



The Senate

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May 28, 2013

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OFFICE OF THE PRESIDENT
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MEMORANDUM

TO: Honorable Donna Mercado Kim
President of the Senate

FROM: Brickwood Galuteria 
Chair, Committee on Tourism and Hawaiian Affairs

RE: Informational Briefing Relating to the Auditor's Report on the Department of Hawaiian Home Lands' Homestead Services Division

BACKGROUND

On May 23, 2013, your Committee on Tourism and Hawaiian Affairs (Committee) held an informational briefing to discuss the findings and recommendations of a recent report issued by the Office of the Auditor, titled *Audit of the Department of Hawaiian Home Lands' Homestead Services Division* (Report). This Report, issued in April, revealed significant operating inefficiencies in the Department of Hawaiian Home Lands' (Department) loan program. Specifically, the Report reviewed the Department's loan program, identified operational problems, and made recommendations for improvements to the loan program. The informational briefing provided an opportunity for the Committee to discuss the Report's findings with the Acting State Auditor and the Department and to hear what improvements and changes the Department was making to address the problems identified in the Report. The discussion at the informational briefing was facilitated by the testimony of the Acting State Auditor, Jan Yamane; the Chairperson of the Hawaiian Homes Commission, Jobie Masagatani; the Deputy to the Chairperson, Darrell Young; and the attendance of several members of the Hawaiian Homes Commission (Commission).

AUDIT FINDINGS

The hearing began with a presentation by the Acting State Auditor, Jan Yamane, summarizing for the Committee the findings and recommendations in the Report. In summary, the Report made two general findings that the Committee found troubling. In its first finding, the Report determined that the Commission failed to meet its fiduciary obligations through its inattention to loan risk guidance. In the Report's second finding, the Report determined that the Department's lax management of lessee loans undermined its ability to serve all its beneficiaries.

Ms. Yamane concluded her presentation by offering several recommendations to the Department to improve its operations, including:

- (1) Providing loan delinquency summaries and reports to the Commission;
- (2) Adopting a risk management plan;
- (3) Improving internal operations involving contested case hearings;
- (4) Equipping loan officers with information, policies, and guidance to improve the loan granting process as well as the loan enforcement process;
- (5) Improving internal controls, including loan documentation and filing systems; and
- (6) Addressing delinquent loans in a more timely manner.

DEPARTMENT OF HAWAIIAN HOME LANDS' RESPONSE

Your Committee also heard testimony from Jobie Masagatani, the Chairperson of the Hawaiian Homes Commission, who presented a response to the Report's findings and recommendations. According to Ms. Masagatani, the Department largely concurs with the Report's recommendations and is committed to improving loan monitoring and enforcement policies and improving training for the staff and the Commission. The Department, however, holds a more optimistic view of the Department's alarmingly high rate of delinquent loans.

According to Ms. Masagatani, the Department's high delinquency rate is due to a number of factors and cannot be blamed solely on negligent staff and mismanagement. To begin with, Ms. Masagatani explained, many loans identified as delinquent are actually current loans. This is because seventy percent of families with delinquent loans who engage in a work-out plan with the Department stabilize their payments, become current on their loan, and are able to remain in their homes. These loans are not classified as current, however, until the Commission authorizes a refinancing of the

entire loan, which may take more than a year. Therefore, many loans classified as delinquent are actually up to date on their payments.

In addition, all of the loans that the Department accepts responsibility for are either high risk or already in default and seriously delinquent. For example, an applicant for a Department loan must show that the applicant does not qualify for assistance from a commercial lender, which generally means that the applicant is too high a risk for a commercial lender whose focus is to keep its loan delinquency rates as low as possible. Therefore, loans granted by the Department are inherently high risk with a higher-than-average risk of default. Furthermore, a majority of the loans in the Department's portfolio are already delinquent when they enter the Department because they are insured through government programs, mainly loans provided pursuant to Section 247 of the National Housing Act, also known as FHA 247 loans. FHA 247 loans originate as private loans between the lessee and a private lender but are guaranteed by the United States Department of Housing and Urban Development and the Department. Once a lessee defaults on a loan and the lender provides notice to the federal government and to the Department, the lender is reimbursed for the loan, and the delinquent loan is assigned to the Department. In this way, the lender is protected from loss but the Department bears the risk of the loan. To complicate matters, by the time the Department receives the delinquent loan, the family may have already missed payments for almost a year, which makes loss mitigation efforts extremely challenging. Therefore, holding the Department's loan default rate to a private lender industry standard default rate may be an unfair comparison.

THE DEPARTMENT'S PROGRESS AND ACTION PLAN

Despite the Department's differing view on the nature of the problems, however, the Department is eager to improve program effectiveness and has already completed the following activities to address operational inefficiencies identified in the Report:

- (1) Held trainings by the Deputy Attorney General on two occasions with the Commissioners on the Commissioners' roles and responsibilities;
- (2) Held trainings for the Commission on two occasions on the FHA 247 loan program and the contested case hearing process;
- (3) Reassessed its direct loan interest rate;
- (4) Improved reports to the Commission on the loan portfolio;
- (5) Analyzed and acted upon the most severely delinquent accounts;
- (6) Clarified internal processes involving the contested case hearing process; and

- (7) Reestablished a tracking system for delinquent loans.

Your Committee, while appreciative of the Department's remedial actions, expressed concern with the Department's follow-through. Although the Department seems capable of making the necessary improvements, your Committee is aware of the Department's history of inefficiency and thus is hesitant to believe that the Department can successfully implement permanent system-wide changes within the next year. Specifically, a number of Committee members noted that similar audits with similar recommendations have previously been done but the Department failed to make improvements based on those audit recommendations, creating a greater problem for the Department today. Your Committee requested assurances from the Department that it would address the inefficiencies identified in the Report and requested specific timeframes in which to expect Department improvements. Accordingly, the Department agreed with, and committed to achieving, the following action plan:

- (1) Improve its loan tracking system within six months;
- (2) Improve its loan delinquency status reports for the Commission within six months;
- (3) Develop a Risk Management Plan within six months to a year;
- (4) Begin reviewing Department loan policies and procedures, to improve clarity and consistency, within six months;
- (5) Implement greater internal controls within six months; and
- (6) Establish benchmarks to evaluate the loan program as needed.

THE COMMISSION'S RESPONSE

Finally, it should be noted that the Commission submitted its own written response to the Committee. Like the Department, the Commission disagreed with the Report's unflattering characterization of the loan program inefficiencies. It argued that the Commission vigorously pursues cancellation of delinquent leases after alternatives to lease cancellations have been explored. The Commission, however, supports the Department's efforts to educate the Commission and staff on pertinent issues relating to loan risks and loan management; recommends review of current policies; and approves of steps taken to update the reporting requirements.

CONCLUSION

Your Committee is cautiously optimistic that the Department will use this opportunity to recalibrate the loan program and revive the public's confidence in the Department. Therefore, your Committee intends to request a status report from the Department in six months as to the progress made under the foregoing action plan. If sufficient progress has not been made at that time, your Committee intends to pursue other avenues of relief and oversight.