

# 1 – EXECUTIVE SUMMARY

## BACKGROUND

The City and County of Honolulu began its involvement in the area surrounding the Ewa Villages community beginning in the early 1980's with the redevelopment of Fernandez Village. Revitalization of the Ewa Villages itself was later initiated through the development of a community-based master plan in 1991 which provided a blueprint for the redevelopment and preservation of the historic villages and became known as the Ewa Villages Revitalization Project (Ewa Villages).

Ewa Villages was undertaken at a time when the demand for affordably-priced homes was extremely strong and there was a limited supply of privately developed affordable homes. Since that time, market conditions have changed dramatically and the demand for housing in general has weakened, especially at the affordable spectrum.

A management audit covering Ewa Villages and other Housing Development Special Fund projects was conducted by KPMG Peat Marwick LLP and completed in October 1997. The management audit identified opportunities to improve project management and found that the City Administration's project forecasts to be extremely aggressive and costs to be significantly understated. As it turned out, the City refinanced \$43.5 million of general obligation bond anticipation notes in October 1998.

Additional concerns have also been raised by the City Council. Some of the major issues which initiated this management review include:

- The unavailability of timely, complete, consistent and meaningful information relating to the financial and operating status of Ewa Villages;
- The need to objectively assess the reasonableness of the City Administration's financial projections for Ewa Villages;
- The desire to conduct an update of the on-going management oversight of Ewa Villages following the elimination of the Department of Housing and Community Development (DHCD); and
- Concern over the City's ability to repay the \$43.5 million of tax-exempt commercial paper (TECP) due by October 22, 2000 to avoid future refinancing and debt service costs.

The objective of this management review is to provide the City Council with a clear understanding of the current status and future plans for Ewa Villages—specifically, the project's financial and operational status as of March 31, 1999; the development, marketing and strategic plans for Ewa Villages; the project's sales to date; the City's present management structure for administering this project; and the financial projections for Ewa Villages.

## SUMMARY OF MAJOR REPORT FINDINGS

1. **There have been significant advancements and accomplishments at Ewa Villages.** Since 1997, there have been marked improvements in the restoration and physical appearance of the Ewa Villages community. The City has implemented innovative home ownership programs and used CDBG/HOME funding to boost real estate sales prices and revenues. Affordable housing and community-based economic development have been provided to the community as a whole, while preserving the historic characteristics of Ewa Villages. Community facilities, including parks and commercial buildings, have been restored and completed.
2. **The City's projections of \$44.8 million in real estate sales over the next 19-month period appears to be questionable.** In general, the remaining unsold inventory at Ewa Villages is less attractive to buyers and developers than the properties that have been sold to date. Although the real estate market for the Ewa region appears to be improving, the demand for residential real estate remains weak. Nevertheless, the City Administration is projecting *all of the salable real estate assets* at Ewa Villages, both developed and vacant sites, to be sold out over the 19-month period between April 1999 to October 2000 (the date of the upcoming TECP repayment).

In comparison, it has taken four years to achieve real estate sales of about \$69 million. Upon review of the remaining salable inventory, collection of about one-half (\$23.5 million) of the projected \$44.8 million in sales by October 2000 appears to be questionable due to: a weak demand for vacant land sites; dependence on the availability of CDBG/HOME funding, the time required to process these grants/loans and sales agreements; pending litigation on existing sales or development contracts; and required site improvements and regulatory approvals.

3. **There is a lack of comprehensive and meaningful financial reporting for Ewa Villages.** Despite the City's risks associated with this real estate development project and repeated requests by the City Council for financial information on the current status and future plans for Ewa Villages, there continues to be a lack of comprehensive and meaningful financial reporting for the Ewa Villages project. Historical and forecasted financial information presented to the City Council does not compare the Ewa Village's actual performance to budgeted revenues and expenses, nor does it provide an analysis of significant budget variances to monitor and evaluate project performance and to identify concerns that need further inquiry. In addition, the financial information presented to the City Council appears to be somewhat misleading as it presents only those project expenses funded from the Housing Development Special Fund (HDSF), and exclude project expenses paid or to be paid from two other funding sources. Further, those financial projections do not consider the repayment of general obligation bonds used to develop Ewa Villages even though bond repayments will be paid with HDSF monies. As with other real estate developments in the private sector, financial projections should include all project costs and commitments to provide stakeholders with a clear understanding of the

financial status of Ewa Villages.

4. **A \$21.9 million deficit has been projected for Ewa Villages as of October 22, 2000.** Based on the City Administration's financial projections, there will be a \$21.9 million shortfall for the project as of October 22, 2000, the due date of the TECP. If expenses funded from non-HDSF sources were considered, the shortfall would increase by \$1.7 million to \$23.6 million. It is important to note that this projected deficit is as of a particular point in time and the project is not fully completed. The City will still own other vacant and improved land at Ewa Villages. However, these properties are not presently planned for sale; may lack the required zoning; or may be infeasible to develop due to infrastructure, historic preservation requirements or other market reasons.

It is also important to note that the Ewa Villages project has broader project goals which are not necessarily financial in nature. These include the development of affordable housing for special target groups, community revitalization and historic preservation, community-based economic development and development needed community services and facilities.

5. **Full bond repayment is questionable** – The City's ability to fully repay the outstanding \$43.5 million TECP on October 22, 2000 is contingent upon the City selling its most valuable real estate assets at Ewa Villages at the projected sales prices, and collecting all sales proceeds by that date. This appears to be questionable. In addition to the TECP, the City is faced with the daunting task of repaying \$29 million in outstanding general obligation bonds dedicated to Ewa Villages, with no identified saleable real estate assets and escalating net rental losses at Ewa Villages. The City Administration has not reported this outstanding general obligation bond commitment in its reports to the City Council, nor its sources or plans for repayment of this debt.

## **EWA VILLAGES PROJECT OVERVIEW**

In general, there has been some advancement of all of the major goals for Ewa Villages, which were set forth in the Ewa Villages Strategic plan dated May 1997. Some of the advancements include:

- Affordable-priced homes or rent-to-own units have been offered to the tenants of record (TOR)—the number of homes that have been sold to TORs have increased to about 31% of the eligible tenants of record;
- The historic plantation character has been preserved;
- Significant improvements have been made to the physical appearance and public facilities for the community since 1997; and
- The City's regional flood mitigation efforts are nearly complete.

However, there are still key issues that need to be resolved including:

- Management of Varona Village is problematic due to the low rents received and the high costs of maintaining these unrehabilitated homes;
- Placement of the remaining 62 tenants of record in a more permanent type of housing has been difficult due to their unwillingness or inability to move and take on added responsibilities of homeownership;
- Rehabilitation of the unrehabilitated homes has been uneconomical due to the high cost of rehabilitation in comparison to new construction—meanwhile, these dilapidated homes create an unfavorable appearance to potential homebuyers;
- The extent of hazardous waste contamination and clean-up costs on the former Amfac Sugar mill and old mill commercial site is undetermined making the salability of the site uncertain;
- Outstanding claims against the City by Ewa Villages Non-Profit Development Corp. (EVNDC) have not been resolved; and
- The collectability of sales proceeds of \$5.5 million for a development site is uncertain due to a legal dispute with the purchaser, Unity House.

Parcels and residential products sold to date at Ewa Villages have generally been the prime golf-front parcels with improved site infrastructure or newly constructed homes. The remaining unsold inventory is generally more difficult to sell and includes multifamily sites, unrehabilitated homes and a site in the flood plain. The unsold inventory consists of 199 single-family homes and lots, of which only 43 are new homes, and two multifamily parcels of about 20 acres each, which do not have site infrastructure improvements.

The remaining unimproved inventory at Ewa Villages is planned to be sold in bulk to developers including the unrehabilitated units and the large vacant parcels through the request for proposal process (RFP). The rehabilitated units and individual vacant lots are being marketed to both individual buyers and to developers. All remaining *new home inventory* and *individual lots* may be sold to either individual buyers or in bulk to developers.

The City has utilized substantial amounts of Community Development Block Grant (CDBG) and HOME Investment Partnership Program (HOME) funding to effectively lower the purchase price of residential sites which were sold to developers, including land at Area A, Area B and Area I. This is an eligible use of federal funding programs, however, the decision to dedicate a large portion of the City's annual funding to one project (versus other island-wide projects) should be evaluated as a matter of desired policy.

In addition to the remaining salable inventory of land and homes available, the City will still own other vacant and improved land at Ewa Villages such as Varona Village and the mill commercial site. However, in their strategic plan, the City has not indicated plans to sell these assets, therefore, they are not analyzed in this report.

Overall, the Ewa housing market appears to be improving. Ewa sales volume has dramatically increased and marketing time has decreased, both in response to falling prices, indicating a trend towards market stabilization.

In comparison to the market, Ewa Villages has experienced a decline in sales volume:

- Single-family resale prices in the Ewa Plain have decreased over 11% in the last two years. However, sales of new homes at Ewa Villages indicate an average price decrease of only 3% over the same period. Thus even greater price reductions may need to be considered to make the project competitive.
- Home resale volume has *increased* 246% from 1996 to 1998 in the Ewa Plain. In contrast, individual home/lot sales at Ewa Villages *decreased* from an average of 10.3 homes per month in 1996 to 3.7 during the first quarter of 1999.
- Therefore, it appears that Ewa Villages has not participated in the improvement in residential sales activity which has been experienced in the overall Ewa area.

## **PROJECT MANAGEMENT REVIEW**

DHCD was dissolved as of June 30, 1998. Since that time the responsibilities of the Ewa Villages project have been distributed to 11 City departments under the direction of the Office of the Managing Director. This "management team" has addressed issues relating to the hazardous waste contamination, improper use of water, flood mitigation, Varona Village upkeep, outstanding developer and homebuyer claims, etc. However, this new horizontal management structure creates an environment where day-to-day oversight and decision making is difficult.

- Project activities are implemented at the departmental level, however decisions of any significance are made by the Managing Director's office. The Managing Director's office is responsible for and is actively involved in many other aspects of the City's operations. Thus, it is difficult to provide the necessary level of project oversight under the circumstances.
- Since no individual department is ultimately responsible for Ewa Villages, concerns from subdevelopers, contractors and community associations are not addressed in a timely manner.

In addition, there has been a lack of timely, complete and meaningful financial reporting on the project.

- Despite the commitment by the City Administration to provide the City Council monthly reports, there was no routine, comprehensive financial reporting on the project prior to March 1999.
- Information that was presented to the City Council was done on a reactive basis after repeated requests, rather than a proactive basis.
- Existing reports do not accurately portray the full financial perspective of Ewa Villages as a real estate development. Project expenditures presented are limited to HDSF and do not include other fund expenditures on Ewa Villages.
- Financial reporting formats which are utilized internally or presented to the City Council are not geared to providing a comprehensive picture for decision making or management control.

## **FINANCIAL REVIEW**

Overall, the City Administration's revenue forecasts appear to be overly aggressive and are likely not achievable in the study period ending in October 2000. The City's ability to realize all of the forecasted revenues by October 2000 is questionable due to the City's optimistic timing of sales, pending legal disputes, required site improvements and approvals, and dependence on the availability of CDBG/HOME funds.

In addition, the City's rental operations at Ewa Villages have progressively worsened from a net profit of approximately \$77,000 in fiscal year 1994 to a net loss of approximately \$(265,000) in fiscal year 1998. The rental operations are expected to face additional financial strain as tenants are relocated to permanent locations and out of the City's income-generating properties. Further study of the causes and solutions to stem these losses needs to be undertaken.

The City Administration's projected deficit for the Ewa Villages Project, *as recorded in the HDSF*, is anticipated to grow from about \$(9.5) million as previously reported as of

March 1997, to about \$(21.9) million at October 2000 based upon forecasts prepared by the City Administration as of March 1999:

**Ewa Villages Revitalization Project**  
(As of October 22, 2000—HDSF expenditures only)

	<u>Millions</u>
Net sales and other receipts	\$113.8
Project development costs	(116.4)
Debt services and other bond costs	<u>(19.3)</u>
Project deficit as of October 22, 2000	<u>\$(21.9)</u>

Following the dissolution of the DHCD, the HDSF now only funds a portion of the project expenditures. Around \$1.7 million has been budgeted for Ewa Villages from various funds and is not accounted for in the HDSF or tracked for the project as a whole, as shown in Exhibit 1-A.

However, if other expenditures related to Ewa Villages *which are paid from other funds* are included, the project as a whole could be expected to be at a deficit of \$(23.6) million as of October 2000:

**Ewa Villages Revitalization Project**  
(As of October 22, 2000 – expenditures from all funds)

	<u>Millions</u>
Projected deficit – HDSF expenditures only	\$(21.9)
Additional non-HDSF expenditures	<u>(1.7)</u>
Projected deficit as adjusted	<u>\$(23.6)</u>

## **BOND REPAYMENT ANALYSIS**

In October 1998, the City refinanced a portion of \$63.5 million of general obligation bond anticipation notes associated with Ewa Villages. In its place, the City issued \$43.5 million in TECP maturing no later than October 2000. This resulted in additional refinancing and debt service costs to the City. Interest expense (excluding any interest income offset from available HDSF funds) associated with the \$43.5 million TECP bonds amounted to approximately \$3 million for the two-year period ending October 22, 2000.

The City Administration has represented to the City Council that the Housing Development Special Fund will be able to fully repay the \$43.5 million TECP by October 2000 and still have a \$1.7 million surplus, as stated in its strategic plan dated April 1999 and in recent reports to the City Council. However, this representation appears to be extremely aggressive and misleading for the following reasons:

- **Revenue projections are extremely optimistic** - About \$44.8 million in net sales revenues are projected by the City Administration to be transacted over the next *19-months*, as compared to \$69.1 million which was sold over the *last four years* since the commencement of the project in 1994 through March 31, 1999. This appears questionable due to the short time period remaining, lower desirability of the parcels for sale and weak multifamily and bulk sale markets.
- **Delays in sale of the multifamily site are probable** - There are pending flood mitigation, request for proposal and escrow requirements for the multifamily site near the old mill which will likely delay sale of this \$3.5 million site well beyond the October 2000 repayment date.
- **Availability of CDBG/HOME funding** for Area H and the unrehabilitated homes requires approval by the City Council. This overall policy issue and specific project usage has not been determined.
- **Additional bond repayments (besides the \$43.5 million in TECP) are intended to be paid from the HDSF** - Approximately \$29 million in general obligation bond proceeds which were expended on Ewa Villages also remain outstanding as of March 31, 1999. Accordingly, the total outstanding debt dedicated and allocated to Ewa Villages amounted to \$73.1 as of March 31, 1999. The City Administration will repay these general obligation bonds with proceeds from the HDSF, however, no repayment plan on these long-term bonds has been presented to the City Council.

## PROJECT RECOMMENDATIONS

Based on our review of the Ewa Villages Revitalization Project, the following recommendations are suggested to improve the efficiency and accountability of the project.

1. **Establishment of standard financial reporting which is prepared for internal project monitoring, as well as for review by the City Council. This reporting should be:**
  - **Routine and timely** – Reporting at regular monthly or quarterly intervals to ensure timely review and intervention on critical business decisions. Reporting information proactively will enable the City to identify concerns that need further inquiry and respond appropriately. This is especially important in assessing the City’s ability to repay the TECP as the October 2000 maturity date draws closer.
  - **Comparable to prior periods** – Reporting information consistently to permit comparison from period to period and of budgeted to actual results.



- **Accurate and complete** – The content of financial presentation must be complete to enable meaningful interpretation of historical and projected results. This includes accounting for *all project expenses and bond repayments* that should be repaid from Ewa Villages, not merely the upcoming \$43.5 million repayment of the TECP, which appears to be the sole focus of the repayment analysis presented in the Strategic Plan.
  - **Presented in a meaningful form** – Present key financial information which contributes to an accurate portrayal of the financial status of the project.
  - **Verifiable** – Support key assumptions with relevant information.
- 2. **Monitor all revenues and expenses** associated with Ewa Villages (not only those expenditures funded through the HDSF) to ensure comprehensive financial accountability of the development.
- 3. **Establish communication protocols** to increase interdepartmental working relationships and improve response time to subdeveloper and community concerns.
  - **Establish and report meeting minutes of the Ewa Villages Task force** to clearly delineate responsibilities, timetable, cost, etc. for actions, tasks or decisions discussed.
  - **Designate a point of contact** and empower them with the administrative authority and ability to directly respond to identified issues or problems.
- 4. **Define an “exit plan”** which clearly delineates actions, responsible parties and timeline with regard to the City’s role and on-going level of involvement, if any. This includes plans to develop or retain other long-term assets such as Varona Village and the surrounding area. This “exit plan” should define what constitutes project completion and should be communicated to the Ewa Villages community.
- 5. **Evaluate the appropriateness of using a significant portion of Oahu’s CDBG/HOME funding** on the sale of future bulk parcels at Ewa Villages, versus other areas throughout Oahu.
- 6. **Evaluate the rental program** to assess how to increase or enforce rental collections and control expenses (residential and commercial) to reduce the escalating rental losses at Ewa Villages.
- 7. **Prepare to refinance or extend the terms of the TECP** to minimize interest charges and keep refinancing costs at a minimum.

8. **Prepare a plan** identifying specific sources of funds to be used to repay the general obligation bonds used to finance the development of Ewa Villages.
9. **Evaluate the bond repayment** capacity of Ewa Villages project with respect to *all outstanding bonds*, not only the upcoming TECP repayment.
10. **Lastly, the Ewa Villages Task Force should continue its efforts to resolve the following issues:**
  - Collection of sales revenues from the sale of the market lot site to Unity House of \$5.5 million;
  - Permanently placing the remaining 62 tenants of record;
  - Rehabilitation or sale of the unrehabilitated homes;
  - Determination of the nature and extent of hazardous waste issues and the required remediation measures and costs; and
  - Settlement of FVNDC developer claims and the future legal status of their rehabilitation contract with Ewa Villages.