Auditor General's Department
Performance Audit Report

Jamaica Mortgage Bank (JMB)
Management of Construction Loan Portfolio

The Auditor General is appointed by the Governor General and is required by the Constitution, Financial Administration and Audit Act, other sundry acts and letters of engagement, to conduct audits at least once per year of the accounts, financial transactions, operations and financial statements of central government ministries and departments, local government agencies, statutory bodies and government companies.

The Department is headed by the Auditor General, Pamela Monroe Ellis, who submits her reports to the Speaker of the House of Representatives in accordance with Section 122 of the Constitution of Jamaica and Section 29 of the Financial Administration and Audit Act.

This report was prepared by the Auditor General's Department of Jamaica for presentation to the House of Representatives

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Auditor General Overview

One of the main objectives of the Jamaica Mortgage Bank (JMB) is to finance housing developments island-wide through the mobilization of loan funds for on-lending to developers and other financial institutions. As such, JMB provides construction financing loans to developers, whose project proposals meet the Bank's housing guidelines. As at March 31, 2016, JMB's loan portfolio totalled $1.7 billion (including allowance for impairment losses), of which $970 million (or 57 per cent) was outstanding for over one year.

The performance audit was undertaken to determine whether JMB was managing its loan activities efficiently and effectively, in order to execute its mandate of facilitating affordable housing solutions for Jamaicans. Our audit focused on JMB's loan approval and monitoring processes including the conduct of due diligence and activities following loan disbursement.

We noted instances of inconsistent application of JMB's loan policy between 2003 and 2015, which may have contributed to the high level of non-performing loans (NPL). NPLs averaged 68 per cent of total loan portfolio over the six-year period FY 2010/11 to 2015/16. We noted that although there was a trend decline in non-performing loans, performing loans also declined over the period. The stock of NPLs at March 31, 2016 was however, $1.2 billion (57 per cent) lower when compared to the stock of NPL at March 31 2009, but the reduction was mainly due to settlement arrangements with delinquent borrowers, which resulted in write-off of $165.2 million and potential losses totalling $225.2 million representing the difference between the fair value and the recorded cost.

JMB in response to our concerns indicated that its non-performing loans are sufficiently collateralised. However, the accumulation of such assets should be of concern to the JMB and the Government, as JMB may be left holding assets which may prove difficult to liquidate. Further, evidence suggests that in the event that the assets are indeed disposed of, JMB may not realize the full value of the loans.

JMB should consider the recommendation contained in this report in order to improve its governance practices and strengthen its loan approval and monitoring processes.

I wish to thank the management and staff of JMB for the courtesies extended to my staff during the audit.

Pamela Monroe Ellis, FCCA, FCA, CISA
Auditor General

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FACT SHEET

- **67%** Stock of non-performing loans: $1.2 billion as at March 31, 2016
- **$165M** Write off due to settlement with delinquent borrowers
- **$225M** Potential losses on past due loans (difference between fair value and recorded costs)
- **$237M** Loans to acquire land contrary to JMB policy
- **$74.8M** Loans to liquidate debt with commercial bank contrary to JMB policy

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Executive Summary

Jamaica Mortgage Bank (JMB) was established in 1971, as a private limited company under the Companies Act of 1965 with an authorized share capital of $5 million. In June 1973, by way of an Act of Parliament, JMB was converted to a statutory corporation. JMB's mandate is to finance safe and affordable housing so that all Jamaicans will have access to home ownership. Accordingly, JMB mobilizes resources for on-lending to developers and other financial institutions. As at March 31, 2016, JMB had borrowings totalling $955 million, while loans receivables totalled $1.7 billion.

The performance audit was undertaken to determine whether JMB was managing its loan activities efficiently and effectively, in order to execute its mandate of facilitating affordable housing solutions for Jamaicans. Our audit focused on JMB's loan approval and monitoring processes including the conduct of due diligence and activities following loan disbursement.

In our Annual Report 2008/09, we reported that *"the Bank's accounting records revealed outstanding loans totalling $2.7 billion on twenty-four (24) projects as at March 31, 2009"*. At March 2016, four of the 24 projects previously reported, had outstanding loan balances totalling $591 million.

Our Performance Audit was conducted from May 2016 to August 2016 and covered the period FY2010/11 to FY2015/16. However, this report includes an assessment of the steps taken by the Bank to recover loans, approved as far back as 2003, which are non-performing loans as at March 2016. The key findings and recommendation are outlined below.

Key Findings

JMB'S NON-PERFORMING LOANS AVERAGED 68 PER CENT OF ITS TOTAL LOAN PORTFOLIO

1. JMB non-performing loans (NPLs) averaged 68 per cent of the total loan portfolio over the six-year period FY 2010/11 to 2015/16. The stock of NPLs at March 31, 2016 was $438.2 million (27 per cent) lower when compared to the stock of NPL at March 31, 2011. However, the reduction was due mainly to settlement arrangements with delinquent borrowers, which resulted in write-off of $165.2 million and potential losses totalling $225.2 million, representing the difference between the fair value and the recorded cost. The continuing high level of NPLs implied that JMB might not have maximised the efficiency of its pool of loanable funds, thereby undermining its ability to deliver on its mandate to foster the development of affordable housing solutions for Jamaicans. Further, inability to collect on NPLs represents an opportunity cost, as interest lost could have been invested in other loans or financial instruments.

INCONSISTENT STANDARDS APPLIED TO LOAN APPROVALS

2. JMB did not consistently assess the financial and technical capabilities of developers to meet their obligations under the respective loan agreements. JMB's Board and Management inconsistently applied its loan policy and did not conduct adequate due diligence in all instances prior to loan

approval. Review of Board Minutes revealed no evidence of discussions where the Board approved the deviation from policy. This was evident in the approval of five loans totalling $453.3 million, which did not result in the provision of any housing solution, thereby undermining its effectiveness in delivering on its core mandate.

Loan for Land Acquisition - $77.1 million

3. In February 2015, JMB approved a loan of $77.1 million to provide financing for the acquisition of 76.7 acres of land in Clarendon, without fully assessing the financial capacity of the Developer to repay the loan. JMB's Management Submission to the Board indicated that the Bank was approached to assist with the acquisition of the development lands "**as time was of the essence**" in the transaction and investment funds being raised by the Developer, would only become available after the deadline for closing the transaction. Review of Board Minutes for February 2015 revealed that the Chairman and other board members had indicated that they were uncomfortable in making a rushed decision. However, the senior officer of the Bank informed the Board that Management "*would not be compromising the due diligence process and that he, at this juncture, was comfortable with all the information submitted and the management felt sufficiently comfortable to make the recommendation"*.

The Developer has since failed to repay the loan. JMB indicated that the Bank holds ample security as the latest appraisal of the land dated June 30, 2016, indicated a value of $130 million to $140 million, and the Bank expects *full recovery from sale of the lands under the powers of its mortgage*. However, we noted a 40-45 per cent diminution in value, in a context where the appraised value was $235 million at July 2014.

Loan for Land Acquisition - $160 million (US$1.45 million)

4. In June 2014, JMB approved a loan of $160 million (US$1.45 million), representing 84 per cent of the purchase price, to a developer, to complete the acquisition of 255 acres of land for residential development. JMB records showed that the land was being sold under the powers contained in a mortgage by a debt recovery company. JMB's Board Submission noted that "**in the interest of time"**, the Bank was treating with the acquisition ahead of the project development aspect on the understanding that the completed proposal for financing the infrastructure works would be submitted to the Board by July 2014. Accordingly, JMB only conducted a preliminary financial assessment of the proposed project and deferred the conduct of a detailed analysis to the July 2014 Board meeting, which was approximately one month after the loan was approved. To date, the Developer has neither provided any financial proposals nor commenced infrastructural works and as at March 2016, the amount owed was $176.76 million.

Recommendation

In accordance with its fiduciary responsibilities, JMB should improve its loan management practices. This could facilitate greater control over loan approval and disbursement processes and reduce the incidence of non-performing loans to improve JMB's effectiveness in fostering the development of affordable housing island wide.

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Part One

Introduction

Background

1.1 The Jamaica Mortgage Bank (JMB) was established in 1971, as a private limited company under the Companies Act. The Bank was converted to a statutory corporation by the enactment of the Jamaica Mortgage Bank Act on June 5, 1973[1]. JMB's mandate is to finance safe and affordable housing so that all Jamaicans can have access to home ownership.

Function of JMB

1.2 Section 4 of the JMB Act states that it shall be the duty of the Bank to:

- foster the development of housing;
- directly or indirectly to assist societies registered under the Co-operative Societies Act to develop co-operative housing; and
- develop an active mortgage market.

1.3 Section 5 (2) of the JMB Act further states that in carrying out its duties, the Bank may:

a) guarantee loans made from private investment sources for building development;
b) sell investments of whatever kind belonging to the Bank as and when appropriate;
c) lend money on security to be used for the construction of premises for private residential purposes or of a commercial or industrial nature;
d) lend money on mortgage and carry out any other transactions involving mortgages;
e) furnish financial advice and provide or assist in obtaining managerial, technical and administrative services for persons engaged in building development in Jamaica.

1.4 JMB's Construction Financing Policy[2] requires that each loan be assessed to ensure that the proposed project meets established criteria. This involves detailed analysis of the viability of the proposed projects and assessment of the developer's experience. The general criteria include project proposal, bill of quantities, construction schedule and approval from the required regulatory bodies, including local authorities. Project proposals must demonstrate an excellent probability of units being sold before the completion of construction. The project assessment includes a technical evaluation, a financial evaluation and a legal review of the issues surrounding the project. To obtain financing, project proposals of prospective developers must meet JMB's housing guidelines, and the developer must be knowledgeable about the housing sector, have a good track record and be able to fund 20 per cent of the total development cost.

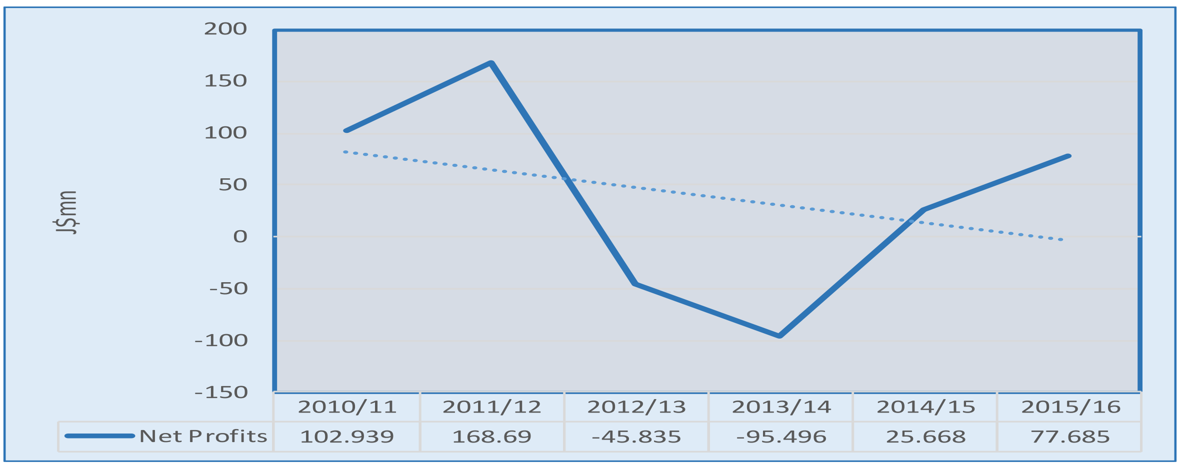
[1] In this report, the term 'the Bank' is also used in reference to Jamaica Mortgage Bank
[2] Revised February 2014

JMB's Financial Performance

1.5 The JMB Act authorises the Bank to utilise funds for financing the construction of premises for private residential, commercial or industrial purposes. JMB earns interest on such loans to developers and other lending institutions. JMB also generates revenue from short-term investments as well as, commitment and administration fees payable on loans disbursed. As at March 31, 2016, interest earned on JMB's loan portfolio accounted for 45 per cent of earnings.

1.6 A review of JMB's financial statements for 2010/11 to 2015/16 showed that the Bank recorded net profits for four of the six years. Of note, JMB's net profit amounted to $77.7 million in 2015/16, which reflects an improvement relative to previous year, but was lower than profits recorded for 2010/11 and 2011/12. JMB experienced losses of $45.8 million and $95.5 million for the financial years 2012/13 and 2013/14, respectively (**Figure 1**).

Figure 1 Net Profit/Loss for the period April 2010 to March 2016



Source: AuGD analysis of JMB Audited Financial Statements

1.7 As at March 2016, JMB's assets totalled $2.6 billion, representing a 13.2 per cent decrease below the previous year ($3.03 billion). Loan receivables and land held for housing development represented 60 per cent of total assets. Section 9 of the JMB Act, grants the Bank the authority to borrow funds for meeting any of its obligations or discharging any of its functions. JMB's liability as a percentage of total assets improved, falling to 39 per cent as at March 31, 2016 from 55 per cent as at March 31, 2010.

Table 1: Liabilities / Total Assets

	2015/16	2014/15	2013/14	2012/13	2011/12	2010/11	2009/10
Total Liabilities ($'000)	1,014,718	1,498,453	1,267,794	1,529,644	1,529,356	1,058,517	1,716,370
Total Assets ($'000)	2,631,230	3,029,922	2,922,229	3,136,890	3,182,828	2,543,299	3,098,213
Liability as a percentage of total assets[3]	**39%**	**49%**	**43%**	**49%**	**48%**	**42%**	**55%**

Source: AuGD analysis of data provided by JMB

1.8 Bonds and loan payables comprised three Shelter Bonds totalling $900 million and a loan of $50 million from the National Insurance Fund, as at March 31, 2016. Of this amount, $750 million (79 per cent) is due before March 2017. As at March 31, 2016, construction and mortgage loans to 21 developers totalled $1.7 billion, of which 57 per cent ($970 million) was outstanding for over one year; 13 per cent ($211 million) for over 90 days; 30 per cent was current.

Audit Scope and Methodology

1.9 The performance audit was undertaken to determine whether JMB was managing its loan activities efficiently and effectively, in order to execute its mandate of facilitating affordable housing solutions for Jamaicans. Our audit focused on JMB's loan approval and monitoring processes including the conduct of due diligence and activities following loan disbursement. The Performance Audit was conducted from May 2016 to August 2016 and covered the period FY2010/11 to FY2015/16. However, this report includes an assessment of the steps taken by the Bank to recover loans, approved as far back as 2003, which are non-performing loans as at March 2016. The audit was planned and conducted in accordance with the Government Auditing Standards, which are applicable to Performance Audit and issued by the International Organization of Supreme Audit Institutions (INTOSAI). Our assessment is based on the review of internal and external documents, interviews with senior management and staff, observations and analysis of information provided by JMB.

[3] Liability-to-Assets – refers to the ratio of an entity's liability to total assets

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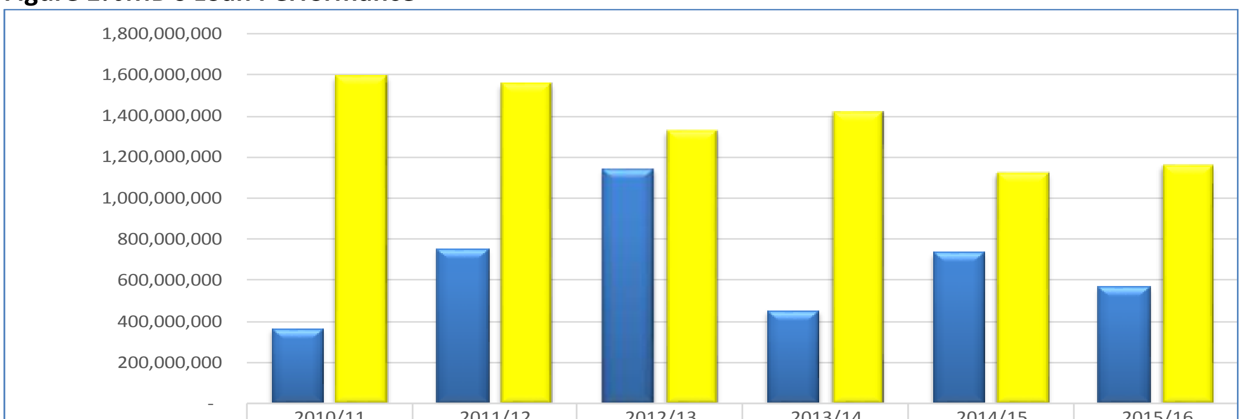
Part Two

Loans Management

JMB's non-performing loans averaged 68 per cent of its total loan portfolio for the last six years

2.1 In our Annual Report (2008/09), we indicated that 24 project loans had outstanding balances amounting to $2.7 billion as at March 31, 2009. NPLs accounted for $0.9 billion or 35 per cent of total loan balances[4]. In 2014, JMB introduced a Risk Metrics methodology to evaluate the viability of projects and the financial position of developers to improve the quality of the Bank's loan portfolio. Despite this action, the stock of NPLs increased by 2.8 per cent to $1.2 billion (67 per cent of total loans) at March 31, 2016, relative to March 31, 2015 **(Figure 1)**.

Figure 1: JMB's Loan Performance



	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Performing	361,846,639	752,265,487	1,143,372,254	448,885,645	732,053,467	565,026,636
Non-Performing	1,593,566,872	1,558,265,525	1,324,767,254	1,417,985,089	1,123,951,642	1,155,323,583

Source: AuGD analysis of data provided by JMB

2.2 Further, we noted that JMB's Board and Management inconsistently applied its loan policy, and in some instances, did not conduct adequate due diligence, thereby contributing to continued deterioration in the quality of the loan stock. The Bank approved six loans totalling $800.1 million to which the loan policy was not consistently applied. One loan was approved with the required feasibility study, another was approved with restrictive covenant on the Certificate of Title, while four loans were approved to clear debt and acquire land. We noted that five ($453.3 million) of the six loans approved, did not result in the provision of any housing solution, thereby undermining the Bank's effectiveness in fostering the development of affordable housing island wide.

2.3 Although the stock of NPLs at March 31, 2016 was $1.2 billion (57 per cent) lower when compared to the stock of NPL at March 31 2009, the reduction was mainly due to settlement arrangements with

[4] Analysis based on JMB's audited financial statement as at March 31, 2009

delinquent borrowers. JMB also projected that it could suffer losses amounting to $225.2 million (principal and interest) in respect of five NPLs[5] after accounting for expected proceeds from the sale of the related collateral **(Figure 2)**.

Figure 2: Expected Loan Losses ($) at March 31, 2016

Loans	Loan Approved	Loan Amount Disbursed	Loan balance as at March 31, 2016	Expected Proceeds from sale of collateral	Expected Loss
Loan No. 1	239,000,000.00	204,002,229.00	213,850,263.38	138,650,000.00	75,200,263.38
Loan No. 2	300,000,000.00	300,000,000.00	346,812,613.99	346,812,613.99[6]	0.00
Loan No. 3	45,000,000.00	44,836,797.00	88,694,296.53	0.00[7]	88,694,296.53
Loan No. 4	200,000,000.00	37,651,392.00	51,886,769.53	22,500,000.00	29,386,769.53
Loan No. 5	60,000,000.00	49,156,023.00	25,060,168.90	7,500,000.00	17,560,168.90
Loan No. 6	60,000,000.00	60,000,000.00	73,591,431.37	59,200,000.00	14,391,431.37
Total	**904,000,000.00**	**695,646,441.00**	**799,895,543.70**	**574,662,613.99**	**225,232,929.71**

Source: AuGD analysis of data provided by JMB

Inconsistent standards applied to loan approvals

2.4 Section 4(2)(a) of the Jamaica Mortgage Bank Act states that the Bank shall in the performance of its duty '*have regard to the financial standing of every applicant and to the financial and economic merits of every scheme proposed'.* However, JMB did not always undertake adequate due diligence, prior to the approval of loans by the Board. Best practice dictates that proper due diligence should be conducted prior to the approval and disbursement of the loan.

2.5 The evidence suggests that JMB's Board and Management approved loans without properly assessing the financial and technical capabilities of developers to meet their contractual obligations. We noted instances where loans were approved to clear debt obligations and to acquire land contrary to established guidelines, without clear justification. Section 3.23 of the Construction Financing Policy states:

… no loan disbursement shall be made for categories such as land, design fees, legal fees, developers overhead and profit, save and except in circumstances where payment of these cost are deemed necessary by the bank.

Land Acquisition Loan - $77.1 million

2.6 In February 2015, JMB approved a loan of $77.1 million to provide financing for the acquisition of 76.7 acres of land in Clarendon, without fully assessing the financial capacity of the developer to repay the loan within three months. We noted that the developer's company was incorporated in January 2015, approximately one month prior to JMB's Board approval of the loan. JMB's Management Submission to

[5] Six Loans totalled $695.6 million, including principal and outstanding interest.

[6] JMB reported that the amount is expected to be collected based on a summary judgement against the developer and global freezing order of all bank and investment accounts.

[7] Valuation reports to determine market or force sale value of property outstanding

the Board indicated that the company was *'seeking to forge a borrowing relationship with JMB to support its first foray into land acquisition which should also allow it to transition into residential development'*. JMB records indicated that the former owners had obtained subdivision approval from the Clarendon Parish Council to construct approximately 535 middle income homes. However, the Developer (purchaser) indicated an intention to *'seek fresh approval in its name and to increase the number of units to 570*'.

2.7 We noted that JMB assessed the net worth (£690,000) and income (£41,861 for 2014) of the principal director. While the assessment of the net worth and income of the principal director is useful, we did not see an assessment of available disposable income (after adjusting for expenses); the ability to liquidate personal assets and the amount of capital invested in the newly formed company. Further, we saw no evidence that the principal developer's experience in executing real estate developments was verified. In a letter dated January 15, 2015, a senior officer of the Bank indicated that the acquisition of land to provide housing solutions was not its usual course of business. The officer indicated that this arrangement was accommodated in only few instances where there was a clear housing development plan in place. The required development plan was not presented.

2.8 JMB's Housing Guidelines stated that developers must be knowledgeable about the housing sector, have a good track record and be able to fund 20 per cent of the total development cost. In August 2016, JMB indicated that *'since the Board is the body that approves policy, it also has the authority to waive or vary established policy positions'.* However, review of Board Minutes for February 2016 revealed no evidence that the Board discussed and approved any deviation from the guidelines in justifying approval of the loan.

2.9 Review of Board Minutes revealed that the Chairman and other board members indicated that they were uncomfortable in making a rushed decision. However, the senior officer of the Bank informed the Board that Management "*would not be compromising the due diligence process and that he, at this juncture, was comfortable with all the information submitted and the management felt sufficiently comfortable to make the recommendation".* On February 26, 2016, JMB's Board approved the loan application with one board member abstaining.

2.10 The Developer subsequently failed to repay the loan within the three months, necessitating an extension to December 31, 2015 and the issuance of a demand letter on March 1, 2016, requiring immediate payment by April 2, 2016. It is clear that the Board may have exercised poor judgement in this matter given the Developer's failure to honour the loan obligation and JMB's failure to exercise its option to call the guarantee, despite identifying income of £41,861 for 2014, when the Developer's eligibility for the loan was assessed. To date, the loan remains unpaid.

2.11 We believe that JMB, in seeking to provide a letter of commitment to the Vendor by the February 28, 2015 deadline, would have denied itself the opportunity to fully explore the Developer's ability to repay the loan, and undertake the proposed housing development on the land. JMB indicated that the Bank holds ample security as the latest appraisal dated June 30, 2016 indicated a value of $130 million to $140 million, and the Bank expects *full recovery from sale of the lands under the powers of its mortgage*. However, we note a 40-45 per cent diminution in value, as JMB'S management, in its submission to the Board in February 2015, indicated an appraised value of $235 million as at July 29, 2014.

Potential Conflict of Interest

2.12 Further, by way of correspondence dated January 13, 2015, the Developer's lawyer, who was also board member of JMB, submitted the Developer's application for loan financing. Board Minutes of February 25, 2015, also revealed that the board member had introduced her client to the Management and outlined the project as "*something the Bank would be interested in*". A senior officer of JMB by way of e-mails dated February 19th and 20th, 2015 brought a potential conflict of interest to the attention of the board member. The board member resigned by way of letter dated February 20, 2015, five days before the Board meeting to consider the loan application. JMB in its response dated November 14, 2016, acknowledged that *in order to avoid this issue arising, the board member decided it would be best to resign from the Board*. Additionally, we noted that this particular applicant was a related party to a board member, which we believe may have influenced the early consideration of the loan application. The Board Minutes (February 2015) noted that the Chairman expressed concern with the application based on the position that the financing of land acquisition fell outside of the policy of the Bank and the matter of how the application came to the Bank. He further expressed that the Bank may not have embraced the application, had it been presented by another party.

2.13 Review of Board Submission (Section 3.0) dated February 17, 2015 indicated that:

…. the consideration sum is US$1.1M (J$122,100,000 for stamp duty purposes) and the deposit of US$10,000 and further payments amounting to US$450,000 have been paid on condition that the Vendor receives a suitable Letter of Undertaking (LU) for the balance purchase price within sixty (60) days of signing. However, the Agreement was not stamped until November 14, 2014, and the Purchaser obtained an extension to the period for presentation of the LU to January 15, 2015, at which time, Notice was served by the Vendors' attorney making "**time of the essence"**.

However, the Purchaser is of the view that if a Commitment Letter were presented to the Vendors' attorney by February 28, 2015 (pending a formal LU) it will provide sufficient assurances that funds are available to close the transaction.

In the circumstances, therefore, we are treating with the acquisition ahead of receipt of a detailed project development proposal on the condition that we will be given a right of first refusal for the financing, and that the proposal will be presented to us within six (6) months of completion of the purchase.

Land Acquisition Loan - $160 million

2.14 In June 2014, JMB approved a loan of $160 million (US$1.45 million), representing 84 per cent of purchase price to complete the acquisition of 255 acres of land for residential development. JMB indicated that the land was acquired with sub-division approval by the Saint Ann Parish Council. Our review of JMB's Management submission to the Board showed that the land was being sold under the powers contained in a mortgage by a debt recovery company.

JMB's Management in its submission to the Board, indicated that:

…the consideration sum is US$1.7M (J$181,900,000 for stamp duty purposes) and the deposit of US$170,000 and further payment of US$85,000 have been paid on condition that the vendor receives a suitable Letter of Undertaking for the balance purchase price within forty-five (45) days of signing (or by 26/6/2014). The purchasers stand to lose US$50,000 of their deposit plus other out of pocket expenses if they fail to meet the deadline and have already obtained an extension to June 26, 2014. In the interest of time, therefore, we are treating with the acquisition ahead of the project development aspect on the understanding that the completed proposal for financing the infrastructure works will be submitted to the Board by July 2014.

2.15 The loan was disbursed in November 2014, and JMB expected that the repayment of the loan would be provided from the proceeds of the sale of lots in the development, once the proposed project was completed. However, JMB only conducted a preliminary financial assessment of the proposed project, which determined sales proceeds of approximately $738 million over a 24-month period. JMB deferred the conduct of a detailed analysis for the next Board meeting slated for July 2014, approximately one month after the loan was approved.

2.16 By way of correspondence dated November 14, 2016, JMB acknowledged that time was of the essence in the transaction and that *"JMB like any good financier, took this into account in considering the proposal".* JMB further indicated that a number of unforeseen incidents resulted in protracted delays in the Bank receiving a proposal for financing the serviced lots development, and consequently, in the loan not performing to expectation. These include issues with the duplicate Certificate of Title, administrative challenges faced in preparing the development proposal for financing; and a medical emergency, which adversely affected the Developer's cash flows and debt servicing. This turn of events confirms that JMB should have undertaken a rigorous and objective due diligence in the evaluation of the loan application, to ensure that the interest of JMB was protected.

2.17 To date, the Developer has neither provided any financial proposals nor commenced infrastructural works and as at March 31, 2016, the amount owed was $176.76 million. JMB in its response dated November 2016, indicated that ample collateral coverage was provided and the land being acquired had an appraised value of $1,500 million as at February 2014. However, it is our view that the adequacy of collateral does negate the need for comprehensive due diligence prior to loan approval, as the collateral would only be applicable in case of default.

JMB approved loan for housing development on land designated for single dwelling

2.18 In November 2009, JMB's Board approved a loan of $200 million, to construct 16 townhouses on land which was approved for a private dwelling house as per Certificate of Title. Review of the Certificate of Title showed that the land should not be subdivided, and only a private dwelling house should be constructed, which must face the roadway. By way of letter dated October 27, 2009, JMB was aware that the developer was seeking to modify the restrictive covenants through the Supreme Court. This would allow for the issuing of the 16 splinter titles by the National Land Agency (Titles Office). Despite the existence of the restrictive covenant, JMB disbursed a total of $37.65 million to the Developer between

May and June 2010 based on submission of quantity surveyor certificates, which indicated the progress of construction works.

JMB in its November 14, 2016 response, indicated that:

…a lending institution will commence disbursement of the loan, once subdivision approval has been granted by the Regulatory bodies and the Developer has commenced the process of having the relevant modification done.

It is highly unlikely that once the Regulatory bodies have granted an approval that the approval for modification would not be granted by the Courts.

2.19 Although JMB indicated the existence of Parish Council approval for the subdivision, the Board's decision to approve the loan before the Court's ruling, appeared premature. The submission of building approval is a pre-requisite for the application to discharge or modify a restrictive covenant. As at March 2016, amounts owed totalled $51.8 million (including interest) and JMB projected a loss of $29.4 million after recovery of an estimated $22.5 million from the sale of the collateral.

Absence of feasibility study for joint venture - $300 million

2.20 In April 2006, JMB granted a loan of $300 million to a developer to provide interim financing for the construction of 558 serviced lots and 100 two-bedroom detached housing units. This was a Joint Venture Agreement between the Developer, the National Housing Development Corporation[8] and the Minister of Housing. The loan was to be repaid by November 2008, within 24 months after disbursement. The initial cost of the development was estimated at $441 million and the additional equity was to be provided from purchaser's deposits and equity from the developers. The loan was to be secured against first ranked debenture creating a first charge over all assets of the developer and the limited personal guarantee in the sum of $180 million.

Phase 1 – Operation Pride Scheme – consisting of 326 lots to be sold to the informal squatters occupying the land.

Phase 2 – Green Field Site – consisting of 332 solutions, inclusive of 100 two and three bedroom houses and 232 serviced lots to be sold on the open market.

2.21 We found no evidence that JMB assessed the feasibility of the project, prior to the Board's approval in April 2006. JMB's Project Briefing Report dated August 4, 2008 required the joint venture partners to prepare and present to the JMB, a *cogent business plan* outlining the feasibility of the project and its ability to repay the existing loans as well as, the additional facilities requested.

2.22 JMB's records revealed that in January 2008, 85 per cent of the loan had been disbursed and the project was only 35 per cent complete. Correspondence to the portfolio Ministry stated that: "*The*

[8] NHDC merged with Caribbean Housing Finance Corporation Limited (CHFC) and the Program for Resettlement and Integrated Development Enterprise (PRIDE) - Operation PRIDE to become the Housing Agency of Jamaica (HAJ).

progress of the development is significantly behind schedule due to a number of delays and unanticipated challenges. The NHDC, who had the responsibility of collecting the deposits and administering the Operation Pride Phase, has been having difficulty in collecting the deposits for the informal settlers, which has negatively impacted the reflows and will in essence threaten the repayment of the loan. Further, the sale of the units and the lots on the Open Market phase of the development has not been well received by the market due to design issues and access to the location among other reasons".

2.23 As at February 2008, when the loan was fully disbursed, the entire project was only 55 per cent completed. JMB reported that Phase 1 was 95 per cent completed, while construction commenced on only 15 of the 100 units in Phase 2. JMB did not provide any information regarding the status of 232 service lots. JMB only collected $792,545 on this loan. As at March 31, 2016, the outstanding loan balance totalled $346.8 million in a context where JMB has made bad debt provision for the full amount in accordance with accounting convention.

2.24 Despite the difficulties encountered in the first project, JMB approved a second loan in June 2009. The loan was rescinded on February 2010, one year after it was approved without any disbursements, as the contractor failed to inject the required capital in the project, as per conditions stated in the new loan. JMB subsequently brought the matter before the Court and in December 2016, JMB reported Bank *recently won a $1.3 billion judgement against one of its single most indebted developers*. The assertion by JMB that this was one of its single most indebted developers, underscores the importance of rigorous due diligence, prior to approving loans.

Housing Development Loan granted to delinquent developer - $119.63 million

2.25 JMB approved a loan of $30 million in September 2005 to provide interim financing for the development of 54 service lots (Phase 1) in the parish of Manchester. JMB records showed that the loan application was conditionally approved by the Board (July 2004), subject to a review of the marketability of the service lots. We saw no evidence that the requested study was done, however, JMB indicated that it relied on a market demand survey conducted by a government entity in 2004. JMB indicated that, as far back as 2007, that it identified that the loan funds were utilized for infrastructure works in both Phase 1 and Phase 2. This was contrary to the loan agreement and commitment letter, which indicated that loan proceeds should be confined to Phase 1. Our review of the project briefing report dated April 2009 indicated that disbursements in Phase 1 amounted to $28.72 million and the project was only 70 per cent complete.

2.26 Despite evidence that the developer was experiencing difficulty in disposing of the service lots, JMB approved another loan facility up to a maximum of $58 million in March 2010, to complete the infrastructure works. The commitment letter dated April 22, 2010, for the new loan indicated that the outstanding amounts on the initial loan, including accrued interest *'is expected to be repaid prior to the repayment of this new facility'*. Both loans should have been repaid by April 2013. However, as at March 2016, the developer owed $119.63 million[9]. Phase 1 of the development was completed and the lots were put up for sale. However, JMB reported that numerous unsuccessful efforts were made to liquidate the collateral to recover the loan.

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[9] Amount comprised principal $867.21 million and interest of $32.91 million

Loan granted to liquidate debt - $74.8 million

2.27 In October 2003, JMB approved a loan facility and disbursed $44.8 million to a developer to provide interim financing to *'assist in the release of securities held on the land; and to fund the approval process for a proposed housing development'*. The loan should have been repaid in 24 months, ending in November 2005. Prior to the approval of the loan, JMB had in its possession, a July 2003 valuation report which noted incidents of squatting; and that the land was prone to *flooding* and *swamping*. The developer did not commence construction of the proposed housing development. In August 2005, JMB sought to dispose of the land to another government entity engaged in housing development. However, the entity rejected the offer, citing similar concerns of flooding and noted that mitigation efforts would be costly. To date, the loan remains unpaid and JMB has not exercised its option to invoke the personal and unlimited guarantee in accordance with the Loan Agreement. JMB made a provision for bad debt for the total loan balance of $88.6 million at March 2016.

2.28 In October 2004, JMB disbursed another loan of $30 million to the same developer for the liquidation of outstanding debt with a local financial institution. JMB secured the loan through a four storey commercial building owned by the developer, with repayment period of approximately 10 years, or before August 2014. We were unable to determine the basis on which the loan was approved by the Board, as JMB was unable to locate the requested Board Minutes. At March 2016, the loan balance amounted to $56.2 million. JMB records revealed that the Board made a decision to exercise its rights to dispose of the property by public auction on May 24, 2014. JMB records indicated that the property had a market value of $82.7 million and a forced sale value of $66.1 million in July 2014. Our review of Board Minutes dated February 2016 revealed that the Bank, acting on advice from the Ministry, agreed to accept $50 million in full and final settlement of the loan. This would result in a loss to JMB of $6.2 million.