

INTERNAL AUDIT REPORT

CITY OF MANCHESTER

NEW HAMPSHIRE



US FIRST Mortgage Covenants Review

Prepared by

City of Manchester, NH – Finance Department

Internal Audit Division

**INTERNAL AUDIT REPORT
CITY OF MANCHESTER, NEW HAMPSHIRE
US FIRST MORTGAGE COVENANTS REVIEW**

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July 30, 2001

Committee on Lands and Buildings
City of Manchester, New Hampshire
Honorable Aldermen: Cashin, Gatas, Levasseur, Shea, Thibault

Dear Honorable Committee Members:

In June, a letter was received by a concerned taxpayers' group raising concerns about the status of the mortgage agreement between the City of Manchester, NH (City) and US FIRST for a building at 200 Bedford Street. Internal Audit (IA) determined that it would be appropriate to review the status of the covenant provisions in the mortgage agreement.

IA's procedures were limited to a review of the covenant provisions at June 30, 2001. Annually US FIRST receives a financial audit from a public accounting firm and has received an unqualified opinion in the most recent audit for the year ended June 30, 2000.

The review procedures began with an examination of the mortgage agreement and other documentation between the City and US FIRST. IA then determined which covenants should be tested and developed an audit program to address these points.

Conclusion

Based on the testwork performed it appears that US FIRST complied in all material respects with the covenants tested except for lead dust testing. IA, as noted in the accompanying report, has determined that US FIRST has discontinued testing for lead dust contamination without a recommendation from their environmental consultant or approval from the City.

The draft review report was sent to the Director of Finance at US FIRST for his review and comment. The observation generated and the auditee written response is included on page six. The auditee response indicates general agreement with the report's finding and states that corrective action will be taken. We appreciate the courtesy and cooperation of the staff and administration of the US FIRST on this assignment.

Respectfully Submitted,

Kevin Buckley, CPA
Internal Audit Manager

INTRODUCTION

AUDIT BACKGROUND

In June a letter was received by a concerned taxpayers' group raising concerns about the status of the mortgage agreement between the City and US FIRST for a building located at 200 Bedford Street. Internal Audit (IA) determined that it would be appropriate to review the status of the covenant provisions in the mortgage agreement. Internal audit has performed this review in the past. The Finance Officer of the has been designated by state law, city charter and local ordinance with the authority to conduct such examinations and audits.

Our review was conducted in accordance with standards, established by the American Institute of Certified Public Accountants, as well as standards applicable to financial and compliance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

AUDIT SCOPE AND OBJECTIVES

Our review was limited to the mortgage covenants in the mortgage agreement between the City of Manchester, NH and US FIRST for property located at 200 Bedford Street in effect at June 30, 2001.

The results of our testing are included in the Status of Mortgage Covenants section of this report found on pages three through six.

BACKGROUND OF AUDITEE

The US Foundation For Inspiration and Recognition of Science and Technology (US FIRST) is a non-profit corporation founded in 1989 to interest and inspire students in mathematics, science and technology. In 1994 US FIRST entered into an agreement with the City to purchase a building, for \$1,995,000, in the historic millyard district at 200 Bedford Street for use as a museum, open to the public, for programs and displays for the inspiration and recognition of science and technology. The City would purchase the building with proceeds from a \$2,300,000 general obligation bond and US FIRST would renovate and develop the building into a science museum. US FIRST would own the building and the City would hold a \$2,000,000 mortgage on the building that contained provisions that if met, the mortgage would be forgiven. In case of default of the mortgage covenants the building ownership would revert to the City. At the time of purchase the building was partially occupied by St. Mary's Bank and the Wee Play School Inc. These two for-profit organizations would be allowed to remain as lease tenants. All lease proceeds are deposited in a separate account and are used to offset maintenance expenses of the building. It was also determined that the Millyard Museum (a non-profit organization) would occupy a section of the building for its fair share of taxes, assessments, insurance and common maintenance expenses.

STATUS OF MORTGAGE COVENANTS

COVENANT 1: RENOVATION OF PREMISES

To complete renovations of portions or all of the premises (other than those leases approved and consented to as contemplated in covenant 2 below) and commence operation of portions or all of the premises for use as a museum, open to the public, for programs and displays for the inspiration and recognition of science and technology by not later than each of the dates set forth below.

- At least 10,000 square feet on or before July 1, 1996
- At least 25,000 square feet on or before July 1, 1998
- At least 50,000 square feet on or before July 1, 2001
- At least 75,000 square feet on or before July 1, 2004

CURRENT STATUS:

Approximately 18,000-sq.ft. in the basement of the building (first floor) is occupied by the Millyard Museum, if the hallway display area is included. The remaining space consists of a loading dock of approximately 2,800-sq. ft., used for all tenants, and storage space and staging areas used by the science museum of approximately 9,200-sq. ft.

The second floor consists of approximately 15,000-sq. ft. occupied by the Wee Care childcare center and the remainder by US FIRST Place science museum. The science museum section of approximately 15,234-sq. ft. consists of some exhibits but mostly hands on labs and work areas. There is also a small theatre area for doing demonstrations and contests included within this space.

The south end of the third floor is mostly empty storage space (approximately 15,000-sq. ft.). At one time the Dinosaurs exhibit was housed here and is also used for storage of some equipment owned by the City. At the north end is a storage/meeting area and temporary exhibit space for the science museum (approximately 15,000-sq.ft.).

The fourth floor is occupied in the south half by the SEE science museum (approximately 15,000-sq. ft.) and the north half by the US FIRST administrative offices and meeting rooms (approximately 15,000-sq. ft.).

The fifth floor is entirely occupied by St Mary's Bank offices (30,000-sq. ft.).

CONCLUSION:

Total space occupied by the SEE science museum and US first in use, as a science museum open to the public is approximately 69,434-sq. ft. Of this amount 30,234-sq. ft. is in daily continual use to the public with additional 24,200-sq. ft. open and used by the public on an as needed part-time basis for programs and displays for the recognition of science and technology. This would give approximately 54,434-sq. ft. of space used for programs and displays for the recognition of science and technology that would appear to fulfill the square footage requirement in the mortgage agreement.

AUDITEE RESPONSE:

U.S. FIRST wishes to point out that this mortgage covenant was incorrectly worded when the original document was drafted and executed. Attachment 1 is a July 22, 1994 letter from U.S. FIRST to the City stating the commitment for museum occupancy for the building. This commitment was agreed to by the then-City Coordinator and the then-Mayor. At the City's insistence, it was agreed that at least 15,000 square feet would be made available to the NH Industrial Heritage Commission for a museum. (The Industrial Heritage Commission later passed on its rights to the Manchester Historical Association.) It was agreed that such museum space, if developed, would clearly count towards the museum space commitment. Attachment 2 is a December 29, 1997 letter from U.S. FIRST which requests an amendment to the mortgage to correct the wording of Covenant #1. Unfortunately, the City has yet to address this request and subsequent requests.

A lease was negotiated and signed with the Manchester Historical Association (MHA) and the MHA has subsequently raised funds and constructed an excellent museum on the first floor. U.S. FIRST believes that this 18,000 square foot area clearly meets the intent of the City for qualifying museum space. We would appreciate the City taking action on a long-standing request for an amendment to this covenant.

Therefore, we would argue that the 18,000 square feet that MHA is utilizing for museum space should be added to your totals. The City's intent for this covenant was to assure that museum space would be developed in the building that could be used by the citizens of Manchester and might also be a tourist attraction for those visiting Manchester. The MHA Millyard Museum fully meets that intent.

COVENANT 2: LEASE AGREEMENTS

Not to enter into any lease, license, sublease, contract or other occupancy of the premises or any part thereof for purposes other than those of the museum and currently outstanding leases to St. Mary's Bank and Wee Play School, Inc. or any amendment thereof, without in each case the prior written approval of the form of the lease and consent to the lease or amendment thereof by the City.

CURRENT STATUS:

The only leased spaces as of June 30, 2001 were to St. Mary's Bank and Wee Play School, Inc. US FIRST currently also leases space, rent free, for the Millyard Museum. The lease stipulates that the Museum will pay their proportion of building expenses and was approved by the City.

CONCLUSION:

US FIRST appears to be in compliance with the leasing covenant.

COVENANT 3: INSURANCE REQUIREMENT

To keep the building and structure and all fixtures covered by this mortgage now or hereafter on the premises insured against loss by fire or other hazards, such insurance to be in an amount sufficient to avoid coinsurance, first payable in case of loss to the City who shall be named as an additional insured.

CURRENT STATUS:

US FIRST currently have insurance coverage with Utica Mutual Insurance Co. with the City named as an additional insured.

CONCLUSION:

US FIRST appears to be in compliance with the insurance covenant.

COVENANT 4: BUILDING CONDITION

To keep the premises at all times in as good repair and condition as the same now are or hereafter may be put.

CURRENT STATUS:

IA performed a visual inspection of the entire building and found it to be clean and orderly with no evidence of major repairs needed.

CONCLUSION:

US FIRST appears to be in compliance with the building condition covenant.

COVENANT 5: TAXES AND ASSESSMENTS

To pay when do all taxes, charges, assessments and water rates to whomever laid or assessed, on said premises or any interest therein.

CURRENT STATUS:

From a review of tax records, City accounts payable, FY 2000 independent audit report and review of US FIRST's general ledger IA noticed no instances where US FIRST was delinquent in any payments.

CONCLUSION:

US FIRST appears to be in compliance with the tax and assessment covenant.

COVENANT 6: ACCOUNTING RECORDS

To keep and maintain orderly books, records and accounts, including without limitation true and accurate records and books of accounting and current files of lease arrangements, which books, records and accounts shall be open and made available to persons designated by the City and such persons shall be entitled to enter the premises and inspect the same.

CURRENT STATUS:

IA was given copies of all leases, the general ledger for the facility accounts for the month of June, bank statements for June with accompanying reconciliation to book and copies of note confirms from their independent auditors. All documents appear complete and agree with one another. Rent amounts per agreements equal deposits and expenditures appear reasonable. The most recent independent auditor's report has an unqualified opinion.

CONCLUSION:

It appears that US FIRST is maintaining orderly books, records and accounts that are open and made available to persons designated by the mortgagee.

COVENANT 7: LEAD DUST MONITORING

To continue to monitor the existence of lead dust within the premises, and specifically to carry out a program of quarterly cleaning, and semi-annual testing, for lead dust by qualified environmental consultants and testing laboratories and provide written evidence to the City within 21 days. The testing and cleaning program shall continue until the City, upon the recommendation of its environmental consultant, determines that such programs are no longer necessary.

CURRENT STATUS:

US FIRST has discontinued its program of lead dust monitoring but does not have the approval of the City.

CONCLUSION:

US FIRST is not in compliance with the lead dust covenant.

RECOMMENDATION:

If US FIRST's environmental consultants have determine that lead dust testing is no longer necessary they should present the lab reports to the City and request approval to discontinue the testing and cleaning program.

AUDITEE RESPONSE:

U.S. FIRST has not appropriately followed up with the requirements as defined in covenant #7. Unfortunately when there was a change in personnel in 1995, this requirement did not get properly passed on. Now that U.S. FIRST has been reminded of this requirement, it will comply with the requirements of covenant #7 on a go forward basis We are currently in the process of scheduling the testing to resume as soon as possible.

U.S. FIRST will report back to the City of Manchester, in writing, with a testing schedule and commitment to comply with this covenant. If it is determined that lead dust testing is no longer necessary, U.S. FIRST will present the lab report to the City and request approval to discontinue the testing and cleaning program.

ATTACHMENTS



Attachment 1

July 22, 1994

Mr. John Snow
City Coordinator
Manchester, NH 03101

Dear John,

As I explained previously, FIRST would prefer to see any revision language written in the form of a right of the City instead of an automatic event. Therefore, We would like to have it say that if the defined milestones are not met, then the City has the right, at its sole determination, to take over ownership of the building.

The milestones that we would recommend are;

Occupancy of interior space by not-for-profit organizations for operating museums and museum support functions:

Square Footage	Time
At least 10,000 square feet	By 7/1/1996
At least 25,000 square feet	By 7/1/1998
At least 50,000 square feet	By 7/1/2001
At least 75,000 square feet	By 7/1/2004

John, I recognize that 75,000 square feet might appear to be a conservative objective but please remember that with St. Mary's possibly occupying until 2012, the maximum space available is approximately 117,000 square feet. Therefore 75,000 would represent 64% of the maximum available space. Additionally, the first floor - north area might not be desirable to some museums.

Please give me a call with any questions or comments.

Best regards,

Robert M. Tuttle



December 29, 1997

Mr. Samuel A. Maranto, Jr.
Program Planner
City of Manchester Planning Department
The Beacon Building 814 Elm Street
Manchester, NH 03101

Dear Mr. Maranto,

Enclosed please find the following documents you requested:

1. Amendment To Mortgage between FIRST and the City of Manchester signed by Dean Kamen, FIRST Founder, and notarized (amends the commencement of the first 10,000 square feet to July 1, 1998).

Please return a complete and notarized copy of the amendment with the Mayor's signature for our records.

2. Summary of Jobs Retained and Created by FIRST

The updated report on jobs retained and created by FIRST, as per the FIRST/City of Manchester agreement.

Please note: This update indicates an accelerated growth by FIRST on its job creation schedule from the report in the 1996 FIRST/City of Manchester agreement. Please let me know if FIRST has now met all requirements and fully satisfied our agreement.

Regarding the Mortgage between FIRST and the City of Manchester, this is an appropriate time to clarify and make the following correction:

2. Section 2.(a) of the Mortgage is hereby amended to delete the following words starting on the fifth line:

, open to the public, for programs and displays for the inspiration and recognition of science and technology

and replace them with the following words:

or educational program space, primarily open to the public, for programs and displays for FIRST, Science Enrichment Encounters (SEE), N.H. Industrial Heritage Commission/Manchester Historical Association, or other complementary, not-for-profit organizations

Lastly, regarding our contract with the Community Development Finance Authority (CDFA), I need to receive a letter from the City of Manchester, signed by the appropriate City official, consenting to mortgage the property to the CDFA. Here is a draft for your use:

DRAFT OF LETTER TO FIRST FROM CITY OF MANCHESTER

The City of Manchester hereby consents to U.S. FIRST (United States Foundation for the Inspiration and Recognition of Science and Technology) mortgaging the real estate at 200 Bedford Street, Manchester, NH to the Community Development Finance Authority (CDFA) as collateral for the December 22, 1997 letter agreement between U.S. FIRST and CDFA.

I have tried to reach you several times unsuccessfully, and will contact you after January 5. I look forward to speaking with you and discussing these issues.

I hope you had a wonderful holiday season and cheers to a great 1998 ! Thank you as always for all of your help.

With respect,

DIA STOLNITZ

Dia Stolnitz
Project Director, FIRST Place

Encls.