



State of New Jersey

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June 24, 2014

Leslie A. Anderson
Executive Director
New Jersey Redevelopment Authority
150 West State Street
P.O. Box 790
Trenton, NJ 08625

Re: New Jersey Redevelopment Authority, Selected
Fiscal and Operating Practices
Report PA-24

Dear Ms. Anderson:

Pursuant to the State Comptroller's authority as set forth in *N.J.S.A. 52:15C-1 et seq.*, we reviewed selected fiscal and operating practices of the New Jersey Redevelopment Authority (NJRA).

Background

NJRA was created in 1996 as an independent State authority to provide a coordinated State response to revitalizing New Jersey's most distressed urban neighborhoods. To accomplish its mission, NJRA partners with community-based organizations, real estate developers and businesses to initiate redevelopment projects that foster economic opportunities. NJRA is authorized to finance various types of redevelopment projects, ranging from industrial projects to facilities intended for educational or cultural purposes. Through the issuance of bonds and other sources of funding, NJRA offers various forms of financial assistance to developers including loans, loan guarantees and equity investments, as well as consultative services including

technical assistance and planning services. During the period 2008 to 2011, NJRA approved 41 projects.

NJRA is governed by a board consisting of 21 members including 10 state government officials serving in ex-officio capacity, 7 public members appointed by the Governor, 2 public members appointed by the Senate President and 2 public members appointed by the Assembly Speaker. The Commissioner of the Department of Community Affairs serves as the chair of the Authority.

During the time of our audit, NJRA employed a staff of 12 individuals. In Calendar Year 2012, NJRA salary and benefit costs were approximately \$1 million.

Audit Objective, Scope and Methodology

The objective of our performance audit was to evaluate selected NJRA fiscal and operating practices. Our audit covered the period January 1, 2008 through May 12, 2014, although in some cases relevant project agreements and related documentation we reviewed were executed prior to January 1, 2008.

Specifically, we evaluated NJRA's:

- project application and funding processes;
- program tracking efforts and measurement of program performance; and
- policies and procedures for purchases of goods and services, and usage of the NJRA credit card.

As part of our audit procedures, we reviewed applicable statutes, regulations, NJRA agreements and related documents, and NJRA policy statements. We also interviewed NJRA personnel to obtain an understanding of their job responsibilities and operations, and NJRA's system of internal control.

We conducted our audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and

conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Concerning our review of NJRA's policies and procedures for purchases of goods and services, and usage of the NJRA credit card, we identified relatively immaterial matters which we discussed with NJRA officials.

Audit Findings and Recommendations

Our audit identified weaknesses in NJRA's internal controls concerning its loan underwriting process. We also found that although required by law, NJRA has not prepared a bi-annual strategy document for ten years.

Loan Underwriting

Loan underwriting is the process through which a lender decides whether a loan applicant is creditworthy, whether the loan would be a prudent use of funds and, ultimately, whether the applicant should receive the loan. NJRA has a credit rating system to assess project risk and developers' credit worthiness. While we saw evidence that NJRA obtained pertinent financial and related information, NJRA's files did not contain adequate written documentation (e.g., a checklist of review steps taken) of its efforts to assess the credit rating of developers and project risk.

We judgmentally selected 3 projects (1 from the 41 projects and 2 that were approved prior to our scope period) for a closer review to include examination of the current status of the project and the processes NJRA followed regarding project funding. Of the three projects, NJRA's commitment for funding had expired for one and the remaining two had gone into default. We analyzed available financial information from NJRA's files and found the following:

- 200 North Broad Street, Trenton – The goal of this project was to renovate a 13,824 square foot building, thereby creating office and retail space in Trenton. The developer applied to NJRA for \$250,000 of pre-development funds, which NJRA approved on March 25, 2010. The total project cost including construction was estimated to be \$1,340,450. Fifteen months later, NJRA's commitment for funding expired because the developer could not obtain construction financing from a bank.

We reviewed relevant tax returns for 2007, 2008 and 2009 and found rental losses for all three years reflected on the developer's personal tax returns. According to the developer's personal financial statements filed with the application, between 2004 and 2010 the value of the property reportedly increased from \$234,300 to \$1,430,000. There was no documented appraisal of the property supporting the increased valuation nor did NJRA provide us with any documented analyses indicating that it had reviewed the developer's financial records.

A more thorough review and analysis by NJRA of the financial background of the borrower prior to the execution of the funding agreement could have addressed these concerns.

- 432-452 South Broad Street and 12 Hamilton Avenue, Trenton – The goal of this project was to create 99 rental housing units in Trenton as well as commercial/retail space and parking. The developer received approval for acquisition and pre-development funding totaling \$1,540,000 from NJRA on April 27, 2005 and the loan agreement was signed on March 17, 2006. Because the title of the underlying property remained with the original property owner, NJRA placed a first lien on the property. The total project cost was estimated to be \$16.3 million. This project ultimately went into default due, in part, to the developer's inability to secure construction financing from a banking institution. The amount outstanding that is owed to NJRA as of June 27, 2012 is \$1,237,062.

Our review of the financial statements for the two partners involved in the project found that there was no support for assets (e.g., securities, real estate holdings) listed on the application. For example, one partner listed real estate with a market value in excess of \$2.4 million and an interest in another business valued at \$4 million with no documentation to support such ownership and interest. There was no evidence that NJRA conducted a thorough financial review of the developer, which might have caused NJRA not to extend the requested financing.

- The Neighborhood House expansion project was a multi-phased expansion project that would enhance and increase the number of preschool and infant classrooms in Plainfield, NJ. The applicant applied for \$1,067,000 for acquisition, site assembly and

redevelopment of the properties. NJRA funded the loan from its Urban Site Acquisition program. This project is currently in default for failure to secure construction financing.

We reviewed the relevant information available at NJRA and found that the loan was secured by a lien on multiple properties, of which the appraised value was \$1.6 million. Our further review of the audited financial statement used to apply for the loan identified total net assets of \$1,947,759. We note that \$1,697,267 was in a restricted trust fund; the applicant did not own or control the associated trust. Only the investment income of \$53,585 from the trust could be used to support general activities. The loan amount outstanding as of June 27, 2012 is \$1,099,111.

Utilizing a thoroughly documented credit rating system would put NJRA in a better position to assess the financial condition of prospective borrowers, and to determine the viability of each project and its potential benefit to the State.

Bi-annual Strategy Document

Pursuant to *N.J.S.A. 55:19-45*, NJRA is responsible for developing a strategy document “setting forth the goals and priorities governing the selection of the projects it anticipates participating in or assisting.” That statute further states, “In selecting projects for its participation, and in evaluating those projects in which it has participated, the authority shall devise and employ techniques for forecasting and measuring relevant indices of accomplishment of its goals of economic revitalization, including specifically:

- the number of jobs created, or to be created, by, or as a result of, the project;
- the cost, or estimated cost, to the State, involved in the creation of those jobs;
- the amount of private capital investment in, or stimulated by, a project, in proportion to the public funds invested therein; and
- in the case of an industrial project or a multi-purpose project which has, as one of its elements, a project classified as an industrial project, a determination, based upon written findings, that the project would not be undertaken but for the participation of the authority.”

According to the statute, this document is to be prepared bi-annually. However, our review found that since 1997, NJRA has prepared only two such strategy documents, the most recent one being issued approximately ten years ago, in 2003.

NJRA does prepare an annual report, however, it does not contain all of the items required by *N.J.S.A. 55:19-45*.

Recommendations

1. Maintain a complete project file that includes written evidence that the underwriting process has been followed.
2. Develop the strategy and performance metrics required by *N.J.S.A. 55:19-45*.

Reporting Requirements

We provided a draft copy of this report to NJRA officials for their review and comment. Their comments were considered in preparing the final report and are attached as Appendix A.

The Office of the State Comptroller is required by statute to monitor the implementation of our recommendations. To meet this requirement and in accordance with *N.J.A.C. 17:44-2.8(a)*, following the distribution of the final audit report, NJRA shall report to the Office of the State Comptroller within 90 days stating the corrective action taken or underway to implement the recommendations contained in the report and, if not implemented, the reason therefore.

We thank the management and staff of the NJRA for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,



William P. Challice, CIA, CFE, CGFM
Director, Audit Division

c: Commissioner Richard E. Constable, III, Esq., Chairman, Authority Board



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June 11, 2014

LESLIE A. ANDERSON
EXECUTIVE DIRECTOR

Mr. William Challice
Director
Audit Division
Office of the State Comptroller
P.O. Box 024
Trenton, NJ 08625-0024

Dear Mr. Challice:

Thank you for the opportunity to respond to the Office of the State Comptroller's (OSC) performance audit of the New Jersey Redevelopment Authority (NJRA). During the period of time covering March 2011 through May 2014 which OSC conducted its performance audit, NJRA's staff remained steadfast in its commitment to provide OSC with all of the required information and adhered to high standards of accountability, efficiency and good governance.

NJRA's enabling statute, P.L. Chapter 62, was signed into law in 1996. Accordingly, NJRA became fully operational in 1997. NJRA's mission is to provide a unique approach to revitalization efforts in New Jersey's cities by providing financing opportunities in distressed communities.

As a result of significant disinvestments in housing and commercial activities, the economic vitality and revitalization of these communities has been impacted negatively. Oftentimes, NJRA has the challenge of being the first lending institution to provide approved investments for predevelopment or acquisition costs. As the catalyst to spur the redevelopment process in the sixty-eight (68) eligible municipalities, NJRA's decision to invest in projects strives to balance the assessment of risk with the mission to improve the quality of life in urban neighborhoods.

NJRA's response to the OSC findings is as follows:

OSC Recommendation:

Maintain a complete project file that includes written evidence that the underwriting process has been followed.

NJRA Response: In an effort to continuously improve operations, the NJRA will ensure that it fully documents its underwriting process and that all relevant documentation is contained in the project files.

The NJRA loan underwriting process conforms to established industry standards for financing real estate developments. NJRA's loan underwriting procedures outline the steps staff takes when making a determination to recommend financing to the NJRA Board of Directors. Among

other things, the underwriting process includes documentation concerning project evaluation, risk assessment and review of borrower/guarantor financial information and collateral determination.

For its review and approval, NJRA's Board of Directors is provided with comprehensive project and financial review information that summarize the steps taken during the underwriting process that includes the rationale for the recommendation. Such information includes a redevelopment context for the project (e.g., redevelopment plan, neighborhood/project description), a summary of loan terms (e.g., interest rate, term, site description, source of repayment, development team, legal counsel conditions to close on financing and other relevant covenants), background on developers that includes their financial information and level of development expertise (e.g., project descriptions) and a description of the collateral that will be used to secure the loan.

It is important to note that NJRA approved financing investments are secured by 1st mortgage liens on subject properties. In 2010, NJRA further enhanced its underwriting process by requiring commitment letters from other funders included in proposed projects. Moreover, NJRA requires corporate and/or personal guarantees from private developers.

OSC Recommendation:


Develop the strategy and performance metrics required by *N.J.S.A. 55:19-45*.

NJRA Response: NJRA will prepare a bi-annual strategy document that it will post on its website.

Nonetheless, NJRA does collect and report salient information concerning project outcomes related to its financing activities. Specifically, such information is presented in its EO37 (Corzine) annual report to the Governor and Legislature, among other documents. NJRA's annual report is posted on its website at: www.njra.us.

Despite the inherent challenges of urban investment, NJRA has demonstrated a proven track record of successful investments in projects throughout urban New Jersey. NJRA will continue to refine its procedures and processes to further ensure the efficacy of its allocation of resources.

Sincerely,



Leslie A. Anderson
Executive Director

C: Richard Constable, Commissioner