



OFFICE OF THE PUBLIC AUDITOR

**Guam Housing Corporation
FY 2005 Highlights**

May 8, 2006

The Guam Housing Corporation (GHC) is continuing to make financial progress. For the third year, the Corporation saw an increase in net assets. In 2005, the increase in net assets was \$902,000. This is a 43% increase from the 2004 increase in net assets of \$630,000. These gradual improvements underscore the progress GHC has made since implementing a cost restructuring plan in 2001.

Operating revenues were \$3.2 million, a decrease of \$318,000 or 9%. However, operating expenses also decreased \$401,000 or 14%, to \$2.6 million. The lower operating expenses can be attributed to a 93% decline in the Housing Division's bad debt expense, a decrease of \$473,000 to \$38,000. Housing Division salaries, wages and benefits expense increased 14%, or \$95,000 from the previous year to \$781,000, and one additional staff member was hired. In addition, the Housing Division's depreciation expense rose 127% to \$38,000. These increases were offset by the large decrease in bad debt expense.

Interest from mortgage loans, the Corporation's largest source of revenue was \$2 million. This was a decrease of 11% due to a declining loan portfolio. Loans totaling \$1.6 million, or 44 loans, were paid off in FY2005. The loan payoffs created an increase in the Housing Division's cash to \$8.7 million, and consequently a notable 436% increase in interest income on bank deposits to \$129,000.

During FY2005, GHC issued \$734,000 in new loans compared to only \$141,000 in FY2004. However, GHC continues to confront challenges inherent in its function as a mortgage lender to individuals who are not able to qualify as borrowers through conventional means, and its exposure to default risk is considerably higher than that of traditional mortgage lending institutions.

The Housing Division has improved its loan servicing by hiring a collections officer and stepping up its collection efforts. Loan receivables outstanding for more than 90 days have decreased to \$4.3 million, representing 17% of the Corporation's total loan portfolio, compared to \$5.4 million, representing 19% of the portfolio in the prior year.

The value of foreclosed assets has increased over the last three years. Foreclosed assets increased from \$528,000 in 2003, to \$1.7 million in 2004, and increased by 42% to \$2.4 million in 2005. Although the resale of the foreclosures also increased 148% from the prior year, more aggressive action should be taken to sell non-interest earning foreclosed properties.

In FY 2005, GHC continues to report an outstanding liability of \$10.6 million associated with the design and build of off-site infrastructure for the Lada Estates project. The contractor is suing for the payment of \$10.6 million plus accrued interest of \$5.9 million. The Corporation's legal

counsel believes that the contractor's claim is not valid pursuant to the terms of the contract and under Guam Law. As of September 30, 2005, the matter remains unresolved.

The Rental Division has become increasingly significant to the operations of GHC, with the division's rental income comprising a quarter of the Corporation's total operating revenues in 2005. The Rental Division's net earnings rose to \$231,000 from \$141,000, a 64% increase from last year. Division operating expenses declined nominally.

The auditor's report on compliance and internal controls revealed 12 findings, of which six are noted as material weaknesses and six are repeat findings. The material findings include:

In Finding 05-01, 15 loans totaling \$1.4 million were outstanding in excess of 90 days, and were pledged as collateral with the Federal Home Loan Bank of Seattle. It was found that the Corporation did not adhere to procedures for identifying and servicing delinquent loans in a timely manner, and that its policies and procedures may still be ineffective. This same condition was found in FY2004 and FY2003.

In Finding 05-02, loans in arrears three months or more represent 17% of the Corporation's loan portfolio. While these delinquent loans comprise less of the loan portfolio compared to 2004, the composition is still large and the Corporation can incur material losses if more regular monitoring of current receivables is not implemented.

Finding 05-07 indicates that the Corporation had advanced funds on behalf of the borrowers for the disbursements of hazard insurance and real property taxes, reducing the mortgage loan trust fund balances to as much as \$12,700 owed to the Corporation. This same condition was found in FY2004 and 2003.

In Finding 05-11, the Rental Division did not maintain recertification forms in tenant files, nor was there other evidence to indicate that tenants were properly recertified to reside in the units. The Rental Division conducts recertification of tenants to verify continuing ability to pay rent, or eligibility to participate in the housing program. This same condition was found in FY2004.

In Finding 05-12, several of the tenant files in the Rental Division did not contain income verification to participate in the housing program. The potential exists for the Corporation to incorrectly determine eligibility and tenant monthly rent. This same condition was found in FY2004.

Additional findings for the Housing Division indicate that a Guam Housing Corporation employee loan was pledged as collateral to the Federal Home Loan Bank of Seattle, some loans did not have typhoon insurance coverage, and that GHC has not pursued a receivable of \$2.9 million due from the Government of Guam.

See the Management's Discussion and Analysis (MD&A) for further details.