

# INTERNAL AUDIT REPORT

## CITY OF MANCHESTER

### NEW HAMPSHIRE



**FIRST Mortgage Covenants Review**  
**At May 31, 2004**

Prepared by  
City of Manchester, NH – Finance Department  
Internal Audit Division

**INTERNAL AUDIT REPORT  
CITY OF MANCHESTER, NEW HAMPSHIRE  
FIRST MORTGAGE COVENANTS REVIEW  
AT MAY 31, 2004**

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June 22, 2004

Committee on Accounts, Enrollment and Revenue Administration  
City of Manchester, New Hampshire  
Honorable Aldermen: Smith, Shea, Guinta, Osborne and Thibaultt

Dear Honorable Committee Members:

A request was made to Internal Audit to determine the status of the mortgage agreement between the City of Manchester, NH (City) and the United States Foundation For the Inspiration and Recognition of Science and Technology (FIRST) for a building at 200 Bedford Street. Internal Audit (IA) agreed 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 May 31, 2004. Annually 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, 2003.

The review procedures began with an examination of the mortgage agreement and other documentation between the City and 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 FIRST complied in all material respects with the covenants tested except for a slight delay in complying with square footage requirements. IA has noted in the report that FIRST will most likely not be in compliance with the square footage requirements as of July 1, 2004. IA does not consider this a major breach of the mortgage covenants as steps are being taken to comply with the square footage requirement and compliance should be achieved within 2 months of the specified date.

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

Respectfully Submitted,

Kevin Buckley, CPA  
Internal Audit Manager

# INTRODUCTION

## AUDIT BACKGROUND

A request was made to do an update of a prior report on the status of the mortgage agreement between the City and FIRST for a building located at 200 Bedford Street. Internal Audit (IA) has agreed that it would be appropriate to review the status of the covenant provisions in the mortgage agreement. IA has performed this review in the past most recently at June 30, 2003. The Finance Officer of the City of Manchester, NH 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 FIRST for property located at 200 Bedford Street in effect at May 31, 2004.

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 (FIRST) is a non-profit corporation founded in 1989 to interest and inspire students in mathematics, science and technology. In 1994 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 FIRST would renovate and develop the building into a science museum. 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 were 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 assessments, insurance and common maintenance expenses. A similar arrangement has been reached in 2001 with the University of New Hampshire, which occupies 1,833 square feet of space in the building.

Upon completion of current renovations one and one half floors of the building will be occupied by the Science Enrichment Encounters (SEE) Science Center. SEE is a non-profit interactive science center whose mission is to promote the understanding, enjoyment and achievements of science. During the 12 months ended May 31, 2004 over 85,000 visitors have enjoyed the center and its special exhibits.

## **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 on next page) 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 (MHA), 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 Play childcare center and the remainder by FIRST Place science museum. The science museum section of approximately 15,000-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 University of New Hampshire Cooperative Extension Service leases approximately 1,800-square feet of space at the north end of the building.

The south end of the third floor (approximately 15,000-sq. ft.) is in the process of renovation. When complete some time in July it will connect to the SEE Science Museum on the fourth floor by a stairwell and contain permanent exhibits. The north end (approximately 15,000-sq.ft.) is in the process of renovation to house temporary traveling exhibits for both FIRST and the SEE Science Museum. The expected completion date is sometime in August 2004.

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 FIRST administrative offices and meeting rooms (approximately 15,000-sq. ft.).The FIRST administrative office contains approximately 1,200-square feet of display area plus an additional 5,000 in the Annex.

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

### **OBSERVATION:**

Total space occupied by the SEE science museum and FIRST in use, as a science museum that when complete will be open to the public is approximately 75,400-sq. ft. Of this amount all but 15,000-sq. ft. will be in daily continual use to the public with additional 15,000-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. As of July 1, 2004 FIRST will be out of compliance until the new renovations are completed. The new renovations will give approximately 75,400-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 when

complete. In addition the Manchester Historic Association Millyard Museum dedicates much of its space to the historic technology displays.

**AUDITEE RESPONSE:**

As was the case in 2001, FIRST wishes to point out that this mortgage covenant was incorrectly worded when the original document was drafted and executed. FIRST's Attachment 1 is a July 22, 1994 letter from 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 (MHA)). It was agreed that such museum space, if developed, would clearly count towards the museum space commitment. FIRST's Attachment 2 is a December 29, 1997 letter from FIRST, which requests an amendment to the mortgage to correct the wording of Covenant # 1. Unfortunately, the City has never addressed this request and subsequent requests including FIRST's written response to same in August 2001.

Additionally, a lease was negotiated and signed with MHA and MHA has subsequently raised funds and constructed an excellent museum on FIRST's first floor. FIRST believes that the approximately 18,000 square feet clearly meets the intent of the City for qualifying museum space. Once again, FIRST requests and would sincerely appreciate the City taking action on this long-standing request for an amendment to Covenant # 1.

FIRST will continue to argue that the 18,000 plus square feet area that MHA is continuing to utilize for museum space should be added to the reported 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.

Since the Manchester Historic Association dedicates much of its' museum space to historic technology displays, and since the Millyard's history is an inspirational story of the power of science and technology, FIRST believes that MHA's square footage should be included in the calculation of space devoted within the facility. Doing so raises the square footage so used to 93,400. This is in addition to the facts stated above and FIRST's similar written response and request in the Auditee Response of 2001.

**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. FIRST currently also leases space, rent free, for the Millyard Museum and UNH Cooperative Extension Service. The lease stipulates that the Museum and UNH Cooperative Extension Service will pay their proportion of building expenses.

**CONCLUSION:**

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:**

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

**CONCLUSION:**

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. A new roof membrane was recently installed on the building.

**CONCLUSION:**

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

**COVENANT 5: TAXES AND ASSESSMENTS**

To pay when due 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 2003 independent audit report and review of FIRST's general ledger IA noticed no instances where FIRST was delinquent in any payments.

**CONCLUSION:**

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 May, and bank statements for May. All documents appear complete and agree with one another. The amount of rent due per agreements equal the monthly deposits and the level of expenditures appear reasonable. The most recent independent auditor's report has an unqualified opinion.

**CONCLUSION:**

It appears that 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:**

FIRST has been conducting annual lead dust testing as per the agreement.

**CONCLUSION:**

FIRST is in compliance with the lead dust covenant.

## **ATTACHMENTS**

Following are documents supplied by FIRST to help clarify their position.