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AUDIT OF USAID/THAILAND'S HOUSING
GUARANTY PROGRAM

Audit Report No. 2-493-89-14
July 10, 1989

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT
MANILA

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DATE: July 10, 1989

MEMORANDUM

TO: Dr. John R. Eriksson, Director, USAID/Thailand
Mr. David L. Painter, Director, RHUDO/Asia

FROM: *William C. Montoney*
William C. Montoney
Regional Inspector General, RIG/A/M

SUBJECT: Audit of USAID/Thailand's Housing Guaranty Program
(Project No. 493-HG-003)
Audit Report No. 2-493-89-14

The Office of the Regional Inspector General for Audit/Manila has completed its audit of the USAID/Thailand Housing Guaranty Program. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains one recommendation. Parts a. and b. of the recommendation are closed on issuance of this report while part c. is considered resolved. Please advise me within 30 days of any additional actions taken to close part c. of the recommendation.

I appreciate the cooperation and courtesy extended to my staff during this audit.

Background

The Housing Guaranty Program's Low Income Housing Policy and Program Assistance Project began in August 1980. The implementing agency was the Royal Thai Government's National Housing Authority (NHA). The Regional Housing and Urban Development Office/Asia (RHUDO/Asia) was responsible for A.I.D. oversight of the project. The project's purpose was to increase the availability of safe, sanitary shelter

affordable by low income families and to improve the implementation of approved National Housing Policy in Thailand.

In general, the Housing Guaranty Program worked as follows. The implementing agency of the host country identified housing related costs under the program and solicited U.S. financial institutions to provide long-term loans to be guaranteed by A.I.D. The financial institution offering the best loan terms was selected by the host country and a payment mechanism was established by the host country to repay the loan, including principal and interest. If the host country failed to comply with the terms of the loan, the United States Government was obligated to pay the lending institution any remaining principal and interest.

Loan guarantees of \$40 million were authorized under this project. On September 30, 1983, NHA contracted with Citibank, N.A. for a \$10 million loan to be guaranteed by A.I.D. NHA did not borrow any more A.I.D. guaranteed loan funds under the project, and on September 23, 1987, the remaining \$30 million in loan guaranties was deauthorized by A.I.D.

The \$10 million was allocated to seven project housing sites within Thailand. Two sites were near Bangkok in the towns of Bang Plee and Lad Krabang, and the remaining sites were located in five regional cities. Exhibit 1 shows the number of low cost units targeted to the urban poor and the portion of the \$10 million loan attributed to each project site.

Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Manila made a performance audit of the Housing Guaranty Program's Low Income Housing Policy and Program Assistance Project in Thailand. The specific objectives of the audit were to determine if the project achieved its purpose and if the Royal Thai Government complied with the terms of the loan documents regarding the \$10 million which A.I.D. guaranteed. To accomplish these objectives, the auditors reviewed pertinent project documents, records, and reports. The auditors also interviewed RHUDO/Asia and NHA officials, and several owners of project housing units. The audit covered activities from August 5, 1980 through December 31, 1988. Audit field work was performed during the period February through April 1989. Field work included site visits to housing projects in Bang Plee and Lad Krabang, Thailand.

The amount audited was \$10 million in loan guaranties. The audit showed that 5,700 low cost housing units were constructed at Bang Plee and Lad Krabang. These units represented \$8.5 million in allocated expenditures from the \$10 million loan and almost 70 percent of the 8,300 total project housing units.

The review also included an examination of RHUDO/Asia's internal controls related to the \$10 million loan. The audit was made in accordance with generally accepted government auditing standards.

Results of Audit

The Low Income Housing Policy and Program Assistance Project did not fully achieve the project's primary purpose of increasing the availability of safe, sanitary shelter affordable by low income families. The Royal Thai Government was properly repaying the \$10 million loan which was guaranteed by A.I.D. However, many operational problems continued several years after the units at two major housing sites had been constructed. Since investors were not precluded from purchasing housing at these sites, the 1980 Project Implementation Agreement may have been breached by NHA.

The Project Agreement May Have Been Breached - Several operational problems existed at the two largest project housing sites. Chief among them was that ineligible persons had purchased several low income units. Also, low income housing units had high vacancy rates and high mortgage payment arrearages. Because NHA had not corrected these operational problems, many of the targeted beneficiaries of this project, the urban poor, were not provided improved shelter. Further, because it had not established adequate safeguards to prevent investors from purchasing units intended for low income families, NHA may have breached the August 5, 1980 Project Implementation Agreement.

Discussion - In 1987, RHUDO/Asia deauthorized the remaining \$30 million in loan guarantees for the project because it was not achieving its stated purpose of providing safe, sanitary shelter affordable by low income families. The specific problems cited included high vacancy rates, large numbers of past due mortgage payments, and indications of land speculation within the project sites. The audit showed that high vacancy rates and large numbers of mortgage payment arrearages continued. Also, the audit found specific examples of low income housing units that had been

purchased by investors. These investments were contrary to and may have represented a breach of the 1980 Project Implementation Agreement.

At Bang Plee, 1,256 (40 per cent) of 3,162 low cost housing units had never been occupied. All the units had been originally sold in June 1985. As of December 31, 1988, NHA records showed that about 1,300 of the units were \$567,000 in arrears on payments due NHA. The auditors interviewed the owners of 11 low income houses and found that eight were not original owners and were not shown on NHA ownership documents as being the current owners. Two of the eight admitted that they had contracted directly with previous owners to purchase the units because NHA would have charged about \$200 to formally transfer ownership. Consequently, NHA and RHUDO/Asia had no assurance that subsequent owners were eligible to purchase low income units.

Similar conditions existed at the Lad Krabang housing site. Of 2,572 low income housing units, 636 (25 percent) had never been occupied. All of the units were originally sold in November 1984. Approximately 1,400 units were identified in NHA records as being \$780,000 in arrears on their mortgage payments. The occupants of 10 units said that they were the owners of the houses. However, NHA deed of sale documents showed that six of the 10 units were recorded in other names. Two of the current owners claimed they contracted directly with previous owners to avoid ownership transfer charges.

The National Housing Authority had maximum income limitations for original buyers of low cost units at Bang Plee and Lad Krabang. These income limitations also applied to persons who subsequently purchased low cost units from previous owners. However, because of the informal system of contracting found at the two project sites, NHA was not able to verify the new buyers' incomes. As a result, ineligible buyers had purchased low cost units using this system.

Investors had acquired low income units at Lad Krabang. Three multi-unit apartment buildings, two ten-unit structures and one five unit building, were built on three low income housing sites. The owners of these buildings were interviewed by the auditors. One of the owners, who ran a food service business on the project site, built his ten-unit apartment building in late 1988 for about \$20,000. The owner lived in one of the apartment units and rented the remaining nine units. Another owner, who lived in Bangkok and worked as a district safety inspector, built his

ten-unit structure about two years ago for nearly \$17,000. His reason for constructing the apartment building was to house workers who were employed in his decorative light factory. The last owner did not know the details of her purchase, including where her property was located or the cost of the property. She referred the audit team to her attorney, who stated that the five-unit building was built in late 1988 for his client's business and was used as a training site for individuals who made artificial flowers. Photographs of these three buildings and of three unoccupied low income houses are shown in Exhibit 2.

In July 1987, RHUDO/Asia performed an internal assessment of the project and found many deficiencies associated with NHA's implementation of the project. The identified deficiencies included the same occupancy, arrearage, and investor problems presented in this audit report. The assessment also showed that NHA had not appreciably reformed its policies or management structure as recommended by RHUDO/Asia. The assessment report recommended that NHA not receive any additional A.I.D. funding for this project. Consequently, on September 23, 1987, A.I.D. deauthorized the remaining \$30 million in loan guarantees. Following the deauthorization, all official project activities involving RHUDO/Asia and NHA coordination and cooperation ceased. RHUDO/Asia stopped monitoring NHA activities and NHA assumed complete operational responsibility for the project housing sites.

Because of the vacancies, past due mortgage payments, and ineligible buyers, the project had not fully achieved its purpose of providing affordable shelter to the urban poor. Because low income units were constructed and purchased by investors, NHA did not comply with a special covenant under Section 6.03, Eligible Beneficiaries, of the 1980 Project Implementation Agreement. Section 6.03 states "The shelter solutions financed by the Loan shall be affordable by families earning below the medium urban income in Thailand.... The NHA shall take such steps as are reasonable and practical to assure that the benefits of the various subprograms remain available to eligible beneficiaries. Included in such procedures, for example, may be rights of repurchase by the NHA in the event the owner of a serviced site/core house desires to sell the property within five years" Section 8.01, Suspension and Acceleration, of the Agreement provides remedies to A.I.D. for noncompliance by NHA. Section 8.01 states, in part, that if the Borrower materially breaches this Agreement and such breach is not rectified within a period of 90 days from the delivery of

notice by A.I.D., then A.I.D. may require the Borrower to prepay immediately to the Investor all or any part of the unpaid loan principal. The Agreement, however, did not define what constitutes a material breach.

Recommendation No. 1

We recommend that RHUDO/Asia:

- a. determine whether the National Housing Authority materially breached the 1980 Project Implementation Agreement with A.I.D. by allowing investors to purchase low income property with loans guaranteed by the Low Income Housing Policy and Assistance Project;
- b. take action in accordance with Section 8.01, Suspension and Acceleration, of the Project Implementation Agreement if it is determined that a material breach of the Agreement occurred; and
- c. notify the National Housing Authority of A.I.D.'s concern regarding high vacancy rates and large mortgage payment arrearages in this project.

USAID/Thailand and RHUDO/Asia provided joint written comments to the draft audit report. The joint response did not challenge the facts presented in the draft report. However, both offices disagreed with the draft report's conclusion that the National Housing Authority had materially breached the Project Implementation Agreement. The response described Section 6.03 of the Agreement as being contrary to current A.I.D. policy because the covenant places undue restraint on free market mechanisms.

RHUDO/Asia officials offered to waive the provisions of Section 6.03 which conflict with A.I.D.'s policy of deregulating housing markets. Finally, RHUDO/Asia officials agreed to meet with NHA officials to emphasize A.I.D.'s concern about high vacancy rates and large mortgage payment arrearages.

Since USAID/Thailand and RHUDO/Asia officials have jointly determined that a material breach of the Agreement did not occur and have offered to waive the provisions of the Section 6.03 covenant for policy reasons, we will close parts a. and b. of Recommendation No. 1 on issuance of this report. Since RHUDO/Asia officials have agreed to meet with NHA officials to express A.I.D.'s concern about high vacancy rates and arrearages, we will consider part c. of

Recommendation No. 1 resolved on issuance of this report. This part can be closed on presentation of evidence that the agreed to meeting and expression of A.I.D. concern took place.

AUDIT OF
USAID/THAILAND'S
HOUSING GUARANTY PROGRAM

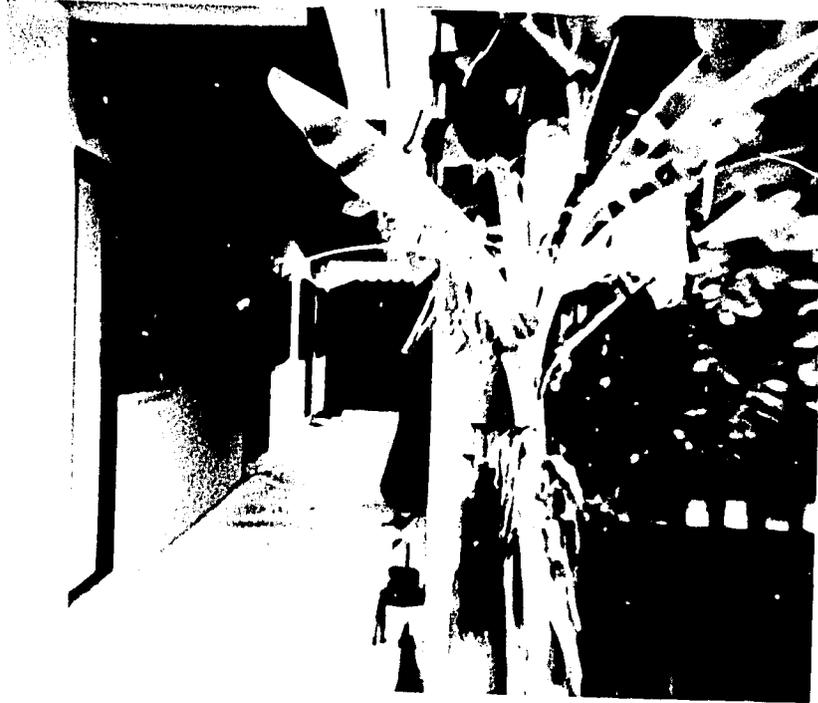
EXHIBITS AND APPENDICES

EXHIBIT 1

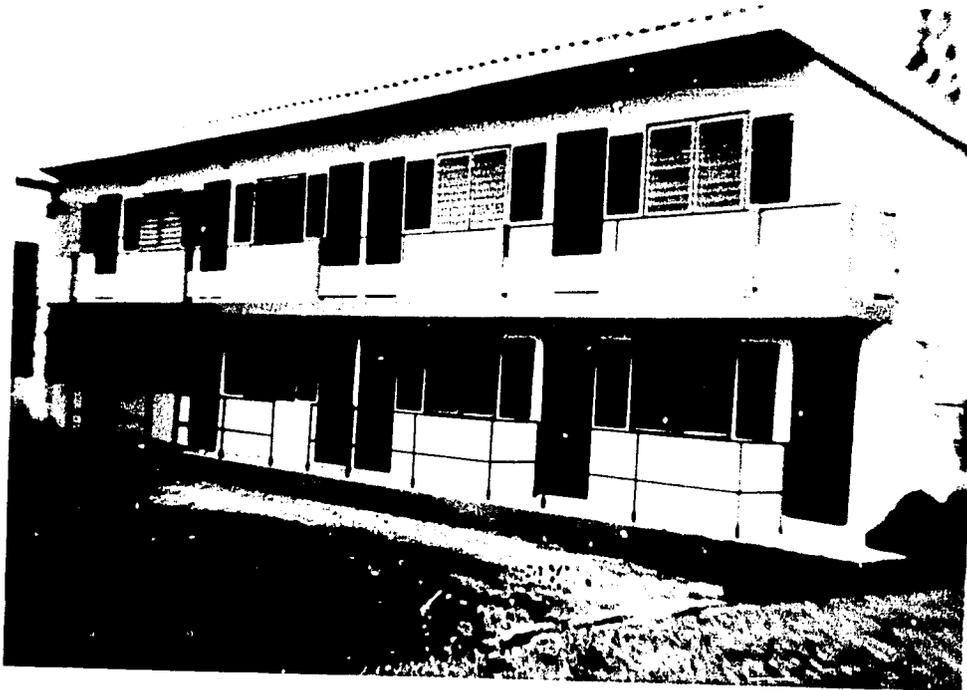
Summary of the Housing Project Sites
As of September 30, 1988

<u>Project Site</u>	<u>Number of Low Cost Housing Units</u>	<u>Allocation of A.I.D. Guaranteed \$10 Million Loan</u>
<u>BANGKOK: NEW TOWNS</u>		
Bang Plee	3,162	\$ 3,990,000
Lad Krabang	<u>2,572</u>	<u>4,520,000</u>
SUB-TOTAL	<u>5,734</u>	<u>\$ 8,510,000</u>
<u>REGIONAL CITIES</u>		
Chiangmai	669	\$ 794,000
Khonkaen	474	37,000
Songkhla	553	657,000
Nakhon Sawan	415	1,000
Chantaburi	<u>420</u>	<u>\$ 1,000</u>
SUB-TOTAL	<u>2,531</u>	<u>\$ 1,490,000</u>
TOTAL	<u>8,265</u>	<u>\$10,000,000</u>

Photographs Of Investment Properties
And Unoccupied Housing Units At
Lad Krabang And Bang Plee Project Sites



Front and rear view of two story,
ten-unit investment apartment building
located at Lad Krabang low income housing site.
Nine units were rented, and owner lived in one unit.



A two story, ten-unit apartment building located at Lad Krabang housing site. Building was used to house factory workers who were employed by the unit's owner.



A five-unit apartment building located at Lad Krabang housing site. Building was purchased as an investment for the owner by her attorney.



A one story row house at Lad Krabang which had been vacant since November 1984. Mortgage payments were 49 months in arrears as of December 1988.



A one story row house at Bang Plee housing site which had been vacant since July 1985. Mortgage payments were 35 months in arrears as of December 1988.



A two story row house at Bang Plee housing site
which had been unoccupied since 1985. Mortgage
payments were 37 months in arrears as of December 1988.



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MEMORANDUM

Date: June 16, 1989

TO: Mr. William C. Montoney
Regional Inspector General, RIG/A/M

FROM: Dr. John R. Eriksson, Director, USAID/Thailand *John R. Eriksson*
Mr. David L. Painter, Regional Director, RHUDO/Asia *David L. Painter*

SUBJECT: USAID and RHUDO Comments on the May 10, 1989 Draft Audit Report
for the Thailand Housing Guaranty program (Project No.
493-HG-003)

General Comments

The Draft Audit Report was received by USAID and RHUDO on May 17, 1989. The sections entitled Results of Audit and Recommendation were radically different from the draft which was discussed with the audit team on April 26, 1989. As a result, we do not feel that the current Audit Report reflects the views of USAID or RHUDO as presented in that discussion.

Comments on the Audit Findings

USAID and RHUDO agree that the project as originally designed, i.e., with a total life-of-project funding level of \$50 million, was not going to adequately achieve its stated purpose. In fact, USAID and RHUDO reached that conclusion over two years before this audit took place and we then took appropriate action. That is why the remaining \$30 million authorized but not disbursed by the project was deauthorized in September 1987.

USAID and RHUDO do not agree that the NHA materially breached the Project Implementation Agreement. Nor do we agree that the breach of the special covenant in Section 6.03 of the agreement (whether it occurred or not) is sufficient grounds for A.I.D. to withdraw its loan guaranty.

Was There a Material Breach of the Agreement?

The first sentence of Section 6.03 states that "The shelter solutions financed by the Loan shall be affordable by families earning below the median urban income in Thailand." This was indeed the case for all A.I.D. financed units sold by the NHA. The Audit Report does not dispute this fact. Indeed it states that "The National Housing Authority had income requirements for original buyers of the low cost units at Bang Plee and Lad Krabang." The units produced were quickly sold to eligible families because they were affordable. NHA is not in breach of this part of the covenant.

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The second sentence of Section 6.03 states that "The NHA shall take such steps as are reasonable and practical to assure that the benefits of the various subprograms remain available to eligible beneficiaries." (The last sentence suggested possible options for doing so, but is not binding.) The audit team found that some units had been sold by the original purchasers. The Audit Report faulted NHA for not interfering in this free market transaction. However, it was not established that this free market transaction denied the benefit of the program to eligible beneficiaries.

More importantly, whether a breach is material or not depends upon the importance of the covenant to A.I.D. policy and goals in Thailand. In this regard, there has been a substantial shift in A.I.D. policy away from undue restraint of free market mechanisms such as the 1980 covenant included as Section 6.03 of the Project Implementation Agreement. It is no longer A.I.D. policy to require government agencies to regulate and control the sale of private property between their citizens. Nor is the policy of the RTG. In fact, it is illegal in Thailand. A.I.D. policy is now to encourage governments to deregulate housing markets while they encourage production of non-subsidized low-cost units which low-income families can afford. For cost reasons these units will be of such a standard that higher income families will not find them attractive to live in. We believe that this is the best way to assure that continuing housing benefits reach eligible beneficiaries. In this policy context, NHA's inability to control the resale of A.I.D. financed units does not constitute a material breach of the agreement from A.I.D.'s perspective.

The three examples of private investment in multi-unit apartments is another case where it is not clear that eligible beneficiaries lost their benefits under the program. First, it seems likely that the occupants of the new units are actually eligible beneficiaries based on information contained in the Audit Report itself. Second, it is now also A.I.D. policy to encourage private investment in low-cost housing. Although the apartments were not an intended output of the project, they suggest that a free market will provide housing for the poor. The fact that the NHA could not prevent the construction of these units does not constitute a material breach of the agreement from A.I.D.'s perspective.

In conclusion, we find no grounds to substantiate the Audit Report's position that NHA materially breached Section 6.03 of the Project Implementation Agreement. However, to better reflect A.I.D.'s policy position, we also believe that the provisions of the second sentence in this 1980 covenant should be waived by A.I.D.

Is the Proposed Remedy Appropriate?

Even if the NHA did materially breach Section 6.03 of the Agreement, we do not believe that A.I.D. should withdraw its loan guaranty. Since this remedy is optional and not automatic, its exercise requires programmatic and policy judgement.

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Programmatically, the withdrawal of the guaranty and forced repayment of the loan would not serve the purpose of resolving the issues raised in the Audit Report. It would temporarily increase the foreign exchange burden on the Ministry of Finance, but it would not materially affect the NHA's policies or operations.

RHUDG/Asia and USAID/Thailand are also concerned about the negative effects that land speculation and informal resales have had on NHA's housing projects. However, these are nationwide phenomena which cannot be solved in isolated projects. To be solved at all, they must be solved on the national level. Land speculation is legal and widespread in Thailand. This is primarily because the effective tax rate on land is much lower than it is on other types of investment. We are assisting the RTG to correct this distortion through our work on several studies that will help the RTG draft the framework for a new property tax system. RTG has also established a program for improving the cadastral system in Thailand. However, the informal system is so widespread that the improvement program is expected to take twenty years to complete. In the meantime, we are already assisting the RTG to set up an interim monitoring system for land in the Bangkok area, where the problem is most acute. These are positive programmatic steps being undertaken to eliminate the root causes of land market distortions.

In terms of policy, the exercise of our remedies for breach of Section 6.03 would send the wrong signals to the RTG. A.I.D. policy is to encourage free markets, not government regulation in Thailand. A.I.D. policy is to support private investment, not to thwart it. Yet enforcing Section 6.03 of the agreement as currently written would contradict those important policy directions. From that reason, the proposed remedy represents an incorrect policy choice. We believe it is more appropriate to waive those portions of the 1980 covenant which contradict A.I.D. policy.

In conclusion, we find no programmatic or policy grounds for believing the proposed remedy is appropriate.

Comments on the Audit Recommendations

We disagree with the first recommendation because the Project Implementation Agreement has not been materially breached. Furthermore, the instruction that NHA should repossess private property on the grounds of Section 6.03 is illegal in Thailand and contradicts established A.I.D. and RTG policy on discouraging government interference in free markets.

We agree with the second recommendation. RHUDG will meet with the NHA to discuss the audit findings and impress upon them our continuing concern about vacancy rates and mortgage payment arrearages at the project sites.

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We disagree with the third recommendation. A forced repayment of the loan would serve no useful programmatic or policy purpose. RHJDO/Asia has been delegated authority to implement HG program agreements, and this includes selecting remedies in the event of breach. A forced repayment would be counterproductive to U.S./RTG bilateral relations at a time when A.I.D. is trying to devise a new strategy for Advanced Developing Countries utilizing Thailand as an example. This being the case, it is clearly not in A.I.D.'s best interest to exercise the recommended remedy.

In light of this audit, we are now aware that Section 6.03 of the agreement could be construed by the NHA as A.I.D. encouragement for government interference in the housing market. To clarify our policy position, we intend to notify NHA in writing that we waive the provisions of Section 6.03 that imply that NHA should control resales of A.I.D. financed units at the project sites. This will bring our agreement into line with A.I.D.'s policy of deregulating housing markets.

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