condition precedent to AID's guaranty initial disbursement contained in Section 5.02.C of the Implementation Agreements No. 525-HG-010 and -011. The audit demonstrated that RHUDO/PSA had not approved or concurred in the design, plans or site locations of the housing projects. MIVI's internal procedures for the selection of program beneficiaries had never been formalized, and were listed in a draft document neither approved by MIVI and BHN nor sanctioned by RHUDO/PSA. The document included two selection criteria which were contrary to the implementation agreements. The home improvement program had been used to finance construction of new structures rather than improving, expanding or modifying existing ones, as required by the agreements. Periodic reports and information related to the program were required by a covenant but had neither been submitted by the GOP nor requested by RHUDO/PSA, thus eliminating an important management tool for control and monitoring. Finally, the master file of the mortgage portfolio had been under the control of MIVI, even though a covenant held the BHN responsible for sub-loan recoveries. It is to the advantage of all parties concerned that this master file be transferred to BHN, so that the sub-loan portfolio can be managed, administered, and controlled by BHN through its own computer system. The absence of effective monitoring limited the effectiveness by which program objectives were being achieved.

#### RHUDO/PSA-USAID/Panama Comments

"In general, we are disappointed in the audit report in that we believe it does not present a balanced view by giving credit for accomplishments and actions taken by the Mission to correct deficiencies. There is obviously a difference of opinion between the auditors and the Mission regarding the degree of direct intervention and monitoring that should be exercised by AID in implementing a Housing Guaranty Program. There is also a significant disagreement regarding the amount of monitoring that was actually exercised by RHUDO/PSA and USAID/Panama. These specific concerns are addressed in our response to individual findings and recommendations and especially in regard to [this] recommendation."

#### Office of Inspector General Comments

The draft report contained twelve finding sections; this has been reduced to seven in the final report in an attempt to achieve greater balance. Further, we have included as Exhibits a telegram and memorandum requested of the RHUDO which present the positive aspects of the program. If there is a disagreement about the level of monitoring required to manage an HG activity, this stems from our view that housing programs are among the most visible and politically sensitive forms of AID assistance. Given the size of this program in relation to other AID activities in Panama, the high-profile nature of this form of assistance is further magnified. Accordingly, it is our considered opinion that the high-profile nature of this activity warrants at least as much implementation oversight as other forms of AID assistance. Moreover, AID Handbook 7 clearly states that

program monitoring for HG projects is to be found in AID Handbook 3; that is, the guidance is the same for HG as for other AID activities.

RHUDO/PSA-USAID/Panama Comments (cont'd.)

"The negative tone of the report detracts from the significant accomplishments that have been achieved by the Housing Guaranty Program in Panama. The RHUDO and USAID believe that the report should acknowledge more forthrightly the fact that the program exceeded its planned physical outputs by 5,000 "housing solutions" or over 60 percent. This was accomplished by convincing the GOP to finance a much larger proportion of home improvement loans for low income Panamanian families. This created some management and monitoring problems but promised to assist a far larger number of people."

Office of Inspector General Comments

This report goes to substantial lengths, in our view, to give program managers all the credit they are due for HG program accomplishments. According to a status report prepared at our request by RHUDO/PSA in November 1986, the number of units originally planned (Nov. 1979) was 8,127. The revised total as of April 1986 was 13,305 units. Not included in the original total were 7,422 home improvement loans which, it would appear, program managers now wish to portray as "housing solutions." While it is true, as the reports point out, that many home improvement loan beneficiaries used their loans to build units "from scratch," not all of them were able to complete those units because HG financing was insufficient for this purpose. As a result of our field visits, contacts with GOP officials, and reviews of pertinent documents, we would estimate that perhaps half the home improvement loans resulted in completed new units (many times with additional financing from other sources). Thus, while we would agree that the program has exceeded its production targets, it is substantially less than the level of accomplishment claimed by program managers..

RHUDO/PSA-USAID/Panama Comments (cont'd.)

'More important were the program's policy achievements. In 1984, the GOP reformed the National Mortgage Bank (BHN) by establishing the General Manager as its legal representative and a private sector board to oversee the BHN's financial management. This separation from the Housing Ministry (MIVI) will ensure better financial management of the BHN, the country's major institution financing low cost housing. The Mission and RHUDO also played a key role in implementing a BHN debt restructuring plan with the Social Security System which now puts the bank in a position to continue financing low cost housing in the future. Also, policies on market interest rates, private sector construction of publicly financed projects and the promotion of the concept of having market forces resolve low cost housing problems are among the accomplishments achieved by the program. Finally, the USAID and RHUDO have promoted the implementation of improved management systems for the BHN and MIVI, more efficient organization of those institutions, reductions in work force and other reforms geared to minimizing the role

of the government in line with GOP efforts to meet World Bank and IMF restrictions related to the deficit and public sector employment (See Panama 2649 sent to RIG/A/T, February 27, 1987). This magnitude of impact required substantial effort on the part of the relatively small staff implementing this \$50 million program which, when implemented, will provide 22,000 Panamamian families with improved housing."

Office of Inspector General Comments

This report also attempts to give full marks to program managers for their accomplishments in the area of shelter sector policy reform. The telegram cited above was appended to the draft as well as to the final report. The report also notes (see Other Pertinent Matters) that the GOP has yet to comply with important covenants in the last two AID ESF cash transfer agreements regarding the issuance of a revised national housing policy. A discussion draft of the policy statement has been circulating within cognizant GOP ministries for more than one year now. Also mentioned is the fact that MIVI seems extremely reluctant to turn over to the BIN the balance of its home loan portfolio. In fact, MIVI continues to retain the great majority of the over 42,000 loans that will eventually, it is hoped, make up BIN's mortgage loan portfolio. This delay in following through on promised shelter sector policy reform measures casts doubt on whether promised reforms can be transformed into operational realities.

RHUDO/PSA-USAID/Panama Comments (cont'd.)

"Another issue relates to the use of data. The Mission requested that a scientific sample of the housing solutions (e.g. home improvement loans, serviced lots, core units, urban renewal units, etc.) financed under the program be carried out so that representatives and reasonable conclusions of the program could be made. The audit team initially agreed in October 1986 to scientific sampling, but when the audit team returned to Panama in December 1986, the Mission was informed that a scientific sample would not be made. The Mission then asked that, at least, representative projects be selected for sampling. This also was ignored. As a result, the draft audit report includes findings based on questionable sampling procedures and conclusions drawn from data that were not statistically accurate. The Mission believes that adequate sampling and statistical procedures are essential when dealing with 13,000 housing units built throughout the Republic of Panama."

Office of Inspector General Comments

Our use of random albeit judgmental sampling techniques is adequately explained in the scope section of this report. The Panama HG Program subject of this review is divided into several different categories of housing "solutions" at over twenty locations throughout the country. To conduct a statistically valid, stratified random sample of this variegated and disperse universe was deemed beyond the resources of the RIG office. The report plainly states that no attempt was made to project our limited sampling results to the universe. Rather, they were

used to illustrate the lack of administrative program controls and oversight being exercised by AID and GOP officials.

RHUDO/PSA-USAID/Panama Comments (cont'd.)

"The audit report states that AID Handbook 7, Chapter 5 and Handbook 3, Chapter 11, should be used to monitor the Housing Guaranty Program. This guidance is very general. We believe that the PRE/H Manual, Chapter 6, on Housing Guaranty Implementation Guidance more clearly defines RHUDO monitoring and management responsibilities. These guidelines take into consideration the fact that HG resources are not appropriated funds and states that the RHUDO is primarily concerned with policy and institutional objectives, the disbursement of the HG loan, and the overall implementation of the project by the institutions involved. The extent to which the RHUDO should be involved in matters related to shelter is to be addressed in the PP. The guidance also states that the RHUDO should be careful not to assume direct control over construction and delivery of the project. AID is not the "owner" of the project and a local entity invariably has legal responsibility for project implementation....The Project Paper for 525-HG-011 defined the implementation responsibilities and roles of the various participant agencies and RHUDO....RHUDO is primarily responsible for review of project feasibility plans. All pertinent feasibility studies have been received, reviewed and approved by RHUDO. The Project Paper for 525-HG-012, pages 41 through 43, further describes GOP and AID implementation and management responsibilities....

"RHUDO staff made numerous field trips to visit projects both in Panama City and the countryside. These visits are documented on RHUDO files; for example, see Attachment 4 and 5. During the seven year life of the program, we have conducted meetings almost weekly with BHN, MIVI and MIPPE staff. When important problems emerged during implementation, (e.g., arrearages, mortgage registration, etc.), the RHUDO took action to resolve the problems. Many of the actions recommended in the draft audit report were documented and action taken by the Mission prior to the audit. Disbursements have been suspended and will not be resumed until the GOP takes appropriate actions to comply with the deficiencies we have identified....This demonstrates that the RHUDO and USAID were making a number of difficult management decision regarding the implementation of the program. However, this is not reflected in the report....

Office of Inspector General Comments

While the PRE/H Manual may more clearly define RHUDO monitoring and management responsibilities, any interpretation of that subordinate guidance that would detract from or limit the guidance set forth in AID Handbook 3 would be improper, in our view and understanding of overall Agency program guidance procedures.

Feasibility studies were in fact received and on file in the RHUDO/PSA office in Panama City. However, we found no evidence that they had been reviewed or approved by RHUDO/PSA staff. In fact, during the audit we were advised by RHUDO/PSA members that they did not feel it was their responsibility to approve these studies because responsibility for program management lay primarily with the COP.

We also reviewed the two site visit reports attached to the auditees' response during the audit. But we found only those two in RHUDO/PSA's files. Furthermore, at many project sites visited we were advised by local project officials that the auditors were the first AID officials they had ever met.

The foregoing observations, taken together with the preceding six findings and the deficiencies included in the Other Pertinent Matters section of this report (following) will, we feel confident, convince an objective reader of this report that AID's management and monitoring of the HG Program in Panama has been seriously deficient. The recommendation will therefore remain open until such time as effective action is taken by management to correct the problems noted in this report and until such time as RHUDO/PSA-USAITD/Panama provides this office with evidence that it has become substantially more involved in the operations of the HG Program and the resolution of its defects.

## B. Compliance and Internal Controls

### 1. Compliance

RHUDO/PSA needed to ensure compliance with key provisions of the implementation agreements to achieve fully program objectives. Finding No. 1 disclosed that of three criteria used to select HG Program beneficiaries, two were inappropriate. Finding No. 2 disclosed that earnings of program beneficiaries exceeded gross median family income and that the beneficiary income table was not revised periodically as required by the agreements. Finding No. 3 disclosed that a condition precedent to AID's first disbursement to set up separate accounting records was never verified. Finding No. 5 disclosed that periodic follow-up visits were not conducted to the Torrijos-Carter housing sub-project to see that houses were occupied by approved beneficiaries, a contractual requirement. Finding No. 6 disclosed that the majority of the home improvement sub-loans were used to construct new housing "solutions" instead of improving an existing unit as required by the implementation agreements. Other than the conditions cited above and in the Other Pertinent Matters section following, tested items were in compliance with applicable laws and regulations and nothing else came to out attention that would indicate that untested items were not in compliance with applicable laws and regulations.

### 2. Internal Controls

RHUDO/PSA needed to improve internal controls. Finding No. 2 disclosed that verification of family income was not given the required attention to ensure that only applicants with income below the median would participate in the program. Finding No. 3 disclosed that the HG loan-generated portfolio had not been segregated or reported on by GOP officials. Finding No. 4 disclosed that sub-loan delinquencies were not sufficiently managed and monitored. Finding No. 6 disclosed that the home improvement program was not receiving sufficient field supervision to ensure proper use of resources. Finding No. 7 disclosed a need for substantially more AID involvement in HG program activities.

### C. Other Pertinent Matters

Four other matters warrant management's attention.

Economic Support Fund Agreement Policy - AID's Economic Support Fund (ESF) cash transfer agreements with the Government of Panama for 1985 and 1986 contained several covenants by means of which AID sought to achieve certain policy reforms by the GOP. First among the stated covenants for both 1985 and 1986 was one by which the GOP agreed (by August 1986) to "prepare and publish a national housing policy which sets forth objectives and strategy for meeting low income housing needs over the next five years, and which defines the respective roles of public and private sectors in meeting the needs." While RHUDO/PSA and USAID/Panama have had certain success in moving the GOP toward this goal (see statement of accomplishments attached as Appendix 1), this covenant had yet to be complied with at the time of our review. The GOP had issued a draft policy statement in March 1986 which, one year later, was still circulating within cognizant executive branch agencies of the GOP. However, it had not been adopted by the GOP or published as its formal policy statement for the sector. Since the auditees failed to comment on this important area of non-compliance, we can only assume that the policy remains at the discussion draft stage. In that case, the GOP has yet to comply with the covenants.

Sales Contract - The implementation agreements required that reimbursement requests prepared and submitted by MIVI for AID reimbursements of completed housing "solutions" be supported by duly executed and properly registered mortgages. The audit showed that AID-guaranteed sub-loans made under the urban renewal sub-projects had been reimbursed based on Sales Contracts - temporary legal documents - pending the issuance of the corresponding mortgage. The use of this document as support for AID-guaranteed sub-loan reimbursements was in violation of implementation agreement provisions. This practice developed because the GOP could not meet the legal requirements in acquiring and registering urban renewal lands in a timely fashion. The absence of a duly executed and properly registered mortgage could complicate AID's liability as guarantor of the U.S. investor in the event loans were defaulted. The audit questioned this practice and requested a legal opinion on the validity of the contract. In response to the draft audit report, the Mission indicated that the Regional Legal Advisor (RLA) and the General Counsel for Housing (GC/H) had determined that the Sales Contracts were valid and binding documents under Panamanian and U.S. law and that the GOP would be so informed.

Delivery of Deeds - The implementation agreements required that property deeds be registered and issued to beneficiaries participating in the program. The deeds were to be recorded in the Public Registry and were to be delivered to corresponding homeowners. However, the audit disclosed that 43 percent of the homeowners interviewed had not received the corresponding property deed. This was due to both ineffective program implementation and lack of effective communication between MIVI/BHN and the homeowners. The beneficiaries felt that true ownership of the property was still uncertain without a legal document, affecting

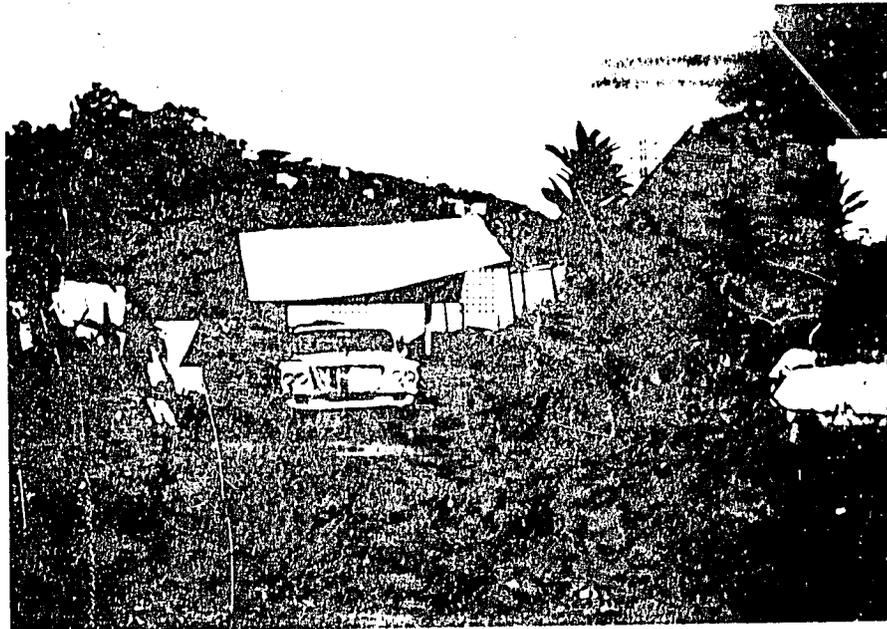
their morale and, ultimately, property maintenance. In response to the draft audit report, the Mission agreed that the delivery of deeds has been a problem. Further, the Mission indicated that current practice is for the MIVI to call mortgagees to inform them that mortgage documents are available for pick up, but the procedure is ineffective because people do not collect them. Notwithstanding, the response went on to say that the Mission believed that the GOP should not be responsible for actually delivering deeds as this was the responsibility of the beneficiary family. The OIG believes, however, that this remains an important psychological aspect of the program and would expect RHUDO/PSA and USAID/Panama to continue to make appropriate representations to the BIN and MIVI in this matter.

Construction and Maintenance Problems - MIVI was expressly charged in the project paper with post-occupancy management and administration of the AID-guaranteed housing sub-projects. The audit found that some buildings at Santa Ana and Chorrillo sub-projects had construction and maintenance problems. Although the tenants had reported these problems to MIVI, many were still awaiting remedy. These problems developed because: nobody appeared to have responsibility for repairs and maintenance, especially in the event the contractor or his insurer ceased operations or defaulted on their responsibilities; the resident associations of some buildings were not operating for various reasons; no social action plan had been developed by MIVI for these residents; and there was no maintenance program. The failure to correct these construction and maintenance problems led to reduced satisfaction by the tenants, contributed to long-term deterioration of the apartments and buildings, and, in our view, tended to increase sub-loan delinquencies. In response to the draft audit report, the Mission recognized the need for improved monitoring of contractor performance and inspection procedures and stated that MIVI had taken adequate actions to resolve the construction problems. Regarding the resident associations, the social action plan, and the maintenance program, the Mission indicated that these are the responsibility of the owner/resident as government involvement in the post construction and occupation phase will result in reliance on the public sector to maintain and repair private property. Further, the Mission indicated that the residents of urban renewal units have demonstrated substantial capacity to organize in the past and are capable of organizing to better maintain their own houses in the future. The OIG believes that although these residents have demonstrated substantial capacity to organize in the past, this was largely due to the coordinating role undertaken by MIVI at the beginning of the project. Also, the OIG believes that these services are an integral part of the Program, as set forth at great length in the Project Paper. Furthermore, MIVI has a well-staffed but largely inoperative social affairs department whose responsibilities include activities such as these.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011

PART III - EXHIBITS AND APPENDICES

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



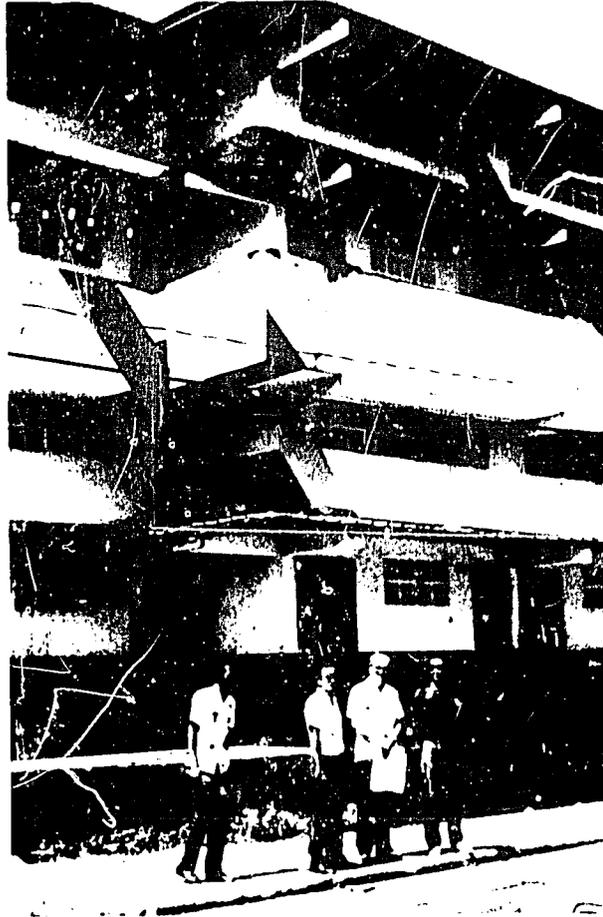
Front and back view of a house at Torrijos-Carter sub-project. Overgrown weeds and junk piles show lack of post-occupancy education and supervision.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HIG-010 AND 525-HIG-011



Two houses showing "FOR SALE" signs at Torrijos-Carter sub-project. Home owners sold houses without notifying the Ministry of Housing, showing the effect of a lack of post-occupancy supervision.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



Front view of building constructed at the Chorrillo urban renewal sub-project.



New AID funded construction on left and original wooden structures on right - Chorrillo.

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AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



Human sewage leaking from a blocked waste pipe in upper apartment in building No. 11 at the Chorrillo urban renewal sub-project. The blockage occurred shortly after the owner moved in and had not been repaired. The overflow leaked down the outside wall creating a health hazard. This shows the lack of supervision and maintenance. As a result the owner had not been making payments.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



Addition to an apartment, Chorrillo urban renewal sub-project. This addition was built on the sidewalk and blocked the rainwater drainage system, showing the effect of a lack of supervision.

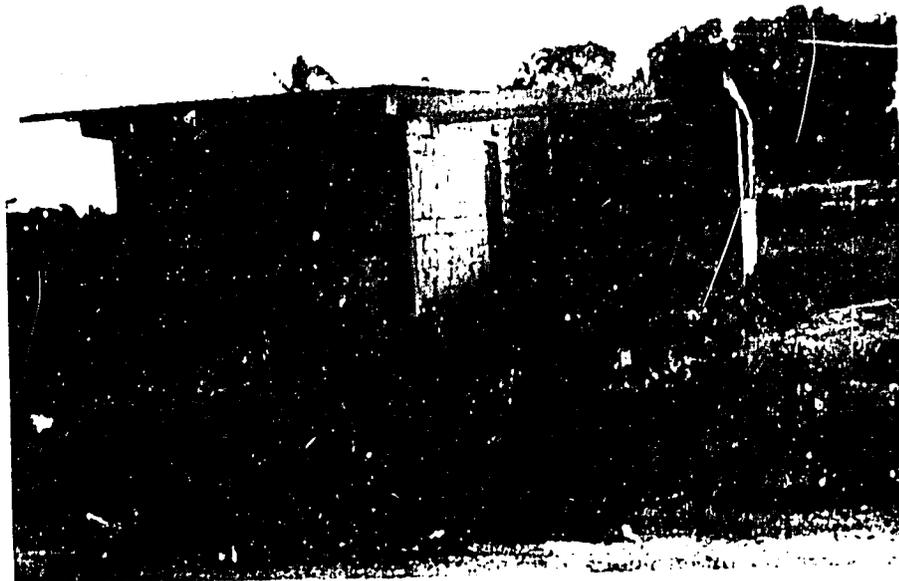
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AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



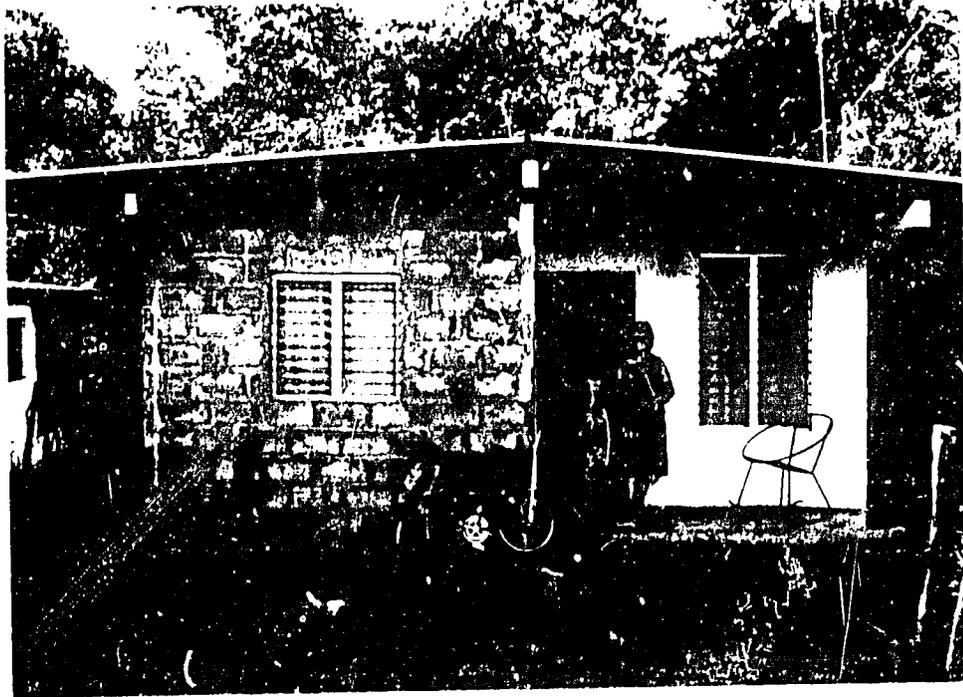
New construction started with a home improvement subloan at Penonome area. The front wall was made with a poor mixture of sand and cement but failed in the wind, showing a lack of supervision.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



Suspended construction on serviced lot at Loma Colorado sub-project showing the effect of lack of selection criteria. The funds loaned were insufficient to complete construction.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HG-010 AND 525-HG-011



Basic Unit and improved house at Mi Dulce Hogar sub-project.

AUDIT  
OF AID-ASSISTED SHELTER SECTOR  
ACTIVITIES IN PANAMA  
PROJECTS NO. 525-HIG-010 AND 525-HIG-011



New construction in a serviced lot in Pozo Azul sub-project. The home owner, besides the loan for the lot, obtained a home improvement subloan for \$1,900 and another loan for \$3,000 from Chase Manhattan Bank. This unequal distribution of subloan resources demonstrates the lack of selection criteria.

Translation of  
Pertinent Excerpts from the

PROPOSAL FOR THE CREATION OF A [BENEFICIARY] SELECTION COMMITTEE

III. PROCEDURES

1. Transmittal and receipt of the application

1.3 Letter of Employment for all members of the group who declare income; the letter of employment must include any withholdings aside from the net income which should be well specified. (Underline added)

2. Analysis and selection

On the basis of the analysis made [of the application], Committee members must select three (3) applications for each housing unit, in accordance with the established social, economic and political criteria. (Underline added)

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1.3. Adjudicar las viviendas de los diferentes proyectos del Ministerio de Vivienda.

1.3.1. Proyectos en proceso de construcción.

1.3.2. Proyectos facturados y/o finalizados.

2. Funciones Especificas.

2.1. Recibir las solicitudes de vivienda que envíe la Sección de Procesamiento de Solicitudes, analizar las mismas sobre la base de la información social y económica que éstas contengan.

2.2. Seleccionar tres (3) solicitudes por cada solución habitacional, sobre la base de los critérios sociales, económicos y políticos establecidos para tales fines.

2.3. Presentar y sustentar la selección efectuada al Director de Bienes Raíces y de Asuntos Sociales o en su defecto a quien se designe para efectuar la selección final.

2.4. Adjudicar a las familias seleccionadas y notificar por escrito a ambos directores.

2.5. Enviar información de las familias adjudicadas al Depto. de Desarrollo Comunitario para realizar la charla de orientación y participar en dicha actividad para explicar la adjudicación realizada a los beneficiarios según los criterios establecidos. Enviar información de las familias adjudicadas a la Sección de Reubicaciones con el fin de controlar unidades de vivienda para la reubicación futura de otras familias.

2.6. Citar y garantizar que se realicen los trámites administrativos correspondientes. [ Enviar a la Dirección de Bienes Raíces los expedientes adjudicados para finalizar los trámites administrativos. ]

*Handwritten notes:*  
- by Depto. de Desarrollo Comunitario  
- para explicar la adjudicación realizada a los beneficiarios según los criterios establecidos.  
- Enviar información de las familias adjudicadas a la Sección de Reubicaciones con el fin de controlar unidades de vivienda para la reubicación futura de otras familias.

2.7. Mantener actualizado al Sr. Ministro y al Sr. Vice-Ministro a través de las Direcciones de Asuntos Sociales y ~~la de Bienes Raíces~~ sobre la condición de los proyectos en términos de las soluciones adjudicadas y pendientes.

2.8. Garantizar en coordinación con el Jefe del Departamento respectivo, que las viviendas adjudicadas en los diferentes proyectos estén habitadas por sus respectivos adjudicatarios.

### III. PROCEDIMIENTOS.

#### 1. Envío y recibo de la solicitud

La Sección de Procesamiento de Solicitudes enviará las solicitudes procesadas por proyecto a la Comisión de Adjudicación, con ~~Visto Bueno~~ del Jefe del Departamento correspondiente, con copias para las Direcciones de Bienes Raíces y Asuntos Sociales.

Las solicitudes deberán llegar a la <sup>Sección</sup> Comisión con los siguientes requisitos completos:

- 1.1- Solicitud
- 1.2- Informe Social, resultado de la investigación socio-económica realizada.
- 1.3- Carta de Trabajo de todos los miembros del grupo que declaren ingresos; en la carta de trabajo debe aparecer todo tipo de descuentos además del ingreso neto bien especificado.  
Ficha del Seguro Social, Declaración de Renta y la constancia de cualquier otro ingreso declarado. En caso de que amerite debe aparecer el Talonario de Cheque.
- 1.4- Fotocopia de Cédula de Identidad Personal del solicitante y cónyuge.

AUDIT OF THE HOUSING GUARANTY PROGRAM IN PANAMA

Sub-loan Delinquency by Sub-projects and Number of Sub-loans

<u>Project</u>	<u>Sub-project</u>	<u>Number of Sub-loans</u>		<u>Percent Delinquent</u> (90 days or more)
		<u>Outstanding</u>	<u>Delinquent</u>	
525-HG-010	Loma Colorada	598	310	52
	Paraiso I	41	0	0
	Paraiso II	29	7	24
	Mi Dulce Hogar	48	18	38
	Solano	39	18	46
	Elisa Chiari	190	59	31
	La Feria	68	17	25
	Nata	4	1	25
	Pezo Azul	52	27	52
	Las Penitas	73	50	68
	La Villa	27	0	0
	* Juan XXIII (I)	20	0	0
	* Juan XXIII (II)	28	0	0
	San Martin de Porres	33	6	18
	Sub-Total	<u>1,250</u>	<u>513</u>	<u>41</u>
525-HG-011	Chorrillo	553	299	54
	Santa Ana	678	407	60
	San Miguel	324	182	56
	Llano Bonito	228	166	73
	Curundu	168	111	66
	Torrijos-Carter	2,292	761	33
	Luzon	160	85	53
	Anton	14	2	14
		Sub-Total	<u>4,417</u>	<u>2,013</u>
	Total Both Projects	<u>5,667</u> =====	<u>2,526</u> =====	<u>45</u> ===

\* Beneficiaries of these two sub-projects had not been billed.

AUDIT OF THE HOUSING GUARANTY PROGRAM IN PANAMA

Sub-Loan Delinquency by Sub-projects and Value of Sub-Loans

<u>Project</u>	<u>Sub-Project</u>	<u>Value of Sub-Loans</u>		<u>Percent</u>
		<u>Outstanding</u>	<u>Delinquent</u> (90 days or more)	<u>Delinquent</u>
525-HG-010	Loma Colorada	\$ 362,945	\$ 96,738	27
	Paraiso I	249,497	0	0
	Paraiso II	186,840	2,512	1
	Mi Dulce Hogar	97,737	5,252	5
	Solano	21,606	2,394	11
	Elisa Chiari	311,406	14,122	5
	La Feria	147,833	4,337	3
	Nata	15,627	176	1
	Pozo Azul	111,331	5,584	5
	Las Penitas	166,518	15,201	9
	La Villa	120,657	0	0
	Juan XXIII (I)	51,416	0	0
	Juan XXIII (II)	83,618	0	0
	San Martin de Porres	216,782	2,876	1
		Sub-Total	<u>\$ 2,143,813</u>	<u>\$ 149,192</u>
525-HG-011	Chorrillo	\$ 3,205,010	\$ 248,584	8
	Santa Ana	4,741,425	382,528	8
	San Miguel	2,147,886	195,185	9
	Llano Bonito	1,535,371	197,358	13
	Curundu	1,129,863	149,245	13
	Torrijos-Carter	11,441,948	697,455	6
	Luzon	104,892	8,422	8
	Anton	42,702	280	*
	Sub-Total	<u>\$24,349,097</u>	<u>\$1,879,057</u>	<u>8</u>
	Total Both Projects	<u>\$26,492,910</u> =====	<u>\$2,028,249</u> =====	<u>8</u> ==

\* Less than 1 percent.

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AMEMBASSY PANAMA

RUFHTG/AMEMBASSY 06UCIGALPA 0624

SEC RUFHTG/SFCSTATE ASPTC 6511

MISSION SUMMARY OF PROGRAM

ACCOMPLISHMENTS

OCIAS PANAMA 02649

IDAC

06UCIGALPA FOR FRED KARLHAMMER, RIG/A/T  
TATE FOR E. KESLTER, FRE/H



OC 12356: N/A

SUBJECT: ACCOMPLISHMENTS OF GOALS AND OBJECTIVES  
PROJECTS 525-HG-010 AND 011

PERCENTAGE OF THE OVERALL GOALS AND OBJECTIVES  
OBTAINED.

BOTH HG PROGRAMS BEING REVIEWED EXCEEDED  
SUBSTANTIALLY THEIR ORIGINALLY PLANNED PHYSICAL  
OUTPUTS. PROJECT NO. 525-HG-010 WILL REACH 4,353  
FAMILIES RATHER THAN 1,927 ORIGINALLY PLANNED WITH THE  
SAME LEVEL OF RESOURCES - AVERAGE COST OF SOLUTION WAS  
DLRS. 1,498 INSTEAD OF DLRS. 3,362 PLANNED. NUMBER OF  
BENEFICIARIES UNDER PROJECT NO. 525-HG-011 WAS 8,952  
AS OPPOSED TO 6,202 ORIGINALLY PLANNED. AVERAGE  
SOLUTION COST WAS DLRS. 3,391 INSTEAD OF DLRS. 4,896  
PLANNED. RESULTS MAY BE ATTRIBUTED TO OUR ABILITY TO  
CONVINCE THE INSTITUTIONS TO INTRODUCE PROGRAM CHANGES  
SUCH AS: REDUCING THE NUMBER OF COMPLETED UNITS  
ORIGINALLY PLANNED, AWARDED CONSTRUCTION CONTRACTS TO  
PRIVATE BUILDERS, AND PROMOTING LOWER COST SOLUTIONS  
SUCH AS SERVICED LOTS AND HOME IMPROVEMENT LOANS.

2. SIGNIFICANT ACCOMPLISHMENTS

WHAT HAVE BEEN THE SIGNIFICANT ACCOMPLISHMENTS?  
THE SHELTER DELIVERY SYSTEM FOR LOW INCOME  
FAMILIES REPRESENTED BY BHN AND MIVI IN PANAMA HAS  
BEEN STRENGTHENED AND PROJECTS CAN BE IMPLEMENTED IN A  
RELATIVELY EFFICIENT MANNER FROM THE POINT OF VIEW OF  
DESIGN AND CONSTRUCTION, AND WITHIN THE CONTEXT OF  
ADEQUATE SERVICES AND FACILITIES. BHN AND MIVI, AS  
THE TWO BASIC PARTICIPATING INSTITUTIONS, IMPLEMENTED  
A PROGRAM INVOLVING A DEFINED LOW INCOME FAMILY  
CLIENTELE AND PROVIDING A SERIES OF SHELTER  
ALTERNATIVES AFFORDABLE BY THE TARGET GROUP. BOTH  
INSTITUTIONS UNDERWENT SUBSTANTIAL CHANGES IN THEIR  
STRUCTURE AND GENERAL POLICY OBJECTIVES WHICH ALLOWED  
THEM TO RESPOND ADEQUATELY TO THE CHALLENGE. SOME OF  
THE MOST OUTSTANDING ACHIEVEMENTS HAVE BEEN:

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## A. STRENGTHENED FINANCIAL POSITION OF BHN

- TRANSFER TO BHN OF ALL ASSETS OF ITS PREDECESSOR INSTITUTION, IVU.
- REDUCTION OF BHN'S DEFICIT FROM DLRS. 20.0 MILLION TO DLRS. 2.0 MILLION BY CONVERTING IN 1981 DLRS. 18.1 MILLION OF THE DLRS. 23.0 MILLION PROVIDED BY THE GOP IN 1979 FROM A LOAN TO A CAPITAL CONTRIBUTION.
- GOP AND THE CONTRALORIA AUTHORIZED AND SANCTIONED IN 1983 A GENERAL ACCOUNT ADJUSTMENT AT BHN WHICH INCLUDED THAT THE GOP TAKE OVER OF PART OF BHN'S EXTERNAL DEBT AND FORGAVE BHN'S REMAINING DLRS. 5.0 MILLION DEBT WITH THE GOP INCLUDING PRINCIPAL AND INTEREST.
- EXTERNAL AUDITORS WERE CONTRACTED.
- RG LOANS WERE MADE AVAILABLE TO BHN AS A CAPITAL CONTRIBUTION
- PART OF BHN'S DEBT WAS REFINANCED AND THE PROCEEDS OF THE BANK OF JAPAN LOAN WERE CONVERTED TO A CAPITAL CONTRIBUTION BY THE GOP.
- OPERATIONAL COSTS OF MIVI WERE NO LONGER CHARGED TO BHN BUT TRANSFERRED TO MIVI'S OPERATIONAL BUDGET.
- INTEREST RATES WERE ESTABLISHED THAT WERE MORE OR LESS CONSISTENT WITH MARKET CONDITIONS AS THEY INCREASED FROM 7 PERCENT TO 10 PERCENT, AND 12 PERCENT (DEPENDING ON SOLUTIONS).
- VARIABLE INTEREST RATES WERE ESTABLISHED TO ENSURE THAT LOW INCOME FAMILIES WOULD BE ABLE TO REPAY LOANS/MORTGAGES.
- INNOVATIVE MORTGAGE PAYMENT SCHEMES WERE AUTHORIZED TO ENSURE ACCESSIBILITY OF LOW INCOME FAMILIES.
- REDUCTION OF SUBSIDIES WAS ESTABLISHED AS A CLEAR POLICY OBJECTIVE, E.G., COST ACCOUNTING SYSTEM

PROJECTS 525-HG-010 AND 011  
ESTABLISHED, DIRECT COST ADDED TO COST OF SOLUTION,  
ALL BENEFICIARIES REQUIRED TO REPAY LOANS.

A FINANCIAL STRATEGY FOR THE HOUSING SECTOR WAS  
FOUNDED BY THE GOP IN 1981 AND AN INVESTMENT PLAN WAS  
ESTABLISHED WITH THE PARTICIPATION OF MIPPE, BHN,  
IWI, CAJA DE AHORROS AND CAJA DE SEGURO SOCIAL.

A DISPURSEMENT AGREEMENT WAS SIGNED IN 1984 BY  
PH, MIVI, MIPPE, AND SANCTIONED BY THE CONTRALORIA  
GENERAL DE LA NACION TO REGULATE AND CONTROL THE  
TRANSFER OF FUNDS FROM BHN TO MIVI TO PROVIDE  
FINANCING FOR CONSTRUCTION OF HOUSING PROJECTS.

AN INTERNAL AUDITING SYSTEM WAS ESTABLISHED AT  
PH.

A TECHNICAL ASSISTANCE PLAN WAS AGREED UPON FOR  
THE DEVELOPMENT GRANTS.

THE REAL ESTATE DEPARTMENT, WHICH OPERATED AS  
PART OF MIVI, WAS FORMALLY TRANSFERRED TO THE BHN IN  
DECEMBER, 1984 ALLOWING THIS INSTITUTION TO TAKE OVER  
THE MANAGEMENT OF ITS OWN MORTGAGE PORTFOLIO FOR THE  
FIRST TIME.

LEGISLATION WAS PASSED AT THE END OF 1984 WHICH  
STRENGTHENED THE AUTONOMY OF THE BHN BY INTRODUCING  
CHANGES IN THE COMPOSITION OF ITS BOARD OF DIRECTORS  
ALLOWING FOR THE PARTICIPATION OF THE PRIVATE SECTOR;  
THE GENERAL MANAGER SUBSTITUTED THE MINISTER OF  
HOUSING AS THE BANK'S LEGAL REPRESENTATIVE; INTEREST  
RATE CAPS ON THE OPERATIONS OF THE S AND LS WERE  
LIFTED AND THE CONVERSION OF THE ASSOCIATIONS TO STOCK  
CORPORATIONS WAS AUTHORIZED.

THE BHN REACHED AN AGREEMENT WITH THE CAJA DE  
SEGURO SOCIAL ON THE ISSUE OF REPAYMENT OF PAST CSS  
LOANS, STRETCHING OUT THE REPAYMENT OF THE TOTAL  
OBLIGATIONS OVER A 15 YEAR PERIOD STARTING IN 1987 AND  
WITH THE GOP AGREEING TO PAY UP TO 30 PERCENT OF BHN'S  
ANNUAL OBLIGATION.

A MANAGEMENT AUDIT OF BHN WAS COMPLETED PROVIDING  
THE INSTITUTION WITH A VERY CLEAR AND DETAILED  
SCENARIO OF ITS CURRENT PROBLEMS AND SPECIFIC AND  
DIRECT RECOMMENDATIONS WITH RESPECT TO STRUCTURAL AND  
OPERATIONAL CHANGES NEEDED.

A SOFTWARE DEVELOPMENT PROGRAM FOR DATA  
PROCESSING APPLICABLE TO PHN'S ACCOUNTING SYSTEM WAS  
COMPLETED WHICH WILL ALLOW PHN TO PROPERLY REGISTER  
ALL ITS OPERATIONS AND ESTABLISH PROPER MANAGEMENT  
PROCEDURES AND CONTROLS.

PHN HAS PRESENTED TO USAID A RECUPERATION PLAN  
WHICH CALLS FOR THE CONTINUATION OF THE GOP'S CAPITAL  
CONTRIBUTIONS FOR AT LEAST THREE YEARS; THE MAXIMUM

UTILIZATION POSSIBLE OF LONG TERM EXTERNAL RESOURCES;  
AND SUSTAINED INVESTMENT OF REFLOWS OF ITS MORTGAGE  
PORTFOLIO TO ENSURE A REASONABLE RATE OF GROWTH, AND  
OTHER MEASURES SUCH AS:

- 1. IMPROVED INCOME GENERATION (E.G., THE SALE  
OF LAND ASSETS);
  - 2. REDUCED OPERATING EXPENSES;
  - 3. REDUCED ARREARAGES;
  - 4. SALE OF MORTGAGE BACKED SECURITIES;
- UNDER THESE CIRCUMSTANCES, DECAPITALIZATION OF  
PHN SEEMS UNLIKELY AND RATHER GROWING LEVELS OF  
RESOURCES FOR INVESTMENT WILL BE AVAILABLE WHICH  
ENSURE THE INSTITUTION'S VIABILITY AS WELL AS  
REPLICABILITY OF HOUSING PROGRAMS.

F. INSTITUTIONAL CHANGE AT MIVI

MIVI ABANDONED ITS PREFERENCE FOR COMPLETED TWO  
AND THREE BEDROOM SINGLE FAMILY DETACHED HOUSING AND  
HIGH RISE APARTMENT STRUCTURES AND BEGUN TO TAILOR ITS  
PROGRAMS TO THE NEEDS AND CAPABILITIES OF LOWER INCOME  
FAMILIES. THAT CHANGE OF POLICY PRODUCED 13,300  
RATHER THAN 8,100 UNITS IN HGS 010 AND 011.

PROJECTS 125-PC-010 AND 011

ESTABLISHED, DIRECT COST ADDED TO COST OF SOLUTION, EXTENSIVE REVISIONS OF STANDARDS FOR DESIGN AND CONSTRUCTION OF PROJECTS AND INFRASTRUCTURE WERE NECESSARY WHICH ARE NOW PARTLY BEING USED IN LOW COST PROJECTS PROVIDED EXCLUSIVELY BY THE PRIVATE SECTOR.

A CLOSE RELATIONSHIP BETWEEN DEMAND/NEED AND PRICE WAS OBTAINED BY ADOPTING LOWER COST SOLUTION TYPES (E.G., SITES AND SERVICES AND HOME IMPROVEMENT CASES), AND OPTIONAL REPAYMENT SCHEMES (E.G., VARIABLE INTEREST RATES).

INTEREST RATE POLICIES WERE ADJUSTED TO REFLECT COST OF FUNDS.

CONSTRUCTION FINANCING AND ADMINISTRATIVE COSTS WERE INCLUDED IN THE SALE PRICES OF SHELTER OPTIONS INCLUDING SUBSIDY ELEMENT IN HOUSING PROGRAMS.

MIVI ABANDONED THE DIRECT CONSTRUCTION OF PROJECTS AND BEGAN TO USE PRIVATE CONTRACTORS FOR SHELTER AND INFRASTRUCTURE CONSTRUCTION.

MIVI INCORPORATED AS PART OF ITS PROJECTS THE EVALUATION OF THE ENVIRONMENTAL IMPACT OF SUCH PROJECTS.

THE SOCIAL SECTION OF MIVI WAS MADE A DIRECTORATE AND THEIR EVALUATIONS OF PROJECTS HAVE PROVIDED VALUABLE INFORMATION TO THE PROCESS OF DESIGN AND DETERMINATION OF ALTERNATIVES TO SERVE FAMILIES IN THE LOWER PERCENTILES OF THE INCOME DISTRIBUTION.

A TECHNICAL ASSISTANCE PROGRAM FOR MIVI WAS AGREED UPON AND AS A RESULT, THE FOLLOWING ACTIVITIES HAVE BEEN IMPLEMENTED:

1. A SERIES OF WORKSHOP-SEMINARS WITH AMPLE PARTICIPATION OF MIVI'S STAFF WAS CONDUCTED, COVERING DIVERSE BASIC THEMES DETERMINED BY MIVI.
2. A MANAGEMENT AUDIT OF THE INSTITUTION WAS COMPLETED BY AN INDEPENDENT CONSULTANT.
3. A COST ACCOUNTING SYSTEM WAS DESIGNED TO ENSURE THAT ALL PROJECT COSTS BE PROPERLY REGISTERED AND CHARGED.

#### C. PROGRAM SUPPORT

THE HOUSING PROGRAM IMPLEMENTED BY FEN/MIVI CONSTITUTES A MAJOR COMPONENT OF THE GOP PROGRAM WHICH, IN SPITE OF BUDGET CONSTRAINTS AND THE GENERAL LIQUIDITY PROBLEMS IT FACES, CONTINUES TO BE PROVIDED WITH ALL NECESSARY COUNTERPART RESOURCES.

THE CONTINUATION OF THE GOP EFFORTS IN PROVIDING

SHELTER SOLUTIONS TO THE LOWER INCOME FAMILIES HAS BECOME A VERY IMPORTANT PUBLIC COMMITMENT THROUGH MESSAGES AND SPEECHES BY THE HIGHEST RANKING PUBLIC OFFICIALS INCLUDING THE PRESIDENT OF THE REPUBLIC, THE MINISTER OF HOUSING, LEGISLATORS, AND OTHER PUBLIC OFFICIALS. THE CUSTOMARY PRESENCE OF THE PRESIDENT OF THE REPUBLIC, MINISTERS OF STATE, LEGISLATORS, MEMBERS OF THE FORCES FOR THE DEFENSE, AT PROJECT INAUGURATIONS, IS ANOTHER EXAMPLE OF THE PUBLIC SUPPORT THAT THE PROGRAM MERITS.

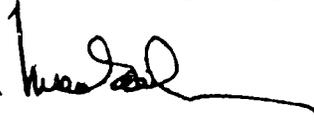
- CHANGES IN THE LEGISLATION TO GRANT AUTONOMY TO THE BEN AND ENABLE IT TO OPERATE AS AN EFFICIENT FINANCIAL INTERMEDIARY HAVE BEEN SUPPORTED BY THE EXECUTIVE BRANCH AND APPROVED BY THE LEGISLATIVE BRANCH.

- THE MINISTRY OF PLANNING AND ECONOMIC POLICY PROMOTED, WITH USAID SUPPORT, A STUDY TO SET UP GENERAL POLICY GUIDELINES REGARDING THE HOUSING AND URBAN DEVELOPMENT SECTOR. THIS STUDY WAS COMPLETED AND CIRCULATED TO INSTITUTIONS AND GOP OFFICIALS FOR CONSULTATION. THE POLICY GUIDELINES CONTAINED IN THE DOCUMENT WERE GENERALLY EXCELLENT AND BASICALLY ALMOST COMPLETELY COMPATIBLE WITH USAID POLICY ON BOTH SUBJECTS.

PROJECTS 515-HG-C10 AND P11  
FURNISHED, DIRECT COST ADDED TO COST OF SOLUTION,  
AN ADDITIONAL AND VERY SIGNIFICANT POLICY CHANGE  
REPRESENTED BY THE RECENT DECISION BY MIVI TO ALLOW  
LEASE OWNERS TO DEVELOP HOUSING PROJECTS ON CERTAIN  
MIS ZONED FOR URBAN RENEWAL PROJECTS. THIS WILL  
LEAD TO SIGNIFICANT PRIVATE SECTOR INVESTMENT IN  
HOUSING PROJECTS IN REVITALIZING STAGNANT CORE CITY  
BLOCKS.

## memorandum

DATE: February 3, 1987

REPLY TO  
ATTN OF:William Gelman, Chief RHUDO/PSA APPENDIX 2  
Page 1 of 3

SUBJECT:

AID's Congressional Presentation on Panama's Housing Sector Operations

TO: Carlos Cabrera

MISSION COMMENTS ON AID'S  
CONGRESSIONAL PRESENTATION ON  
PANAMA'S HOUSING SECTOR OPERATIONS

One of AID's primary housing objectives is to meet low cost housing needs by promoting greater private sector involvement in the production and finance of low cost housing. The rationale for this objective is that GOP debt problems will restrict, to some extent, the level of GOP support for the housing sector, and, from a strategic standpoint, AID should promote the involvement of Panama's strongest financial institutions, private sector banks, in the financing of low cost shelter solutions. The underlying assumption was that, if the banks were to provide mortgage financing to low income families and the experience proved to be successful, the banks would continue to do so with their own resources in the future. On September 29, 1986 a new housing program was authorized whose design called for Housing Guarantee resources to be channeled through a trust to be established by a major private bank to Panamanian mortgage banks.

Since authorization, USAID/Panama and RHUDO have been negotiating the terms of the Implementation Agreement with the three Panamanian private mortgage banks who have made comments. The document is expected to be signed March, 1987.

As a companion activity, AID authorized a technical assistance grant whose purpose was to support the objective cited above. Specifically, the Project Paper for 525-HG-013 in its analysis demonstrated that the production and financing of low cost shelter through the private sector was constrained by a series of factors. Among these were:

1. Some private sector housing finance institutions such as the Savings and Loan Associations which traditionally served AID's target group were weak and relatively ineffective. Technical Assistance was to be provided to see if these associations could be reorganized to become more effective.
2. Low cost housing production is affected by costly norms and standards as well as poorly designed administration and public registry procedures. Technical assistance was to be provided to make recommendations which would reduce housing production costs, thereby improving the affordability of low income families in Panama.

3. Savings mobilization is a major source on housing investment. Technical assistance is to be provided to the institutions implementing the program as well as to the GOP to increase the mobilization of savings.

AID will continue its current activities with the GOP that are tied to the Torrijos Carter Treaty Agreement. Approximately \$25 million remains to be disbursed under the 525 HG-012 program. The activities to be funded are urban renewal walk up apartments, home improvement loans and other minimal costs solutions. We have attempted to encourage the GOP institutions to only finance solutions that the private sector will not finance at this time (i.e. the lowest cost or most problematic housing solutions) and that private contractors be used to build solutions rather than construction through force accounts.

The GOP, through the Ministry of Planning and Economic Policy, issued a draft report which was financed by an AID DG. This document represents, to my knowledge, the first GOP attempt at a sectorial policy based on the current economic conditions of the country. A copy of said document has been shared with you. Issuance of a GOP policy was made a condition of ESF assistance for FY 86.

The GOP has embarked on a series of policy reforms to stimulate private investment in housing. These reforms were largely the result of AID policy dialogue with the GOP and the private sector and were implemented through legislation or regulations listed below:

1. LEY 36 DE 8 DE NOVIEMBRE DE 1984

This law eliminates a subsidy on interest rates for low cost housing based on a surcharge on commercial and personal loans.

2. LEY 37 DE 8 DE NOVIEMBRE DE 1984

Allows a contractor or construction firm a deduction of \$1,000 on net taxable income on the first sale of each new social interest house built hereafter.

3. LEY 38 DE 8 DE NOVIEMBRE DE 1984

All newly constructed housing (and other types of building) were exempt from rent controls pre-established in Law No. 93 of October 4 of 1974.

4. LEY 39 DE 8 DE NOVIEMBRE DE 1984

The Banco Hipotecario Nacional was reorganized and separated administratively from MIVI, e.g. legal representation was given to the General Manager, a Board of Directors was established and with ample representation from the private sector. Also

the same law promotes deregulation of the savings and loan industry, e.g. the savings and loan associations may be converted to stock companies, and interest rate caps on lending and deposits were eliminated.

5. DECRETO NUMERO 33 DE 3 DE MAYO DE 1985

This decree regulates and establishes procedures to facilitate and expedite all matters related to Government tendering and contracting in general. MIVI has used these procedures in building most of its recent housing projects.

6. LEY NO. 3 DE 20 DE MAYO DE 1985

Establishes a system of preferential interest rates on mortgage loans granted by both public and private banks as well as savings and loan associations. AID did not advocate this law but was given the opportunity to comment.

7. RESOLUCION NO. 228 DEL MINISTERIO DE COMERCIO E INDUSTRIA (JULIO DE 1985)

SUCASA a private corporation is authorized to issue bonds to be offered to the public, the procedures of which to be used to finance construction of popular housing. AID has advocated secondary mortgage markets operation in Panama and this is an example of the implementation of that concept.

8. LEY NO. 6 DE 30 DE JUNIO DE 1985

Improvements built between July 1, 1982 and December 31, 1987 will be exempt from real estate taxes for 20 years.

WG:AS:aks

66

## memorandum

DATE: April 13, 1987

APPENDIX 3

Page 1 of 10

REPLY TO  
ATTN OF:Denton E. Larson, Acting Director, USAID/PANAMA  
William Gelman, Chief, RHUDO/PSA

SUBJECT:

Draft audit report in AID Assisted Shelter Sector Activities in Panama.

MISSION COMMENTS ON DRAFT

TO: Mr. Coinage N. Gothard, RIG/A/T

AUDIT REPORT

We have reviewed the subject report and have included specific comments on each finding and recommendation together with a report of actions taken or planned to implement the recommendations.

In general, we are disappointed in the audit report in that we believe it does not present a balanced view by giving credit for accomplishments and actions taken by the Mission to correct deficiencies. There is obviously a difference of opinion between the auditors and the Mission regarding the degree of direct intervention and monitoring that should be exercised by AID in implementing a Housing Guaranty Program. There is also a significant disagreement regarding the amount of monitoring that was actually exercised by RHUDO/PSA and USAID/Panama. These specific concerns are addressed in our response to individual findings and recommendations and especially in regard to Recommendation No. 1.

The negative tone of the report detracts from the significant accomplishments that have been achieved by the Housing Guaranty Program in Panama. The RHUDO and USAID believe that the report should acknowledge more forthrightly the fact that the program exceeded its planned physical outputs by 5,000 "housing solutions" or over 60 percent. This was accomplished by convincing the GOP to finance a much larger proportion of home improvement loans for low income Panamanian families. This created some management and monitoring problems but promised to assist a far larger number of people.

More important were the program's policy achievements. In 1984, the GOP reformed the National Mortgage Bank (BN) by establishing the General Manager as its legal representative and a private sector board to oversee the BN's financial management. This separation from the Housing Ministry (MIVI) will ensure better financial management of the BN, the country's major institution financing low cost housing. The Mission and RHUDO also played a key role in implementing a BN debt restructuring plan with the Social Security System which now puts the bank in a position to continue financing low cost housing in the future. Also, policies on market interest rates, private sector construction of publicly financed projects and the promotion of the concept of having market forces resolve low cost housing problems are among the

accomplishments achieved by the program. Finally, the USAID and RHUDO have promoted the implementation of improved management systems for the BHN and MIVI, more efficient organization of those institutions, reductions in work force and other reforms geared to minimizing the role of the government in line with GOP efforts to meet World Bank and IMF restrictions related to the deficit and public sector employment (See Panama 2649 sent to RIG/A/T, February 27, 1987). This magnitude of impact required substantial effort on the part of the relatively small staff implementing this \$50 million program which, when implemented, will provide 22,000 Panamanian families with improved housing.

Another issue relates to the use of data. The Mission requested that a scientific sample of the housing solutions (e.g. home improvement loans, serviced lots, core units, urban renewal units, etc.) financed under the program be carried out so that representative and reasonable conclusions of the program could be made. The audit team initially agreed in October 1986 to scientific sampling, but when the audit team returned to Panama in December 1986, the Mission was informed that a scientific sample would not be made. The Mission then asked that, at least, representative projects be selected for sampling. This also was ignored. As a result, the draft audit report includes findings based on questionable sampling procedures and conclusions drawn from data that were not statistically accurate. The Mission believes that adequate sampling and statistical procedures are essential when dealing with 13,000 housing units built throughout the Republic of Panama.

Detailed comments and report of actions taken or planned are keyed to each recommendation as follows:

Recommendation No. 1

The audit report states that AID Handbook 7, Chapter 5 and Handbook 3, Chapter 11, should be used to monitor the Housing Guaranty Program. This guidance is very general. We believe that the PRE/H Manual, Chapter 6, on Housing Guaranty Implementation Guidance more clearly defines RHUDO monitoring and management responsibilities. These guidelines take into consideration the fact that HG resources are not appropriated funds and states that the RHUDO is primarily concerned with policy and institutional objectives, the disbursement of the HG loan, and the overall implementation of the project by the institutions involved. The extent to which the RHUDO should be involved in matters related to construction, financing, management and marketing of new or improved shelter is to be addressed in the PP. The guidance also states that the RHUDO should be careful not to assume direct control over construction and delivery of the project. AID is not the "owner" of the project and a local entity invariably has legal responsibility for project implementation (See Attachment 1). The Project Paper for 525-HG-011 defined the implementation responsibilities and roles of the various

participant agencies and RHUDO (See Attachment 2). RHUDO is primarily responsible for review of project feasibility plans. All pertinent feasibility studies have been received, reviewed and approved by RHUDO. The Project Paper for 525-HG-012, pages 41 through 43, further describes GOP and AID implementation and management responsibilities. (See Attachment 3).

RHUDO staff made numerous field trips to visit projects both in Panama City and the countryside. These visits are documented on RHUDO files; for example, see Attachments 4 and 5. During the seven year life of the program, we have conducted meetings almost weekly with BHN, MIVI and MIPPE staff. When important problems emerged during implementation, (e.g., arrearages, mortgage registration, etc.), the RHUDO took action to resolve the problems. Many of the actions recommended in the draft audit report were documented and action taken by the Mission prior to the audit. Disbursements have been suspended and will not be resumed until the GOP takes appropriate actions to comply with the deficiencies we have identified (See Attachments 6 and 7). This demonstrates that the RHUDO and USAID were making a number of difficult management decision regarding the implementation of the program. However, this is not reflected in the report. We believe the Executive Summary discussion on management and Recommendation 1a should be eliminated. Recommendation 1b is requested to be closed.

#### Recommendation No. 2:

The audit report noted that income tables for eligibility were established in 1979 and revised in 1981. Income tables were also revised in 1986. The audit report should be so noted. In addition, RHUDO has completed a review of income levels for the period 1981-1986 and has determined that no adjustments were necessary other than those noted above; i.e. GDP grew at only about 0.5 percent per year during this period. In the future RHUDO will review annually maximum income levels and advise the GOP if any changes are required. We request that this recommendation be closed.

#### Recommendation No. 3

The audit report notes that "the BHN did not maintain separate accounting records for the AID guaranteed housing program, a condition precedent to first disbursement contained in Section 5.02.C of the Implementation Agreements No. 525-HG-010 and -011." Documents in RHUDO files indicate that a plan to establish and maintain separate accounting books and records was accepted for meeting the conditions precedent for Program No. 525-HG-011 (See Attachment 8). The BHN submitted the plan for an accounting system but failed to implement the system. USAID has suspended disbursements until the system is implemented and has included

a condition for further disbursement under the HG-011 and HG-012 Programs in Implementation Letter Nos. 4 and 7 (Attachment 7) as follows:

"A formal statement by BHN with full descriptions of the systems and procedures to be employed during a specific timeframe, to create separate accounts for the mortgage and loan portfolio as well as for recuperations for each Housing Guaranty program."

"Evidence that Loan proceeds, their utilization, and Panama's own resources broken down by sub-programs as well as the recuperation of the investment by sub-program by BHN are being recorded and maintained in separate accounts as mandated by Section 6.01(F) of the Implementation Agreement dated September 12, 1979, modified by Amendment No. 1 dated August 25, 1981".

The Mission requests that based on the action noted above the recommendation be closed.

#### Recommendation No. 4

USAID became concerned about delinquencies more than a year ago and requested that MIVI and BHN take corrective action. Various memoranda of conversation between the RHUDO, Minister of Housing and the Manager of the BHN cite this problem as early as February 14, 1986. This concern was raised to the level of a condition for disbursement of HG resources in Implementation Letter No. 6, dated July 2, 1986, (See Attachment 6) which stated the following:

"USAID is concerned about the intended institutional and financial impacts of the overall HG program, and even though we understand that the physical execution of the project is proceeding well, we feel that disbursements must be linked to improvements in program implementation procedures. We request that the following issues be addressed to USAID's satisfaction before resources are disbursed under Program 525-HG-012.

"2. A recent analysis of the BHN portfolio suggests that arrearages are a problem. The level of delinquent payments, among a series of other problems, is affecting the financial viability of BHN. We believe, that corrective actions are necessary now. In particular, we suggest several changes in procedures: 1) joint selection by BHN and MIVI staff of beneficiaries; 2) issuance of mortgages prior to occupancy of units; and 3) more vigorous collections of payments. We also would like to know what the BHN and MIVI plan to do about arrearages problems in buildings already occupied."

On February 18, 1987, the implementing institutions responded to this point stating that actions were being taken. After a review of these actions we concluded that adequate progress had not been made. We communicated this decision to the government in Implementation Letter No. 7 (Attachment 7) which included the following requirement for disbursements to continue:

"An analysis of the current level of arrearages, quantified by the number of loans, amount of funds due, number of months overdue, by region, by project and by type of solution. This will be used as base data against which progress can be measured in reducing delinquencies. The base case analysis should also include a review of those projects which have an extraordinarily high rate of delinquency and the special measures which BHN and MIVI plan to take to resolve these problems."

The Mission requests that the recommendation be closed based on actions taken as noted above.

Recommendation No. 5

As requested by the auditors, the RHUDO has consulted with the RLA. The RLA and GC/H have determined that the Lease-Purchase contracts are valid and binding documents under Panamanian and U.S. Law (See Attachment 9). A letter is being drafted to advise the GOP of this decision.

Although the Lease Purchase agreements meet legal requirements for reimbursements we feel that the issuance of mortgages is important because it actually transfers property rights to beneficiaries. The Mission has been aware of difficulties in the mortgage registration process for a considerable period of time and has addressed the problem in PIL No. 6 (See Attachment 6), which stated:

"5. We understand that the urban renewal projects are subject to very complicated procedures with regard to mortgage registry. Nevertheless, since the urban renewal program is such an important feature of the Government's low cost housing activities, it seems essential that procedures be established to enable the tracking and execution of mortgage documents in a more efficient and systematic way. We would like to have the MIVI and BHN present such a mortgage registration procedure and we want to see evidence of progress in issuing mortgages in urban renewal projects as has been the case in other MIVI-BHN housing projects."

The implementing institutions responded to this point on February 19, 1987 citing the various procedures established under Panama's Civil code which cause delays in mortgage registration and indicated that they have taken several actions to facilitate the registration process such as

periodic meetings for coordination and monitoring. Nevertheless, in PII No. 7, the Mission requested additional information from the Ministry as a condition for disbursement as follows:

"A copy of the Evaluation Commission's report on the process of generating mortgages and BHN-MIVI plan for implementing the recommendations of that report along with a quarterly report which includes information on loan recuperation, arrearages, mortgage generation, and general project progress, in accordance with our conversation with BHN officials in our meeting of February 14, 1986."

Based on actions already taken and planned, we request that the recommendation be closed.

#### Recommendation No. 6

The Mission concurs that the delivery of deeds has been a problem. Current practice is for the MIVI to call mortgagees to inform them that mortgage documents are available for pick up. This procedure does not work because people do not pick them up. The Mission believes that the government shouldn't be responsible for actually delivering deeds; this is the responsibility of the beneficiary family. The recommendation should be eliminated.

#### Recommendation No. 7

The Ministry of Housing does have a mechanism to ensure that housing units are occupied by program beneficiaries at the time of purchase. However, there is no requirement that original beneficiaries occupy the units forever. On the contrary, a considerable amount of movement could and does occur in any housing market. Indeed, a commonly accepted principle exists in housing known as the "filtration process", which describes the phenomenon of how housing, over time, filters down to successively lower income groups. The Mission supports a free and open market system and disagrees with the recommendation that the government restrict occupancy of housing units subsequent to initial occupancy. We recommend that this Finding and Recommendation be eliminated.

#### Recommendation No. 8

With regard to recommendation 8a, the Mission has recognized the need for improved monitoring of contractor performance and inspection procedures. In the July 2, 1986 Implementation Letter (Attachment 6), USAID tied disbursements of HG 012 to the following:

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"6. There have been complaints about quality of construction work in some of the urban renewal projects. We would like to know how MIVI plans to ensure quality control of the work carried out by its contractor."

On February 19, 1987, the implementing institutions responded as follows:

"In relation to quality control of work carried out by contractors, the Ministry of Housing has taken the following actions:

- evaluated the personnel in the Inspection Department and fired six of twenty seven inspectors who have been replaced by more experienced personnel;
- the Panamanian Society of Engineers and Architects has agreed to give ten seminars to improve the staff's technical capacity to begin next month;
- a commission has been created and named to standardize inspection procedures;
- increased supervision of inspection staff;
- increased number of quality control tests and MIVI now requires that suppliers provide specifications on the material they are providing."

We have reviewed these actions with MIVI and have concluded that the actions taken together with implementation plans to resolve construction problems are adequate.

With regard to Recommendation 8b, we question the advisability of requiring the Government of Panama to be responsible for reactivation of the residents associations. We feel that government involvement will result in reliance on the public sector to maintain and repair private property. This is the responsibility of the residents, and we should not encourage government intervention. We believe that the residents of urban renewal units have demonstrated substantial capacity to organize in the past and are capable of organizing to better maintain their own homes in the future.

With regard to 8c, the government presented a social action plan as part of its presentation of the Project Feasibility Document. This plan was carried out during the phase of project development. However, we believe that government involvement in the post construction and occupation phase of this program should be kept to a minimum. This is especially important because of the GOP debt burden and need to reduce government employment.

Our response to recommendation 8d is similar to 8b and 8c re government involvement in post construction activities. The owner/residents, and

not the government, should maintain privately owned condominium apartments.

We request that all sub-recommendations under 8 be eliminated.

Recommendation No. 9

The rationale for the Finding and Recommendation is that the auditors apparently believed that home improvement loans should be used to improve existing units, not to build new units on family owned lots.

While the Implementation Agreement states that home improvement loans are to expand or improve existing structures, many existing structures are so precariously built that a beneficiary must start from scratch and build a new unit. Moreover, this is clearly meant to be part of the program and often reaches the families most in need. This issue was dealt with several years ago at the project design stage. The Project Paper for HG-010 specifically states that loans may be made available to families who own a lot (See Attachment 10).

Moreover, the AID Policy Paper on Shelter published in February 1986 states: "Upgrading projects may also include home improvement loans to residents in project areas. These projects are designed to assist families in the informal sector.... Core Housing: Including a sites and services approach with the addition of a basic housing shell (typically a bathroom and a small multipurpose living area) on each lot, designed to be improved and expanded by the owner. Building materials loans may be provided." (See Attachment 11).

We request that the recommendation be eliminated.

Recommendation No. 10

MIVI has always had at least one architect or engineer to supervise home improvements in every regional office of the Ministry. In addition, the MIVI has recently hired experienced construction supervisors (maestros de obras) in each regional office to provide technical assistance to beneficiaries receiving materials loans. We request that the recommendation be closed.

Recommendation No. 11

While the problem noted by the auditors does not seem to be pervasive, the Mission agrees that MIVI should make every effort to verify income of applicants. We will communicate this concern to the Ministry and request MIVI to ensure compliance with established regulations and procedures. However, we do not feel the Mission is in a position to "ensure full

compliance" as stated. We request the recommendation be reworded, as follows:

"We recommend that USAID/Panama request that the Ministry of Housing issue a directive to all offices that they must fully comply with MIVI's internal regulations and procedures in verifying applicants' income before granting sub-loans."

Recommendation No. 12

The problem detected by the auditors of incomes in excess of established targets was concentrated in one of ten regional offices of MIVI. USAID concurs that this is a problem that needs to be corrected and plans to communicate this concern to the Ministry in the same letter which deals with verification of income. USAID/Panama requests that this recommendation be reworded as follows:

"We recommend that USAID/Panama request that the Ministry of Housing issue a directive to all offices that they must fully comply with the guidelines on income to determine eligible beneficiaries for HG Programs."

Addenda recommendation No. 1

The audit report states that "the criteria employed by the GOP in selecting beneficiaries for the Housing Guaranty Program in Panama included political party affiliation and inaccurate calculation of family income." We have found no evidence to support the allegation that the GOP uses political party affiliation to select beneficiaries. The application forms which are filled out by beneficiaries are included as Attachment 12. They do not include party affiliation.

The report notes that thirteen (5 percent) of beneficiaries' folders included "political recommendation". It should be noted that it is not uncommon for an applicant to request recommendations from the representative of their corregimientos, from a government official, or from the parish priest. These recommendations are not necessarily politically motivated. These are character and need references and according to MIVI spokespersons, a person who is recommended must meet the eligibility requirements of the program. Unless ineligible applicants were granted housing loans, we fail to see how deserving Panamanian families were denied equal opportunity.

With regard to the use of net income versus gross income, this seems to have occurred in one project in the interior which indicates a management problem with one of the ten regional offices of MIVI rather than a deviation from the norm which has been and remains gross family income. USAID believes that action planned to implement Recommendation No. 12 will resolve this difficulty. USAID/Panama recommends that this recommendation and the discussion related to selection criteria be eliminated.

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List of Recommendations

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<u>Recommendation No. 1</u>	6
<p>We recommend that the Regional Housing Office, in consultation with USAID/Panama, suspend further disbursements of AID-guaranteed housing program loan funds until such time as the Government of Panama has adopted and AID has approved beneficiary selection criteria in accordance with the housing guaranty program gross family median income limits, and which do not discriminate against any prospective candidate for any reason.</p>	
<u>Recommendation No. 2</u>	9
<p>We recommend that the Regional Housing Office, in consultation with USAID/Panama and appropriate Government of Panama officials:</p> <ul style="list-style-type: none"><li>a) periodically review the accuracy of beneficiary income tables and revise same accordingly;</li><li>b) obtain from cognizant Government of Panama officials evidence that they have taken appropriate measures to ensure that the incomes of candidates for Housing Guaranty-financed units are properly verified; and</li><li>c) obtain further evidence that income limits, once established, are properly disseminated and observed in the beneficiary selection process.</li></ul>	
<u>Recommendation No. 3</u>	13
<p>We recommend that the Regional Housing Office, in consultation with USAID/Panama obtain evidence that the National Mortgage Bank has established and maintained separate accounting books and records related to AID-guaranteed housing program activities, and suspend further program disbursements until such time as an independent auditing firm certifies that such a system is in place and operating.</p>	

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<u>Recommendation No. 4</u>	16
<p>We recommend that the Regional Housing Office, in consultation with USAID/Panama, obtain evidence that the National Mortgage Bank has established and implemented an effective system for managing and monitoring AID-guaranteed housing program sub-loan repayment delinquencies.</p>	
<u>Recommendation No. 5</u>	19
<p>We recommend that the Regional Housing Office, in consultation with USAID/Panama, obtain evidence that the Ministry of Housing has established and implemented a systematic follow-up mechanism to ensure that housing units are actually occupied by program beneficiaries.</p>	
<u>Recommendation No. 6</u>	21
<p>We recommend that the Regional Housing Office, in consultation with USAID/Panama:</p> <ul style="list-style-type: none"><li>a) review and approve the implementation procedures for carrying out the home improvement program in accordance with the implementation agreements in conjunction with cognizant Government of Panama officials; and</li><li>b) obtain evidence that the Ministry of Housing has established and implemented a supervision plan to ensure proper utilization of construction materials provided under the home improvement program.</li></ul>	

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<u>Recommendation No. 7</u>	25
We recommend that the Regional Housing Office, in consultation with USAID/Panama:	
a) establish and implement effective procedures as required by AID Handbooks 3 and 7, to monitor housing guaranty program activities; and	
b) obtain evidence that the Government of Panama has complied with conditions, covenants and requirements established in Housing Guaranty Implementation Agreements.	

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