

THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE VIRGIN ISLANDS INSPECTOR GENERAL



**INSPECTION OF THE USE OF
LOAN PROCEEDS OF
SELECT PROJECTS IN THE GERS
ALTERNATIVE INVESTMENT PROGRAM:
VI FINEST FOODS**

**ILLEGAL OR WASTEFUL ACTIVITIES SHOULD BE REPORTED TO
THE OFFICE OF THE VIRGIN ISLANDS INSPECTOR GENERAL BY:**

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STEVEN VAN BEVERHOUDT
V.I. INSPECTOR GENERAL

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OFFICE OF THE V. I. INSPECTOR GENERAL

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EXECUTIVE SUMMARY

The following summarizes the major findings from the Inspection of the Use of Loan Proceeds of Select Project in the GERS Alternative Investment Program: V. I. Finest Foods (INR-03-76-19).

Finding 1: GERS Loan Managements (pages 7 to 13)

- GERS did not effectively manage VI Finest Foods's loan.
- GERS advanced \$2.7 million in funds without adequate review.
- GERS failed to ensure all aspects of the project were monitored.
- GERS failed to establish procedures to perform periodic analysis of expenditures.
- As a result, there were questionable contract costs, cost overruns, and the failure to fulfill contract deliverables.
- \$480,850 in loan proceeds were diverted for unrelated purposes.

Finding 2: Loan Repayment (pages 15-18)

- VI Finest Foods never demonstrated the ability to make consistent loan payments.
- GERS failed to foreclose on the loan agreement.
- GERS entered into a settlement agreement with VI Finest Foods to pay off the loan's remaining balance after the property was sold.
- The building was sold to the University of the Virgin Islands for \$8.2 million.
- GERS is negotiating a new loan agreement for the original outstanding principal of \$3.3 million.
- The collectability of this balance remains uncertain.

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September 27, 2021

Nellon Bowry, Chairman
Board of Trustees
Government Employees' Retirement System of the Virgin Islands
3438 Kronprindsens Gade
GERS Complex, 3rd Floor
St. Thomas, VI 00802

Dear Chairman Bowry:

This report contains the result of our inspection of the use of loan proceeds of select projects in the GERS Alternative Investment Program: VI Finest Foods. The objectives of the inspection were to determine: (1) the total amount of the GERS loan proceeds that were disbursed to VI Finest Foods for the construction of the supermarket; (2) whether policies and procedures were followed in the management of the loan; (3) whether the proceeds were utilized in accordance with loan terms and conditions; and, (4) whether VI Finest Foods made loan payments as required in the loan agreement.

We found that GERS did not effectively manage the loan issued to VI Finest Foods under the Alternative Investment Program. Specifically, GERS: (i) did not adequately review services performed and examine expenses incurred for \$2.7 million of loan proceeds issued; (ii) did not ensure that all phases of the supermarket project (the project) were monitored; (iii) failed to ensure that inspectors monitored all phases of the project while continuing to issue funds for the project; (iv) failed to follow established procedures to perform periodic analysis of project expenditures; and (v) provided an additional \$2.8 million beyond the initial loan amount although VI Finest Foods never demonstrated the ability to make consistent payments per the loan requirements.

As a result: (i) the lack of oversight led to questionable contract costs, cost overruns, and incomplete contract services; (ii) at least \$480,850 in loan proceeds was diverted for unauthorized purposes; (iii) VI Finest Food defaulted on the loan; and (iv) the collectability of the remaining loan balance owed to GERS remains uncertain.

We made several recommendations to address the conditions and causes cited in the report. Our recommendations addressed the following areas: (i) monitoring and (ii) due diligence.

An Exit Conference was held on August 11, 2021. There was general agreement with the findings and recommendations made in the report

A response to the recommendations, dated September 14, 2021, was submitted, and is included as Appendix I beginning on page 19 of this report.

If you require additional information, please call me at 774-3388.

Sincerely,

A handwritten signature in blue ink that reads "Steven van Beverhoudt". The signature is written in a cursive style with a blue ink color.

Steven van Beverhoudt, CFE, CGFM
V. I. Inspector General

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INTRODUCTION

BACKGROUND

On November 2, 2005, Act 6794, the Retirement System Reform Act of 2005, became law. Among other things, the Act allowed the Board of Trustees of the Government Employees Retirement System of the Virgin Islands (GERS) to enter into alternative investments by the establishment of the Alternative Investment Program. GERS established the Alternative Investment Program to increase income by allowing for more risky investments with higher rates of return. According to GERS' officials, GERS suspended new investments under the Alternative Investment Program in March 2015.

Prior to the program's suspension, GERS, on June 30, 2014, entered into a construction loan agreement with VI Finest Foods, approving \$8.2 million to build a supermarket designed to conduct the retail and wholesale sale of food, office supplies, and general household products.

At the time that GERS approved the loan, VI Finest Foods, a St. Thomas-based business, operated a wholesale company and had contracts with the Government of the Virgin Islands (Government) to provide wholesale food items to various Government entities.

The loan was approved to cover the supermarket's construction, the purchase of equipment and inventory, fund a Capitalized Interest Reserve Fund, and a Debt Service Reserve Fund.

According to the loan terms, the supermarket was expected to be completed within 17 months, with a completion date of November 30, 2015; however, VI Finest Foods did not meet this date, citing unforeseen setbacks and a need for additional funds to complete the project.

In November 2015, VI Finest Foods requested an additional \$2.8 million from GERS. On May 24, 2016, GERS amended the original loan, increasing VI Finest Foods' total loan amount to \$11 million.

GERS disbursed the \$11 million of loan proceeds over the construction period, 2014 through 2017. The following schedule summarizes the breakdown of the disbursements.

Schedule of Loan Disbursements

Recipient	Purpose	Amount Disbursed
VI Finest Foods	Supermarket Construction	\$ 8,811,273
Dudley, Topper, Feuerzeig, LLP	Refrigeration Contractor- Initial Draw	774,919
Dudley, Topper, Feuerzeig, LLP	Construction Contractor- Mobilization	130,000
VI Port Authority	Back Rent	77,070
Internal Transfer	Capitalized Interest Reserve	432,676
Internal Transfer	Debt Service Reserve	311,259
Internal Transfer	Debt Service Payment	33,000
Waiver, Legal & Administrative Fees	Closing cost for loan increase	292,907
Dudley, Topper, Feuerzeig, LLP /Pedro Williams	Legal and other fees	69,836
Standard International Group	Consulting Fees	67,060
Total		\$11,000,000

On March 1, 2019, after almost two years in operation, the West Bay Supermarket closed. Eleven months later, on February 12, 2020, the University of the Virgin Islands purchased the building from VI Finest Foods for \$8.4 million.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the inspection were to determine: (1) the total amount of the GERS loan proceeds that were disbursed to VI Finest Foods for the construction of the supermarket; (2) whether policies and procedures were followed in the management of the loan; (3) whether the proceeds were utilized in accordance with loan terms and conditions; and, (4) whether VI Finest Foods made loan payments as required in the loan agreement. Our inspection covered the loan agreements GERS entered into with VI Finest Foods under the Alternative Investment Program.

We performed our inspection in accordance with the Council of the Inspectors General on Integrity and Efficiency “Quality Standards for Inspections” between March 2019 and December 2020. We obtained and reviewed all documents related to the supermarket loan agreements and the eventual sale of the property, which occurred in February 2020. We interviewed GERS officials who had a role in administering the loan, VI Finest Foods representatives, and a member of the Board of Trustees. We researched best practices to document traditional lending standards when approving and servicing commercial loans and managing commercial construction loans.

PRIOR AUDIT COVERAGE

We issued report INR-01-GERS-15 Inspection of the Alternative Investment Program Administered by the Government Employees Retirement System on March 7, 2016, which discussed the merits of the loan. This report showed that, initially, a financial consultant recommended that GERS “not invest” due to market competition, questionable repayment ability, and the limited retail grocery experience of the borrower. However, the consultant later changed the recommendation to “consider for a loan,” while still citing the identical concerns

when recommending not to invest. The GERS Board approved the loan, although the underlying concerns cited by the consultant did not change. At that time, VI Finest Foods' bank account showed no evidence of cash flow or readiness to establish a supermarket.

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RESULTS

CONCLUSION

We found that GERS did not effectively manage the loan issued to VI Finest Foods under the Alternative Investment Program. Specifically, GERS:

- did not adequately review services performed and examine expenses incurred for \$2.7 million of loan proceeds issued;
- did not ensure that all phases of the supermarket project (the project) were monitored;
- failed to ensure that inspectors monitored all phases of the project while continuing to issue funds for the project; and,
- failed to follow established procedures to perform periodic analysis of project expenditures.

In addition, GERS provided an additional \$2.8 million beyond the initial loan amount, although VI Finest Foods never demonstrated the ability to make consistent payments per the loan requirements.

As a result:

- the lack of oversight led to questionable contract costs, cost overruns, and incomplete contract services;
- at least \$480,850 in loan proceeds was diverted for unauthorized purposes;
- VI Finest Food defaulted on the loan; and
- the collectability of the remaining loan balance owed to GERS remains uncertain.

We made several recommendations to address the conditions and causes cited in the report. Our recommendations addressed the following areas: (i) monitoring and (ii) due diligence.

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FINDING 1: GERS LOAN MANAGEMENT

GERS did not effectively manage VI Finest Foods' loan according to the terms of the loan agreement. Specifically, GERS advanced \$2.7 million in funds without adequate review of services performed and scrutiny of expenses paid.

We attribute these conditions to GERS' failure to ensure that all aspects of the project were monitored, while continuing to issue funds. Also, GERS failed to follow established procedures to perform periodic analyses of project expenditures

This resulted in questionable contract costs, cost overruns, and the failure to fulfill contract deliverables. It also led to the diversion of \$480,850 of loan proceeds for unrelated purposes.

Background

The initial loan given to VI Finest Foods on June 30, 2014, was \$8.2 million. The original loan's budget line-items encompassed the following:

\$8.2 Million Loan Budget	
Cost Items	Amount
Construction costs	\$2,668,089
Site Modification costs	925,000
Project Management and Startup	125,000
Sewer Line	85,000
Lease payments during construction	74,640
Asbestos Removal	60,000
Consulting	10,000
Inventory	1,500,000
Supermarket Equipment	950,000
Working Capital Cash	475,360
Point-of-Sale System	125,000
Delivery Vans	110,000
Freezer Trucks	90,000
Office Equipment	50,000
Capitalized Interest Reserve	432,676
Debt Service Reserve	311,259
Consultant, Legal, Government fees	136,896
VI Port Authority (Back Rent & Security Deposit)	77,070
	\$8,205,990

On May 24, 2016, GERS approved an additional \$2.8 million to complete the project, bringing the total loan to \$11 million. The line items budgeted for the additional \$2.8 million loan proceeds were as follows:

\$2.8 Million Supplemental Loan Budget	
Cost Items	Amount
Refrigeration Payments	\$332,963
Construction Change Orders	433,000
Pad Mount Transformer	40,200
Generator/Transfer Switch/Circuit Breaker	50,000
Relocation of WAPA Poles	20,000
Parking Lot	250,000
Trash Compactor	15,000
Elevator/Electrical/Generator Room	29,000
Third Floor Bathroom	50,000
Internal Audio Security System	25,000
Solar Power Installation	250,000
Complete Point of Sale	40,000
Security System/Office Equipment	195,941
Working Capital Cash	400,000
Business Insurance	35,000
Start-up Personnel Costs	335,000
Closing costs	292,907
Total	\$2,794,011

Best business practices governing a construction loan call for the lending agreement to detail the conditions under which the lender will release the funds. Before a drawdown (draw) of funds request is approved, the lender requires an on-site inspection to determine that the borrower used the previously disbursed funds according to the project plan and the budget. They also determine the status of work performed.

Regarding GERS and VI Finest Foods loan agreement, the agreement required that before GERS periodically advanced loan proceeds, they would obtain a written report from GERS' Supervisory Inspector (inspector), or another individual designated by GERS, indicating the status and quality of the completed work. It further required that the work comply with plans and specifications. Also, GERS would designate a representative to inspect the borrower's books and records and discuss the borrower's affairs, finances, and accounts as often as is reasonable.

As a result, GERS hired an inspector to review the project's construction work as a prerequisite for advancing loan proceeds. The inspector reviewed VI Finest Foods' architect's progress

reports of the building construction, performed periodic inspections at the site, and recommended whether GERS should advance the requested funds. GERS issued the recommended payments via a wire transfer to VI Finest Foods' bank account established for the project. VI Finest Foods would then pay its contractors. This process was followed for the construction phase of the project, but not for the other phases.

No Verification of Non-Construction Contract Services Performed

GERS entered into an unwritten agreement with a firm to serve as the project's inspector. The lack of a formal agreement with specific details of the expectations of the project inspector led to a different interpretation of the loan's management responsibilities and expectations. We found that GERS expected that the inspector was responsible for reviewing all aspects of the project and providing a report of the work completed to GERS. They would then make a recommendation to GERS to approve the draw request submitted by VI Finest Foods. However, the inspector's interpretation of their role was to inspect the physical building's construction only. The inspector conveyed their position in correspondence to GERS when GERS asked the firm to review a payment request for the refrigeration contractor and IT contractor. GERS advanced the funds to VI Finest Foods for these requests, without its inspector, VI Finest Foods' architect, or another GERS-appointed inspector verifying the previous completion of work. As a result, two crucial and significant contracts totaling \$2,320,111 were not adequately evaluated and monitored for performance.

Refrigeration Contract. VI Finest Foods entered into a contract totaling \$1,722,042 with a company to provide refrigeration and store equipment for the supermarket. Subsequent change orders increased the total cost to \$1,998,230. The contractor received their first payment of \$774,919 or 45% of the contracted amount when VI Finest Foods closed its loan on June 30, 2014.

In March of 2015, GERS asked its inspector to review a \$619,935 draw request for the contractor. In a letter dated March 16, 2015, to the GERS Administrator, the inspector indicated that they had an issue with advancing the additional funds to the contractor, citing the following concerns: (a) the contractor would be receiving 90% of the total contract amount without any verification of the status of the manufacturing of the equipment; (b) the inspector was not previously involved in the contractor's requests for draws; and, (c) the inspector focused primarily on the draws for the building construction. VI Finest Foods later provided photographs of the equipment's progress, and the inspector recommended the payment. Although the inspector ultimately recommended this payment, they did not review any other payment requests for this contractor.

During our review, we identified two subsequent draw requests totaling \$481,222. GERS continued to advance loan funds to pay the contractor without an official inspection of the contractor's performance. At our inquiry about the monitoring of this contract, the GERS Administrator stated that they advanced the funds after receiving reports and holding meetings with GERS' staff and engineer, and VI Finest Foods' principals and architect. Also, they performed at least two site visits with the same individuals and verified that the equipment was installed. However, we did not see a site inspection report from GERS or VI Finest Foods'

architect. Also, VI Finest Foods' architect informed us that they did not perform a detailed review to verify that contract line items were completed.

Ultimately, the refrigeration contractor did not finish the required work as agreed to in the contract. VI Finest Foods' representative stated that problems with the contractor's performance led to the contract's cancellation. In total, GERS had already advanced \$1,876,077, or 93% of the contract cost. VI Finest Foods subsequently hired another contractor to complete the contract terms at an additional cost of \$62,139.

IT Contract. VI Finest Foods gave a \$321,881 sole-source contract, dated August 20, 2015, to an Information Technology (IT) business to install a point-of-sale system. A point-of-sale system is a computerized network that consists of the main computer linked with several checkout terminals that manage sales, inventory, and customer information. The contractor also installed the security and audio systems.

In the approved loan documents, the point-of-sale system was budgeted for \$125,000. We are unaware if GERS, during the project's feasibility review, evaluated the cost of the point-of-sale system to determine if the amount budgeted was reasonable. We noted that the original loan did not include budgets for the security and audio system. However, they were subsequently included in VI Finest Foods' amended loan. Also, because the contract was a sole-source contract, we could not determine if VI Finest Foods received the best price possible for this service.

However, in August 2015, after the contract was executed, VI Finest Foods requested a draw of \$160,941, or 50% of the contracted amount, from GERS to pay their IT contractor. The contractor would then order the equipment to commence the work. Specifically, VI Finest Foods requested that GERS release \$160,941 from the budgeted funds for office equipment (\$50,000) and the point-of-sale system (\$125,000) to make this payment.

GERS consulted their inspector on this draw request, and the inspector brought to GERS' attention that VI Finest Foods planned to use the Point-of-Sale and office equipment budgets which totaled only \$175,000. If GERS advanced the funds, there would only be \$14,059 remaining in the budget. The inspector noted that VI Finest Foods would need an additional \$160,940 to complete the services of the contract. In addition, the inspector indicated that: (1) VI Finest Foods had not obtained competitive bids for this work and, (2) the contractor did not provide drawings or specifications of this work.

Furthermore, the inspector informed GERS that they inquired of VI Finest Foods about the sole-source contract. VI Finest Foods indicated that the contractor provided his equipment at cost and was the only contractor on St. Thomas who performs installation, configuration, and training on supermarket and retail point of sale systems. Moreover, the inspector also informed GERS that they did not have a qualified individual on staff to evaluate the pricing of the equipment and services of this contract. They recommended that GERS use their in-house IT Department to evaluate the pricing or authorize the inspector to hire an independent consultant to perform this analysis.

Ultimately, the inspector did not make a recommendation on releasing the funds. Because the contract cost 'far exceeded' the budgeted amount, the recommended that GERS review the terms of the financing agreement with VI Finest Foods to ensure that all of its requirements were met. The inspector noted that they were not privy to the financing agreement between GERS and VI Finest Foods.

GERS proceeded to advance the funds without the inspector's recommendation. GERS provided no evidence that their IT Department evaluated the contract's pricing or that they hired an independent consultant to assess the IT contract. Neither did GERS provide a report showing the review of the contractor's services performed.

After VI Finest Foods' initial request to pay the IT contractor, they requested three more draws in February 2016, January, and February 2017. GERS advanced a total of \$390,739 to VI Finest Foods to pay the contractor, \$68,858 more than the contracted amount. We were not provided with a change order to justify the overpayment. However, we found a \$35,000 loan advanced by one of the supermarket project's principals to the IT contractor. The contractor requested a reduction to future contract payment. However, we saw no evidence that GERS or VI Finest Foods withheld the IT contractor's loaned amount.

GERS' Administrator indicated that they relied on VI Finest Foods' architect's progress reports when deciding to approve the advance of loan proceeds for the non-construction contracts. However, from our review, besides the progress reports of the building contractor's work, VI Finest Foods' architect's reports did not provide details on other contractors' and vendors' work. Furthermore, VI Finest Foods' principals and architect informed us that they focused on the building construction and just perused the other work performed. Also, from interviews with VI Finest Foods principals and their architect, they did not perform a detailed review of the IT contractor's services. They were unsure who was primarily responsible for overseeing the work.

Monitoring of Project Expenses

We saw no evidence that GERS performed due diligence in reviewing how VI Finest Foods used the funds previously received. We found that V.I. Finest Foods used at least \$480,850 of loan proceeds to cover their wholesale business expenses. We were not provided evidence that GERS gave written consent approving the use of the loan proceeds to pay for expenditures not authorized by the loan terms. This was partly due to GERS not placing the same level of scrutiny on the draw requests for non-construction expenses as they did for the building's construction. When we inquired of GERS officials about their process for reviewing project expenditures during the construction of the supermarket, the Administrator said they did not plan to review expenditures until VI Finest Foods completed the project.

The schedule below shows the list of questionable expenses paid by VI Finest Foods for their wholesale business.

**Questionable Expenditures
2014-2016**

Type of Cost	Amount
Food Inventory	\$317,765
Warehouse Freezer	67,500
Shipping	49,836
Loan Application Fee	20,000
Business Fees	10,585
Taxes	8,134
Warehouse Rental	4,030
Warehouse Laborer	3,000
Total Expenditures	\$480,850

Expenses Unrelated to Supermarket Project. In June 2014, when VI Finest Foods and GERS closed the loan, GERS advanced loan funds to VI Finest Foods totaling \$444,024. VI Finest Foods immediately reimbursed their wholesale company \$20,000 for the loan application fee, a cost explicitly not allowed by the contract terms. On July 1, 2014, they paid \$6,857 in tax liens and in November 2014, paid \$1,277 for their 2013 income tax. Also, VI Finest Foods covered expenses related to their wholesale business. For example, they purchased food totaling \$73,450 and paid \$20,859 for the food shipment; \$3,000 to a VI Finest Foods' worker; \$3,000 for warehouse rental located on St. Croix; and \$8,072 for other business expenses. GERS did not analyze VI Finest Foods' use of the initial funds disbursed. The borrower continued to use subsequent draws for their wholesale business expenses during the supermarket's construction. In December 2015 and January 2016, more than a year and a half before the supermarket's grand opening on April 15, 2017, VI Finest Foods purchased food totaling \$128,025; and used \$27,524 for shipping.

Additionally, we found that two months after the additional loan funding approval, in August 2016, VI Finest Foods purchased \$10,513 in food items. Also, in October 2016, VI Finest Foods used loan funds of \$60,000 from the supermarket's bank account to make a payment on a freezer purchased for their wholesale business. At our inquiry about these expenditures, a VI Finest Foods' principal informed us that GERS knew they had an ongoing business. They further stated that the expenses paid with loan proceeds were to sustain the business. However, records provided by GERS showed no evidence that they approved funds for purposes unrelated to the project.

Loan Funds Diversion. Based on our review of provided documents, GERS did not authorize the use of loan proceeds for unrelated business expenses. V.I. Finest Foods requested to use loan proceeds for its wholesale business; however, GERS did not approve the request. Nor did GERS monitor the project expenditures to ensure that loan proceeds were not being used for the wholesale business.

Specifically, in documents provided by VI Finest Foods representatives, we found a letter dated December 28, 2015, addressed to the GERS Administrator requesting funds from the loan's

inventory budget. The funds were to purchase food for the VI Department of Education, with whom VI Finest Foods had a contract to provide school lunch supplies.

We inquired of GERS' Administrator about this request. The Administrator provided us with correspondence dated January 11, 2016, in which GERS informed VI Finest Foods that the request for funds was unrelated to the project. The correspondence further noted that with the planned opening of the supermarket being July 2016 inventory orders would be placed in May or early June 2016. Despite this response, VI Finest Foods persisted in using loan funds for the wholesale business. Just a day later, on January 12, 2016, we noted that VI Finest Foods proceeded to divert existing loan funds in the supermarket bank account to purchase food totaling \$87,195.

Again, in February and March 2016, VI Finest Foods made another purchase of food totaling \$18,583 with no-evidence of written approval for loan funds to be used for the borrower's outside wholesale business. Although GERS established procedures to analyze the borrower's records and accounts periodically, GERS continued to advance loan proceeds without reviewing how VI Finest Foods used the funds.

The diversion of loan proceeds to fund the wholesale business, in part, contributed to funds not being available to complete the supermarket. Therefore, those funds were replaced when VI Finest Foods requested the additional \$2.8 million loan. As GERS approved the additional loan funds, GERS did not improve its monitoring of the expenditures.

Recommendation

We recommend that the Board of Trustees of GERS:

- 1.1 Ensure that if a similar program is restarted, a unit, within GERS, is created to oversee and monitor project costs according to industry standards.

GERS' Response

The response indicated agreement with the recommendation. GERS officials indicated that GERS would create a unit to oversee and monitor all projects, to include project costs if the Alternative Investment Program is restarted. The expected completion date is before restarting a similar Alternative Investment Program since the program has been suspended.

V.I. Inspector General's Comments

Based on the response submitted, we consider this recommendation resolved, but not yet implemented pending evidence of the establishment of a monitoring unit, should the Alternative Investment Program be restarted.

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FINDING 2: LOAN REPAYMENT

VI Finest Foods never demonstrated the ability to make consistent loan payments during the required loan repayment period. As a result, GERS filed to foreclose on the loan and ultimately entered into a settlement agreement with the supermarkets' principals to pay off the loan's remaining balance after its closure and its premises were sold. GERS is now negotiating a new loan agreement to address the original loan's \$3.3 million outstanding principal that remained after the supermarket's premises were sold. The collectability remains uncertain.

Background

According to the June 30, 2014 loan agreement, GERS gave VI Finest Foods ten (10) years to repay the loan. The repayment schedule called for interest-only payments in the first year and five months (July 30, 2014, to November 30, 2015) and principal and interest payments in the remaining eight (8) years and seven (7) months (December 30, 2015, to June 30, 2024) of the loan. The loan terms were as shown below:

Original Loan Amount: \$8,205,989.26			
Term: July 30, 2014 to June 30, 2024			
Description	Amount	Repayment Term	Total
Interest-only Payments Made		17 months	\$ 276,693.52*
Principal & Interest Payments	\$103,752.93	103 months	\$10,686,551.79
Total Repayment Amount			<u>\$10,963,245.31</u>

**Paid from Capitalized Interest Reserve Fund*

As a part of the loan's purpose, GERS funded a Capitalized Interest Reserve Fund of \$432,676. A capitalized interest reserve account is used by lenders to periodically advance loan funds to pay interest charges on the outstanding balance. The interest is capitalized and added to the loan balance. GERS used this fund to make the interest-only payments in the first 17 months of the loan.

The loan was amended on May 24, 2016, increasing the loan amount to \$11,000,000. The schedule below details the loan terms.

Refinanced Loan: \$11,000,000			
Term: September 30, 2016 to March 31, 2025			
Description	Amount	No. of Payments	Total Repayment
Principal & Interest Payments	\$139,079.18	103 months	\$14,325,155.54

Inconsistent Loan Repayment

We found that VI Finest Foods failed to make their initial loan payments as required by the loan terms. Although GERS accommodated some of VI Finest Foods' requests to pay its loan outside of the agreed loan repayment terms, VI Finest Foods was still unable to make consistent loan payments.

Delayed Loan Repayment. GERS' loan with VI Finest Foods required the borrower to start interest-only payments on July 30, 2014, thru November 30, 2015. After that, principal and interest payments would begin on December 30, 2015, thru June 30, 2024. Within the loan agreement, GERS set aside \$432,676 in a Capitalized Interest Reserve Fund. GERS used the Capitalized Interest Reserve Fund to make all the interest-only payments required by the \$8.2 million loan terms.

We found that in November 2015, one month before VI Finest Foods was required to start principal and interest payments on the loan, VI Finest Foods wrote to GERS informing them that they could not begin those payments. VI Finest Foods' reasons cited were project delays and the need for additional funds to complete the project. Also, VI Finest Foods requested to start repayment three months after completion of the project. GERS granted VI Finest Foods an additional \$2.8 million to complete the project and amended the loan repayment plan by requiring principal and interest payments of \$139,079 starting September 2016. Additionally, GERS canceled the accrual of interest on the outstanding loan balance for ten months, from December 2015 to August 2016.

Inconsistent Loan Payments. In September 2016, VI Finest Foods failed to make the first loan payment, as required. As a result, GERS used the Capitalized Interest Reserve Fund to make the September loan payment, leaving a balance of \$16,903 in the fund.

In October 2016, VI Finest Foods again failed to make the loan payment. VI Finest Foods explained that they were unable to make the loan payment because they had to make advance payments to some of their vendors to avoid delaying the project's completion. The Capitalized Interest Reserve Fund, with a balance of only \$16,903, was not enough to make October's payment of \$139,079. As a result, VI Finest Foods requested from GERS a credit to use \$122,176 of loan proceeds to pay their October 2016 loan payment. GERS granted the credit. VI Finest Foods later made both the November and December payments in December 2016.

In calendar year 2017, VI Finest Foods made only two payments, in February and March, totalling \$278,158. These payments were for the January and February 2017. After the February 2017 payment was made, GERS records showed a delinquent balance of \$99,854. VI Finest Foods did not make any payments over the next 12 months, thereby accumulating a delinquent loan balance

of \$1,262,894. They resumed payments in April and May 2018. Those payments totaled \$769,000.

In July 2018, when the loan arrearage grew to \$968,896, GERS liquidated \$1,300,021 in collateral provided for the loan. GERS applied the \$331,125 difference between the collateral and arrearage to the loan's principal balance.

Loan Foreclosure

On November 13, 2018, GERS filed to foreclose on the loan. By March 1, 2019, the supermarket ceased operations, one month shy of making its second anniversary. At the same time, facing foreclosure, on April 24, 2019, VI Finest Foods sort to mitigate the loan default by leasing the building to the University of the Virgin Islands. The building was leased for \$42,805 monthly, and the rental income was assigned to GERS to offset required loan payments. On February 12, 2020, the University of the Virgin Islands purchased the building for \$8,400,000. On March 5, 2020, when the payment was received, the loan balance was \$11,742,273. Payments were first applied to the loan's accrued interest. The remaining outstanding principal balance was \$3,342,273.

The following schedule identifies and summarizes payments to GERS to satisfy the loan as of the supermarket building's sale.

Description	Amount Paid
Loan Principal	\$11,000,000
Accrued Interest	4,442,048
Reserve Funds Payments	(554,852)
VI Finest Foods Payments	(1,325,317)
Collateral Forfeiture	(1,300,021)
Rental Income	(299,948)
Remaining Loan Funds Applied	(219,637)
Sale of the Building	(8,400,000)
Outstanding Principal Balance	\$ 3,342,273

GERS took legal action to recoup the \$3,342,273 remaining principal balance from VI Finest Foods. GERS is presently in the process of negotiating an agreement with VI Finest Foods to settle the loan debt.

Recommendation

We recommend that the Board of Trustees of GERS:

- 2.1 Perform due diligence in evaluating borrowers' qualifications to minimize risk to members of GERS and maximize returns.

GERS' Response

The response indicated agreement with the recommendation. It stated that GERS will update the Alternative Investment Program Policy to include specific due diligence procedures to evaluate a borrower's qualifications. The expected completion date is prior to the restart of a similar Alternative Investment Program since the program has been suspended.

V.I. Inspector General's Comments

Based on the response submitted, we consider this recommendation resolved, but not yet implemented pending evidence of a copy of the updated policy corresponding to the restart of the Alternative Investment Program.

GERS' RESPONSE
GOVERNMENT EMPLOYEES' RETIREMENT SYSTEM
OF THE VIRGIN ISLANDS

"Contributing today for a better tomorrow"

September 14, 2021

Mr. Steven van Beverhoudt, CFE, CGFM
Virgin Islands Inspector General
Office of the V.I. Inspector General
2315 Kronprindsens Gade #75
Charlotte Amalie, St. Thomas, V.I. 00802-6468

Re: GERS Responses to Inspection Reports

Dear Inspector General van Beverhoudt:

Our responses to the Inspection Report for the Inspection of Procedures to Control Re-Employment of Retired Government Employees and the Inspection Report for the Inspection of the Use of Loan Proceeds of Select Projects in the GERS Loan Program are attached.

Sincerely,



Nellon L. Bowry
Chairman, GERS Board of Trustees

Attachments

cc: Honorable Albert Bryan, Jr. Governor of the Virgin Islands
GERS Board of Trustees
Austin L. Nibbs, CPA, Administrator/CEO

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GERS' RESPONSE

GOVERNMENT EMPLOYEES' RETIREMENT SYSTEM OF THE VIRGIN ISLANDS

"Contributing today for a better tomorrow"

GERS RESPONSE TO INSPECTION OF THE USE OF LOAN PROCEEDS OF SELECT PROJECTS IN THE GERS LOAN PROGRAM

FINDING 1: GERS LOAN MANAGEMENT

The GERS concurs with recommendation No. 1.1.

Plan of Action:

Create a unit within the GERS to oversee and monitor all projects to include project costs if the Alternative Investment Program is restarted.

Person Responsible for Implementation:

Investment Officer / Investment Analyst/Administrator

Expected Implementation Date:

Prior to restarting a similar Alternative Investment Program since the program has been suspended.

FINDING 2: LOAN REPAYMENT

The GERS concurs with recommendation No. 2.1.

Plan of Action:

Update the Alternative Investment Program Policy to include specific due diligence procedures to undertake in evaluating borrower's qualifications.

Person Responsible for Implementation:

GERS Policy Committee/Administrator

Expected Implementation Date:

Prior to restarting a similar Alternative Investment Program since the program has been suspended.

ADDITIONAL INFORMATION NEEDED TO CLOSE RECOMMENDATIONS

<u>Recommendation Number and Status</u>	<u>Additional Information Needed</u>
Finding 1:	
1.1 Resolved, not implemented.	Provide evidence to show that policies have been created for the establishment of a monitoring unit should a program be reestablished
Finding 2:	
2.1 Resolved, not implemented.	Same as 1.1 above.

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