



Barbados Audit Office

Special Audit
on the
National
Housing
Corporation
High Rise
Apartments
at the
Grotto
and
Valerie



Grotto High Rise Apartments



Valerie High Rise Apartments

Strengthening public accountability by providing fair and independent reports

BARBADOS AUDIT OFFICE



Special Audit on the National Housing Corporation High Rise Apartments at Grotto and Valerie

September 2016

MISSION STATEMENT

The Mission of the Audit Office is to strengthen public accountability by providing fair and independent reports after careful examination of accounting records and use of resources.

THE GOAL

The goal of the Audit Office is to promote staff development, achieve a high standard of auditing and contribute to the general efficiency and effectiveness of the Public Service.



THE BARBADOS AUDIT OFFICE
Weymouth Corporate Centre
Roebuck Street, St. Michael BB11080, Barbados



Tel: (246) 535-4257
Fax: (246) 535-4270
Email: audit@bao.gov.bb

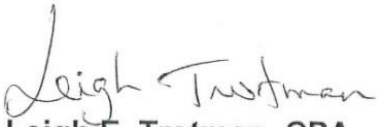
September 15, 2016

His Honour The Speaker
The House of Assembly
Parliament Building
BRIDGETOWN

Sir,

I have the honour of submitting to you for laying before the House of Assembly in accordance with Section 38 (2) and 38 (5) of the Financial Management and Audit Act, 2007 – 11, a Special Report on the National Housing Corporation High Rise Apartments at the Grotto and Valerie.

Yours faithfully,


Leigh E. Trotman, CPA
Auditor General

Acknowledgement and Appreciation

The Auditor General gratefully acknowledges the kind assistance and cooperation given to personnel of the Auditor General's Office during the conduct of this Audit by:-

- The Permanent Secretary and staff of the Ministry of Housing, Lands and Rural Development; and
- The General Manager and staff of the National Housing Corporation.

2. Sincere appreciation is also extended to the officers of the Audit Office whose efforts contributed to the successful completion of this assignment.

Special Audit of the National Housing Corporation

High Rise Apartments

Table of Contents

EXECUTIVE SUMMARY	1
<i>APPROVAL PROCESS</i>	2
RECOMMENDATIONS	6
CHAPTER 1	8
INTRODUCTION	8
BACKGROUND	8
SCOPE OF THE AUDIT	10
AUDIT METHODOLOGY	10
AUDIT OBJECTIVES	10
AUDIT MANDATE	10
CHAPTER 2	11
PROCESSING OF PROPOSALS	11
PROPOSALS SUBMITTED TO CABINET BEFORE APPROVED BY NHC BOARD	12
INADEQUATE INFORMATION FOR DECISION MAKING	13
ABSENCE OF TENDERING PROCESS	13
CHAPTER 3	16
INCREASE IN PROJECT COSTS	16
VALERIE PROJECT	16
AUDIT COMMENT	17
GROTTO PROJECT	18
CHAPTER 4	22
FINANCING OF THE PROJECTS	22
CHAPTER 5	26
RENTAL RATES	26
IMPACT OF TRANSFER OF OWNERSHIP LEGISLATION	28
LEGAL FEES	29
CONCLUSIONS	30
RECOMMENDATIONS	31

Executive Summary

Introduction

The National Housing Corporation (hereinafter referred to as the NHC or the Corporation) is a state agency which has responsibility for the development of land and the construction of housing units for sale or rental to lower and middle-income persons. In addition, the Corporation provides loans for the purchase of land and houses.

2. Documentation reviewed by the Office indicated that the Corporation received over three thousand applications for rental accommodation during a seven year period. A large number of these applicants were reported to earn less than \$1,500.00 per month “therefore disqualifying/eliminating them from being eligible to purchase a low income house from the Corporation”. The need for an increase in the construction of rental units to assist these applicants was therefore advanced.

3. In addition, the NHC reported that the majority of applications for rental accommodation were from persons living in urban districts where there was limited space for new housing. For these reasons, consideration was given by the NHC to the construction of high rise rental units in the urban districts.

4. In January 2011, the Board of the NHC and the Cabinet of Barbados approved the construction of high rise apartment units for rental at several urban sites, using the Joint Partnership Housing Program¹ which was approved by the Cabinet in 2009. These included the projects at Valerie in Collymore Rock and the Grotto in Beckles Road, St. Michael, at estimated costs of \$15.799 million and \$18 million respectively.

Findings

¹ Under this Program, the NHC provides the land and engages a private sector partner who provides the financing and carries out the works. At the completion of the project, the NHC reimburses the partner under the terms of the contract.

Approval Process

5. Any project undertaken by the Corporation should first be approved by its Board before onward submission to the Cabinet for ratification. It was however noted that these projects were approved by the Cabinet on the 13th January 2011, and thereafter by the Board, by Circular Resolution, between the 14th and the 20th January 2011.

6. There was no evidence provided to indicate that the Management of the NHC carried out the necessary financial and technical review on the Grotto and Valerie projects before submission to the Board for approval. Such a review would have assisted the Board in determining whether the proposals as presented met the Corporation's policy objective of providing housing for lower income persons in a cost effective manner.

7. The Management of the Corporation did not go to public tender with these projects even though the expenditure exceeded the \$100,000 threshold, then applicable under the Financial Rules 1971. The tendering process would have advertised the project to a larger pool of potential developers, therefore facilitating greater competition in the selection process.

8. According to the evidence provided, the NHC Board approved the Grotto project for the construction of seventy-six (76) apartment units in three (3) blocks at \$18 million. The Circular Resolution, by which this project was approved by the Board, contained a proviso that the selected Developer be requested to submit a proposal for the construction of the apartment units in three (3) blocks by March 2011. No proposal was seen from the Developer for the construction of seventy-six (76) apartment units in three (3) blocks.

9. A proposal was submitted by the Developer on the 10th October 2012 for the construction of eighty (80) units in five (5) blocks, and eighty-four (84) car parking spaces at a cost of \$27.85 million, which was \$9.85 million more than the \$18 million

approved by the Cabinet and the Board of the NHC. There is no evidence that this request was assessed by the Corporation.

10. On the 31st October 2012, the General Manager forwarded a copy of this proposal to the Permanent Secretary, Ministry of Housing, requesting approval of the additional sum by Cabinet and the Ministry of Finance and Economic Affairs (Ministry of Finance).

11. On the 4th December 2012, the Permanent Secretary requested from the Management of the Corporation cost breakdowns for the \$18 million approved by the Board and Cabinet, and the \$27.85 million submitted by the Developer, in order to justify the request for the increase from the amount approved by the Cabinet. On the 14th May 2013, the Permanent Secretary received “an elemental breakdown” of the \$27.85 million from the Developer, but there was no evidence that a cost breakdown for the \$18 million was received.

12. Evidence seen indicates that the contract had been signed and the project commenced (1st April 2013) before the Permanent Secretary received the requested information. Therefore, the Permanent Secretary’s efforts to reconcile the cost increase before seeking Cabinet’s approval was frustrated. The increase was subsequently approved by Cabinet on 30th May 2013.

13. The contract had stipulated that eighty-four (84) parking spaces should be provided at the Grotto High Rise complex. According to information supplied by the Developer, the cost for these spaces was stated as \$856,919. There was an approved reduction of car parking spaces to forty-three (43); however, no evidence was seen of a related adjustment to the cost of the project.

Valerie Project - Reconciliation of Costs

14. The Valerie project incurred an increase in cost of \$7.7 million over the \$15.799 million originally proposed by the Developer and approved by the NHC Board and the Cabinet. This increase was due in part to the addition of a number of items in the revised proposal which should have been included in the original submission. These included fees for design consultants, finance and legal fees, and a waste water plant.

15. These omissions highlight the need for proposals to be subjected to technical analysis to ensure that all relevant information is included by developers. Any proposal that does not include all the relevant costs is deficient and will mislead the decision making authorities.

Rental Rates

16. The NHC has indicated that housing units for lower income earners should be provided at a cost of \$125,000 to \$195,000. However, the construction costs of these high rise units ranged between \$300,000 and \$450,000 per unit. Even though all the units were built within the agreed time frame, the high cost per unit obtained within these projects would have impacted negatively on the NHC being able to provide these units to lower income earners without substantial subsidisation.

17. The Corporation bases rental rates for its high rise apartments on the construction costs of the buildings recovered over a thirty-five (35) year period. With the introduction of legislation which allows the transfer of ownership to tenants after renting for a period of twenty (20) or more years, it is not clear why the thirty-five (35) year payback period is being used. It should also be noted that in the case of the Valerie High Rise apartment units, certain costs were not considered. These included the cost of land on which the units were built, which was \$400,000 (purchase price in the 1980's), a variation cost of \$630,000, and interest penalty of \$240,000. At the Grotto, the cost of the land, \$6.766 million, and interest penalty of \$784,746 were not included.

18. All of the seventy six (76) units at the Valerie High Rise complex have been allocated to lower income earners on a rental basis. At the conclusion of the audit no

determination had been made as to whether the Grotto units would be placed on the market for sale or rented to lower income earners.

19. Based on the information provided by NHC, at May 2016, forty-seven percent (47%) of the tenants of the Valerie High Rise Apartment Units were in arrears. The rental rate being charged at Valerie is \$700 per unit. If the same approach for determining the rental rate for Valerie is used for the Grotto project, it is expected that the resulting rate will be a challenge for lower income earners renting these units given the higher construction cost which is used as a base for defining rents.

Financing the Projects

20. One important factor in the financial arrangements for the Valerie and Grotto projects was the challenging financial status of the Corporation. This was evident when the Corporation was unable to pay the Developer in full for these Projects after the submission of the certificates of practical completion as required by the contracts. As a result, the Corporation incurred interest penalties of \$240,000 and \$784,746 for the Valerie and Grotto projects respectively.

21. The Corporation sought funding of \$23.58 million from the Government to settle liabilities on the Valerie Project. In addition, the sum of \$27.85 million was utilized from the Housing Credit Fund (the Fund) to pay the contractor for the Grotto Project. However, a legal opinion was issued to the effect that such transfer of funds from this Fund “could not be substantiated in law”.

Conclusion

22. The National Housing Corporation

- did not carry out any proper financial planning and failed to comply with the procurement requirements as prescribed by legislation in the awarding of the contracts for the high rise units at Valerie and the Grotto; and
- was unable to provide housing for lower income earners in a cost effective manner with regard to these two (2) projects.

Recommendations

23. There are several areas in which improvements can be made to the procurement and construction activities undertaken by the Board of the National Housing Corporation.

- i. The Ministry must respect the role and mandate of the Corporation, and no proposals should be sent to the Cabinet involving the Corporation unless they have been approved by the Board.
- ii. Proposals received should be subjected to technical and financial analysis before being presented to the Board.
- iii. The Board should not undertake projects unless they are deemed to be cost effective while meeting the Corporation's policy objectives.
- iv. The Board of the National Housing Corporation must put measures in place to ensure that procurement procedures as prescribed by legislation are followed.
- v. Persons responsible for disregarding the views of the Board and the Cabinet should be held to account.

- vi. The Board should ensure that adequate financing is available prior to the start of each new housing project

CHAPTER 1

Introduction

This report contains the results of the Special Audit on aspects of the Urban High Rise Program of the National Housing Corporation (hereinafter referred to as the NHC or the Corporation), which is a Statutory Board established by Cap. 226 of the Laws of Barbados. The Corporation has a mandate to:

- i. acquire, hold and manage land and other property of any kind whatsoever and sell, let, lease or otherwise dispose of such land or other property on such terms and conditions as the Minister of Housing determines; and
- ii. carry out development, building, maintenance, repair, improvement and other operations.

1.2 The overall goal of the Corporation is to contribute to the improvement of the housing conditions of citizens of Barbados. This includes the provision of affordable housing, which is defined as the delivery of a quality product at a reasonable price. The Corporation aims to provide these solutions without placing an undue financial burden on members of the community.

Background

1.3 The Urban High Rise Apartment Units Projects reviewed fell under the Joint Partnership Housing Programme of the National Housing Corporation. Under this programme, capital projects undertaken by the Corporation are financed by joint partners from the private sector. The joint partners are paid after the projects have been completed. These Public-Private Sector Partnerships therefore allow the Corporation to pursue capital projects where the required financing is not immediately available.

1.4 The National Housing Corporation has been focusing on the Urban High Rise Apartment Units Project with a view of satisfying the increasing demand for rental units in the urban areas of the Country. In 2012, Management of the NHC indicated that there were over twenty-seven thousand (27,000) applications for rentals in the Corporation's database. It indicated that over three thousand, six hundred and eighty (3,680) applications for rental accommodation had been received during the period 2003 to 2009, of which twenty-six percent (26%) of the applicants earned less than \$1,500.00 per month, therefore disqualifying them from being eligible to purchase a low income house from the Corporation. During the period 2004 and 2009, the Corporation provided housing for less than ten percent (10%) of the applicants.

1.5 The Board was informed that this situation highlighted the need for an increase in construction of rental units to assist those persons who do not have the resources to purchase a low income house from the Corporation or obtain a housing solution on the private market. The Corporation indicated that the majority of applications for rental accommodation were from persons living in the urban districts where there was limited space for new housing. As a result, consideration was given to the construction of high rise rental units in the urban area.

Identification and Allocation of Land for New Urban High Rise Apartment Units

1.6 Since 2011, five (5) areas in St. Michael have been identified for the purpose of constructing three hundred and ninety (390) high rise apartment units to assist in satisfying the demand for rental units in the urban areas. Three (3) of these areas, the Grotto, Valerie, and Eckstein Village, have been targeted for the construction of one hundred and ninety-eight (198) units for lower income earners, while the other two (2) areas, Exmouth and Mason Hall Street, have been targeted to provide one hundred and ninety-two (192) units for lower and middle income earners.

Scope of the Audit

1.7 The audit covered the period 1st April 2010 to 31st March 2015, with special focus on the contractual arrangements at the Grotto and Valerie Projects under the Urban High Rise Programme.

Audit Methodology

1.8 The audit included interviews with personnel from the National Housing Corporation, the Ministry of Housing, Lands, Urban and Rural Development (the Ministry of Housing), and the Town and Country Development Planning Office (TCDPO). In addition, there was a review of the relevant Cabinet papers and decisions, Board papers and decisions, and files from the Ministry and the Corporation.

Audit Objectives

1.9 The Objectives of the audit were to assess:

- whether the financing and procurement arrangements surrounding the award of contracts for the high rise apartment units at Valerie and the Grotto were in compliance with legislation and established policies; and
- whether the NHC has been able to provide housing to lower income earners in a cost effective manner.

Audit Mandate

1.10 This audit was conducted under the provisions of Section 113 (2A) of the Constitution of Barbados, which empowers the Auditor General to carry out examinations into how Statutory Authorities and Government entities “use their resources in discharging their functions as regards the efficiency and effectiveness of those resources”.

CHAPTER 2

Introduction

The construction of high rise apartment units at the Valerie and the Grotto sites was included in a number of projects approved by the Board of the National Housing Corporation and the Cabinet of Barbados in January 2011.

2.2 These two (2) projects, which were awarded to a Developer using the Joint Partnership Approach, were affected by a number of issues. These related to such matters as the manner of approval of the projects and the awarding of contracts, financing, increase in project costs, and the overall decision making process.

Processing of Proposals

2.3 The general procedures to be followed by the Corporation at the time the contracts were awarded were as follows:-

- i. The Management of the Corporation forwards the project specifications including the method of financing to the Board of the Corporation for approval.
- ii. The project is advertised by tender or information sent to prospective developers who would submit proposals.
- iii. Contracts over \$100,000 would go to public tender.
- iv. Tenders/bids received are reviewed by the Tenders Committee of the Board with the assistance of the technical staff of the Corporation and a recommendation made to the Board.

-
- v. The Board reviews the information from the Tenders Committee and makes a recommendation to the Ministry indicating that, if approved by the Ministry, a cabinet paper should be prepared and sent to the Cabinet of Barbados for approval of the project. It should be noted that the cabinet paper should include all relevant costs, the sources of financing, and input from the Ministry of Finance.

2.4 The evidence indicates that these procedures were not always followed by the Corporation and/or the Ministry in relation to the Valerie and Grotto projects.

Proposals Submitted to Cabinet before Approved by NHC Board

2.5 In January 2011, the Board of the NHC and the Cabinet of Barbados approved the contracting of the Developer to construct seventy-two (72) units at Valerie at a cost of \$15.799 million, and seventy-six (76) units at the Grotto at a cost of \$18 million. These projects were approved by the Cabinet on the 13th January 2011 and by the Board Members of NHC by a circular resolution during the period 14th to 20th January 2011.

2.6 The dating of the Circular Resolution and the Cabinet Paper (both on the 10th January, 2011) and the fact that the Cabinet decision (13th January) was approved before the NHC Board completed its voting process (14th to 20th January), indicates that the proper decision making process was not followed in the approval of these projects. The Board's approval should have been obtained before Cabinet's approval was sought.

Basis of the Cost of Contracts Approved by Cabinet and the Board of NHC

2.7 While the \$15.799 million approved in respect of the Valerie project was based on a proposal submitted by the Developer, no documentation was provided by the Corporation to support the \$18 million approved in respect of the Grotto project.

Inadequate Information for Decision Making

2.8 Based on available information, the Board approved the projects, initially valued over \$33 million, without the benefit of advice from its technical staff. In the absence of competing bids, it would not have been possible to determine if the price was in line with that of other contractors in the market. The need for a technical assessment was therefore even more critical, as the Board had no other way of determining the reasonableness of the proposals. The technical and financial analysis should have been carried out and presented to the Board in support of any recommendation by the Management of the NHC. There was no evidence that this procedure was carried out for these projects.

Absence of Tendering Process

2.9 The Corporation has adopted the procurement rules under the Financial Rules which in January 2011 required that any contract exceeding a threshold of \$100,000 should undergo a tendering process unless authorised otherwise by Cabinet in accordance with the Rules. The Private Public Partnerships **were** subjected to the procurement procedures outlined in these Rules, but they were not applied in relation to the Valerie and Grotto projects.

2.10 The NHC Board approved the Developer as the Joint Partner for the Valerie and Grotto Projects without the benefit of the tendering process. In the absence of this process and other supporting documentation, the basis on which the Developer was selected could not be determined.

Audit Comment

2.11 Even though a private company was being used to finance and build the apartments, this was no reason for disregarding the process of public tendering. Adherence to this process would have placed the Corporation in a position to ensure that it was obtaining the most competitive bids the market had to offer in terms of price and quality.

2.12 Typically, tendering involves ensuring that a reasonable number of suitable suppliers of the required goods and services have an opportunity to submit proposals. The process should be transparent, and seen to be so. Proposals should be processed and evaluated fairly, so that contracts are awarded to the best bidders, taking the price and quality into consideration.

Corporation's Response

It is clear that the Financial Management and Audit Act, Cap. 5 and the Financial Management and Audit (Financial) Rules 2011 bind the Crown. However, there are a number of provisions in the Act and rules that are not applicable to statutory corporations.

NHC ensures compliance with the Financial Management and Audit (Financial) Rules 2011 but there have been joint partnership projects ... where the tendering process was not used. There was Cabinet and Board approval to proceed with these projects. Historically, joint partnership projects have been treated differently. However, it is recommended that it should be made clear on whether the rules are binding on NHC as they are different schools of thought.

Inappropriate Intervention by Permanent Secretary (Acting), Ministry of Housing

2.13 In its decision on the 13th January 2011, Cabinet approved the Developer for the Grotto and Valerie projects with the requirements that the Developer should provide full financing for the projects, and engage two (2) small contractors for the duration of each project. However, on 20th January 2011, the Permanent Secretary (Acting) issued letters of award to three (3) contractors, including the Developer approved by Cabinet, to carry out aspects of the Grotto project at a cost of \$6 million each, with each contractor required to fully finance the particular aspect assigned.

2.14 This action by the Permanent Secretary (Acting) was at variance with what the Cabinet had approved. There was no explanation given as to why the project was subdivided and letters of award issued to three (3) contractors since the Cabinet decision approved a single developer. At the time the letters of award were issued, no written documentation was seen from any of these contractors expressing interest in this project.

2.15 The role of awarding contracts to any developer is the responsibility of the NHC Board. In the circumstances, the Permanent Secretary (Acting) had no authority to issue the letters awarding contracts to developers on behalf of the NHC. However, It should be noted that the two other contractors did not take up their offers and the work was carried out by the Developer.

CHAPTER 3

Increase in Project Costs

The combined construction costs of the Valerie and Grotto projects increased by more than \$17.55 million over the original amounts approved by the NHC Board and the Cabinet. The changes which influenced the increased costs on the Valerie project were in part due to requests from NHC, requirements by Regulatory agencies, and submissions from the contractor. The reasons for the increased cost on the Grotto Project could not be analyzed since there was an absence of cost details on the original project approved by the Cabinet and the Board. Issues pertaining to the increases were as follows:-

Valerie Project

3.2 The Developer initially submitted a proposal of BDS \$15.799 million for the Valerie Project. This was for the provision of buildings, external works, a sewage system as well as overheads and profits. The Developer subsequently made two (2) further submissions, which involved variations totaling \$7.78 million. The Audit found no evidence that the initial proposal was scrutinized by the Corporation.

3.3 The first variation was for \$7.150 million and covered additional work on Blocks 1 and 2, the construction of a Waste Water Plant, a Block for Disabled Persons, Infrastructure, Overheads and Profit, Design Consultants, and Finance and Legal Fees. Part of this cost should have been included in the original proposal. This was in relation to Infrastructure (\$1.155 million); Waste Water Plant (\$632,673); Design/Consultant fees (\$600,000); and Finance and Legal Fees (\$1.85 million). The second variation, for \$630,000, was in respect of tiling and kitchen cabinets.

Comparison of Original and Revised Proposals

Description	Original Proposals \$	Revised Proposals \$	Variation \$
Blocks 1 and 2	12,387,745.00	13,500,000.00	1,112,255.00
External Works	1,244,800.00	1,244,800.00	0.00
Sewage Systems (septic tanks)	867,000.00	867,000.00	0.00
Overheads and Profit	1,300,000.00	1,640,000.00	340,000.00
Total	15,799,545.00	17,251,800.00	1,452,255.00
New Items			
Block for Disabled Persons		1,460,800.00	1,460,800.00
Waste Water Plant		632,673.00	632,673.00
Infrastructure		1,155,200.00	1,155,200.00
Finance and Legal Fees		1,850,000.00	1,850,000.00
Design Consultants		600,000.00	600,000.00
Total		5,698,673.00	5,698,673.00
Tiles and Kitchen Cabinets		630,000.00	630,000.00
Total	15,799,545.00	23,580,473.00	7,780,928.00

Audit Comment

3.4 A number of items with a combined cost of \$4.237 million (including payment for the design consultants, and finance and legal fees) should have been included in the original proposal. Consequently, the original proposal was understated. This was a major oversight on the part of the Board and/or the Ministry and resulted in far from adequate information being submitted to the Cabinet. This failure further highlights the importance of conducting adequate technical and financial analysis of proposals before they are sent to the Board and the Cabinet.

Grotto Project

3.5 The Grotto Project was originally approved by the NHC Board and the Cabinet for the construction of seventy (76) units in three (3) blocks at a cost of \$18 million. The project was approved by the Board with the provision that the contractor would be asked to submit a proposal for the construction of the apartment units in three (3) blocks by March 2011. No evidence was seen that such a proposal was submitted by the Developer by March 2011.

3.6 On the 10th October 2012, the General Manager, NHC received from the Developer a proposal for the construction of eighty (80) units in five (5) blocks with eighty-four (84) car parking spaces, at a cost of \$27.85 million. Compared with what had already been approved by the Board, this represented an increase in the number of blocks (from three (3) to five (5)) and the number of units (from seventy-six (76) to eighty (80)) at an increased cost of \$9.85 million.

3.7 On the 31st October 2012, the General Manager forwarded a copy of this proposal to the Permanent Secretary, Ministry of Housing. In addition, the General Manager highlighted the increase and indicated that, "Based on the difference, the National Housing Corporation is requesting approval of the additional sum by Cabinet and the Ministry of Finance".

Audit Comment

3.8 No evidence was seen that financial and technical analyses were undertaken in relation to the additional sum before the request for approval was made. In the absence of such analysis, the basis on which the General Manager was requesting the approval for the increase in costs could not be determined.

Corporation's Response

The General Manager sought to bring to the attention of the Permanent Secretary the request for the increase. This is against a background that the land was owned by the Crown and it was the Crown that would be financing the project. It would have been within the jurisdiction of the Ministry of Finance to assess the same.

Reconciliation of Cost Differences

3.9 On the 4th December 2012, the Permanent Secretary requested “the submission of a cost-breakdown for the revised proposal ... for the construction of 80 High-rise Apartments at a cost of \$27.85 million”. The Permanent Secretary also requested “a cost-breakdown for the \$18 million which was the original estimated construction cost for the seventy-six (76) units approved by the Cabinet on the 13th January 2011.” This was to justify requesting the approval of the additional amount of \$9.85 million by Cabinet.

3.10 By letter dated the 5th December 2012, the Developer referenced an “original proposal” for \$25.9 million, stating that the difference between this proposal and the proposal for \$27.85 million “was due to the redesign of the site at the request of the Chief Town Planner as the site now accommodates five (5) buildings in different locations and additional parking”.

3.11 The Permanent Secretary was not satisfied with this response from the Developer. On the 22nd April 2013, the Permanent Secretary wrote the Developer indicating that the Ministry had no evidence that clearly demonstrated “the basis on which the contract sum was arrived at”. The Permanent Secretary then requested the Developer to submit, “as a matter of urgency, the detailed proposal inclusive of the Bill of Quantities and any other data in support of the price proposal”.

3.12 On the 14th May 2013, the Permanent Secretary received “an elemental breakdown” of the \$27.85 million but no evidence was seen that a cost breakdown for the \$18 million was received from the Developer. By this time, according to the evidence seen, the contract had been signed and the project had already commenced on 1st April 2013. The Ministry of Finance had not yet commented on the price escalation, nor identified the source of funding from which the NHC would have met its obligations to the Developer. Therefore, the Permanent Secretary’s efforts to reconcile the cost increase were frustrated.

3.13 This was the state of affairs which existed when Cabinet was asked to approve a price increase from \$18 million to \$27.85 million. The Cabinet was also informed that the contract for the project had already been signed and, in its decision on the 30th May 2013, agreed to the price increase from \$18 million to \$27.85 million.

Comparison of Amount approved by the Board with the Developer’s Proposal

3.14 A summary of the project costs is as follows:-

GROTTO HIGH RISE UNIT PROJECT

Description	Approved by the Board \$	Developer’s Proposal \$	Difference \$
Site Preliminaries		2,300,000.00	
Building 1		3,190,000.00	
Building 2		3,190,000.00	
Building 3		3,190,000.00	
Building 4		3,190,000.00	
Building 5		3,190,000.00	
External and Infrastructure Works		3,000,000.00	
Sewage systems and waste water plant		1,750,000.00	
Finance and Legal Fees		2,150,000.00	
Design Consultants		750,00.00	
Overheads and Profit		1,950,00.00	
	18,000,000.00	27,850,000.00	9,850,000.00

Reduced Parking Spaces

3.15 The contract had stipulated that eighty-four (84) parking spaces should be provided at the Grotto High Rise complex. According to the “elemental breakdown” provided by the Developer, the cost of providing carparks and driveways was \$856,919 for eighty-four (84) parking spaces. There was an approved reduction of car parking spaces to forty-three (43); however, no evidence was seen of a related adjustment to the cost of the project as a result.

Audit Comment

3.16 There was an absence of adequate information on the Grotto project. In the first instance, it was not clear where the \$18 million originated. This amount was included in the papers submitted to and approved by the Cabinet and the Board of the NHC in 2011. However, there was no documentation seen from the Developer for \$18 million. When asked to provide a reconciliation the Developer indicated that the price had increased from \$25.9 million as per his original proposal to \$27.85 million; however no proposal was seen for the \$25.9 million.

3.17 Before the Permanent Secretary could receive clarity on the matter, or before the Cabinet or the NHC Board could approve the variation, the contract was signed. This was a most unsatisfactory state of affairs as it circumvented the authority of the accounting officer to carry out a proper review and analysis of the variations to justify the increase in cost of the project submitted to the Cabinet of Barbados.

CHAPTER 4

Financing of the Projects

The Corporation signed finance agreements with the Developer for the two (2) projects. A Bank provided loans to the Developer and the Government of Barbados was the Guarantor. Under Clause 4 of the Contracts, the Developer was to complete the apartments and the NHC was to pay the full cost fourteen (14) days after the issue of the Certificate of Practical Completion.

4.2 It was originally envisaged by the Corporation that a \$65 million loan would be obtained to finance the projects under the Joint Partnership Program but this financing option was not pursued. No funds were budgeted by either the National Housing Corporation or the Ministry of Housing to meet the financial obligations of these Projects. This resulted in the Ministry of Finance having to source funding for both projects.

Valarie Project

4.3 On receipt of the invoice for payment from the Developer for the Valerie Project in July 2012, the Corporation wrote to the Ministry of Housing and indicated that it was in no position to pay the sum required to meet its financial commitment to the Developer. Therefore, the Corporation sent the invoice to the Ministry of Housing to be forwarded to the Ministry of Finance, since a guarantee was provided from that Ministry for the project.

4.4 It should be noted that the payment due to the Developer was not made within the stipulated time of fourteen (14) days after receipt of the Certificate of Practical Completion. As a result, the Corporation incurred an interest penalty of \$240,000.

4.5 On 23rd May 2013, the Ministry of Finance paid \$23.58 million plus the interest penalty for the Valerie Project. This was seven (7) months after the Certificate of Practical Completion was issued on 1st October 2012. Proceeds from the sale of Government's remaining shares in the Republic Bank (Barbados) Limited were used to make the payment.

Grotto Project

4.6 The payment for the Grotto Project was not made in accordance with the agreement. On the 14th October 2014, the Developer submitted a Certificate of Practical Completion which required the full payment of the contract price of \$27.85 million. There were no funds immediately available to facilitate the payment due to the Developer.

4.7 Subsequently, financing was obtained from the Housing Credit Fund held by the Central Bank of Barbados, through the declaration of a \$30 million dividend to the Government of Barbados. The payments were made in two (2) installments: \$24.215 million was paid in March 2015, and \$3.635 million was paid in July 2015. As a result of the delays in payment to the Developer, an amount of \$784,746 was incurred as interest penalty.

Charge on the Housing Credit Fund

4.8 The Housing Credit Fund (the Fund) was established 'for the purpose of providing funding, through financial intermediaries and other approved financial institutions, to assist in the provision of housing for lower and middle income households in Barbados in order to broaden the ownership base in Barbados'. With effect from the 11th March 2010, the Governor of the Central Bank was appointed Trustee of the Fund.

4.9 Under the Trust Deed which established the Fund, the Governor of the Central Bank, as Trustee, has the right to advance funds to the Government only if the fund is terminated, and only then the Government is entitled to a proportionate part of the Capital that it had subscribed to the Fund.

4.10 The Corporation wanted to borrow from the Fund to finance the Grotto project, with the Government as a guarantor. However, NHC did not qualify to borrow funds, because it was neither a financial intermediary nor other approved financial institution, as required by the legislation governing the Fund.

4.11 It should be noted that a legal opinion on the matter was sought and it noted that Government could not be considered as a shareholder since there are no shareholders under the Trust Deed. The opinion further stated “The Trust Deed ... only allows for the transfer of assets from the Fund to Government on the Termination of the Fund. As the Fund was not terminated, the transfer of \$30 million from the Housing Trust Fund to the Government cannot be substantiated in law”.

Audit Comment

4.12 The NHC has been facing financial challenges for a number of years and projects such as the building of the high rise apartment units would require a loan or an injection of capital by the Government. Arrangements could also have been made in which the Developer was paid in installments over some period of time as is the usual case with Public Private Partnership arrangements. Since payment in full for each project was due on the presentation of the certificate of practical completion, it was the responsibility of the NHC and the Ministry of Housing to ensure that funds were included in the estimates for the purpose of paying the Developer or that some other arrangements for payment were put in place.

4.13 The lack of financial planning for these projects resulted in challenges in paying the Developer on their completion. In addition, it resulted in over \$1 million in interest penalties as a result of the delayed payments.

CHAPTER 5

Completion of Projects

Both projects were completed within the time frame as provided under the contractual agreements. The Valerie project was completed within seventeen (17) months whereas the Grotto Project was completed within eighteen (18) months.

5.2 Even though all the units were built within the time frame, the increase in the cost on each project, when viewed from the original approval, would have impacted negatively on the NHC's ability to provide these units to lower income earners without substantial subsidization.

Rental Rates

5.3 The Board of the NHC set the time-period for recovering the cost of construction of the units in the Urban High Rise Program at thirty-five (35) years. In respect of the Valerie Project, the management of NHC recommended that the rental rate be set at \$758.94 per month based on the recovery of the construction cost for seventy-two (72) units (\$318,756 per unit) over the period of thirty-five (35) years. It should be noted that the cost recovery did not include the acquisition cost of the land which was \$400,000 (purchase price in 1980's), a variation cost of \$630,000, and the interest penalty of \$240,000. The rental rate was set by the Board at \$700.00 per month, which was below the rate which the Management had recommended.

5.4 The Grotto Project comprised of eighty (80) units built at a total cost of \$27.85 million, or \$348,125 per unit. The NHC estimated that the monthly rental charge for these units would be around \$828.87, using the thirty-five (35) year cost recovery method. This cost did not include the acquisition of the two (2) parcels of land at \$6.766 million which represents an additional \$84,581 per unit, nor did it include the interest penalty of \$784,746. These additions would result in the average cost per unit exceeding \$400,000.

5.5 The Corporation had indicated that the reason for building the units was to provide housing for those persons with lower income and such properties fall within a range of \$125,000 to \$195,000. However, the units that were completed fell within a much higher range. At the conclusion of the audit, no determination had been made as to whether the Grotto units would be placed on the market for sale or rented to lower income earners.

5.6 The challenge faced by lower income earners to pay the subsidized rental rate at the Valerie High Rise Apartment Units is a cause for concern. This is evident from the fact that forty-five (45%) of the tenants were in arrears at January 2016. If the same approach for determining the rental rate for Valerie is used for the Grotto project, it is expected that the resulting rate will be a challenge for lower income earners renting at the Grotto given the higher construction cost.

Corporation's Response

It must be noted that at the 31st March 2016, 11% of the tenants at Valerie are in arrears. This represents a decline of 20% from January 2016. The Corporation has made an effort to collect outstanding arrears in these units and its efforts are bearing fruit.

5.7 The Corporation's response is not supported by the information it provided to the Audit Office which indicated that arrears was forty-eight percent (48%) at 31st March 2016.

Impact of Transfer of Ownership Legislation

5.8 Current legislation allows National Housing Corporation tenants to purchase their rental units if they satisfy certain terms and conditions. The legislation states that the tenant should have 'good financial standing with the Corporation in respect of the unit; ...resided in the unit for 20 years or discharged the obligations of the tenant for that period; and will pay such legal fees and expenses that are connected to the transfer.'²

5.9 The Corporation has a number of areas where it has built high rise rental units, and it is seeking to recover the construction costs on these units over a thirty-five (35) year rental period. This legislation hereinbefore mentioned has no restrictions on which tenants from which areas are allowed to seek transfer of ownership after twenty (20) years. In this regard, it is not clear why a thirty-five (35) year payback period was chosen, since tenants are entitled to apply for transfer of ownership after twenty (20) years.

Corporation's Response

The National Housing Corporation (Transfer of Terrace Units) Act 2013 gives the NHC the discretion to transfer ownership of its legal estate to tenants that satisfy its terms and conditions. The use of the word "may" in Section 3 (1) of the Act gives the NHC this discretion. It therefore means that the NHC can determine which legal estates will fall within the scope of this legislation.

Secondly, Section 6 (1) of the Act gives the Minister responsible for Housing and Lands the authority to make regulations for the purpose of regulating the procedure and practice of this Act.

² National Housing Corporation (Transfer of Terrace Units)Act 2013,section 3(1)(a)(i)(ii)(iii)

NHC's position is that it does not follow that this legislation means that all legal estates of the NHC will automatically fall within the scope of this legislation. NHC has to determine whether the high rise units will fall within the scope of the legislation.

Legal Fees

5.10 The National Housing Corporation engaged the legal services of an Attorney-at-Law (the Attorney) to provide advice on the Condominium Act and contract services on Urban High Rise Apartment Unit Projects. The Attorney billed the Corporation for \$741,581.15, which he subsequently reduced to \$500,000 after concerns were raised by the Corporation. The Corporation was still not satisfied and continued negotiations with the Attorney for further reductions, until agreement was finally reached for an amount of \$50,000, which was said to be acceptable to both sides.

5.11 The NHC has a legal team in place which provides advice to the Board and Management. In this instance, it sought the advice of a private attorney but without any agreement on the likely cost. Such an agreement should have been pursued before the services were acquired. The difference between the original and final billings should be a cause for concern for the Corporation on how it acquires services.

Corporation's Response

The Corporation engaged external counsel to prepare the form of contract required for the Joint Partnership as the same would need to comply with the Condominium Act in the event of sale of the units. It was envisaged that the form of contract used at Valerie would be the template for other high rise developments of the NHC including the Grotto and Exmouth projects. This would avoid the need to incur legal fees for other projects.

Conclusions

5.12 There were a number of issues which came out during this review, some of which contributed to the Corporation not being able to provide housing for lower income earners in a cost effective manner through the Valerie and Grotto projects. These issues include:

- i. poor financial state of the Corporation;
- ii. high construction costs per unit relative to the cost range set for low income housing;
- iii. poor financial planning;
- iv. lack of regard for the role and responsibility of the Board by the Ministry;
- v. absence of proper analysis before decisions were made; and
- vi. failure to follow prudent procurement procedures.

5.13 The poor financial state of the Corporation prevented it from being able to finance these projects. This resulted in the Corporation having to seek financing from Central Government to pay the Developer. Careful consideration therefore needs to be given in relation to any future construction unless adequate sources of financing are available.

5.14 One of the main aims of these projects was to provide affordable housing for lower income earners. However, the overall construction costs have resulted in the cost per unit being above the price range designated by the Corporation for lower income earners. This shortcoming could have easily been revealed with a simple financial analysis of the Developer's estimated construction costs.

5.15 After the initial plan to borrow money to finance these projects was not pursued, no further plan for the payment of the Developer was initiated until the project was nearing completion. The Corporation did not have the required finances, nor were the amounts budgeted for from the Consolidated Fund. As a result, the Corporation and the Government were presented with challenges in paying the Developer in a timely manner.

5.16 Important decisions were taken without the prior approval of the Board. One of these decisions involved the Ministry of Housing bypassing the Board and submitting proposals directly to the Cabinet. The Ministry of Housing should not presume to act on the Corporation's behalf where the authority has been vested in the Corporation.

5.17 The Valerie and Grotto projects were characterized by poor decision making. For example, there was no evidence that the proposals for these projects were subjected to the relevant technical and financial assessment prior to decision making. In light of its financial position, the Board did not give sufficient consideration to the implications of accepting bids which promised upfront financing but required payment in full immediately after construction. It was not financially prudent for this Corporation and the Ministry to act in such a manner which resulted in large interest penalties as this did not serve the Public's interest.

5.18 The procurement procedures employed in relation to these projects did not afford the Corporation the opportunity of obtaining the best arrangement the market had to offer in terms of price and quality. As a result, the reasonableness of the amounts quoted by the contractor could not have been assessed using other proposals.

Recommendations

5.19 There are several areas in which improvements can be made to the procurement and construction activities undertaken by the Board of the National Housing Corporation.

- i. The Ministry must respect the role and mandate of the Corporation, and no proposals should be sent to the Cabinet involving the Corporation unless they have been approved by the Board.
- ii. Proposals received should be subjected to technical and financial analysis before being presented to the Board.
- iii. The Board should not undertake projects unless they are deemed to be cost effective and meet the Corporation's policy objectives.
- iv. The Board of the National Housing Corporation must put measures in place to ensure that procurement procedures as prescribed by legislation are followed.
- v. Persons responsible for disregarding the views of the Board and the Cabinet should be held to account.
- vi. The Board should carefully examine its approach in providing lower cost housing.
- vii. The Board should ensure that adequate financing is available prior to the start of each new housing project.