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AUDIT OF
A.I.D. MANAGEMENT OF OWNED AND LEASED
PROPERTY IN LESOTHO

AUDIT REPORT NO. 3-632-89-08
January 31, 1989

UNITED STATES OF AMERICA

AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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January 31, 1989

MEMORANDUM FOR DIRECTOR, USAID/LESOTHO, Jesse L. Snyder

FROM: RIG/A/NAIROBI, Richard C. Thabet

SUBJECT: Audit of A.I.D. Management of Owned and Leased Property in Lesotho

The Office of the Regional Inspector General for Audit, Nairobi has completed its audit of A.I.D. management of owned and leased property in Lesotho. Five copies of the audit report are enclosed for your action.

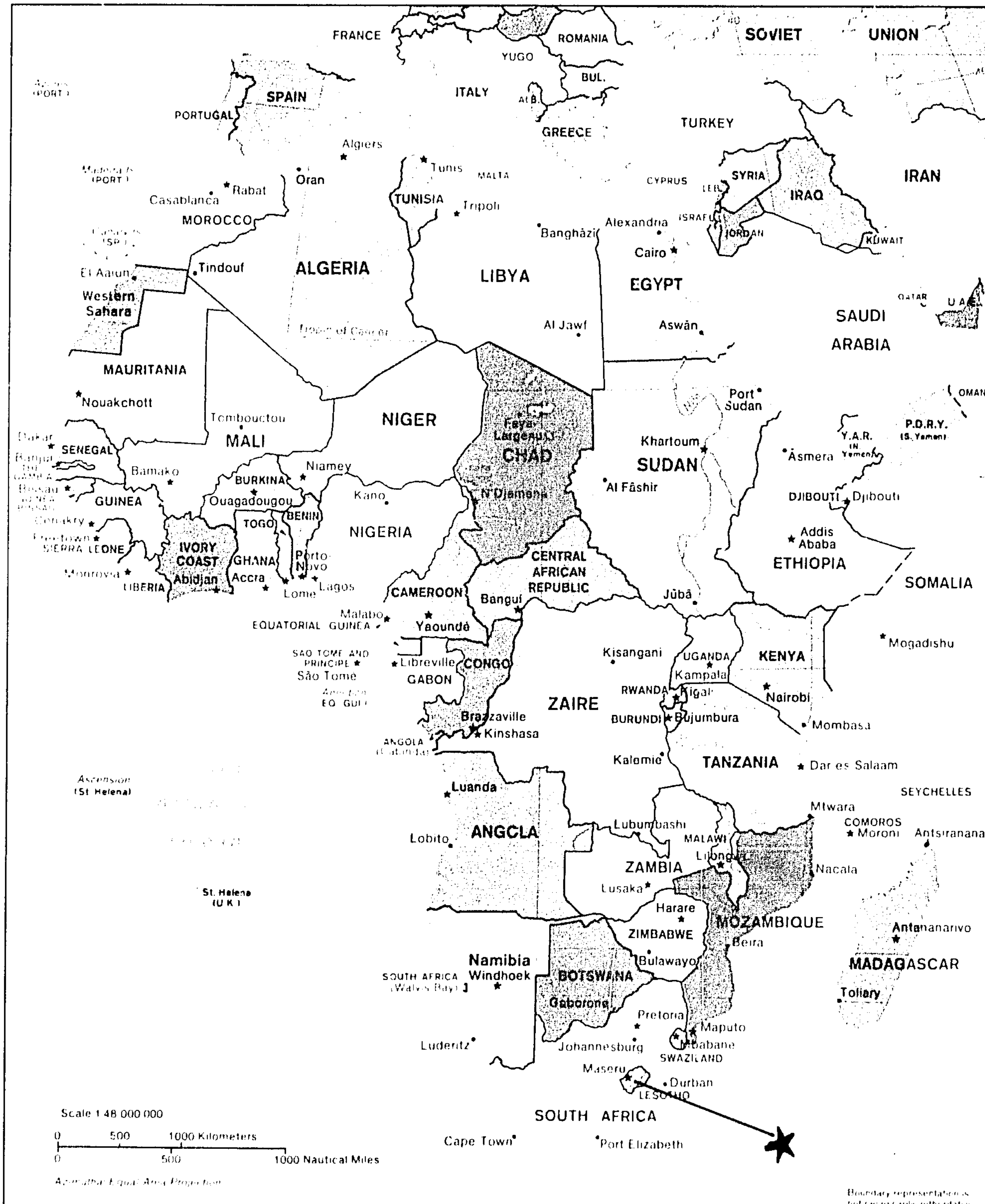
The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains two recommendations which are resolved but will not be closed until completion of planned or promised actions. Please advise me within 30 days of any additional actions taken to implement the recommendations.

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

Background

The Foreign Affairs Manual (FAM) volume 6, sections 720 and 731 set forth the Uniform Department of State/A.I.D./United States Information Agency regulations for leasing residential quarters and acquiring real property abroad. The Manual stated that A.I.D./Washington had authority under section 636 (a) of the Foreign Assistance Act of 1961, as amended, to lease, for up to ten years, offices, buildings, grounds and living quarters. Missions could enter into leases not exceeding $25,000 a year or 5 years in duration. Leases exceeding these limits had to be submitted to Management Operations/Overseas Operations, A.I.D./W for prior approval. Section 636 (c) of this Act, as amended, gave A.I.D. authority to spend up to $6 million annually to renovate, construct or purchase real property facilities. Further A.I.D. missions had authority to acquire property through lease purchase options.

Africa



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In recent years, demand for high cost housing in Maseru/Lesotho has increased. This has resulted mainly from the Highland Water Project which has attracted many expatriates to Lesotho. There has not been an increase in the supply of housing sufficient to meet the increased demand. As a result, rents increased in some cases from two or three times their recent levels, and rental rates for properties under leases executed some years back are below the current market rates. Consequently, landlords have an incentive to renegotiate rental rates, or as an alternative, terminate existing leases and re-lease properties at significantly higher rental rates.

On October 31, 1988 USAID/Lesotho had: (a) seven residential leases at a yearly total cost of $41,140; (b) one warehouse lease costing $6,355 per year; (c) four U.S. Government owned residential houses which were purchased during the period February 1976 through October 1977 at a cost of $228,944; and (d) an office building which was constructed on U.S. Embassy owned land during the period 1978 to 1981 at a cost of $300,313. Real property was managed by USAID/Lesotho's Executive Office.

Audit Objectives and Scope

The staff of the Regional Inspector General for Audit/Nairobi conducted an audit of A.I.D. management of owned and leased property in Lesotho. The objectives of the audit were to determine whether: (a) leased/owned property exceeded or did not meet A.I.D.'s needs; (b) leasing/acquisition regulations were being implemented in a manner which protected the U.S. Government's interests; and (c) the alternative used (leasing or acquisition) was the best for acquiring the required space.

The audit was conducted at USAID/Lesotho during October and November 1988. Relevant documents were reviewed, responsible Mission officials were interviewed and site visits were made. The audit scope included $41,140 in yearly rental costs for all the Mission's seven residential leases and $228,944 used for the purchase of four U.S. Government owned residential houses. The review of internal controls and compliance was limited to the findings presented in this report. The audit was made in accordance with generally accepted government auditing standards.

Results of Audit

The audit found that USAID/Lesotho's leased/owned property did not exceed its needs in terms of size and quantity. However, U.S. Government interests were not always protected through its leasing practices and there was no assurance that leasing was the best alternative for acquiring residential housing.

USAID/Lesotho stayed within prescribed size limitations, and occupancy rates were high. Lesotho was classified as category 5 for housing which entitled occupants to 1,880 square feet of living area for a three bedroom house and 2,500 square feet for a four bedroom house. The audit showed that the average leased or U.S. Government owned house in Lesotho was only 1,684 square feet for three bedroom houses and 2,043 square feet for four bedroom houses.

In addition, of the 11 houses that USAID/Lesotho leased or owned, the occupancy rates for 1986, 1987 and the first ten months of 1988 were about 97, 94, and 94 per cent, respectively.

However, USAID/Lesotho did not register lease agreements with the government as required. Further, the Mission did not perform a cost analysis to determine if it was more advantageous to buy real property in Lesotho than to lease it. The report recommends that USAID/Lesotho (1) establish procedures to ensure registration of current and future leases, and (2) prepare a cost analysis to support a request for acquiring additional housing.

1. <u>Lease Agreements Were not Registered</u> - A.I.D. regulations required Missions to register lease agreements where the host country governments provided registration systems. USAID/Lesotho did not register its leases even though Lesotho Government law required them to be registered in order to become valid. This occurred because the Mission did not establish procedures to ensure that registration was done. Failure to register leases could cost the Mission up to $87,000 in increased rental costs.

Discussion - A.I.D. Handbook 23, Chapter 5 stated that in many countries lease terms were not enforceable by law unless the lease agreements were registered. It further required Missions to register all leases unless the local jurisdictions did not provide registration systems or the systems did not result in added protection of the rights of the U.S. Government. The Handbook also stated that Missions should not leave registration up to the lessors. Lesotho was one country where registration of leases was important. The Lesotho Government Deeds Registry Act of 1967 required lease agreements of three years and over to be registered at the office of the Registrar General. Failure to register made leases null and void.

Prior to 1987, USAID/Lesotho had not registered any of its seven residential leases. In March 1987, one lessor terminated a lease agreement which was not scheduled to expire until March 1989. In February 1988, another lessor sold his property and terminated the lease with USAID/Lesotho. This forced

USAID/Lesotho to enter into a new lease with the new landlord at an increased monthly rent. In both cases, the Lesotho Ministry of Foreign Affairs advised the Mission that the leases were null and void because they had not been registered as required. Later, USAID/Lesotho requested one lessor to register but never verified later that it was done. The Mission sent copies of five agreements to the Ministry of Foreign Affairs, but did not know if registration was actually achieved. No action was taken by the Mission on one lease recently entered into.

USAID/Lesotho was not aware prior to 1987 of the importance of registering leases in Lesotho because they had no problem with any lease. After 1987, the Mission became aware of the importance of registering leases, but did not establish procedures to ensure the landlords actually registered the leases as required by the Lesotho Government law. The current Mission management could not explain why such procedures had not been established.

This resulted in increased costs to USAID/Lesotho. One of the two leases, which the Mission lost because of failure to register, had been negotiated at a rent of about $387 per month. The lease gave the Mission the option to renew the lease up to July 1997 with a 12 per cent price escalation every four years. Since the lease was not registered, it was declared null and void and the Mission had to negotiate another lease with the new landlord for $816 per month (a 111 per cent increase) for the first 15 month period and $1,020 per month (a 25 per cent increase) for the following 16 month period. If all of USAID/Lesotho's landlords terminated their leases and asked for similar increases, the Mission would pay about $87,000 more than would be paid under the current lease terms (see exhibit 1).

<u>Recommendation No. 1</u>

We recommend that the Director, USAID/Lesotho:

(a) take the necessary steps to ensure registration of all existing leases; and

(b) establish Mission policy and procedures to ensure registration of future Mission leases.

In responding to the Record of Audit Findings (RAFS) submitted at the audit exit conference, USAID/Lesotho Management agreed with this finding and recommendation. In formally commenting on the draft report, the Mission stated that it had initiated action to register all leases and had established internal policies and procedures to ensure registration of all future leases.

Based on Mission Comments, we consider Recommendation No. 1 resolved. We will close the recommendation upon receipt of documentation showing that the Mission has (1) taken the necessary steps to register all existing leases and (2) established policies and procedures to ensure registration of future leases.

2. <u>USAID/Lesotho Could Save On Operating Expense Funds by Acquiring More Residential Housing</u> - Although A.I.D. has authority to purchase real properties abroad, USAID/Lesotho has not purchased any residential housing since 1978. This occurred because of a belief that funds to buy property abroad were not available. USAID/Lesotho could save up to $360,000 over a 15-year period for each additional government owned house.

Discussion - Section 636(c) of the Foreign Assistance Act of 1961, as amended, gave A.I.D. the authority to spend up to $6 million annually to renovate, construct or purchase real property facilities abroad. The proposed acquisition was to include a comparison of acquisition costs against the estimated long-range leasing costs for a 15-year period. As an alternative, A.I.D. missions had authority to acquire property through lease purchase options. A portion of the funds for exercising an A.I.D. purchase option would be provided from section 636 (c) funds . When a Mission desired to exercise an approved purchase option, it had to notify A.I.D./W at least 6 months in advance.

USAID/Lesotho had saved money by purchasing their own housing. During the period February 1976 and October 1977, the Mission purchased four residential houses at an average cost of $57,236. Today the Mission provides housing to 10 employees but only requires 7 leases (one leased house was being used for TDY personnel) at an annual cost of only $41,14^ in rent. However, USAID/Lesotho had not purchased any residential housing since 1978.

There was a belief that section 636(c) funds were not available. Consequently, USAID/Lesotho did not prepare a comprehensive cost analysis to determine whether it was more advantageous to the U.S. Government to purchase additional real property than to lease it. The analysis, if favorable, needed to be presented to A.I.D./W to justify use of section 636(c) funds or lease/purchase options. The analysis would show that the demand for high cost housing has increased in Maseru/Lesotho in recent years without an increase in the supply of housing sufficient to meet the demand. As a result, market rates for rental housing have dramatically increased in some cases to two or three times their recent levels.

FIGURE 1. EXAMPLE OF GOVERNMENT OWNED PROPERTY

USAID/Lesotho has saved operating expense funds by purchasing housing such as the Mission Director's residence pictured above.

The analysis would also show that the U.S. dollar enjoys a favorable exchange rate to the local currency which has been devalued to only 43 per cent of its 1983 value. Therefore, acquisition costs in Lesotho were lower than in other countries where the value of the U.S. dollar had declined.

Based on USAID/Lesotho's and a private architect's current estimates of $81,630 for purchasing an average sized four bedroom house, a $12,245 annual rent payment, and a continuous inflation rate of 11.6 per cent for rental costs (the average rate for the period July 1987 to July 1988 as reported by the Mission's economist), we expect that A.I.D. would recoup its outlay for purchase costs (from no rental payments) in about six years. Over a 15-year period, A.I.D. would save about $360,000 less increased maintenance costs and the Federal Government's cost of money required for the purchase outlay1/. See Exhibit 2.

Recommendation No. 2

We recommend that the Director USAID/Lesotho prepare a comprehensive cost analysis justifying the use of section 636(c) funds or lease/purchase agreements to purchase additional residential housing.

In responding to the Record of Audit Findings (RAFS) submitted at the audit exit conference, USAID/Lesotho management stated that it was unrealistic to expect to get section 636 (c) money. The Mission, however, agreed with the proposition to enter into lease purchase agreements. The Mission stated that it had no further comments on the draft report submitted to them for their review.

1/ The audit did not include computations of increased maintenance costs and the Federal Government's costs of money required for the purchase outlay. Increased maintenance cost would include only structural maintenance, such as roof repairs, since lease practices in Lesotho required the tenant to pay for day-to-day maintenance. Further, the Federal Government's cost of money would be far less under a lease purchase option as compared to an immediate purchase. These computations should be included in the comprehensive analysis called for by this report recommendation. Also to be included in this comprehensive analysis would be investment risk factors such as any political instability.

Recommendation No. 2 is considered resolved. The recommendation will be closed upon receipt by RIG/A/N of documentation showing that the comprehensive cost analysis recommended by this report has been prepared.

Other Pertinent Matters

Although A.I.D. Handbook 23 Chapter 5 required leases to provide for renewal periods and to specify the rental rates for the renewal periods, this was not the case in USAID/Lesotho. Out of the eight Mission leases, three had no options for renewal and in the other five leases, rental rates for the renewal periods were subject to negotiation. As a result, the Mission could experience substantial rental increases and/or lose favorable lease terms and the costs expended for security upgrades. For example in early 1988, the Mission experienced a 111 per cent rent increase under one of its leases. The Mission should establish a policy to ensure that all leases provide for renewals and caps on the amounts to be paid when such options are exercised.

A.I.D. Handbook 23 Chapter 5 states that leases should preferably provide for monthly or quarterly rental payments unless the mission gets tangible benefits in return for extended advance rental periods. However, all of the current eight USAID/Lesotho leases call for 12-month advance rental payments or longer (ranging from 12 to 18 months). Further, there was no evidence that the Mission received any tangible benefits in return. A Mission official stated that advance rental payments was the prevailing practice in Lesotho. However, evidence showed that the Mission can realize benefits in return for advance rentals. In 1978, for example, the Mission obtained a 5 per cent discount and a 4-year fixed rental amount in return for a 12-month advance rental payment. Under the Mission's current practice of advance rental payments, the cost of money to the U.S. Government is not offset by any financial benefits under USAID/Lesotho's leases. USAID/Lesotho should establish procedures to ensure that future leases do not call for more than 6 months advance rentals unless the Mission obtains benefits. The efforts of the Mission to obtain such benefits should be documented in the lease files, whether successful or not.

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IN LESOTHO

EXHIBITS AND APPENDICES

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Exhibit 1

Computation of Possible Rent Increases As A Result of Failure to Register leases1/

Lease Number	First 15 Months From	First 15 Months To	Increase in Rent (Maloti)	Next 16 Months From	Next 16 Months To	Increase in Rent (Maloti)	Total Increase in Rent (Maloti)
(1) A.I.D-LE-632-83-05	Nov. 1988	Jan. 1990	M.11,655	Feb. 1990	May 1991	M.18,336	M.29,991
(2) A.I.D-LE-632-79-02	Nov. 1988	Oct. 1989	10,848	2/	2/	- o -	10,848
(3) A.I.D-LE-632-79-03	Nov. 1988	Oct. 1989	10,848	2/	2/	- o -	10,848
(4) A.I.D-LE-632-83-06	Nov. 1988	Jan. 1990	16,650	Feb. 1990	May 1991	26,208	42,858
(5) A.I.D-LE-632-84-07	Nov. 1988	Jun. 1989	7,992	2/	2/	- o -	7,992
(6) A.I.D-LE-632-88-12	Nov. 1988	Jan. 1990	33,300	Feb. 1990	Sep. 1990	26,200	59,500
(7) A.I.D-LE-632-88-13	Nov. 1988	Jan. 1990	29,300	Feb. 1990	Sep. 1990	22,200	51,500
Possible increase in rent for the next 31 months			M.120,593			M.92,944	M.213,537
Using a rate of M.2.45 = 1.00 US $ this is							$87,158

1/ Based on one unregistered USAID/Lesotho lease which was declared null and void and later increased by 111 per cent during an initial 15-month period and a 25 per cent increase during a following 16-month period.

2/ Lease expired.

Analysis To Determine If It Is Advantageous To U.S. Government To Acquire Additional Housing

Year	Yearly Rental Increase Compounded @11.6 Percent Annually (Maloti)	Cumulative Rental Payments (Maloti)
1	M.30,000	M.30,000
2	33,480	63,480
3	37,364	100,844
4	41,698	143,542
5	46,536	189,077
6	51,933	241,010a/
7	57,957	298,967
8	64,680	363,647
9	72,183	435,830
10	80,556	516,386
11	89,900	606,286
12	100,328	706,614
13	111,966	818,580
14	124,954	943,534
15	139,449	1,082,983b/

a/ Based on an estimated M.200,000 ($81,630) cost of purchasing a four bedroom house, the break-even point would occur during year 6.

b/ Over a 15-year period, the Mission would save M.882,983 or $360,401 (M.1,082,983-200,000).

ACTION: AID-3 INFO: ECON RLO

VZCZCNA0796 28-JAN-89 TOR: 15:15
RR RUEHNR CN: 46763
DE RUEHRU #0297 0271512 CHRG: AID
ZNR UUUUU ZZH DIST: AID
R 271511Z JAN 89 ADD:
FM AMEMBASSY MASERU
TO AMEMBASSY NAIROBI 6482
BT
UNCLAS MASERU 00297

AIDAC

FOR RIG/A/N JARMAN

E.O. 12356 N/A
SUBJECT: AUDIT OF AID MANAGEMENT OF OWNED AND LEASED PROPERTY IN LESOTHO

REF: NAIROBI 2676

1. MISSION HAS NO COMMENT RE DRAFT REPORT.

2. RE RECOMMENDATION NO. 1: MISSION HAS INITIATED ACTION TO REGISTER ALL LEASES AND HAS ESTABLISHED INTERNAL POLICY AND PROCEDURES TO ENSURE REGISTRATION OF ALL FUTURE LEASES. SMALLEY
BT
#0297

NNNN

Appendix 2

REPORT DISTRIBUTION

Mission Director, USAID/Lesotho	5
AA/AFR	1
AFR/SA/SLB	1
AFR/CONT	1
AA/XA	2
XA/PR	1
LEG	1
GC	1
AA/M	2
AA/PFM	1
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REDSO/ESA	1
IG	1
DIG	1
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IG/LC	1
IG/ADM/C&R	12
AIG/I	1
RIG/I/N	1
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