Final Report
and
Recommendations
of the

STATE OF NEW JERSEY
COMMISSION OF INVESTIGATION

on the

NEW JERSEY
HOUSING FINANCE AGENCY

State of New Jersey

COMMISSION OF INVESTIGATION

28 WEST STATE STREET
TRENTON, N.J. 08608
TELEPHONE (609) 292-6767

COMMISSIONERS

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CHAIRMAN

ROBERT J. DEL TUFO
WILLIAM S. GREENBERG
HENRY S. PATTERSON, II

JAMES T. O'HALLORAN
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JOHN O. DAVIES
EXECUTIVE ASSISTANT

COUNSEL
MICHAEL V. COPPOLA
JAMES A. HART
GERARD P. LYNCH

DECEMBER 20, 1982

TO: The Governor and the Members of the Legislature of the State of New Jersey:

The New Jersey State Commission of Investigation herewith submits its final Report (#2) and Recommendations on its investigation of the New Jersey Housing Finance Agency. This transmittal is made under Section 4 of L. 1979, Chapter 254 (NJSA 52:9M-1 et seq), of the Act creating the Commission.

Respectfully Submitted,*

Arthur S. Lane, Chairman
Henry S. Patterson, II, Commissioner
Robert J. Del Tufo, Commissioner

*Commissioner John J. Francis, Jr., who concluded his service with the SCI on August 1, 1982, had disqualified himself from participation in this investigation and report because the law firm with which he is associated represents charitable sponsors of HFA projects. Commissioner Robert J. Del Tufo did not join the Commission until the final stage of the investigation. Commissioner William S. Greenberg was appointed to the Commission after the conclusion of the inquiry.

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STATE COMMISSION OF INVESTIGATION

REPORT (#2)

ON THE

NEW JERSEY HOUSING FINANCE AGENCY

I. INTRODUCTION AND FORMAT OF REPORT

The New Jersey State Commission of Investigation (SCI) issued its first report on the New Jersey's Housing Finance Agency on March 23, 1981, pursuant to a mandate to investigate the HFA from then Governor Brendan T. Byrne. The initial report focused on corruption, conflicts of interest and other derelictions of duty as well as on an irresponsibly permissive atmosphere at the agency that resulted in the improper advancement of projects of favored loan consultants. The Commission realized at the time that other aspects of its overall inquiry would require more extensive review and comment, chiefly the complex facets of HFA project financing. Therefore the SCI decided to cover agency project financing activities and issues in a separate report.

Report (#2) is divided into four sections. Section I, the introduction, describes the format and objectives of the report. Section II provides a detailed explanation of the HFA's basic project financing procedures. In Section III, the HFA's role in processing five projects is reviewed. This section illustrates certain project processing practices that the SCI questions as improper or inappropriate. While the events discussed in this section took place some years ago, before the Agency began cleaning house after the appointment of Bruce M. Coe as Executive Director* in 1979, the comments remain valid since they identify past weaknesses in the HFA's operations that should not be countenanced in its future performance. Section IV lists the Commission's recommendations for correcting these shortcomings.

The Commission submits this report to the Governor and the Legislature with the hope that its proposed reforms will strengthen an Agency which has, despite past improprieties, earned a deserved

*Coe resigned as Executive Director in December, 1981.

reputation as the nation's foremost developer of mass housing for people of low and moderate incomes. The Commission believes that the implementation of its recommendations will safeguard for the HFA a critically essential public image of credibility and integrity.

II. PROJECT FINANCING BACKGROUND

A. Explanation of Agency Procedures

A knowledge of the types of projects funded by the HFA and its funding procedures is necessary in order to understand the project discussions contained in this report. When either nonprofit or for-profit projects are approved for coverage by the Agency's periodic bond sales, the bond proceeds provide for all or most construction and other developmental costs in return for which the HFA assumes mortgages on the projects. The following analysis of various types of project funding procedures at the Agency explains their basic characteristics and differences.

1. NonProfit Projects

In financing projects sponsored by nonprofit entities, the HFA provides 100 per cent of the costs required for development. During the initial developmental stages, "seed money" loans provided by the Department of Community Affairs (DCA) are made available to the nonprofit sponsor to cover certain costs for architectural, legal, loan consulting, land surveying and other professional services authorized by the Agency. A seed money loan is important to nonprofit sponsors since they generally lack the necessary funds to develop projects to a point where the HFA can decide whether to proceed with mortgage commitments and construction.

An HFA mortgage commitment equal to 100 per cent of total project costs is based on the expectation that the project will generate sufficient revenues to pay the principal and interest required on the loan. The primary factor in projecting revenues is the Federal Rent Subsidy committed to the project, a subsidy that is calculated to provide the income needed to pay the debt service. In instances where revenue projections, including the portion to be provided by the Federal subsidy, are insufficient to cover operating expenses and mortgage repayment, the project is deemed to be financially unfeasible and ineligible for a mortgage commitment.

After the Agency conducts a bond sale and obtains bond proceeds for the committed mortgage amount, the mortgage money is advanced to the project on a monthly basis during its construction and initial rent-up. These advances are equal to 100 per cent of all the construction and related costs recognized and approved during a particular month. The monthly advances go from the Agency's bond proceeds account to the project's construction account, which is jointly controlled by the Agency and the sponsor. Checks signed by both an Agency representative and the sponsor are drawn against the construction account for payment of recognized costs. When the project is completed, the Agency will have provided 100 per cent of all recognized costs such as: 1) site acquisition, 2) construction materials and labor certified as having been spent by the general contractor, 3) the general contractor's profit and overhead fee, 4) professional service fees, 5) finance charges, including fees to the Agency, 6) selling or rent-up expenses, and 7) working capital. Working capital

can be used for operating expenses until the project is sufficiently occupied to produce rental revenue to meet its expenses. The project's seed money loan is repaid to DCA out of the initial mortgage advance.

Only in nonprofit projects do the mortgageable costs allowed for professional services include the services of a loan consultant. Nonprofit sponsors, many of whom lack experience in real estate development, are permitted a maximum of $27,500 for employing such a loan (or housing) consultant. The HFA's "Guide for Development of Limited Dividend and Nonprofit Housing" describes such a consultant and his duties as "the head of the nonprofit development team, the other members being the architect, attorney and builder...the housing consultant is...an individual or firm possessing experience and competence in the organization and planing of housing, market evaluation and marketing, site selection, procurement of financing, evaluation and selection of attorneys, architects, building contractors, property managers, and other required participants, and in the preparation of applications and other necessary documents..."

2. Limited Dividend Projects

In the processing of for-profit, or limited dividend, projects, seed money is not provided to the sponsor and the Agency is limited by statute to mortgaging only 90 per cent of the total development cost. The for-profit sponsor, accordingly, must provide 10 per cent of the total cost, an equity position that is established on a monthly basis during the construction and initial rent-up period. As the Agency each month advances 90 per cent of recognized development costs to the jointly controlled construction account, the sponsor provides his 10 per cent equity portion and the total is used to cover the checks drawn against this account to pay those costs. Thus, when the project is completed the Agency will have provided 90 per cent of HFA-approved costs certified as having been spent by the sponsor and the general contractor, up to the amount of the mortgage commitment.

HFA-approved costs for limited dividend projects differ in a number of respects from those allowed for nonprofit projects. For example, in limited dividend projects the Agency does not recognize the general contractor's profit and overhead fee as a mortgageable cost. Instead the amount and payment of this fee is regarded as the responsibility of the limited dividend developer/sponsor. However, the Agency recognizes a developer's fee significantly larger than a contractor's fee as a mortgageable cost. In addition to thus compensating the developer/sponsor for having to pay the general contractor's fee, the developer's fee, according to HFA's fee schedule, is "... compensation for the services performed and risks assumed by the developer in effectuating approval of the site and application for the mortgage loan...and the completion of the project." The development fee also covers costs incurred by the developer in connection with travel, research, feasibility and market surveys, negotiations of contracts, negotiations for land acquisition, excess land costs (if any), preparation and processing of required documents, office overhead and other packaging costs. The developer's

fee is determined as a percentage of the construction cost and, in the limited dividend projects examined by the SCI, ranged from $320,345 to $1,177,049. The contractor's profit and overhead fees for these same projects ranged from $162,350 to $700,000.

The Agency does not recognize the services of a loan or housing consultant for a limited dividend project, except to the extent that many of those services are cited as reasons for the developer's fee. (Until 1978 the Agency had recognized the services of a project planner for limited dividend projects, such services being identified at the time as "project planning, paper work, i.e., applications, budgets, exhibits, etc., and processing." In the projects examined by the SCI, project planner fees ranged from $15,750 to $21,055 and, in each case, the fee was paid to the developer/sponsor or a company owned by the developer/sponsor).

The inclusion of the larger developer's fee, instead of the contractor's fee, is one of several factors that result in a higher total cost for limited dividend projects. This increase in total cost was exemplified in the SCI's examination of three projects which converted from nonprofit to limited dividend status prior to HFA closings. Even though the mortgage commitment for these projects was reduced from 100 per cent to 90 per cent of development costs, because of the larger costs allowed the actual decrease in the dollar amount of the mortgages was less, ranging from 4.78 to 8.57 per cent. Besides the developer's fee, the other factors in increasing development costs were allowances for higher construction costs (partly due to the fact that limited dividend projects are not exempt from the State sales tax), and establishment of larger reserves for "contingencies."

Limited dividend projects differ from nonprofits in certain financial aspects of projected and actual operations. Limited dividend projects normally have lower debt service costs because their mortgages are lower. However, the subsidized operations also include cash return to the sponsor. The maximum annual return allowed is 8 per cent of the sponsor's equity portion of total development cost. Any portion of this return that is not available for payment during a particular year may be paid in a subsequent year in addition to the 8 per cent earned in that year. Increased costs due to a provision for return on equity in limited dividend projects are not as significant as larger payments by nonprofits for debt service since payment of return on equity is made only if and when funds are available. Consequently, projects are more feasible -- and in some cases only feasible -- as limited dividend projects.

3. Syndication of Projects

Limited dividend projects also have access to additional private sector funds generated from syndication by limited dividend sponsoring entities.

The limited dividend sponsoring entity is usually a limited partnership, with the developer assuming the role of general partner.

Syndication involves the marketing and sale of a portion of the partnership to investors who wish to become limited partners. These limited partners agree to contribute a predetermined amount of money for a percentage of ownership interest, or unit, in order to share in the partnership tax losses, which they can use to "shelter" other income against income taxes.

Given the total development cost of a particular project, broken down into construction components, professional fees, interest and finance charges, and with subsidized revenue and estimated annual expenses -- including depreciation -- generally being predictable, the amount of annual tax losses that will be generated from the project can be estimated with some degree of accuracy. The Federal rent subsidies provide project operations with a modest but positive cash flow in that they are calculated to cover the project's cash expenses, mortgage principal repayments and return on equity cash distributions. However, depreciation as a large non-cash expense results in a "for-tax-purposes" loss even while a project is generating a positive cash flow. This pivotal depreciation factor represents the federal government's effort to encourage private sector investment in subsidized housing developments. Such investment is spurred by allowing the use of accelerated methods of calculating depreciation expense, which results in large tax shelter losses for investors during the early years of a project's operation. For these investors, a guaranteed tax shelter is more important than receiving a cash return on equity. In fact, it is not unusual to find a disproportionate amount of cash distributions from a project being retained by the developer/general partner as a management fee and not passed on to the investor.

In most syndications, the developer/general partner will market the limited partner investment interests through a professional syndicator. The syndicator provides the legal, accounting, marketing and other services necessary in placing these units. After taking into account various project-related costs and syndication expenses, the syndicator and developer/general partner negotiate a split of syndication proceeds. The agreement between the syndicator and developer/general partner normally requires the syndicator to guarantee the total contributions to be made by limited partner investors. These investors make their required contributions in installments over a period of years.

The status of individual limited partners in the partnership is that of a passive investor with no managing duties and no control over the affairs of the project. In most instances their only involvement with the partnership is through the syndicator or an investment broker used by the syndicator to market limited partner units. In order to protect the interests of these investors, the partnership agreements often provide for a fiscal general partner selected by the syndicator. In some cases this fiscal general partner is a corporation wholly owned by the syndicator. A fiscal general partner has varying degrees of authority over the use of partnership capital and other matters of concern to the limited partner investors.

Additional investor protection is sometimes provided by what is known as a second tier partnership. Under this arrangement all limited partner investors in a project are joined in a separate limited partnership business entity, which then becomes the sole limited partner. The new second tier limited partnership entity consists not only of the investors but also a general partner selected by the syndicator. This second tier general partner manages the investors' capital contributions and deals with the developer/general partner of the sponsoring groups in accordance with the agreements between the first and second tier entities.

The existence of this added element of project investment protection has a positive effect on a syndication's marketability. Sound management of the partnership and the project is of utmost importance to investors because a mortgage foreclosure could confront them with severe tax reverses. If a project were foreclosed, the Internal Revenue Service could "recapture" past tax shelter losses that were based on accelerated depreciation by requiring the investors to recognize some of those losses as ordinary income in the year of the foreclosure. This threat of an IRS recapture gives the HFA leverage in seeking additional funds from the limited partnership to forestall a foreclosure. In essence, the Agency is able to bargain with investors in a project facing foreclosure in an effort to salvage it.

The amount that syndicators paid to a developer/sponsor for the right to sell subsidized housing investments continually increased during the period 1975-79, according to the SCI's examination of 10 project syndications. The most recently syndicated project examined by the SCI generated gross syndication proceeds of more than 22 per cent of the mortgage, with the developer/sponsor's portion being in excess of 16 per cent.

4. Developer's Interim Funding Role

During the syndication process, the limited dividend project developer's role in paying the required 10 per cent equity portion of total development costs is tantamount to providing interim funding. Although personal resources advanced toward a project's financial requirements are repaid to the developer when syndication proceeds become available, his financial participation is by no means insignificant. The 10 per cent equity, which must be available on a timely basis, decreases the bond proceeds required of the Agency and otherwise enhances the feasibility of the project.

Even though the 10 per cent equity position is established during construction and rent-up, the HFA requires the limited dividend project developer to provide the cash or its equivalent at the time of closing. This demonstration of financial ability is critical, since the Agency can only appropriate bond proceeds equal to 90 per cent of the costs necessary to complete construction.

Acceptable to the Agency as alternatives to cash payment of a developer's 10 per cent equity are irrevocable letters of credit

and/or pledges of fees which the HFA controls as mortgageable costs. When a particular pledged fee is earned, the Agency generally advances to the jointly controlled contruction account its 90 per cent portion of this fee. At this point, however, instead of authorizing payment of the fee, the Agency can allow the developer to apply the advanced funds toward payment of his 10 per cent portion of other mortgageable costs. In effect, the developer receives equity credit for 100 per cent of the pledged fee since, in addition to using the 90 per cent portion advanced by the agency, he does not have to provide his 10 per cent portion from his own personal resources. In projects examined by the SCI, pledged items included architect fees, legal fees, the developer's fee and the project planner's fee (when it was still recognized as a mortgageable cost). The pledges are repaid as the developer receives syndication proceeds. The developer's fee is not normally repaid in cash but is treated as an offset against his equity requirement. Payment of a contractor's fee can also be deferred until the receipt of syndication proceeds.

Because of the increasing syndication value of the limited dividend projects it was funding, the HFA has imposed additional financial requirements payable from syndication proceeds. The most important of these requirements is a Development Cost Escrow (DCE) account. This account is controlled by the Agency and provides a financial cushion against short term operating difficulties and a reserve for capital improvements to benefit tenants or reduce maintenance or replacement costs that would otherwise draw on operating funds. The Agency also imposes a fee payable from the syndication proceeds.

B. Types of Limited Dividend Projects

The SCI examined three types of limited dividend projects processed by the Agency: 1) Those which were processed as limited dividend projects from the outset; 2) those initiated as nonprofits but which converted to limited dividend projects prior to closing, and 3) those which began as nonprofits and were converted to limited dividend projects after closing but prior to the completion of construction.

Projects which began as nonprofits but were converted to limited dividend status prior to mortgage closing were processed much the same as those which began as limited dividend projects. Mortgage commitments for 100 per cent of total costs, committed when the projects were nonprofit, were reduced to 90 per cent of total costs when the projects converted. Despite some increases in costs, the dollar amount of the mortgages was reduced. As a result, the new limited dividend developer/sponsor had to provide for the interim funding normally associated with straight limited dividend projects. However, one significant difference between those projects which began as limited dividend and those which began as nonprofit and were converted prior to closing was the availability of seed money that had been granted to the nonprofits. These seed money advances to the original nonprofit sponsor generally enabled the new limited dividend sponsor to avoid using his own resources prior to the Agency's

mortgage closing.

The HFA's ongoing proceedure for financing projects which began as nonprofit and were converted to limited dividend status after closing is discussed in detail on Pp. 37 to 39 of this report.

C. Projects Chosen for Examination

The SCI chose for examination five projects that were closed at the HFA during the mid-1970s. These exemplars demonstrated either inappropriate activities by the Agency or the sponsor or inadaquacies in the procedures by which HFA processed projects. The five projects are: two Essex County projects known as Grace and Nevada, which received special treatment at the Agency because of apparent personal influences and pressures; Maplewood, also in Essex County, which illustrated weaknesses in Agency policy that allowed cut-rate project investments; and Community Haven in Atlantic City and Battery View in Jersey City, in which questionable transactions were authorized by the HFA in 1978.

III. FIVE PROJECT PROCESSING EXEMPLARS

A. Examples of HFA Conversion Abuses

1. Grace, Nevada Projects

a. Background

The Grace Renewal project entered HFA's pipeline in 1975 as a nonprofit project under auspices of the Grace Reformed Church of Newark. Reverend Levin B. West, the pastor at the time, was the president of Grace Development Corporation, the nonprofit entity formed to sponsor the project. Legal services were provided by Oliver Lofton, a Newark attorney. The loan consultant was Planners Associates, Inc., a Newark company owned by Arthur D. Lerner. The project received a seed money loan and, on March 23, 1977, was granted an HFA mortgage commitment.

The Nevada Street project, also located in Newark, entered the agency's pipeline in 1975 under sponsorship of the AFL-CIO Urban Renewal Housing Corporation. This nonprofit corporation was formed by the State AFL-CIO, whose president, Charles Marciante, was also the corporation's president. The initial project attorney was the Trenton firm of Pellettieri and Rabstein. Underwood Mortgage and Title Co., formerly of Irvington, N.J., and Planners Associates, Inc., the Grace loan consultant, acted as the Nevada co-loan consultants. This project also had the benefit of a seed money loan and, on September 24, 1976, was granted an HFA mortgage commitment.

Even though Grace and Nevada began as separate projects which had progressed to the point of receiving HFA nonprofit mortgage commitments, the Commission has combined its review of their transition to limited dividend status because of the timing of certain key events and because the developer/general partner, Lerner, was the same for each project. As for the key events: Each project obtained HFA mortgage recommitments on the same day, June 30, 1977 -- for Grace Associates as the new limited dividend sponsor replacing Grace Development Corporation, and for Nevada Associates replacing Nevada's AFL-CIO corporate nonprofit sponsor; and each project's final mortgage closing as limited dividend projects took place on September 23, 1977. In addition, each project had partnership management agreements with the same corporate entity, LHS Management, which was formed by Lerner, Daniel Horgan and the late Jack Stein. The financial consequences of these parallel conversions are detailed below, followed by a review of testimony at the SCI by participants in the transition process.

b. Grace, Nevada Financing

As previously noted, the HFA had authorized seed money loans to cover various costs incurred by the then-nonprofit sponsors. These loans -- $35,700 for Grace and $70,269 for Nevada -- meant that after conversion their limited dividend sponsors did not have to risk any personal funds for costs prior to HFA closings as limited dividend

projects. At the Grace and Nevada closings in September, 1977, the seed money loans were repaid to the New Jersey Department of Community Affairs with mortgage funds advanced by the HFA.

In accordance with the Agency's financing procedure for limited dividend projects, the total cost of the Grace project was adjusted to $19,200,000 with a mortgage commitment of $17,280,000 and an equity requirement from the sponsor of $1,920,000. The new total cost for Nevada was $11,227,780 with a mortgage commitment of $10,105,000 and a sponsor equity of $1,122,780.

Another adjustment in the financing transition of these projects was the substitution of a developer's fee for the general contractor's profit and overhead fee as a mortgageable cost. The developer's fee for Grace was $1,177,049 and for Nevada $725,330. As customary, these fees were used to reduce the sponsor's equity requirement. The general contractor's fees, which must be paid by the developer in limited dividend projects, included $700,000 payable to Caristo Construction Corp. of Brooklyn, the Grace contractor, and $540,000 payable to Jack Parker, Inc., of Forest Hills, N.Y., the Nevada contractor.

As a result of these financial arrangements, Lerner, the developer/general partner of the Grace and Nevada sponsoring partnerships, was obligated to provide $2,380,401 toward the completion of both of these projects -- $1,140,401 at the closing for equity (net of developer's fees) and $1,240,000 to the general contractors during construction.

c. Agency Irresponsibility

HFA included both of these projects in its September, 1977, bond sale. During the period of almost three months between the time the agency allowed these two projects to convert and their mortgage closings, the HFA did not require Lerner to submit evidence that all necessary funds would be available. The mortgage money committed to these two projects, $27,385,000, represented more than 21 percent of the total bond sale proceeds earmarked for construction of 19 projects. Lerner's failure to provide the required equity of $1,140,401 at the closings jeopordized these two projects and possibly the entire bond sale. The projects were salvaged only by dubious maneuvers orchestrated by the HFA.

Lerner was one of five general partners in the Maplewood Senior Citizens project, which was also part of the 1977 bond sale. In allowing all three projects with which Lerner was associated to use the same syndicator, Atlan-Tex Realty & Funding, the HFA again demonstrated a lack of judgment. Since Lerner failed to confirm his financial capacity to fulfill the developer's funding requirements, the timely completion of Grace and Nevada became dependent upon the Atlan-Tex assets and marketing capabilities which were spread over three projects. The SCI is not aware of any prior dealings by Atlan-Tex or its president and principal stockholder, Maurice Cohn (since deceased), with the HFA or with any other HFA projects. Furthermore, examination of HFA files on Grace, Nevada and Maplewood

failed to yield any evidence that the agency investigated the financial background of Atlan-Tex.

Since no cash or letters of credit were provided by Lerner at the closings, the HFA allowed him to apply toward his equity requirement pledges of $430,738 in fees for professional services to the two projects. However, because the cash generated from a pledged fee depends on the extent of the professional service the Agency recognizes as having been performed, Lerner's pledges provided only $273,537 in available cash.

(Fee pledging is consistent with HFA rules and regulations, although not to the extent evidenced in Grace and Nevada, and is a common practice among HFA's limited dividend project sponsors. Pledging of fees will be discussed in this report's Section IV on recommendations).

After receiving credit for fees pledged, Lerner still lacked $709,663 in cash or equivalent bank guarantees to satisfy the remaining equity requirement, consisting of $233,374 for Nevada and $476,289 for Grace. Normal HFA policy would require Lerner to meet this balance by providing irrevocable bank letters of credit, which would allow the agency to draw from the issuing bank whatever cash might be necessary to cover the equity portion of project costs. However, the HFA did not require cash or a letter of credit from Lerner. Instead, in order to enable the Grace and Nevada projects to close, the Agency initially contradicted its policy by giving Lerner equity credit of $200,663 for marketable securities which were delivered to and held in escrow by the First National State Bank of New Jersey. Marketable securities would be of no value in providing cash toward the sponsor's portion of project costs unless the Agency intended to sell the securities or use them as collateral for a loan.

The remaining $509,000 of the equity balance was provided through a unique pledge of contractor's fees by Jack Parker, Inc., the general contractor for three of the September, 1977, bond sale projects, one of which was Nevada. In separate agreements dated September 23, 1977, but executed on the following day, Parker pledged $282,000 of its general contractor's fee from the Rahway Senior Citizens project toward the equity of Grace and $227,000 of its fee from the Mt. Carmel project in Orange toward Nevada's equity requirement. These agreements stated that Parker would become the owner of all general and limited partnership interests in these two projects if Lerner was unable himself to meet the equity requirements by November 22, 1977. If Parker were to assume ownership, according to the agreement, Lerner's securities were to be returned intact or he was to be paid in cash or partnership interest for those securities. The parties named in these agreements included the Parker Company, Lerner as general partner, and LHS Management, Inc. The LHS corporation had been created by Lerner, Daniel Horgan and Jack Stein for the purpose of taking, in the form of various fees, that portion of syndication proceeds not required for project development costs.

Parker's "concern" about the possibility of assuming as sponsor the financial requirements for the Grace and Nevada projects was a topic of two letters dated September 24, 1977, from William L.

Johnston, then the Executive Director of HFA, to Martin Schwartz, vice-president of the Parker company. The Agency in Johnston's letters confirmed its awareness of this unusual pledge, and also stated:

> The Agency is further aware of the concern of Jack Parker, Inc. as to the assumption of said partnership liabilities. Jack Parker, Inc. has further advised this Office that it may, should conditions warrant in the future, request the Agency to assume the partnership obligations of Jack Parker, Inc. in the project.
>
> While no commitment can be given by this Office at this time with respect to future Agency action concerning Jack Parker, Inc.'s request, it would be my intention on behalf of the staff of the Agency to recommend that the Agency assume the partnership obligations of Jack Parker, Inc. and thereupon sell partnership interest in the development to third party investors.

Johnston was never required to implement his intention to recommend, if necessary, that the HFA assume Parker's obligations. Consequently, the manner in which the Agency could have assumed the role of developer in one of its own projects must be left to conjecture.

Although the HFA's approval of marketable securities and the Parker pledges enabled the Grace and Nevada sponsor to meet artificially the equity these projects required at their closings, these pledges did not provide any cash for the sponsor's ten percent portion of costs after closing. With regard to the Parker pledges, the SCI's examination of Grace and Nevada financial records revealed that no monies were ever received from pledged fees earned by Parker from the Rahway or Mt. Carmel projects. Additionally, the SCI's examination of the Agency's Mt. Carmel file failed to uncover any memoranda or other documentation acknowledging the Parker pledge or directing that Parker's fee be withheld and/or transferred to the Nevada account. In fact, all Mt. Carmel contractor's fees recognized as earned during the period when the pledge was in force appear to have been paid to Parker, despite the pledge.

Since the agency allowed these two projects to close without the normally required cash and/or equivalents, additional policy deviations were necessary to move Grace and Nevada through the early stages of construction prior to the influx of significant amounts of syndication dollars. The agency and the sponsor opened a jointly controlled equity escrow bank account in which syndication proceeds from both Grace and Nevada were commingled. This allowed flexibility in the use of these funds since they were advanced to both projects on an as-needed basis regardless of which project actually generated the syndication proceeds. The initial deposit, $113,000, was the result of an advance from the syndicator on September 27, 1977. As a result of the Nevada syndication, larger deposits were made in December,

1977, and January, 1978. Until April, 1978, when proceeds from the Grace syndication became available for deposit, the Nevada syndication proceeds from this account were applied toward the equity of both projects.

The limited partner investors involved with the Grace project were not, for the most part, the same individuals who invested in the Nevada project. With this in mind, the Commission emphasizes that all deposits to the equity escrow account and other similar transfers of funds between Grace associates and Nevada associates were first paid to and/or charged against fees owed to LHS Management, Inc. The same was true for all such deposits and transfers by and between Belmont Waverly Equities and Essex Union Equities, the second tier partnerships involved with Grace Associates and Nevada Associates, respectively, where Cohlear Funding Corp. was the recipient of such fees. All fees that were to be paid to LHS Management, Inc., and Cohlear Funding were properly disclosed to the investors prior to making their investment. Consequently, the Commission is not implying that any individual or corporate entity involved in this transaction was guilty of any unlawful conduct. The purpose of presenting our findings regarding the equity escrow account is to demonstrate the Agency's active role in placing at risk the rightful assets of the Nevada project, which had not yet satisfied its own cash requirements, toward the equity of the Grace project.

To assist the developer in conserving the small amount of equity cash which was available at the closings, the HFA deferred $719,625 in various fees and financing expenses owed to it until October 31, 1977. Due to tax laws applicable at that time, it was not unusual for the Agency to defer payment of such fees for short periods to allow the completion of syndication. However, the Agency did not require Lerner to pay these deferred obligations until March and April, 1978, well after the completion of Nevada's syndication. Thus, for a period of some five months, the Agency allowed Lerner to delay paying his own equity portion of the fee, $71,962, while depriving itself of the use of, or interest on, $719,625.

The Agency also acted improperly at the closings with regard to land costs, totalling $308,572.82. The Agency recognized these costs as payable to the Newark Housing Authority toward the purchase price of the Grace and Nevada sites. The Agency joined in the preparation -- and retention -- of two checks payable to the Authority on October 14, 1977, while at the same date advancing the 90 percent mortgage portion of these costs, $277,715.54, to the construction account of Grace and Nevada.

Agency personnel did not have the two checks forwarded to the Housing Authority until January, 1978, more than three months after advancing the mortgage money. Examination of Grace Associates' and Nevada Associates' financial records for the period ending December 31, 1977, confirms that the payments to the Authority were intentionally delayed. Since the Agency was aware that the Authority was not going to be paid on October 14, 1977, when it advanced the mortgage money to cover the payment, that advance was improper. The delayed payments to the Authority also allowed Lerner to postpone

payment of his 10 percent portion of this cost, or $30,857, until after the availability of Nevada's syndication proceeds. Since the sponsor had no occasion to use the improperly advanced mortgage funds during the period from October, 1977, to January, 1978, the SCI cannot determine if the Agency would have permitted the sponsor to apply those funds toward equity cash requirements.

Because both projects completed syndication by April, 1978, the flow of syndication proceeds allowed the sponsor to provide the equity cash required and thus release the various pledges made at the closings. The Parker pledges were completely released by January, 1978, after numerous postponements were granted of the "automatic" assumption of ownership by Parker. Payments toward the Grace and Nevada contractors' fees were also made from syndication proceeds. In April, 1978, the marketable securities produced as equity by Lerner were returned. All interest earned from these securities had previously been paid to Lerner.

This Commission notes that there is no evidence that either the Grace or Nevada project is financially unsound. On the contrary, the Development Cost Escrow accounts, previously identified in this report as benefitting a project, are being funded out of syndication proceeds. These DCEs will total $1,095,400, with $136,925 of this amount going to the Agency as syndication fees.

The DCE and fee amounts assessed on Grace and Nevada totaled 4 percent of the mortgage loan for each project. This percentage is twice as high as that assessed on normal limited dividend projects but less than on other projects that converted from nonprofit to limited dividend status. The original DCE schedule for both Grace and Nevada called for payments to begin in 1977. However, this schedule was modified, with the first payments being made in the latter part of 1979, to allow the sponsor greater flexibility in applying syndication proceeds toward equity and contractor fee requirements. Although presumably not the intended purpose for changing the payment schedule, this deferral also allowed the principals of LHS Management, Inc., to begin taking profits from syndication proceeds prior to making any DCE payments.

d. Conversion Profiteering

The investigation conducted by the SCI failed to uncover even one instance -- aside from two $10 loans by Lerner to open project bank accounts -- where this developer, or any of the principals of LHS Management, provided cash from their own resources, independent of money earned from the projects, toward agency-approved project costs and requirements.

The excess of syndication proceeds (after payment of various costs and other HFA requirements), plus a return on equity distribution from the Nevada project, provided significant profits to Arthur Lerner, the principals of LHS Management and others, as will be more fully illustrated later. It is important to note that payments to these individuals, although not approved by the Agency, were only possible because the projects converted from nonprofit to limited dividend status. The Agency, while permitting the conversions, chose

not to apply certain conversion guidelines, also to be discussed later, which would have allowed it to control the syndication proceeds for the benefit of the projects and the nonprofit sponsors. Instead of applying these conversion guidelines, the Agency treated the Grace and Nevada projects as if they had entered the HFA pipeline as original limited dividend projects. Sponsors of such projects, by virtue of the risks and interim funding required of them, are allowed to control syndication proceeds and to profit from these proceeds. With regard to Grace and Nevada, the Agency chose to ignore the fact that seed money advances, combined with various equity funding manipulations, had eliminated such risks and interim funding requirements.

Consequently, the Commission believes, the Agency was responsible for allowing certain individuals and entities to profit at the expense of both projects and their original nonprofit sponsors. Specifically, the Commission questions the propriety and/or justification for the payment of at least $608,607 from Grace and Nevada proceeds to the individuals listed below during the period December, 1977, to February, 1981.

Lerner received approximately $261,882 from Grace and Nevada syndication proceeds. The $261,882 did not include any payments for professional services recognized by the Agency as mortgageable project costs. For loan consulting services, primarily to the original nonprofit sponsors, the Agency recognized $18,982 for Nevada and $21,055 for Grace and authorized these mortgage money payments to Planners Associates, Inc., which is Lerner's company. Lerner's involvement with Grace and Nevada overall has resulted in payments to him amounting to $301,919 through February, 1981.

Payments to Daniel Horgan and/or his company, Daniel Horgan and Son, amounted to $202,725. Horgan's relationship with HFA was described in detail in the Commission's HFA Report (#1) (section III-Parts 2 and 3).

Lofton, the Newark lawyer, received $85,000 from syndication proceeds. Lofton's conflicting role as legal counsel to both the original nonprofit sponsor and to the converters of the Grace project is discussed later. In addition to the syndication monies paid to Lofton, his law firm provided legal services to Grace and Nevada for which the HFA approved payments of $27,594 and $11,265, respectively, under its mortgage loans. With regard to the $27,594 payment, a large portion of the Agency-approved legal fee was for services rendered to the Grace project's original nonprofit sponsor.

Reverend Levin West, president of the original nonprofit Grace corporation, has received $4,000 from LHS Management, Inc., apparently in connection with a consultant's contract dated June 17, 1977, calling for total payments of $21,450 during rent-up.

Marciante, leader of the State AFL-CIO and president of Nevada's original nonprofit sponsor, received $55,000 from LHS for consulting services which are reviewed later. No part of this $55,000 relates to

Marciante's association with the Maplewood project, for which he received an additional $31,950.

2. Grace Project Testimony

a. Deception of Grace Nonprofit Board

Lofton, as counsel to the nonprofit Grace Renewal Corporation, had insisted at the SCI that he made several presentations to the corporation's board of directors about converting Grace to a limited dividend project under Grace Associates prior to the board's approval of that conversion on June 6, 1977. However, the Commission also was informed that Lofton made no such advance notice. That he deceived the board about the proposed conversion was supported by the sworn testimony of several Grace Renewal board members and a corporate official.

Beadle Campbell of Newark, who joined Grace Reformed Church in 1976 and became a member of the Grace Renewal corporation in early 1977, testified that not only had the Board not been advised prior to the June 6 meeting of any discussions with possible syndicators but that the recordation of his vote for conversion at this meeting was in error since he had voted in the negative. Campbell further testified that he complained to law enforcement authorities concerning alleged irregularities regarding the Grace project, including his contention that his name was forged on one or more of the corporate documents. The Essex County Prosecutor's Office investigated that allegation and found that Campbell's signature was in fact forged -- but that no one could identify the forger. Campbell's testimony follows:

Q. Okay. Now, we have so far discussed approximately six meetings that occurred in the early part of 1977 of which there are no minutes. I am now, however, showing you an exhibit which purports to be a copy of the Grace Renewal Development Corporation minutes of a meeting dated June 6, 1977, which denotes in its terms that you were present at that meeting. I would ask you to examine that document first and then I'm going to ask you several questions concerning it. Was that the first time that you can ever recall a proposal being made to you to sell the corporation?

A. That's the only time.

Q. That's the only time. So during these prior six meetings in 1977 you don't recall anybody ever suggesting to you that the corporation was going to be sold or did you want to sell the corporation?

A. I first got wind of it on the street. They said they going to sell you. They said, "Beadle, they're going to sell your project out."

Q. Who told you that on the street; do you remember?

A. Willie Wright was the first one.

Q. W-r-i-g-h-t?

A. Yes. He's the first one that brought it to my attention that they was going to sell the project out.

Q. But nevertheless sometime during 1977 you heard for the first time that Grace was going to be sold in conversation with Wright; is that correct?

A. Yes.

Q. Had you ever heard it from anyone other than Wright at the time you heard it?

A. No. I heard it on the June 6 meeting. That's the only time I heard it.

Q. Did you ever hear of competing proposals, someone else who was going to buy the project other than the entity known as Grace Associates, which eventually bought the project?

A. No, there was no proposition made to none of the board members, to my recollection.

Q. Did you at any time ever hear of any other offer that was made to buy the corporation from anybody else?

A. No.

Campbell testified that he asked Lofton if the nonprofit board was making the "right decision" in changing to a limited dividend status. He said Lofton replied affirmatively. Lofton revealed that Arthur Lerner was the principal of the for-profit group, as Campbell testified:

Q. What did he say?

A. He said, Art Lerner, which was standing outside of that meeting room at the time. He said Art Lerner wanted to buy it.

Q. Okay.

A. I asked him outside, how the hell can somebody buy a corporation that worked for us?

Q. Because Lerner was employed as your planning --

A. He was employed for us. How can he buy the corporation? He's the one get the damn thing moving. I said, "If he can't move it with us, how can be move it for himself?"

Q. What was the answer to that question?

A. It started a big row and that's when I said let me go to the F.B.I., the authorities, the Federal authorities, and find out if this is legal, can you do that, because I'm not willing to give up $19 million with the snap of your finger.

Campbell also testified that although Lerner was standing outside he "didn't come inside the meeting room" and "didn't say a word" on June 6. Campbell said he was the only member of the nonprofit board to vote against the conversion, contrary to the tally of the oral vote contained in minutes of the meeting.

He added that as secretary to the nonprofit corporation he refused to sign the conversion papers. In fact, his refusal led to the forgery of his name on the papers. Campbell testified that he was not invited to a pivotal meeting of the nonprofit board in September, 1977, because he was complaining to law enforcement officials and the HFA at the time about the forgery. His testimony continued:

Q. Was the forgery allegation you made investigated by the Essex County Prosecutor's office, to your knowledge?

A. Yes, it was.

Q. What was the result of that investigation?

A. My name was forged, they didn't know who it was, that was the end of the case.

Q. They said that it was clear your name had been forged, but they couldn't find out who the perpetrator was?

A. Yes. I found out the name was forged.

Rev. Lonzy McCarey of Grace Reformed Church had been a member of the Grace Renewal Corporation's board but claimed his name was "excluded" when the membership list for the board was submitted to HFA. According to his testimony, he was made secretary to the corporation's president "to appease me." As secretary, he attended board meetings but could not vote. He recalled at the SCI that early

in 1977 his car was stolen and later found abandoned but that it had contained a briefcase full of Grace project documents that was never recovered. He also attended the June 6 meeting at which the conversion vote was taken. He not only recalled that this was the first time Lofton or any other corporate officer broached the conversion proposal but also quoted Lofton as contending that the "state" -- meaning the HFA -- was promoting the project's syndication. His testimony on the June 6 meeting, in part:

Q. ...What kinds of things did happen that aren't in these minutes?

A. Well, when they called the meeting, we didn't know what we were going to the meeting for. They just said we going to be in emergency meeting and everything. And when we got there it was explained to us what the meeting was called, because they had a deadline that they had to get some papers and documents signed that we had to transfer the project over from -- to a limited dividend corporation.

Q. All right. Now, who told you all of that?

A. Oliver Lofton.

Q. Had he ever said anything prior to this about selling the project, in effect?

A. No, no.

THE CHAIRMAN: When was the first time he said that?

THE WITNESS: June the 6th.

THE CHAIRMAN: At that meeting you're talking about?

THE WITNESS: Yes.

Q. Did he suggest to you that you had a choice in that matter or that it had to be done?

A. Well, when he explained, we were going, you know, why we rushed in the last-minute thing with documentation and things about that high and asking us to go ahead and make a decision right then.

Q. Okay.

A. And Beadle Campbell, who is the secretary of that corporation was kind of upset because, him being the secretary, he was wondering why he

never knew none of these things that were going on. Oliver Lofton told him being the secretary was just a name anyway, it really wasn't any important position there and that he didn't have time to notify him. So Beadle didn't want to go along with signing no papers and things because he felt like he needed to digest what's in the things. Oliver told him that he didn't have no time for that and the state saying if we didn't pass this thing at a certain time the project wouldn't continue.

Q. All right. Lofton said to you that the state wanted you to --

A. Right.

Q. -- convert?

A. That is right.

Q. All right. There is a notation in the minutes that reads as follows: "He told the board the state would like for them to change to a limited-dividend corporation and he then began to explain to the board what a limited-dividend means to them." Do you recall that happening?

A. He didn't tell us they would like; he told us if we didn't, that the project was going to be held up.

Q. Did he mention how much money the project was going to receive from --

A. He said for the privilege of turning it over to the limited-dividend, the corporation would receive $180,000.

Q. Okay. Did he tell you who the partners were going to be in Grace Associates, the people who were buying the project?

A. Yes. He said Art Lerner, Jack Stein. He didn't name nobody else.

The Commission questioned Board member Lillie Love concerning the June meeting:

Q. Had you heard anything about conversions prior to this June 6 meeting?

A. Not before we was called down for the meeting.

Q. Right. This was the first time you had ever

heard about it?

A. Yes.

Q. Was this an emergency meeting, by the way?

A. I think so.

Q. How did you know that?

A. He called us up at the last minute.

Q. Who was the "he"?

A. Oh, Reverend West.

Q. Reverend West said you have got to come down to Lofton's office right away?

A. Yes.

Q. Why did he say it had to be an emergency meeting?

A. Because some papers had to be signed on that date.

Q. After the September 23rd meeting at Quaker Bridge -- Quaker Bridge Road, did the board meet again? Do you recall having any other meetings after that?

A. They met, but I was absent.

Q. Has anything happened since then with respect to meetings of the board or anything that you recall, other than that one meeting which you did not attend, since September 23rd, 1977?

A. Nobody brought me up to date on anything.

The Commission also took the testimony of Board member Sanford Harp concerning the June 6 meeting and the issues it raised. His testimony follows:

Q. Do you remember what was discussed at this meeting after having looked at those minutes?

A. They said something about if we turn if we transfer over to a dividend that it would benefit us rather than -- see it's been so long ago I can't remember words. I do remember that meeting and I do remember, you know, passing the motion on that.

Q. Was that the first time you heard about that?

A. Yeah.

X X X

Q. Did you go along with the change? Did you vote to change it over to a profit-making venture?

A. Sure. I believe -- I believe -- I believe in what my attorney is doing, what the attorney is doing so whatever he felt was best...

X X X

Q. Did you hear anything about the conversion after that meeting that you can remember?

A. No, not offhand.

Q. Do you remember going down later to Quaker Bridge Road in Trenton, New Jersey Housing Finance Agency, in September of '77?

A. Yes, sir.

Q. Do you remember that being the closing of this project where the money was going to come?

A. I don't know about no monies, but I know about the closing.

Q. You were there?

A. Yeah.

Q. Do you remember this idea of conversion being discussed at that meeting?

A. No.

Q. Do you remember a fellow from the agency by the name of Kadish talking to you?

A. Yes.

Q. Did he discuss conversion?

A. Yeah.

Following is Lofton's reaction to testimony by Grace board members that he did not inform them of the conversion move until June 6:

Q. If Mrs. Lillie Love told us the June 6, 1977, meeting was the first time she heard about conversions, would she be incorrect?

A. Yes, she would be incorrect.

Q. How about Beadle Campbell; if he told us that, would he be incorrect?

A. Absolutely.

Q. And if Sanford Harp told us that the June 6, '77, meeting was the first time he ever heard about conversions, would he be incorrect?

A. Yes, he would be.

Q. And I imagine Elder Lonzi McCarey would be similarly incorrect about the events of the June 6 meeting in his knowledge of conversions?

A. As being the first date that he was aware?

Q. Yes.

A. Yes, sir.

The final confirmation of the Grace project's conversion was not accomplished until the September 23, 1977, meeting at HFA headquarters. At that meeting the decision of June 6, 1977, was reconfirmed by the Grace Renewal board, at which time another member was substituted for Campbell. One HFA representative at this meeting, Richard Kadish, then the HFA's deputy director, made it clear in the minutes thereof that the HFA was not taking any position on conversion of the project.

b. Alleged Meetings with Syndicators

Lawyer Lofton insisted in his testimony at the SCI that not only had he informed Grace Renewal's board members about the proposed limited dividend conversion prior to the June 6, 1977, meeting at which the proposal was activated, but that he had met with several other syndicators and had so informed the board before the June 6 meeting. Since board members and a corporate secretary had testified to the contrary, the Commission sought to substantiate what discussions Lofton and the then pastor, Rev. Levin B. West, had had -- if any -- with syndicators.

The Commission obtained testimony from Harry Calhoun, a principal in Syndereb, Inc., of Washington, D.C., a successful syndicating entity. He testified that he had only one meeting concerning the possible syndication of the Grace project, on October 17, 1975, and that it was his distinct feeling at the time that the Grace project had already been successfully bid upon by others. Mr. Calhoun's testimony, in part:

Q. All right. Now, coming back to the chronology with respect to this specific project, did there come a time subsequent to October when you, in effect, looked over this project?

A. Yes.

Q. What did you do in looking it over?

A. Well, we were looking at several projects, quite frankly, and in the process of looking over projects we looked at this project. One of the project we were looking at was a shopping center project that we were anticipating going into and there were two proposed sites, and we looked at both Grace Renewal and Nevada at the same time, and came to the conclusion...we felt that in the case of Grace Renewal there really had been a deal already cut and there was no need in wasting time.

At a subsequent appearance before the Commission, Lofton was shown a Syndereb memo of the 1975 meeting. However he could not say whether the memo was a fair depiction of a meeting which he had described in previous testimony concerning possible syndication of the Grace project.

The Commission summoned Arthur Lerner and Rev. West for executive session testimony concerning the events leading up to and at the June 6, 1977, meeting of the Grace Renewal board. However, both of these witnesses exercised their Fifth Amendment privilege against self-incrimination and refused to testify about these events.

3. Nevada Project Testimony

a. Background

The Nevada project underwent the same sudden change from nonprofit to limited dividend status, and at the same time, as did the Grace project. As with Grace, the Commission sought information regarding the circumstances of the Nevada conversion. This inquiry centered on Charles H. Marciante, the longtime president of the AFL-CIO, who was the president of Nevada's nonprofit sponsor, the AFL-CIO Housing Corporation.

Arthur Lerner was no stranger to the AFL-CIO's housing plans. When the labor group established its nonprofit corporation and obtained the rights to sponsor it from builder Jack Parker, Marciante arranged for Lerner to become one of the corporation's two loan consultants. Marciante testified about this, as follows:

Q. What did you do first in the process of selecting a loan consultant?

A. Parker had a loan consultant in place and that

was whatever this gentleman's name was, who was there. I was subsequently asked by Mr. Lerner if he could join as a co-loan consultant and I had no objection to that at all.

Q. What gave Lerner the occasion to ask that? Did you know Lerner prior to this?

A. I have known Arthur Lerner for some twenty years.

Q. How did he find out that you had the project in the pipeline at H.F.A.?

A. We are friends socially. I have known him, his father, talked to him about it, what we were doing.

Q. Approximately when was this in relationship to when the project began, shortly thereafter?

A. Yeah.

Q. Did Lerner have a corporate name for the purposes of being involved as a loan consultant?

A. Yes.

Q. Was that Planners' Associates?

A. Yes.

Lerner played almost the same role in the transition of Nevada from a nonprofit to a for-profit project as he did with Grace. Soon after Nevada received its HFA nonprofit mortgage commitment, Lerner began promoting his desire to convert it into a syndication project. Marciante testified about the conversion during three appearances at the SCI. His testimony at the Commission's executive sessions focused in part on how and why he negotiated the sale of the Nevada project to Lerner's for-profit group, Nevada Associates. His testimony covered a promise by Lerner to make a $50,000 contribution to the AFL-CIO scholarship fund, for which he was unable to provide a written commitment, and his subsequent relationship with LHS Management, Inc., as a paid consultant, in connection with which he did produce a contract.

b. AFL-CIO Scholarship Fund

Marciante testified at the SCI that some months prior to the sale of the AFL-CIO's nonprofit housing project he had suggested that the sale be based on the scholarship fund payment. Asked about the origin of this proposal, Marciante testified:

A. Mr. Lerner said to me, "What would you consider

a fair price for the project?"

Q. And?

A. And I told him -- it seemed outrageous at the time. I said, "$50,000 to be assigned to our scholarship fund."

Q. What did you base that figure on?

A. Right out of the air.

Q. Just plucked it?

A. Sure.

Q. Just for the record, this discussion with Lerner took place prior to your advising the board of trustees what the deal was going to be?

A. That's correct.

Marciante next testified about his notification of the AFL-CIO housing corporation's board of trustees and how he quickly obtained its approval of the proposal:

Q. And you discussed this with the board of directors?

A. Yes.

Q. When did you discuss that with the board of directors?

A. I believe it was sometime in '77.

Q. Let me rephrase the question. I asked the question because it was not at a meeting. The meeting was waived and proxies were sent, which would suggest it was discussed over the telephone. Do you recall what you did with your board of directors?

A. Discussed it over the phone with every one of the board members and pointed out to them the possible problems that they would encounter and inform them of the offer that they had of fifty-thousand dollars for the project.

Marciante said he subsequently informed the AFL-CIO membership at an annual convention about the scholarship offer in return for "the transfer of sponsorship of our HFA-funded housing project." No contribution had yet been received when he first testified at the SCI in December, 1979. However when he appeared before the Commission

again in February, 1980, he testified that Lerner's group had finally begun payments on the almost three-year-old promise -- in installments of $1,000 a month. His testimony on these matters, including his surprise at the installment arrangement, follows:

Q. Had it come on May 1st, 1978?

A. No.

Q. When was it going to come?

A. We received the first payment for the scholarship fund January of this year, after matters had been concluded by Mr. Lerner and his group. We received a payment for January and one for February.

Q. Subsequent to your December appearance before this Commission?

A. Yes.

COMMISSIONER PATTERSON: His word as of January 1st, 1980, that money was now due the AFL-CIO?

THE WITNESS: No. He did not spell out a specific time, but it was when Nevada Street -- now, this can be checked out through the H.F.A., and I don't understand that process as to what or how that works, but we did not receive our first payment until, as I say, January, 1980.

COMMISSIONER PATTERSON: How much was that payment for?

THE WITNESS: A thousand dollars.

COMMISSIONER PATTERSON: And the next month, February?

THE WITNESS: A thousand dollars, so it would be...up to the point of fifty months.

X X X

COMMISSIONER PATTERSON: Did it come to you as a surprise that they were going to be monthly payments as opposed to a fifty-thousand-dollar payment?

THE WITNESS: I was told there would be monthly payments and I was sort of surprised.

In his testimony at the SCI, Marciante attributed the delay in

the start of scholarship fund payments to a "cash flow" problem at the Nevada project:

> COMMISSIONER PATTERSON: And because you received the money, "you," meaning AFL scholarship fund received the money in January, the first payment in January, you would have assumed from that they they began getting a positive cash flow, probably December, 1979?
>
> THE WITNESS: Whenever. I don't know when.
>
> COMMISSIONER PATTERSON: Would you have been disturbed if you found out, and I don't know if it is a fact, that they were making a positive cash flow six months before that? That's a supposition.
>
> THE WITNESS: I had no way of knowing when they had a positive cash flow.
>
> COMMISSIONER PATTERSON: There wasn't any follow-through on checking the $50,000?
>
> THE WITNESS: Other than the fact that it was an obligation.
>
> COMMISSIONER PATTERSON: Apparently, if it is written, nobody seems to know where the written material is, and there was no apparent process for someone to say, "Hey, wait a minute, you ought to begin to pay us." All of a sudden, since the last time you were here, money all of a sudden was paid, contributions were made.
>
> THE WITNESS: I can see very clearly the point you are making, sir, but I don't know when there was a cash flow. I am sure that can be determined.

At his three SCI appearances, Marciante was never able to produce a written agreement on Lerner's promise to the AFL-CIO housing corporation of a $50,000 scholarship contribution in return for the right to take over the Nevada project. The Commission's discussion of this issue concluded with the following testimony in October, 1981:

> Q. Have you found such an agreement?
>
> A. No, I have not.
>
> Q. Okay. Have you searched to the best of your ability for such an agreement?
>
> A. Yes, I have.

Q. Okay. I previously represented to you that we, in the records that we have subpoenaed, have no such agreement. Do you recall that?

A. Yeah. Mike, I would like to say, for the record, that I contacted the attorney who was representing us at that time, Pellittieri & Rabstein, in hopes that they could find the agreement between the State A.F.L.-C.I.O. and at the time it was Planners or Nevada Street Associates for that agreement, and they have not been able to find it or make it available to us.

Q. As a matter of fact, part of the records that we subpoenaed were their legal file and such an agreement does not exist there, and their counsel have also told us that they recall drawing up no such agreement or having no such agreement signed as counsel to the A.F.L.-C.I.O.

A. Why didn't they tell me that? Well, all right.

Q. Do you remember independently signing such an agreement, an official agreement between the A.F.L.-C.I.O. and Nevada Street Associates?

A. Truthfully, I don't recall.

c. Details About Consultancy Contract

Although the Lerner project presumably had a cash flow problem that delayed even installment payments on the $50,000 contribution to the AFL-CIO scholarship fund, Lerner nonetheless hired Marciante as a paid consultant in the interim. Long before the first scholarship payment of $1,000 was received in January, 1980, Marciante was receiving $5,000 checks periodically for consulting work, which the witness stipulated was in connection with the Grace project rather than the Nevada project. Excerpts from Marciante's testimony on the consultancy arrangment -- including his duties and fees -- follows:

Q. When did you first discuss becoming a consultant to Mr. Lerner?

A. In, about, June or May, maybe, of '78.

Q. That's about a year after the project was turned over to the partnership of which Mr. Lerner was the general partner on Nevada?

A. Right.

Q. And did Lerner reach out for you as somebody who would be a worthwhile consultant? Did you

reach out for him?

A. He asked me to serve as a consultant for him.

Q. Did he call you on the telephone?

A. I am not sure how it was. It could have been in person or by phone.

Q. And what areas was he interested in your doing consulting?

A. On the general construction, the development of project, the progress of the project and to advise him on how he should proceed.

Q. What did you do subsequent to having discussions and becoming employed as a consultant?

A. I submitted reports, I guess pretty much on a monthly basis, and sometimes more often than that.

X X X

Q. When you talked to Mr. Lerner in May or June of 1978 about becoming his consultant, did you discuss how much you were going to receive for those consulting services?

A. Yes, sir.

Q. What was the result of those discussions?

A. The result of those discussions was that -- I have a contract with Mr. Lerner.

Q. You do have a contract?

A. Yes.

Q. Could you provide that to the Commission?

A. Yes.

Q. When was the contract executed, May or June of 1978?

A. It was June of '78.

Q. And it provides for an amount of money for services rendered?

A. It does not. That would be best termed when you get the document.

Q. Okay. Was this contract actually between -- had you ever been a consultant before this?

A. No.

Q. Was it Mr. Lerner's idea that you should become one?

A. He asked me if I would be interested in being a consultant and I said that I would be.

Q. Did he ask about your background-experience in the areas he was interested in?

A. I think he knew of my -- our past relationship.

Q. Why did he need --

A. He needed the advice.

Q. On?

A. On some of the projects. If you are familiar with the Dutch Reform or the Grace, they took a terrible beating on the construction. It was a mess.

Q. And you, therefore, told him why he was taking these beatings?

A. Yeah.

Q. And you interviewed contractors and employees of contractors in formulation of those reports?

A. We sat with his contractor and tried to get his contractor to take some help because the guy, at the time, didn't know what the hell he was doing and it was like he was losing money and, I believe, when I first asked for a meeting with the contractor, so that he could have some backup, because he was not very knowledgeable --

X X X

Q. There is nothing else, is there, aside from those reports that you did?

A. I advised him on the telephone, on handling different labor situations, on how to expedite problems.

Q. You were a labor consultant?

A. Not really a labor consultant. I didn't consult with our labor people. I said, when he had a problem, who he should reach out for.

Q. Did you talk to any of those people personally?

A. No, sir.

Q. The contract that you had for consulting -- what was the term of that contract? How long did it last?

A. It's -- well, to the completion of the project and then a short period beyond.

Q. Actually, was that contract with an entity known as LHS Management Company, Inc.?

A. Yes.

Q. Which is Mr. Lerner's management company?

A. Yes.

Q. I show you now a packet of four carbon copies of four checks front and back made out from LHS Management. Each one of those checks is in the amount of $5,000 for a total of $20,000 on various dates beginning July 1st, 1978 to March 28th, 1979.

Are those the consulting fees that were paid pursuant to the contract?

A. Yes, sir.

When Marciante appeared before the Commission for a third time, in October, 1981, he was again questioned about his consulting work and the fees paid to him by LHS Management. Marciante had provided the SCI with a copy of his consulting contract, and it was the subject of the following testimony:

Q. Okay. The last time you were here we asked you a question that requested the answer precisely what you were doing consulting work for Mr. Lerner for, in other words, in what field--

A. Yes.

Q. -- you were doing consulting work. The answer was that the contract would speak best on that, so I'm going to show you what's been marked

Exhibit C-306.

A. All right. Do you want these back?

Q. Yes. Thank you.

And ask you to refer to the L.H.S. letter of agreement addressed to you and principally to Paragraph A and, if you would, would you read that to the Chair aloud?

A. Paragraph A reads as follows: "L.H.S. retains you as a consultant and you agree to act as a consultant to L.H.S. in the areas of general management activities and labor relations and negotiations."

Q. And is there any other paragraph that describes the duties that you are going to provide to L.H.S., or are the other paragraphs pertaining to other components of the agreement?

A. I guess, "Among other services you shall render to L.H.S., you shall be available for consultation upon call by L.H.S. and prepare written reports and attend conferences when deemed necessary by L.H.S. relating to existing management activities of L.H.S. or proposed transactions and labor relations or negotiations.

Q. Okay. Anything else there? Take a look at the second page.

A. Well, Paragraphs E, F, G, and H. This is not exclusive -- damages, violation of terms -- no, not as far as duties are concerned, I believe.

Q. Okay. Secondly, again, looking at the end of that agreement at Page 2, the very last paragraph talks about the fees that are going to be paid to you pursuant to that agreement, but does not specify an amount. Is that correct?

A. That's correct.

Q. Do you recall negotiating the amount that was going to be paid pursuant to that contract with Mr. Lerner?

A. Yes. He represented to me that he would pay me $20,000 per year for the beginning of that contract year, and it would be on a as-need basis.

Q. What would be on an as-need basis?

A. The fee.

Q. As who needed it? As you needed it?

A. As long as L.H.S. desired to have the consultation.

Q. Okay. When did you negotiate that with Mr. Lerner?

A. Well, obviously, prior to June 12th of 1978.

COMMISSIONER PATTERSON: The $20,000 is not based on a number of hours or number of days that you were going to do the consulting, it's just what you are going to get paid per year?

THE WITNESS: That's correct.

Q. Whether or not you do anything?

A. I know that I'm required to submit reports, and I have been submitting reports.

Q. Okay. Let me ask it this way: If you didn't submit the reports, would you be paid?

A. I doubt it.

Q. Okay.

A. And quite frankly, there's a question in my mind if I am retained at the present time.

Marciante testified that he sought to avoid a conflict of interest in his combined role as leader of the New Jersey AFL-CIO and as a consultant for Lerner and that he avoided any contact with labor union representatives during his consultancy. He also expressed "regret" in his SCI testimony that he had not put this understanding with Lerner in writing. His testimony on this point:

Q. Okay. You were filing from the time you had the agreement, then, monthly reports on the consulting which you were doing?

A. Yes, sir, I said that.

Q. Okay. Did any of those deal with the labor problems that you contracted to deal with?

A. No, and I'd like to -- I had a subsequent

discussion with Arthur Lerner and told him that I thought it best that I not in any way use my connection in the organization I represent to involve myself with any type of labor negotiation, and I can state, very frankly and candidly, that I in no way have ever used my position to in any way deal with the problems that Mr. Lerner may have had. I have advised him, without contacting union representatives, on potential problems, and you will find those contained in my reports.

COMMISSIONER PATTERSON: Do I understand that that means that you had a further understanding with Mr. Lerner that that part of your consulting work regarding people, employees, labor--

THE WITNESS: Right.

COMMISSIONER PATTERSON: -- would be on the basis of sitting back and giving overall advice and not on the basis of face to face, not meetings with organized labor and management?

THE WITNESS: That's correct, Commissioner. And I regret that I did not have that in writing, because I had no idea that this was going to get as deep into things as it is today. But that was an understanding I had with Mr. Lerner, and he appreciated the position.

Marciante had insisted that his consulting deal with Lerner primarily related to problems at the Grace project. However, he continued to receive checks through 1980, when the Grace project was completed and in the process of "renting up," and he was still submitting monthly reports to Lerner by October, 1981, at which point his consultant's fees amounted to $55,000. Marciante's testimony continued:

Q. All the checks we now have for identification total $55,000. I think you testified before that you received your last check in January, 1981, which could well be this check dated December 30th, 1980, for 15,000. Does that ring a bell?

A. Yes, it does.

Q. Okay. So that that would be the total monies you received on the contract, as far as your recollection goes?

A. That's correct.

Q. Have you continued to submit reports to him subsequent to January, 1981?

A. Yes, I have.

Q. When was the last one you submitted to him; do you know?

A. This month.

Q. This month. Okay. Do you consult at the present moment with any other entity other than L.H.S. or Mr. Lerner?

A. Would that be relevant to the testimony here?

Q. Well, you answered it previously and I would submit to the Chair that it is because we are trying to get an idea of what kind of consulting business you have.

A. Oh. No.

Q. You don't. Do you still work out of your home?

A. Yes.

Q. Do you have any other employees other than yourself?

A. No, not, not really.

Q. Okay.

COMMISSIONER PATTERSON: What's "not really" mean?

THE WITNESS: Well, I'll ask someone to type a letter for me, you know, someone in my family. But that --

COMMISSIONER PATTERSON: But you have no other more or less steady employee working on the consulting business?

THE WITNESS: No.

4. SCI Conclusions on Grace, Nevada Processing

a. HFA's Double-Standard on Conversions

As noted, the Grace and Nevada projects were converted to limited dividend projects before they reached the nonprofit mortgage closing point in HFA's processing pipeline. During the transition of these

two projects to for-profit status, there were guidelines in place at the HFA which would have made it responsible for monitoring these conversions and for proscribing the misuse of funds generated by this change of status. The HFA has enforced such guidelines only with respect to conversions which took place after projects closed as nonprofits. In essence, the Agency viewed pre-closing conversions such as Grace and Nevada as private transactions, even though -- despite such official aloofness -- it engaged in certain inappropriate activities relative to equity maneuvering that were unusually beneficial to both projects' influential promoters and associates.

b. HFA Conversion Requirements

Under the Agency's conversion guidelines, the nonprofit sponsor, who remains with the project as the managing general partner of the new limited dividend partnership, must interview several syndicators and evaluate their proposals with advice of counsel. This agency-approved counsel is not permited to represent any other parties involved in the transaction in any manner whatsoever. Further, no member of the nonprofit sponsoring entity, its employees or professional advisors including loan consultants and attorneys, can receive any fees payable from syndication proceeds other than those disclosed to and approved by the HFA. At least 70 percent of the gross syndication proceeds are required to be controlled by the Agency, which acts as trustee on behalf of the original nonprofit sponsors. In addition those proceeds must provide 1) for funding a Development Cost Escrow, 2) for payment of interest on the seed money loan granted by the State to the original nonprofit sponsor, 3) for contributions to the Agency Portfolio Reserve account, which is used to assist any Agency project that is unable to meet its own debt service or other expenses, 4) for payment of conversion-related costs, which include a fee to the Agency, and 5) for establishing a Community Development Escrow (CDE) account. With Agency approval, funds in this CDE can be used by the original nonprofit sponsor to provide social services and project amenities or for additional community development activities.

Keeping in mind the impact of the HFA's post-closing conversion guidelines on the DCEs and CDEs, the Commission examined four projects which were converted under those guidelines. (Three of these projects were also part of the bond sale that included Grace and Nevada and one was part of a prior sale). The Commission found that syndication proceeds generated from these projects were used to establish CDEs which averaged 4.90 percent of the mortgage amount for the particular project. There were no CDEs established for Grace and Nevada and the 4.90 percent of mortgage far exceeds the $50,000 and $180,000 promised to the original nonprofit sponsors of Nevada and Grace respectively. In addition, much larger amounts were made available for DCEs from these four Agency-guided conversions. The DCEs established for the four projects averaged 6.49 percent of the allowed mortgages compared with 4 percent for Grace and Nevada.

The fact that such a large percentage of syndication proceeds was available for CDEs and DCEs in the case of the four Agency-supervised conversions is attributable to the invocation of certain financing

procedures that the HFA implements only for post-closing conversions. Under these procedures, the agency redefines the total cost of a project to include such additional cost items as the DCE, which are to be paid out of syndication proceeds. Thus, the original nonprofit mortgage remains the same but now represents 90 percent of the redefined total cost. Because syndication proceeds are not applied toward the original development costs they are available for funding larger DCEs and CDEs.

Such close monitoring of post-closing conversion projects contrasts sharply with the HFA's questionable policy of detachment toward the Grace and Nevada conversions. The primary distinction between these two groups of projects -- that is, whether or not they converted after mortgage closings -- was not so significant as to allow a for-profit developer and his associates to syphon off syndication proceeds which could have benefitted the project, the community and the Agency. This will be the subject of an SCI recommendation in Section IV of this report.

B. Example of Straight Limited Dividend Project Abuses

1. The Maplewood Project

a. Introduction

Arthur Lerner, who was associated with the conversion of both the Grace and Nevada projects to for-profit status, and Charles Marciante, the State AFL-CIO president, who was involved in the Nevada transition, were both active in the Maplewood syndication as general partners. Maplewood, a limited dividend project from its outset, was sponsored by Maplewood Senior Citizens Residence Association, a limited partnership whose general partners, prior to the addition of Lerner and Marciante, were Robert J. Jablonski and lawyers Sanford Schneider and Ralph C. DeRose.

The HFA on July 6, 1977, granted this project a mortgage commitment in the amount of $4,500,000, representing 90 percent of the $5,000,000 total project cost. Even without the benefit of a seed money loan that only a nonprofit project can obtain, the partners in Maplewood only had to contribute $1,000 each to get the project to a mortgage closing. No additional interim funding was necessary since the equity requirement, which was $500,000, was satisfied by various fee pledges and a loan from the project's general contractor, B.J. Builders of New Jersey, Inc. Syndication provided the funds to repay the loans and pledges and to satisfy other project costs. The balance of those syndication proceeds then were taken by the general partners as profits and repayment of their original contributions.

The following excerpts from testimony at the SCI and a brief assessment of this testimony are included here to demonstrate how certain HFA processing policies promoted bargain basement housing investments that generated excessive proceeds to promoters.

2. Maplewood Project Testimony

a. Testimony on Partnership Expansion

This witness, a resident of Clifton and a member of the New Jersey Highway Authority from 1973 to 1979, testified that he came to realize in the mid-70s that promoting subsidized housing projects "looked like a good business opportunity." After failing to obtain a project site that straddled the Maplewood-Irvington boundary line, because of local objections in Irvington, the original partnership of which he was a member settled on a site located entirely in Maplewood, whose local officials favored housing for senior citizens. Jablonski became the loan consultant for the partnership although he admittedly had no experience in housing consultancy. Soon after obtaining conditional site approval, the Jablonski-Schneider-DeRose partnership was expanded to include Lerner and Marciante. Jablonski testified about the expanded partnership, its contributions to the deal and its anticipated profits as follows:

Q. Did there come a time when other partners joined you in this project?

A. Yes.

Q. Approximately when was that?

A. A year down the road. Six months after, nine months after conditional site approval.

Q. Who was that person?

A. It was Mr. Marciante and Mr. Lerner, Arthur Lerner.

Q. Who joined the group first?

A. I think Mr. Lerner did. I am talking about actually signing a partnership agreement and papers. I think Mr. Lerner did.

Q. Tell Commissioner Patterson about the initial meeting or the initial negotiations with specific reference to Mr. Lerner's participation.

A. I really can't answer it. It have no idea why Mr. Lerner and Mr. Marciante --

Q. They didn't drop from heaven into your partnership, did they?

A. No. But I think Mr. DeRose made a request one day that he would like Mr. Lerner in, and I didn't oppose it. Number one, I was a minority member of a partnership. I just -- I didn't say anything to either confirm or deny. I probably just acquiesced.

Q. Now, you have got a thousand-dollar investment in a project, and I assume you had some idea of what you had to gain from the project; is that not correct?

A. We had a ballpark figure. The syndication was the key to it. The syndication rises and falls with the market and it's very volatile. Whatever that was at the time -- we had some indication, yes, of what the potential would be.

Q. What was your ballpark indication at that time?

A. I think somewhere around -- with the five partners?

Q. No. Three partners.

A. I think we were figuring about a hundred-and-fifty thousand dollars, a hundred-and-eighty-thousand dollars.

Q. Each?

A. No, no. Collectively. About a hundred-and-eighty-thousand dollars.

Q. About $60,000 each?

A. More than that ultimately, but that's what we were anticipating.

Q. And a hundred-and-eighty-thousand dollars split three ways is $60,000?

A. Right.

Q. And a hundred-eighty-thousand dollars split four ways is $45,000?

A. Right.

Q. And Jablonski is essentially giving Lerner $15,000 on DeRose's statement that he would like Lerner in the project?

A. That's right.

Jablonski next recalled how Marciante was brought in as a partner, thus reducing his expected gain from the deal by an additional $9,000:

Q. ...Did Mr. Marciante join the project contemporaneously with Mr. Lerner or thereafter?

A. I think it was a short time thereafter.

Q. And did Mr. DeRose advise you that Mr. Marciante would be joining, or did you come to find that out another way?

A. I don't think he advised me. I think he said, how would I feel about it, or is it okay.

Q. Your forty-five-thousand is now down to thirty-six-thousand. This one cost you nine-thousand?

A. I am also getting the loan consultant fee, which nobody else is getting. .. I am up to fifty-thousand and will hopefully hold on to some of the project as a tax shelter.

Q. What was the stated reason for Mr. Marciante's presence?

A. I think Mr. DeRose knew that there would be no way, matter, or form that I would refuse Mr. Marciante into this partnership.

Q. Because of your friendship?

A. Yes. He is a close, personal friend of mine for many years standing.

Q. Mr. DeRose didn't bring him into the project because he was your friend?

A. I don't want to speculate on as to why Mr. DeRose brought him in.

Q. Did you discuss with Mr. Marciante entry into the partnership?

A. No. I just said that it was all right and again, now, I am also more of a minority.

Q. But you have a pre-existing close relationship with Mr. Marciante?

A. Long-standing, yes.

b. $1,000 Brought "Substantial" Profit

Marciante testified about his invitation to join the partnership, at a cost of only $1,000. He insisted he didn't know at the time that this investment would enable him to participate in a five-way split of an estimated $180,000 profit. Excerpts from his testimony follow:

Q. Our records show that you invested a thousand dollars in Maplewood project on 2/15/77, which is why I suggested the date, '76, as your initial involvement.

A. I would assume.

Q. How is that project proposed to you and by whom was it proposed?

A. I guess Arthur Lerner asked me and Sandy Schneider. They know my extreme wealth and I use that sarcastically.

Q. At that time, anyway?

A. It's said sarcastically, and they said to me, that, "Charlie, look, here is something that we are working on and we would like you to be part of it. It will help you financially."

Q. Lerner said, "Charlie, I have got a good deal for you"?

A. Well, Lerner and the partners suggested that I join with them in being a partner in the project.

Q. Were you surprised at this offer?

A. Delighted.

Q. And surprised?

A. And surprised.

Q. Did they tell you what was going to be required of you for you to join them in this project?

A. Yes.

Q. And that was a thousand dollars?

A. Yes.

Q. Did they tell you what you were going to get back if the project was successful?

A. Not specifically. I don't think they knew.

Q. Do you recall a figure of $180,000 split five ways?

A. No, sir.

Q. Did you ever come to understand that that's about what it was going to be?

A. No. To this day, I don't know that.

Q. Weren't you curious then how much you might make on this new venture?

A. I told you I was delighted. I had no idea what the amount of money would be.

Marciante's return from his $1,000 investment in the Maplewood project's partnership had amounted to $31,950 at the time of his second appearance at the SCI in February, 1980. Responding to questions by SCI counsel, Marciante recalled that four of the partners -- himself, Jablonski, Schneider and DeRose -- formed JSCR Associates which, for tax shelter purposes, received Maplewood syndication proceeds and split them into four-way payouts. (Lerner's LHS Management, Inc., received his share of Maplewood proceeds). Marciante's testimony on this arrangement and his benefits from it follows:

Q. Later on, in connection with this project, was there another partnership created called JSCR Associates?

A. Correct.

Q. And you were a member of that association also, were you not?

A. Yes.

Q. And the JSCR stood for what?

A. Jablonski.

Q. Schneider, Charlie and Ralph?

A. Right.

Q. Do you recall what the reason for the creation of JSCR was?

A. It was explained to me by Mr. Schneider that it was for a tax purpose.

Q. A vehicle to get a return out of the project is that what he explained to you?

A. Yes.

Q. And did you receive monies from JSCR, also?

A. Yes.

Q. Are you not receiving money currently from JSCR?

A. Yes, I am.

Q. I guess recently, January 2nd, 1980?

A. That is correct.

Q. I am going to again show you a packet of checks, copies of checks, front and back, marked Exhibit C-82 for the purposes of identification and ask you if you can recognize these checks as the checks you received from JSCR Associates, and if you agree with my addition, they total $31,950.

A. Yes, sir.

Q. When you got the first one of those checks on June 22nd, 1978, in the amount of $10,500, did anybody tell you that it was coming?

A. I don't recall.

Q. Were you surprised when you got it?

A. The amount almost knocked me on my proverbial.

Q. It was not a bad investment, that thousand dollars, about a year before?

A. Yeah.

Q. Did you begin to wonder, since you had now recouped about a thousand per cent in a year and a half how much more was coming?

A. Well, I have evaluated the idea that there is a substantial sum of money coming from that project and I am also aware that there is a degree of liability that you can assume, if it doesn't go right.

I believe I am starting to suffer a degree of liability that is not being considered at the present time and it is substantial. So I am sure there will be an offset somewhere along the line.

Q. If there isn't the offset, do you have any idea how much you are going to get now from JSCR out of this Maplewood project?

A. No.

Q. You have got $31,950 on the thousand-dollar investment to date, and you don't know how much is forthcoming?

A. No.

Marciante next was asked if his relationship with Lerner in the Maplewood project had any connection with the AFL-CIO sale of the Nevada project to Lerner. He denied any such connection, according to the testimony:

Q. You entered the Maplewood project about eight months before Mr. Lerner asks you to become a member in Nevada Street. Do you think that had any effect on you with regard to how you received his offer to take over the AFL-CIO project?

A. No, sir.

Q. None whatsoever?

A. No.

Q. Did you think that because of your pre-existing business relationship with Mr. Lerner you might ask for other bids, so-to-speak?

A. Could you clarify that, sir?

Q. Well, did it raise anything in your mind as to being careful, so-to-speak, as to who would get the AFL-CIO project since you had a relationship with Mr. Lerner and people like the SCI, if they looked into it at a later time, they would see you were very open with Lerner?

A. I did not, sir.

Q. Did the consulting work that you did with Mr. Lerner play any part in the discussions, previous discussions, the previous summer concerning the turnover of the AFL-CIO project to him?

A. No, sir.

c. "Whatever the Market Can Bear"

Sanford Schneider, who was Ralph DeRose's law partner at the time, also testified about the origins and financing of the Maplewood

project. He was the attorney on the project's development team. During his testimony he noted that the HFA was not concerned about "how much profit one makes" on a project. Excerpts from his testimony follow:

> Q. Did H.F.A. take any part in the syndication sale?
>
> A. No. H.F.A. (was) only concerned about the identity of the limited partner, and I believe that the H.F.A. received the name of the general -- the name of the limited partners of the first-tier limited partnership that was our investor. They do criminal checks and they are -- I believe they review the limited partnership certificates; they approve of them; they send them to the D.C.A. for approval. To that extent they're involved. But they're not involved in the negotiation or finding of the syndicator. They're not involved in -- they don't care how much profit one makes. Whatever the market can bear. I mean, that's why people are in this business.
>
> X X X
>
> THE CHAIRMAN: So do we understand that the net take of the general partners at that point was $250,000 less the five $1,000 contributions?
>
> THE WITNESS: In essence, you can say that, yes. In essence, you can say that. However, the general partners personally are liable to pay a development cost escrow of approximately $87,000.
>
> X X X
>
> THE CHAIRMAN: In other words, the initial contribution of a thousand dollars from each of the partners was all that the partners' own money that was put into the project?
>
> THE WITNESS: That's right. That's right, sir. The main investment was time and effort.
>
> THE CHAIRMAN: Yes.
>
> THE WITNESS: And imagination and luck.

DeRose was informed that the SCI would cite the Maplewood project in its critique of the HFA and was requested to present his views on that project. After conferring with Schneider, however, DeRose declined to appear at the SCI, saying his recollection of the Maplewood project would duplicate Schneider's.

d. Significance of Maplewood Project Testimony

It is significant that a total partnership investment of $5,000 should yield, by SCI calculations, an actual return in excess of $200,000 within a five-year period. Regardless of Jablonski's opinions concerning the reasons for allowing Lerner and Marciante to share in the project, the testimony clearly reflects the attitude that becoming a partner was tantamount to receiving a gift. This would not have been the case if the Agency had required the partners to put up the $153,742 in equity investment which was provided on their behalf through a loan from the general contractor and a pledge from the architect.

Unlike the Grace and Nevada projects, the avoidance of any significant investment by the Maplewood sponsors did not require any rule-bending or other special treatment by HFA. The agency practice of allowing fee pledging by professionals who are hired by the sponsor and loans or other accommodations by the general contractor, who is selected by the sponsor without any bid requirements, will be discussed in the next part of this report dealing with the lack of cost-saving incentives and policies in agency-processed projects.

C. Cost Inflation on HFA Projects

1. Lack of Cost-Saving Incentives

The Federal Rent Subsidy, which provides the means to repay with interest the mortgage money used to develop a project, establishes the cost limits of the project. Thus, if total estimated development costs are deemed manageable under a given level of subsidy, a project is rated as financially feasible. However, certain cost savings can be achieved below this cost estimate that would reduce the Agency's disbursement of bond issue proceeds to a project. This has not been the case with a number of HFA projects, primarily because Agency policies have encouraged a lack of incentive on the part of developers to reduce costs.

Basically, a limited dividend developer's profit results from the difference, or spread, between the percentage of total development costs that a syndicator will pay him and his own project costs, primarily consisting of the smaller equity and DCE percentage requirements. Since the spread between his percentage proceeds and his percentage costs applies to each dollar of recognized cost, higher development costs should yield higher profits. Consequently, there is no long term benefit in reducing costs below the estimated total cost that is the basis for the mortgage commitment. The only incentive for saving costs stems from the developer's interim funding role (discussed on Pp. 7-8 of this report), which requires him to provide, prior to receiving syndication proceeds, 10 percent of every dollar spent. However, as also evidenced in this report, the developer can avoid these equity requirements by employing arrangements which even further reduce cost saving incentives.

With regard to nonprofit projects, there is no equity requirement and virtually no cost saving incentives for the sponsors. On the contrary, when sponsors convert after a nonprofit mortgage closing they share in the higher syndication values associated with higher total development costs.

2. Costs Prior To and During Construction

a. Fee Pledging Problems

When professional fees are pledged toward the equity requirement, they substitute for cash or irrevocable bank letters of credit that would otherwise be required from the developer. Significantly, the higher a fee, the more valuable it is as a pledge. The agency's fee schedule sets maximum fees for architects and attorneys, who are often involved in fee pledges. However, the Agency permits a developer to select anyone he personally desires to fill these roles. Thus, if he intends to avoid using his personal funds for his equity requirment, it would be self-defeating for him to select someone who would be unwilling to pledge a fee. Obviously, this procedure discourages the selection of qualified professionals who might be available at lower fees but unwilling to wait until syndication proceeds are available to repay the pledges. Consequently, in addition to eroding the cost saving incentives inherent in having to provide interim funding, the practice of fee pledging may cause higher costs for the services performed under that fee. The Agency policy allowing fee pledges will be the subject of an SCI recommendation in Section IV.

b. Construction Cost Inflation

In a system seriously lacking cost saving incentives and lending itself to deals which help to save a developer's investment capital at the expense of Agency bond issue proceeds, the area most susceptible to abuse is the cost of construction, which constitutes from about 65 to 75 percent of total project costs. The Agency's policy for establishing the amount of those costs and the process by which general contractors are selected are not only ineffective from a cost saving standpoint but also vulnerable to corrupt practices.

The HFA allows all project developers to select general contractors of their own choosing. With few exceptions, any contractor who can obtain an Agency-required performance bond is acceptable.

The construction contract entered into by a sponsor and a general contractor specifies, in addition to what is to be paid for all materials and labor, the amount to be paid as the contractor's profit and overhead fee. In nonprofit projects, this profit and overhead fee is determined as a percentage of the actual construction costs. This percentage, according to the HFA's fee schedule, ranges from 7.6 percent on projects with construction costs of $2,000,000 or less to 4 percent on projects with construction costs of $38,000,000 or more. As discussed previously in this report, the profit and overhead fee is recognized as a mortgageable cost in nonprofit projects and, therefore, funds used to pay this fee are advanced from mortgage

money. Limited dividend developers negotiate the amount of this fee with the general contractor and funds used for the payment of this fee are not specifically in the mortgage. The developer's fee is based, in part, on the Agency's recognition of the developer's obligation to pay a contractor's fee but the amount of the developer's fee is not affected by the amount of the negotiated contractor's fee.

The labor and materials cost is established for each project by the HFA's technical staff. Construction is broken down into line items, such as electrical work, plumbing, foundations, site preparation, etc., and estimates of cost are made for labor and materials relating to each line item. Although there is some input from the project's architect and general contractor in establishing these estimates, it is the Agency's technical staff that ultimately decides the maximum allowable costs for each line item -- and therefore the total maximum cost of constructing a project. It is the Agency's position that, if a project is completed at a cost established as reasonable, then full value has been received for the dollars spent.

The HFA has a two-part procedure for controlling construction outlays. Firstly, during construction money is advanced to the contractor based upon the percentage of completion of each line item at the time of the advance, with a small portion being retained until construction is completed. Secondly, the Agency requires a general contractor to certify his construction costs when the job is completed. The general contractor must provide an independent audit of the total cost paid and incurred. This audit involves examination of the various billings, invoices, payroll records and like items evidencing the actual costs incurred by the contractor. However, when work is performed by a general contractor's subcontractor, whose subcontract and the amount to be paid under it is approved by the Agency prior to construction, cost certification merely involves proof that the subcontractor was paid. A subcontractor does not have to provide any other records evidencing his costs for labor and materials. Once actual construction costs are certified, the agency recognizes the total project construction cost as being the lesser of certified cost or the maximum cost established in advance by the Agency. According to contracts examined by the SCI, a contractor must use his profit and overhead fees to absorb any costs exceeding the Agency's maximum unless there are actual approved change orders for these excesses. When certified costs are less than the maximum allowable, the contractor is given half of the amount saved up to a maximum of 1 percent of the total contract.

c. Shortcomings in the Construction Cost Control System

As with the Agency's fee-pledging procedure, the selection of a general contractor can be influenced by the contractor's willingness to make loans or other accommodations to the sponsor of a limited dividend or nonprofit project. Even without considering any of the unsavory practices discussed below, the Agency's system does not require a sponsor to seek out a contractor who is willing and able to perform at the lowest possible price.

Shortcomings in this system relating to certifying the cost of construction materials and labor were made public during the 1981 Federal trial of James M. Canino, who was convicted of fraud involving Parkview Towers, an HFA project in West New York. Canino and Alvin Raphael (deceased) were the owners of A.J. Tenwood Associates, the project's general contractor. Evidence presented at that trial indicated that A.J. Tenwood found subcontractors who were willing to perform certain aspects of the construction for less than the amounts approved by the Agency. However, instead of completing this construction at the lower cost, A.J. Tenwood had the subcontractors inflate their construction proposals and pay the excess money to another company owned by Canino and Raphael. These inflated subcontracts, including approximately $1,500,000 in kickbacks, were certified as part of the total cost of construction. In terms of the Agency's system, so far as subcontractors are concerned, this scheme demonstrated that cost certification is not effective in securing lower costs where Agency-approved cost amounts far exceed the actual necessary costs.

3. Grace Project Construction Cost Abuses

a. Background

In its investigation into various aspects of Grace project construction, the SCI found questionable arrangements involving both the contractor's fee and the cost of materials.

In the summer of 1975, when the Grace project was still a nonprofit, its Grace Development Corporation sponsor selected Vincent B. Carlesimo as general contractor. Carlesimo, a Newark vinegar manufacturer, had no experience as a general contractor nor did he own any construction equipment. Since Carlesimo would have had to subcontract essentially the entire job, his participation as general contractor would have created an extra layer of profit taking. However, Carlesimo was unable to obtain a performance bond and for that reason was rejected by the HFA as the project's general contractor. Nonetheless this rejection did not prevent Carlesimo from sharing in the profits of building Grace.

In place of Carlesimo, the Grace nonprofit sponsor selected Caristo Construction Corporation of Brooklyn as general contractor. In a January 11, 1976, agreement between Caristo Construction and Vin Jud Co., Inc., a corporation owned by Carlesimo, Caristo acknowledged that Vin-Jud was instrumental in its being named general contractor for the Grace Project and stated that Vin-Jud was to be paid 40 percent of Caristo's fee for the job. Since this project was still a nonprofit (its conversion in June, 1977, into a for-profit project was discussed previously in this report), the fee in question was a mortgageable cost to be paid from bond proceeds. In conjunction with the Agency's last nonprofit mortgage commitment to Grace on March 23, 1977, the general contractor's fee was set at $824,039.

With regard to nonprofit projects, there is no equity requirement remained as the general contractor. In an agreement signed by John A. Brunetti, then vice president of Caristo Construction, and Arthur Lerner, the general partner of Grace Associates, the project's limited dividend sponsor after conversion, Caristo agreed to $700,000 as its general contractor's fee. Examination of financial records show that Caristo was paid $525,000 through February, 1981, and that Carlesimo received 12 payments from Caristo totalling $124,400 between October, 1977, and September, 1979 (just prior to the issuance of SCI subpoenaes on this topic).

b. Testimony on Grace Construction Contracts

The Commission heard executive session testimony on various aspects of the construction of the Grace project, including how Carlesimo was initially chosen as general contractor by the original nonprofit sponsor of Grace, the switch to the Caristo company and its relationship to Carlesimo, as well as the commissions paid to Carlesimo on the sale of bricks used in building Grace.

One witness questioned at the SCI was Elder Lonzy McCarey, executive secretary to the president of the Grace nonprofit sponsor. He testified as follows about the selection of a general contractor:

Q. Okay. Do you recall who -- were there competing contractors that were going to build the project? Was there more than one?

A. No, we always were told just who it was going to be and that was it.

Q. Okay. It was always, to your recollection --

A. The one man in New York. What's his name?

Q. Caristo?

A. Caristo. That's the only person they told us about.

Q. How was Vinnie Carlesimo presented to you? Was he in partnership with Caristo?

A. I think they said he was the manager or representative or something for Caristo.

Q. Okay. Do you recall Levin West telling you anything about why the construction company had to be Caristo at any time?

A. No.

Q. Do you recall a meeting at Oliver Lofton's office in Newark where Reverend West talked about why it was going to be Caristo Construction Company?

A. Only reason, because that's the one they selected.

Q. Who was the "they"?

A. Never told us who the "they" was.

Vincent Caristo, the owner of Caristo Construction, negotiated the transaction with the Grace project on behalf of his company. He died in 1978 but the SCI heard testimony from Maurice Levine, general manager of Caristo Construction, on the subject of Carlesimo's participation in the construction contract. Excerpts from his testimony follow:

Q. Were you introduced to Mr. Stein and Mr. Carlesimo?

A. Yes, sir.

Q. And was their status relayed to you; this is Mr. Stein, who is something? Do you recall that?

A. No, I don't.

X X X

Q. Okay. Mr. Carlesimo, did he have any affiliation?

A. From what Mr. Caristo told me, he was going to be our partner on the job.

Q. When you say "partner," you took that to mean he was in the construction business?

A. No, sir, I didn't.

Q. What did you take it to mean?

A. Nothing. He was going to be our partner on the job.

X X X

Q. Okay. Did you come to learn that Mr. Carlesimo was not in the construction business?

A. He represented himself at that time, if I remember, was the name of the outfit was Vin-Jud Construction or Vin-Jud Corporation. I don't know whether he's ever been in construction or ever been in it or not. I really don't.

X X X

Q. Getting back to Mr. Carlesimo, did that surprise you at all, his presence as your partner?

A. Surprise me?

Q. Yes.

A. No, sir.

Q. You said it was unusual. He hadn't done it before?

A. No, sir, it doesn't surprise me.

Q. Why did you need Mr. Carlesimo, in your opinion?

A. I don't follow that.

Q. Why would --

A. I didn't need Mr. Carlesimo.

Q. Did Caristo Construction need Mr. Carlesimo?

A. I assume we wouldn't have had the job unless he was our partner.

Q. Did you come to learn that paying Mr. Carlesimo was the payment of a finder's fee or something in the nature of payment for receiving the business?

A. Mr. Caristo told me that he was to get a certain percentage of the fee, yes.

Q. Certain percentage of the figure received by Caristo Construction for construction?

A. From the $700,000, yes.

Q. Okay.

A. That it was supposed to be our fee on the job.

Q. It was a 60/40 split; correct?

A. Yeah, I believe it was.

Q. Okay. Did you bring with you any documents that we asked you to bring today?

A. Yes, sir.

X X X

Q. I show you what's been marked now Exhibit C-69 for the purpose of identification, which purports to be a copy of an agreement that you brought with you today in response to subpoena. Is that correct?

A. Right.

Q. And that agreement is dated the 11th day of January, 1976, and it is between the Caristo Construction Corporation of Brooklyn, New York, and an entity identified as the Vin, V-i-n, hyphen Jud, J-u-d, Co., Inc., of 828-830 Raymond Boulevard, Newark, New Jersey?

A. Correct.

Q. The operational point of the agreement suggests, you will agree with me, Vin-Jud will assist Caristo in general supervisory functions such as labor relations, labor negotiations, equal opportunities programs. In return for that Caristo will pay Vin-Jud 40 percent of the receipts received by Caristo. Is that fair to say?

A. Yes, sir.

Q. Did Vin-Jud every give Caristo any services whatever?

A. He attended numerous meetings with us. He helped in the community, I know, when we needed help. He knew all the people involved in Grace Associates. That way I would say, yes, sir.

Q. Did he ever provide any supervisory help to you?

A. No, sir.

X X X

Q. By virtue of the agreement that we have marked Exhibit C-69, I believe, Mr. Carlesimo would receive 40 percent of $700,000?

A. Based on this agreement he was to receive 40 percent of the fee, less --

Q. Expenses?

A. Less expenses, less expenses, yes.

Q. Okay. So that's ... $280,000. Is that fair to say?

A. That's correct.

Q. Would you have taken that deal if you were Mr. Carlesimo?

A. I don't -- I can't answer that.

Q. Well, let me rephrase it. Based on your experience in the construction trade, was his aid in the community to you and the obtaining of two subcontractors worth a two-hundred-eighty-thousand dollar fee?

A. I think, I think the most important part here is the fact that he got us the job.

Q. Okay. It is?

A. That's how I feel.

Q. So what you're saying, it was more a finder's fee than a fee for services performed?

A. I wouldn't -- I couldn't call it a finder's fee. You can, but I don't know what they call it.

Q. You wouldn't call it a finder's fee, it was a fee for bringing the job to you?

A. And helping us through the whole process, yes.

Q. Okay.

THE CHAIRMAN: Helping you with the whole process, I suppose, is about two, or two or one percent of actually getting the job for you initially; would that be correct?

THE WITNESS: After we went to fees -- he went to many, many meetings to get the whole project going with the New Jersey Housing Finance Agency, with lawyers' offices, with the community, and he did attend all those meetings.

THE CHAIRMAN: But Stein was there, too?

THE WITNESS: Mr. Stein was there until he died, yes.

THE CHAIRMAN: What did he do, hold Stein's coat or hat or something?

THE WITNESS: They both did work on it.

Vincent Carlesimo testified at the SCI both on his part in the Grace project construction contract deal and on the sale of bricks to the project's general contractor. Excerpts from his testimony on the Grace construction contract follow:

THE CHAIRMAN: How long have you been in the vinegar manufacturing business?

THE WITNESS: About 35 years, sir.

BY MR. O'HALLORAN

Q. Have you ever engaged in the building construction business?

A. Yes, I engaged in sales.

Q. In sales of what?

A. Cement, brick and block.

Q. Is that the extent of your participation in the building construction business?

A. Yes, yes, sir.

Q. Have you ever worked as a general contractor in the building business?

A. No, sir, I have not.

X X X

Q. Are you familiar, Mr. Carlesimo, with an organization known as the Grace Renewal Corporation?

A. Yes, sir, I am.

Q. When did you get to know that organization?

A. Well, I would say seven or eight years ago. Six or seven. At its early inception.

Q. In around 1975 would it be fair to say?

A. Yes, in that area...I became acquainted with the Grace Project, I was friendly with the sponsor, a Reverend West.

Q. Would that be Reverend Levin West?

A. Yes.

Q. Is that the way in which you became associated with Grace Renewal, through Levin West?

A. Well, it was, it was I went to him to ask him if I could be considered to act as a contractor on this job; on the Grace Renewal job.

Q. At the time that you first spoke to Reverend West was the Grace Renewal Corporation, as you know it, a nonprofit group?

A. Yes. I believe so, yes.

X X X

Q. How long had you known Reverend West before you approached him with the prospect of becoming a contractor?

A. I would say, ten years or more.

Q. What was the nature of your relationship, if any, with Reverend West in that period of time?

THE CHAIRMAN: Precinct leader or something like that?

THE WITNESS: No, sir. He was a human rights leader in something and I knew him politically.

BY MR. O'HALLORAN:

Q. Did you have any business relationship with Reverend West in that period of time from --

A. No, sir.

Q. -- 1965 to 1975?

A. None whatsoever.

Q. Were you ever connected in an official way with the Mountain Ridge State Bank?

A. Yes, sir. I still am.

Q. What is your position there now?

A. I'm on the board of directors.

Q. And in 1975 what was your position with that bank?

A. Board of directors.

Q. Were you at any time while you were on that board of directors instrumental in putting together any loans for Reverend West?

A. No, sir.

Q. To your knowledge, did Reverend West ever borrow --

A. Yes, sir.

Q. -- any sums from that bank?

A. I think he did.

Q. But you had nothing to do with aproving those loans --

A. Nothing.

Q. -- or making those loans --

A. Nothing.

Q. -- let's say, easier to obtain?

A. Nothing whatsoever.

X X X

Q. Okay. Just for a moment, to get back to Reverend West, did the Mountain Ridge Bank ever notify him, "him" being Reverend West, that he was late on payments of notes to the bank?

A. They sure did.

Q. Did you have anything to do with speaking to Reverend West about those late charges or the late payments?

A. No, I -- I don't think I would have anything to

do with it. I know they were -- I seen his late name came up and I know they were after him. But --

Q. Did you say anything to the bank about not proceeding vigorously after --

A. Positively not.

Q. -- Reverend West on those late payments?

A. Positively not.

X X X

Q. Okay. Do you know whether that project was to be financed by the New Jersey Housing Finance Agency?

A. Yes, sir.

Q. How do you know that?

A. I came here attempting to do it. I went through it. I know, I was here several times.

Q. Do you know whether H.F.A. approved the project as first presented to the H.F.A.?

A. Well, they wouldn't approve me starting off when I went there.

Q. Why, what was your role to be in this project?

A. Well, initially, I had a friend of mine who was a builder and I wanted to build it with him, and the state turned me down.

Q. Why did the state turn you down?

A. Well, we couldn't bond sufficiently.

THE CHAIRMAN: I mean, what building had you done prior to that time?

THE WITNESS: I hadn't done any myself, but my associate had experience in building.

BY MR. O'HALLORAN:

Q. What is the name of that associate?

A. Judson Leve.

Q. When you say you weren't able to be bonded, are you saying that you could not get the bonds required by the H.F.A., that is, performance bonds or any other bonds required by their rules and regulations? Is that what you're saying?

A. I couldn't meet their standards as a builder and as financial requirements.

Q. And you had no prior experience in building anything of this nature?

A. Not in building, no, I did not.

THE CHAIRMAN: And you never engaged in the building of anything at all prior to this time?

THE WITNESS: No, sir, I did not.

BY MR. O'HALLORAN:

Q. How did it come to be that you were selected by Grace Renewal as the person to do the contracting here?

A. I wasn't selected by Grace Renewal. I asked Reverend West for an opportunity to build, and he said he would entertain such an opportunity if I had the proper credentials; he would turn it over to his board of trustees. I think he was confident that, if I were on the scene, he was confident that I would be sensitive, and that was one of my principal parts to play in it, that I would be sensitive to affirmative action, and that was a primary concern of his and he had known me a long time and he knew that I think along those terms.

X X X

THE CHAIRMAN: Did you tell the housing agency that you were pledged to do this?

THE WITNESS: Yes, I think so.

THE CHAIRMAN: You told them you weren't a builder but wanted to be designated the builder here and you would get somebody else to do the building?

THE WITNESS: No, the housing agency wasn't interested in me at all, sir, because I didn't qualify as a builder and they, as far as they

were concerned, and I asked, in fact, I had asked the housing agency if it were possible for me to joint venture somehow with Caristo and they said no, so that --

BY MR. O'HALLORAN:

Q. Did you ever have any experience with H.F.A. before this application was made on behalf of Grace Renewal?

A. No, sir, I didn't.

X X X

Q. Was it at that time that you formed a corporation for building this project? Was that the beginning of Vin-Jud?

A. No, no. I formed Vin-Jud, I had inherited a building and I formed Vin-Jud, I think it was the timing was almost simultaneous. I formed Vin-Jud to incorporate the building which still is in existence, and that would have been the corporation name had we been able to build.

Q. What was the purpose of the corporation Vin-Jud?

A. Twofold purpose: To put my building in a New Jersey corporation, and if I got the housing job, we were going to build as Vin-Jud corporation.

Q. Now, the other part of Vin-Jud was Judson Leve. Correct?

A. Judson Leve.

Q. Where is he from?

A. Utica, New York.

Q. Is he still in Utica, New York?

A. I think so.

Q. Did you ever have any association with Judson Leve before this corporation was formed?

A. No, sir.

THE CHAIRMAN: What did he do at that point?

THE WITNESS: He was a builder and he lived in an apartment that I lived in Florida and I had known him for a few years.

X X X

THE CHAIRMAN: You didn't know anything about the construction process itself?

THE WITNESS: No, sir, I didn't.

THE CHAIRMAN: Absolutely no prior experience?

THE WITNESS: No, sir. I felt this way: I felt that it's a numbers game and I felt that, with Jud Leve who had certain expertise --

THE CHAIRMAN: Certain expertise in what?

THE WITNESS: Building. In building.

THE CHAIRMAN: What? Building what?

THE WITNESS: He built, as I say, shopping centers and he did some housing jobs.

THE CHAIRMAN: You say "some." What jobs did he do?

THE WITNESS: I don't really remember.

THE CHAIRMAN: And you planned to get a general contractor and you were just --

THE WITNESS: I planned to let Judson do the low-rise. We were going to tackle the low-rise and sub out the big one. We weren't going to do the big one.

X X X

THE CHAIRMAN: I think we would like to know what buildings he put up.

THE WITNESS: Well, I know shopping centers that he had put up.

THE CHAIRMAN: Did you ever see one?

THE WITNESS: No.

THE CHAIRMAN: Have you ever seen any of his housing projects that he built?

THE WITNESS: No, I did not.

X X X

BY MR. O'HALLORAN:

Q. All right. Now, you have stated that you did not become the general contractor on this Grace Renewal job. Who did?

A. Caristo Construction Company.

Q. Did you introduce Caristo Construction to Grace Renewal?

A. Yes, I did.

Q. What experience did you have in business with Caristo Construction before introducing them to Grace Renewal?

A. Just tried to sell them brick every once in awhile, or block or something.

Q. That's all?

A. And I -- that's all.

Q. Now, after Caristo Construction was awarded the job of general contractor on this project, did some written business relationship come to pass between you, or between Vin-Jud, and Caristo Construction?... What agreement did come to pass between you and Caristo?

A. That I would receive 40 percent of the fee less certain office expenses.

Q. Was that a written contract?

A. Yes, it was.

THE CHAIRMAN: You did execute such a contract?

THE WITNESS: Yes, we did.

BY MR. O'HALLORAN:

Q. Of which this is a copy?

A. Yes, sir, it is.

Q. What were you required to do under that contract?

A. Well, essentially, I was going to see that the affirmative action was met and just -- and assist in any other way that I could.

Q. Well, the contract provides that Vin-Jud will assist Caristo in general supervisory functions?

A. Yes.

Q. What supervisory functions did you perform?

A. That we had troubles with a certain type construction, and metal construction or something, and I urged him to dismiss the guy, and I attended a meeting where we did dismiss him, and go a conventional method. They were putting up some Batti Metal or something and that set them back time and money and everything, and I said it's no good, we're not going according to plan, and he sat down and I told the fellow we're not going to need you any more.

Q. Was that the extent of your supervisory function with regard to Caristo?

A. Actually, that's about the only time I ever did have anything to say supervisory, yes.

Q. Were you on the job site on a daily basis?

A. No.

Q. You didn't have any office at the job site?

A. No, I did not.

Q. The contract also --

A. I was very rarely there.

Q. The contract also provides that you would assist in labor relations and labor negotiations?

A. I think that was something that their lawyer put in, and something that I would have been amenable to do if there was any -- if there were any problems, I would relieve the burden of one of their men going, I would do it.

Q. Were you ever called upon to do that?

A. No, sir, I was not.

X X X

Q. All right. Once Caristo became the contractor on the job, did Judson Leve have anything to do --

A. Nothing.

Q. -- with supervisory, labor negotiations?

A. Nothing whatsoever.

Q. When did he cease to be a part of Vin-Jud?

A. He never was a part of Vin-Jud actually without coming into the building. You see, as I say, they ran simultaneously. I don't know exact timing, but at the point where I put the building in the name of Vin-Jud he wasn't on it. I would have added him on if we did the job and had the building up, as part of my financial statement.

X X X

Q. Now, you already said that the contract provided that you would receive 40 percent of Caristo's total fee. Correct?

A. Yes.

Q. What was that total fee to be, so far as you knew?

A. I think it was $700,00.

Q. Your fee, then, by pure simple mathematics, would have been $280,000. Is that correct?

A. That's correct.

Q. Did you, in fact, receive $280,000?

A. No, sir, I did not.

Q. How much did you receive?

A. Around a hundred and twenty.

Q. And were they in periodic payments?

A. Yes.

Q. When did those payments start?

A. I think, about a year after the job started.

Q. Which would be sometime in 1977, you say?

A. Approximately, yes.

Q. And how long did they continue to pay you?

A. For about a year and a half or two years.

Q. Would it be fair to say that you received, in fact, $124,000 from Caristo?

A. Yes, sir.

Q. Does Caristo now owe you any money?

A. Well, he said no and I say yes.

Q. How much do you say he owes? The difference between 280 and 124?

A. Less whatever expenses that this contract implies.

Q. What have you done, if anything, to collect what you say Caristo owes you?

A. Well, I've instructed a lawyer to sue him. I called him many times and he said to me, "I lost money and I don't have it."

Q. He did not?

A. No, sir, he did not.

Q. Of the $124,000 that you did receive from Caristo, did you share that with anybody?

A. No. No, sir.

Q. Did you work for or with Caristo Construction before the Grace Renewal job?

A. No, sir, I did not.

Q. Is it fair to say that Caristo, unless Caristo agreed to share his fee with you, that he would not have gotten that job?

A. Well, I can't say that for sure, because I'm sure that if Caristo would have -- he was a tremendous builder of great stature and he himself was a tremendous human being in the community, and if he could have -- if he did go into a board of trustees without me, on his credentials, I wouldn't say that they wouldn't give it to him, because he had outstanding credentials.

Q. When you say --

A. However, I was the one who led him there and in three minutes, at the time he was doing very, very little or nothing, and in three minutes he said to me, "I need work. You got a deal." That's it.

X X X

Q. Now, you just said that Caristo, or someone on behalf of Caristo, said they were doing nothing and this was a job that, better than doing nothing, they would take this job?

A. That was Mr. Caristo.

Q. Mr. Caristo said that?

A. Yes, sir.

Q. And maybe simultaneous with that statement or shortly after that he agreed to give you 40 percent of whatever the fee was that he got. Is that correct?

A. Yes, right at the, at the same time.

Q. Would it be fair to say that he felt that he had a comfortable profit in only 60 percent of the fee that he would receive on this job?

A. I -- I think he was happy with it, yes, unless he had ulterior motives, which his son-in-law has now, which I highly doubt.

Q. Now, I think you said even though the contract says that you had certain duties and obligations, you really didn't do anything that the contract said you were required to do?

A. Yes, I did do. I did do some.

Q. Would you characterize what you received here as finder's fee?

A. I did do some things. I put some black contractors to work.

THE CHAIRMAN: What else?

THE WITNESS: That's all. I attended that, I attended the meeting where we dismissed Batti Metal and, in fact, consulted with attorneys that would I be in legal -- would I be in the legal posture if I did this; I consulted with a couple of attorneys, and they said, yes.

THE CHAIRMAN: What else did you do?

THE WITNESS: Beg your pardon?

THE CHAIRMAN: What else did you do for this --

THE WITNESS: That's all.

c. Testimony on Commission for Bricks

The SCI investigated the selection and purchase of bricks for the Grace project. During the course of that investigation the SCI found that James P. Fitten Company of Orange, the brick supplier, paid $7,000 to Carlesimo as a commission on the Grace brick sale. Additionally, it was learned that Carlesimo had received a commission on Fitten's sale of bricks for the Pilgrim Baptist project, another HFA project located in Newark.

The SCI heard testimony from Frederick M.X. Fitten, a partner in the Fitten company, regarding the brick sales. Fitten testified that he utilized Carlesimo and Albert Collier, who was the Essex County undersheriff at the time, as salesmen. In describing Collier's role in the Grace sale, Fitten stated that Collier carried brick samples and, along with Fitten, visited the agency and the architect in trying to make sales.

Fitten gave the following testimony regarding Carlesimo's association with the company and the company's efforts to sell the bricks:

Q. After those conversations with the agency, where did Mr. Carlesimo come in? By the way, what did he do? He carry brick around, too, or see other people? What did he do?

A. Well, he was in contact with the architect and in contact with the sponsor on the job and local in Newark sponsoring representative.

Q. And did you contact him, too, about this job around the same time you contacted Collier?

A. Yes, sir, I did.

Q. And had he been a commissioned salesman for you?

A. Yes, he had, on and off for many years.

Q. Starting when?

A. I believe it would be back around 1965-66.

X X X

COMMISSIONER PATTERSON: ...what did Mr. Carlesimo do besides be a commissioned salesman for brick people?

THE WITNESS: I don't know.

COMMISSIONER PATTERSON: You don't know what he does?

THE WITNESS: No.

COMMISSIONER PATTERSON: You don't know what job he may have in his extra time?

THE WITNESS: Well, I believe now he's Essex County Treasurer.

COMMISSIONER PATTERSON: Was he at the time? Do you know if he was the treasurer at the time of the Grace Renewal Project?

THE WITNESS: No, I don't know that at all.

COMMISSIONER PATTERSON: And when you say he's Essex County Treasurer, what do you mean? What's your understanding of that term?

THE WITNESS: I should correct that. He's treasurer of the Essex County Democratic Committee, I believe.

COMMISSIONER PATTERSON: So, he apparently has some political position within Essex County?

THE WITNESS: I would assume it is.

Q. Did you negotiate a commission with Mr. Carlesimo, also?

A. Yes, I did.

Q. How much did you agree to pay Carlesimo on the job?

A. I believe it was -- you have my records again. But, I believe it was $20 a thousand. Correct me.

COMMISSIONER PATTERSON: So, I understand it, you originally were going to charge 165 per thousand bricks to the contractors on the job; is that right?

THE WITNESS: That's correct.

COMMISSIONER PATTERSON: Of which $20 -- I'm sorry, $40 was going to go to two commissioned salesmen; is that correct?

THE WITNESS: No, $30.
COMMISSIONER PATTERSON: But, each of the two gentlemen got a commission for doing the same thing on the same job?

THE WITNESS: On many occasions, and as many jobs I've lost down the road, I felt on a job this size that it would be just as easy to employ a couple of salesmen to try to get the job. I've lost jobs before because I've been in competition.

COMMISSIONER PATTERSON: I'm not quite sure -- did you employ them to get the job?

THE WITNESS: No, I've employed them as salesmen to get any jobs I could through the years.

COMMISSIONER PATTERSON: But, did both these gentlemen work equally as hard getting you the job on Grace Renewal?

THE WITNESS: Well, I don't think equally as hard. You know, I realized what position Mr. Collier was, that he had a full-time job, and I thought Mr. Carlesimo could put more time in it as a salesmen, he could, and he pressed me a little harder for the commission. I felt I had it there, and it was an equitable arrangement, as far as I was concerned.

Q. How did he press you a little bit harder?

A. Sit down as a businessman and negotiate any deal, you know, you look to get as much out of it as you can make as good a deal as you possibly can. When we're going on, I presume I would say, listen, I can get another brick line and try to sell that on a job and get more out of it, and I would counter, well, maybe I can give you a little more, depending on how much I can buy the brick back for the company or if I can pick up some dollars for them on it, which I did.

Q. And part of his pressure was that he implied that he could take this business elsewhere, too?

A. I don't know, you know, implication.

Q. I used the word implied because I said he didn't say it directly, and I assume he said indirectly, and I used the word imply.

A. I don't assume, I really don't know.

Q. $30 out of your $60 profit margin was a 50 percent commission.

A. That's correct.

Q. Did you have any contact with the sponsoring group at all?

A. No. I met Reverend West. I met him at the architect's office, I believe. He's with the sponsoring group.

Q. What did Mr. West represent himself to be with respect to the sponsoring group?

A. He was part of the sponsoring group. That's what he represented himself to be part of the sponsoring group. A job sponsored by his church.

Q. And did he make decisions on behalf of the sponsoring group with regard to the building of the project?

A. I would presume he makes it with the group.

Q. Okay. But, did he appear to be a representative of the group in the meetings that you were there?

A. Obviously he's one of the representatives.

Q. And what was the substance of those discussions?

A. Same as with the architect was, what type of brick you are looking for, what color, what size, and whether we had something acceptable that they liked.

Q. Was this before Mr. Carlesimo was a salesman on the job when you met Reverend West?

A. I think it pretty much was all simultaneously -- I don't know exactly.

Additionally, the SCI discovered a peculiar sales price difference between bricks purchased by Grace's general contractor, who has to certify his cost of materials, and bricks purchased by his subcontractors, where such certification is not required. Caristo, who by virtue of his status as general contractor could have negotiated the price for all the bricks on the Grace job, paid $20 per thousand bricks more than his subcontractor for the same bricks. Excerpts from Fitten's testimony on this issue follow:

Q. Here's what I would like you to explain in your own words. Worth (company) billings, your invoices to Worth on 2/7/79 suggest a hundred-and-fifty dollars per thousand for bricks that's February 7, 1979. Our invoices, and I'll accept your explanation that it was misbilled, so we'll call it 165 on February 7, '79.

On February 9, '79, your invoices show Caristo being billed 185 per thousand for bricks. I wonder why the $15 difference or the $20 difference between Worth and Caristo?

A. Because as I have been finding out, Worth didn't pay his bills at all, and I have very little guarantees of getting the money and most of it is out. So, I felt that brick going to Caristo would help secure my job a little bit better.

X X X

Q. ...The answer I'm looking for is an explanation of why Caristo, two days apart, is being charged $20 more than Worth is being charged

for the same brick.

A. I negotiated the high-rise on a different basis with, I think, if you see in the letter, it is in there and an explanation of that.

Q. That wasn't Mr. Carlesimo's $20, was it?

A. No, sir.

Q. You delivered, also, pursuant to your records, 350,000 bricks to Caristo.

A. Yes, sir.

Q. And Mr. Carlesimo got $7,000 from you at one point, that's 20 times 350. That wasn't the deal you made with Mr. Carlesimo.

A. No, sir, I think you have to, and I'd have to check the records of the dates when I received any monies and so forth. I think that's quite a happenstance.

Q. Okay. You said that you paid -- well, I'll show you the check.

(C-154, a cancelled check, No. 2451, was marked for identification.)

Q. Showing you what's been marked C-154 for purposes of identification, which is a check from your firm to Mr. Carlesimo in the amount of $7,000, dated December the 20th, 1978, which would be prior to the delivery.

A. Yeah, I think that should answer your question right there. It is prior to my delivery.

Q. So, that was not a prepayment of anything?

A. Absolutely not, as I testified before, when I got payment, I paid off the payment.

Q. What was it for, the 7,000?

A. It would be for 350,000 bricks, and it is probably marked in there as such showing our sheets, showing our tabulations.

X X X

Q. Okay. Do you owe Mr. Carlesimo any money today?

A. Yes, I believe I do.

Q. Because you've not been paid from --

A. There is in excess of, I believe, $18,000 due and owing on this job, which I've been calling on a regular basis and found quite an insult yesterday when I received a check for $250 from Caristo and I intend to start suit on it very shortly with regard to it.

X X X

Q. Did anybody at the HFA ever check with you on why Caristo was paying $20 more a thousand...?

A. No, it is my understanding with the agency that these are negotiated deals with the contractors whether they check with them or whether they submit the records, not to my knowledge, nobody checked with me.

Q. Nobody ever asked you why one contractor was paying you $20 a thousand more?

A. No, they didn't.

Q. Did Caristo ever ask you why he was paying $20 more a thousand than Worth?

A. No, he hasn't.

The Commission also heard testimony from Albert Collier regarding his knowledge of Carlesimo's participation in the Grace and Pilgrim Baptist brick sales:

Q. Do you know an individual by the name of Vincent Carlesimo?

A. I met him.

Q. When did you meet him?

A. I met Vinnie, Vincent Carlesimo back in 1972, I think '72 or '73.

Q. What was the occasion upon which you met him?

A. I'm trying to think of the job -- Newark job that I was bidding on, and I did appear before the board at the time to see if our brick was accepted, and I think our brick was accepted. That's when I knew Vinnie was representing some of the other brick companies, Vincent Carlesimo.

Q. Do you know him to have any business relationship with Rick Fitten?

A. No, I did not.

Q. Mr. Fitten ever mention to you that he was an employee of Fitten Brick?

A. That Vinnie was?

Q. Yes.

A. Never mentioned that to me.

Q. Is that a surprise to you?

A. If he's an employee, it is a surprise to me.

COMMISSIONER PATTERSON: Was it a surprise for you to know that he received a commission on Grace Urban Renewal brick?

THE WITNESS: Yes, I was surprised.
COMMISSIONER PATTERSON: As a salesman for Fitten?

THE WITNESS: I would be surprised.

COMMISSIONER PATTERSON: And under the assumption that he was important in getting the sale of the brick?

THE WITNESS: I have no knowledge of that whatsoever.

COMMISSIONER PATTERSON: That surprised you?

THE WITNESS: It does surprise me, yes.

Q. Would it be surprising to you that he got a commission on Pilgrim Baptist, too?

A. Yes, it would be.

Q. Is the situation there basically the same, do you know anything that he did for Fitten Brick to Pilgrim Baptist?

A. I have never seen Mr. Carlesimo in Fitten Company or in my company.

COMMISSIONER PATTERSON: Can you imagine what

he might have done on the Urban -- on the Grace Urban Renewal to earn a commission?

THE WITNESS: I don't know anything that he would have done.

Q. Is it possible that he could have done something or would you necessarily have to know about it if he did something on one of those projects?

A. I would say I wouldn't necessarily have to know. As I said, my function was part-time. Rick Fitten was full-time.

COMMISSIONER PATTERSON: But, you think you and Rick together are the ones that sold the proper party, the general contractor?

THE WITNESS: I think yes, I do.

COMMISSIONER PATTERSON: And you didn't need any help from anybody else?

THE WITNESS: I don't think we needed any help.

Q. Given that answer, would it surprise you to know that Carlesimo got twice as much as you got on the price?

A. Yes, it does.

Q. Would it surprise you to know five times as much on the Pilgrim Baptist?

A. Yes, because I still have monies from both projects.

COMMISSIONER PATTERSON: To be perfectly honest about it, at least in one question as to whether he got paid any more than you have about the amount due assuming a completed project are what Mr. Siavage said five times as much.

THE WITNESS: That's very surprising. I had no knowledge of that whatsoever.

COMMISSIONER PATTERSON: Do you know whether Mr. Carlesimo had any interest in the general contracting of the Grace Urban Renewal?

THE WITNESS: I don't know anything about that at all.

Carlesimo's testimony on his role as a salesman of bricks used at the Grace project confirmed his receipt of $7,000 in commissions. But he could not explain why Caristo Construction paid $20 more per thousand for Bricks on which he received commissions than a subcontractor on the same project at the same time paid for the same kind of bricks. Further excerpts from Carlesimo's testimony follow:

Q. Did you ever do any work for the Fitten Company?

A. I sold for them.

Q. What did you sell for them?

A. I sold brick.

Q. And during what period of time did you sell for the Fitten Company?

A. Oh, I'd say from around 1970 on.

Q. You are a commission salesman, then, for Fitten. Is that correct?

A. Yes, sir.

Q. What arrangement on commissions did you have with the Fitten Company?

A. Well, I would get like five percent of sales or whatever I sold.

Q. Did you ever have an agreement with Fitten that they would pay you X dollars per thousand brick that you sold?

A. Oh, yeah. Yeah. In other words, you sold it, you sold it by thousand, and you would get pid by so much per thousand. It would equate to five percent or whatever it equated to. In other words, if you sold a brick, he would sell you a brick at -- if he sold the brick at a hundred dollars and to meet competition you might have wound up with two and a half dollars a thousand, or five, or ten, whatever it was.

Q. Did the Fitten Company sell the brick that went into the Grace Renewal job?

A. Yes.

Q. And did you participate in the sale of that brick?

A. Yes, I did.

X X X

Q. Do you know how much the price was that Caristo paid for the brick from Fitten Company, how much they paid per thousand; do you know?

A. No, I can't quote the figure. All I can tell you is that you may be sure that it was a price that was highly acceptable for that brick, and highly acceptable to the housing authority and to Caristo.

THE CHAIRMAN: How do you know that?

THE WITNESS: Well, because that was the first thing I made sure in selling it that no one could come back and say that I put in an excessive price and trying to make an inordinate profit out of it.

BY MR. O'HALLORAN:

Q. Do you know whether the Fitten Company was selling brick to Caristo in 1979, in February of 1979? Was the project still going at that time?

A. It might have been.

Q. I show you what was marked C-150. This purports to be a delivery ticket from the James P. Fitten, Jr., Company, to the Caristo Construction on Grace Development. Would you look at that, please?

A. Uh-huh.

Q. Does that refresh your recollection as to the price that Fitten was charging Caristo on the Grace Renewal job?

A. I would say so, yes.

Q. What is the price shown on that delivery ticket?

A. $185.

Q. And that is per thousand?

A. Per thousand.

Q. What would your commission be on a sale of that magnitude?

A. I don't recall at this time. I don't recall at this time.

Q. Do you know a person named Rick Fitten?

A. Sure. Yes, sir.

Q. Did you have an agreement with him that you would receive a commission of $20 per thousand brick?

A. I don't think it was that high.

Q. Did you ever receive payment from the Fitten Company for your activities as a commission salesman?

A. Yes, I did.

Q. How much money did you receive on the Grace Renewal job?

A. On the Grace Renewal?

Q. Yes.

A. I would say 7 to $8000.

X X X

Q. Okay. Let me show you what was marked as Exhibit C-154. This purports to be a check from the James P. Fitten, Jr., Associates, Inc., payable to Vincent Carlesimo in the amount of $7000. Would you look at that check, please?

A. Yes, sir.

Q. What is the date on that check?

A. December 20, 1978.

Q. Now, if you received $7000 from the Fitten Company for your commission on the sale of brick, brick which was delivered in 1979, is that some kind of advance payment that you were receiving there from Fitten?

A. Could -- no. The job started when? In '76?

Q. You were the expert on the job. When did it start?

A. I don't recall the exact date, but this could have been for payments of brick delivered.

Q. That's two months after your payment of $7000?

A. Yes, yes.

Q. How do you explain that?

A. Well, I think everybody started to hit the panic button. Everybody was losing money, nobody was paying anybody, and I think Fitten might still be owing money from the job.

Q. Were you one of the ones hitting the panic button?

A. No.

Q. Why did he have to pay you in advance?

A. He didn't pay pay me in advance.

Q. Did you receive commission on the brick that --

A. No.

Q. -- was delivered in February of 1979?

A. No.

Q. How do you know that?

A. I never got any check after '79. I never got any check after this date. I'm most sure I --

(The witness confers with counsel.)

Q. MKr. Carlesimo, did you sell brick for any other corporation or company to Caristo on this Grace Renewal job?

A. No, sir, I did not.

Q. Do you know when the first delivery of brick to Caristo was on this job?

A. No, I don't. Offhand, I don't recollect the exact date. I didn't even remember the date that the job started.

Q. Would it surprise you to know that no brick was delivered by Fitten to Caristo until 1979?

A. No brick was delivered by Fitten from 1979?

Q. Yes.

A. Yeah, that would surprise me.

X X X

Q. Mr. Carlesimo, does the Fitten Company owe you any money now as commissions for brick you sold on the Grace job?

A. Yeah, I would say they do.

Q. How much would you say they do owe you?

A. Well, I don't know. It's a discussion because he claims he lost money, he didn't get paid monies, in which case I don't get paid.

But may I insert this, sir, at this time: On 12/20/78, prior to this --

Q. Prior to which now? You're pointing to something.

A. Prior to this exhibition, it says 2/9/79, that no brick were delivered by Fitten prior to this. I would say the job was almost completely delivered before this.

Q. You would say that the Fitten Company had supplied nearly all the brick it was going to supply --

A. Before this.

Q. -- to Caristo?

A. Yes, I would say.

Q. Before February of 1979?

A. That's my, that's my --

Q. Well, you ought to know, you were selling the brick, weren't you?

A. I do know. I do know. If I had my records

before me I could say yes for sure, with surety. But I'm saying yes with almost certainty because I don't have facts and figures before me. But I can't for the life of me see how it's possible that this -- that he didn't deliver brick before 1979. My, my, my intelligent recollection is that the job was almost delivered prior to then, completely delivered.

Q. Did any other supplier delivered brick to Caristo on this job, to your knowledge?

A. Not to my knowledge. They might have.

Q. Were you the only one selling on behalf of Fitten Company to Caristo, selling brick that is, on this Grace Renewal job?

A. Yes, sir.

Q. During the entire construction period that you were associated with this job, you were the only brick salesman working?

A. To my knowledge, yes, sir.

Q. Do you know the name Albert Collier?

A. Oh, yes, yes. He worked for Fitten and he --

Q. He worked for Fitten in what way?

A. Salesman, same as I.

Q. Was he selling at the same time you were?

A. He could have been, yes.

Q. Well, can you be more specific than that?

A. I don't know. I don't know.

Q. Did you ever see him on the job site?

A. No, I don't think so. No, I don't think I ever saw him there.

X X X

Q. Do you know whether Collier sold brick to the Worth Corporation on this job?

A. I don't know, sir.

Q. And you did not, you said?

A. No, sir, I sold for Caristo.

Q. Not directly or indirectly. Where did Worth Company get its brick?

A. Through Caristo.

Q. Oh, okay. So that you indirectly, then, were involved in the sale of brick to the Worth Company through Caristo?

A. If they used the brick, yes. Yes.

Q. Well, do you know whether the brick is the same in both jobs?

A. No I don't.

Q. Is the low-rise job brick construction?

A. Yes. Yes, I think it's -- I think it must be the same.

THE CHAIRMAN: It's matching brick with the high-rise, is it not?

THE WITNESS: Yes, yes.

THE CHAIRMAN: And from the Fitten Company, was it not?

THE WITNESS: Yes, I believe so.

THE CHAIRMAN: Would it have to be to be exactly matching?

THE WITNESS: It would have to be to be harmonius.

BY MR. O'HALLORAN:

Q. Mr. Carlesimo, I'll show you what was marked as Exhibit C-152 and which purports to be a delivery ticket from the James P. Fitten, Jr., Inc., to the Worth Engineering on Grace Development, and I would ask you to examine that, please.

What is the date on that delivery ticket?

A. 3/2/79.

Q. What is the quantity of brick shown to have been delivered?

A. 10,500.

Q. Can you look at that ticket and tell me if there is a designation on the style or type of brick delivered?

A. Yes.

Q. What is it?

A. PC-57.

Q. Would you compare what you were just looking at now, Exhibit C-154 with C-152 and compare the style or type of brick on C-152?

A. Yeah, I think it's PC-57. They're the same.

Q. Are they the same brick?

A. Yes.

Q. What is the price per thousand on C-154, on the Worth Engineering ticket?

A. One-sixty-five.

Q. Per thousand?

A. Per thousand.

Q. Can you explain to us how the same brick from the same supplier almost at the same time was $20 more per thousand when it was sold by you to Caristo Corporation than Worth Engineering paid for it?

A. I can't explain it. I don't know why that discrepancy is there.

d. Significance of Testimony on Grace Construction Costs

The SCI raises several questions relative to the testimony it recorded on the selection of the Grace project's general contractor and its "partner," Carlesimo, and on the sale of bricks by the Fitten company and its "salesman," Carlesimo.

Relative to the contractor's fees, the Caristo company's Levine testified that the fee was $700,000 from the time of its January, 1976, agreement with Carlesimo until the final September, 1977,

agreement between Lerner and Caristo. Nonetheless, the HFA's mortgage commitment to Grace's nonprofit sponsor on March 23, 1977, clearly shows a contractor's fee of $824,039. Obviously, the Agency-approved contractor's fee for Grace was far larger than the contractor actually required for his services, especially since Caristo agreed to give 40 percent of the $700,000 to Carlesimo.

As for the testimony on Carlesimo's receipt of commissions for the sale of bricks, if his fee of $20 per thousand did not relate only to those bricks purchased by Caristo, then Fitten still owes Carlisimo about $18,000 for the Grace sale. The Fitten company's records were adjusted to reflect the additional money owed to Carlesimo but, in testimony at the SCI, Fitten conceded that the adjustment was made after he was first interviewed by SCI personnel. In either case, the extra commissions represented inflated costs.

The SCI also learned that Carlesimo received $250 dollar commissions each from Multiplex Concrete, Inc., and Concrete Specialties, Inc., both East Orange companies. Matters concerning Carlesimo, as well as other issues raised by the SCI's investigation, have been forwarded to the U.S. Attorney's office in Newark.

HFA policies which allow sponsors to select contractors who are a party to such agreements and which set the price of construction in amounts high enough to pay for these questionable transactions will be the subject of an SCI recommendation in Section IV.

4. Costs After Construction

a. Background

Since many project costs included in HFA mortgages are based upon estimates made prior to closings, there is normally an amount of unused funds remaining after construction is completed. In addition to development cost items which require less money than originally estimated, each project has mortgage money available for "contingencies". The inclusion of funds for contingencies is a normal procedure for insuring that all the funds necessary to complete the project will be available. These contingency amounts often provide the source of funds used for Agency-approved construction change orders and to cover other non-construction cost items which may have been underestimated originally.

Also included in the mortgage amount are funds designated for "working capital". These funds are available to the sponsor for use in meeting operating expenses, such as utilities, maintenance, etc., during the initial rent-up period when project revenues are not yet sufficient to meet these expenses. Consequently, when project construction is completed there are normally large sums of mortgage money still available from unused amounts included in the original estimates and working capital funds specifically designated for use after construction.

The SCI examined two projects to determine how these funds were applied during the period between the end of construction and the

final mortgage closings. The final mortgage closing establishes the actual amount of mortgage money paid for project development. Funds remaining after the final mortgage closing are treated in accordance with bond offering convenants.

b. Battery View and Community Haven Projects

Battery View Senior Citizen's Housing is a limited dividend project located in Jersey City. The project, which had its initial mortgage closing in June, 1974, began the rent-up phase of development at the end of 1975 when construction was essentially completed. The final mortgage closing took place on February 28, 1978. Community Haven Senior Citizens Housing is a limited dividend project located in Atlantic City. This project, which had its initial mortgage closing in January, 1975, began rent-up in August, 1976, and had its final mortgage closing in December, 1977. Alvin E. Gershen was the developer for both Battery View and Community Haven.

The Commission's inquiry included a review of Gershen's activities, while acting as the designated consultant, in taking control of these two projects for syndication and ownership purposes. These activities reflected an attitude on Gershen's part of disregard for the concerns and objectives of the original nonprofit local groups, which initiated these projects and which he represented, in favor of his own financial prospects. The Commission has not made Gershen's project promotions a part of this report on HFA practices and procedures because the Agency had no direct or official connection with them. In 1975, when these projects were being funded and syndication was already underway, the Agency did not yet have any DCE requirement or conversion policy establishing a CDE. It was only after the time period during which Gershen had completed the syndication of Community Haven and Battery View that the HFA developed any policies or regulations that required it to monitor conversions and syndications. The Commission questions Gershen's tactics in promoting these two projects. However, so far as this report is concerned, the Commission's references to Gershen's projects here must focus on certain transactions by the Agency with Gershen in 1978 that relate to Agency's policies regarding the use of mortgage money after the projects began rent-up.

On March 17, 1978, less than three and a half months after Community Haven's final mortgage closing and only 17 days after Battery View's final mortgage closing, Gershen requested, in separate letters to the Agency, the return on equity cash distributions of $155,064 from Battery View and $121,428 from Community Haven. As indicated previously in this report, return on equity is the cash distribution which is allowed a sponsor from project operations. This amount is calculated as 8 percent per year on the sponsor's equity amount and is payable, with Agency approval, when funds from operations are sufficient for such payment. HFA approved the entire $121,428 requested for Community Haven and allowed payment of $149,448 for Battery View. The SCI does not challenge Gershen's return on equity calculations. However, based on its examination of documents relating to project operations during the period prior to the final

mortgage closings, the SCI finds that the HFA acted improperly when it approved these payments, as the following discussion will explain.

During the initial rent-up period for Battery View, the HFA provided the Battery View project with approximately $317,084 in mortgage money, including working capital, to cover various project expenses. At the final closing, Gershen's accountant submitted a financial statement depicting project operations during the rent-up period and the resultant funds available for distribution of return on equity. That statement, in summary, showed total project income of $699,244 and project expenses, mortgage principal payments and costs to fund repair and replacement accounts totalling $825,572. However, instead of a cash deficit of $126,328, the $317,084 of mortgage money advanced by the Agency created a cash surplus of $190,756. This is the amount shown on the financial statement as being available for payment of the $155,064 requested as return on equity.

The same situation was found to exist with the Community Haven project. The financial statement depicting operating results for the rent-up period submitted by the sponsor's accountant showed total income from operations of $537,185 and expenses, mortgage principal payments and costs to fund repair and replacement accounts totalling $716,593. Here again, instead of a $179,408 cash deficit, Agency mortgage advances totalling $337,303, including working capital, created a positive cash flow of $157,895. Based on the availability of this $157,895, the Agency approved the requested $121,428 return on equity.

During the initial rent-up period for these two projects, the sponsor, in compliance with agency regulations, submitted monthly operating statements showing revenue, expenses and cash balances available at the end of each month. The operating statements submitted for Battery View and Community Haven clearly demonstrated that cash was being accumulated and segregated in savings accounts which the sponsor identified as being for payment of return on equity.

In examining these monthly statements and related records the SCI found instances where the Agency's working capital advances provided the source of funds used for large deposits into the return on equity savings account. Specifically, on February 18, 1977, when the Community Haven operations account showed a balance of $18,388.76, the Agency advanced $92,461,94 for deposit into this account, which included $81,961.54 in working capital. On the same date the sponsor drew a $42,536.58 check on this account and deposited that check into the return on equity savings account. Similarly, in April, 1976, the Battery View sponsor transferred $49,775 from the operations account to the return on equity savings account. The source of funds used for this transfer was $54,585 mortgage advance deposited into the operations account 12 days prior to the transfer.

The monthly operating statements submitted to the HFA covering the periods when these transactions took place clearly evidenced the large increases in the return on equity savings accounts. In spite of its knowledge that the sponsor had accummulated and segregated cash

for payment of return on equity, both before and after these two particular transactions, the HFA continued to provide mortgage money for project expenses instead of forcing the sponsor to use the funds accummulated from prior advances. Consequently, the HFA's unneccessary advances of working capital, which included some "contingency" funds, became part of an inflated total project cost. This will be discussed in Section IV in conjunction with an SCI recommendation relating to this matter.

IV. RECOMMENDATIONS AND COMMENTARY

A. Introduction

The recommendations which follow are proposed with the Commission's acknowledgment that the administration of New Jersey's Housing Finance Agency has been much improved since 1979, when its leadership was changed. Numerous operational and regulatory reforms have been instituted. As a result, the Agency has largely regained its former image of credibility and integrity. The numerous questionable operational tactics and practices which marked the period prior to 1979 were targeted in the Commission's initial report published in March, 1981. This second and final report on the Commission's inquiry focuses on the financial aspects of HFA project processing, primarily during the same time frame covered in the first report. However, the principal purpose of this report is to demonstrate certain continuing inadequacies in the financing procedures for housing projects under HFA jurisdiction.

B. Recomendations

1. Promote Supervised Conversions

The Commission recommends that the HFA actively promote the conversion of nonprofit housing projects into more financially stable limited dividend projects. To implement this recommendation, the Commission suggests that the Agency's innovative "Criteria for Project Selection" be amended to include actual or prospective conversion among such criteria and to provide for the assignment of special point values to projects which agree to convert under Agency rules and regulations applying to the conversion process.

Comment

In its Report (#1) on the HFA, the Commission praised the efforts of the new Executive Director, Bruce Coe, to proscribe favoritism and influence peddling in the selection and processing of housing projects. In order to make this process as objective as possible, Coe instituted a system in which point values were attached to the numerous factors that affected a project's consideration by the Agency. The Commission believes that this point valuation method of establishing objective priorities for processing projects can be expanded in such a manner as to encourage nonprofits to convert to for-profits under the Agency's regulatory guidance.

The Commission was impressed with the Agency's conversion regulations and with the fiscal stability of the converted limited dividend projects which resulted under those regulations. Such projects are financially superior to either nonprofits or straight limited dividends because of the required availability of both DCEs

and CDEs. In both straight limited dividend and conversion projects, the Agency requires that a portion of syndication proceeds be used to establish a DCE, which provides a financial cushion against short term operating difficulties and a reserve for capital improvements. However, unlike limited dividend developers who take a portion of syndication proceeds as normal profit, the nonprofit developer's portion of syndication proceeds are used to establish a CDE. In addition to being an added cushion against operating difficulties, the CDE provides funds which the nonprofit group can use for its community services or for development of additional housing in the community. Projects which remain nonprofit do not have the benefit of either a DCE or CDE.

2. **Apply Guidelines To All Conversions**

The Commission recommends that the Agency conversion rules and requirements, that have applied to projects which convert to for-profit status after mortgage closings as nonprofits, be extended to projects which convert prior to closings.

COMMENT

In conjunction with its recommendation that the HFA actively promote nonprofit housing conversions to for-profit status, the Commission believes the Agency should refuse to provide mortgage funds to projects which do not follow Agency rules and regulations for conversions. In the case of projects which have received nonprofit mortgage commitments, and then seek to convert, the HFA should refuse to grant a mortgage recommitment if its conversion requirements have been ignored or violated. The Commission recognizes that exceptions regarding the distribution of syndication proceeds may be in order when a conversion is necessary to establish a project's feasibility. However, even under such circumstances, all other conversion regulations, including those prohibiting a nonprofit project's attorney from representing any other party in the transaction and preventing hidden agreements under which syndication proceeds are to be paid to members of the nonprofit sponsor, its loan consultant or attorney, should remain in effect.

3. **Construction Contracts Must Be Bid**

The Commission recommends that the Agency require all sponsors seeking project financing via the HFA processing pipeline to award construction contracts on the basis of competitive bidding.

Comment

This Commission believes that the competitive bid procedures mandated for all public contracts should apply to the sponsors of all HFA-processed projects. The funds used to develop these projects,

(including amounts that were diverted for the questionable purposes discussed in Section III of this report) are provided through mortgage loans granted by a state agency empowered to sell tax-exempt bonds for a special public purpose. Taxpayers provide the federal rent subsidies that guarantee that a project will generate sufficient revenues to ultimately permit repayment of these loans. In addition, the State provides "seed money" loans from its public funds to initiate certain types of HFA public housing. It also should be noted that the Agency has already required competitive bidding in connection with the supplemental funding of special or emergency construction activities.

Under the subject of Construction Cost Inflation this report notes that construction costs, which constitute more than two-thirds of total costs, at least, is the area most susceptible to cost inflation. Under the present system, the Agency's technical staff (primarily) decides in line item fashion the maximum allowable cost for materials and labor and the sponsor selects a contractor willing to accept that amount. There is no requirement for attempting to find a willing contractor capable of doing the job for less. The same is true for the contractor's profit and overhead fee in nonprofit projects, where the agency prescribes the fee amount and recognizes that amount as a mortgageable cost. When the amount set by the Agency for either materials and labor or the contractor's fee exceeds the amount required by the chosen contractor, the Agency's present system is vulnerable to wrongful practices (discussed in Section III of this report). With regard to the contractor's fee in limited dividend projects, which the developer is responsible for negotiating and paying, only the developer benefits from obtaining the lowest possible amount. The developer's fee, a larger fee recognized as a mortgageable cost in place of the contractors fee, remains the same regardless of the fee amount accepted by the contractor. In general, the Commission's recommendation would reduce the potential for kickbacks or price profiteering arrangements.

In addition to requiring a sponsor to seek qualified contractors willing to compete for a contract, the Commission would reduce a particular burden on general contractors in limited dividend projects. The Commission suggests in connection with its competitive bid recommendation that in limited dividend projects the entire construction contract, including the contractor's profit and overhead fee, be recognized by the Agency as a mortgageable cost and that the developer's fee be reduced accordingly. Currently, the contractor's profit and overhead fee is paid by the limited dividend sponsor and the timing of those payments is normally fixed to allow for payment with syndication proceeds. Contractors should not be expected to make such accommodations if they are selected on the basis of a competitive bid proposal.

4. **Discontinue Fee Pledges**

The Commission recommends that, except for the developer's fee, the agency discontinue its

policy of allowing fee pledges toward a sponsor's equity requirement,

Comment

The Commission believes that the elimination of fee pledging will convert the requirement for interim equity funding by a project developer into an important cost-saving incentive. This has not been true under fee pledging, since the developer has not had to utilize his personal resources.

Under the Commission's proposal, the only fee that could be pledged would be the developer's own fee but the size of this fee would be sharply reduced since it no longer would include the contractor's profit and overhead fee. The developer's fee has served historically as an incentive for undertaking public housing projects. By preserving its availability for pledging, the Commission believes that, notwithstanding its reduced size, it will retain its value as an incentive. Under the Commission's previous recommendation, the contractor's fees would become part of the mortgage.

5. **No Equity Return From Mortgage Advances**

The Commission recommends that the Agency not allow payment of return on equity from funds made available by mortgage money advances.

Comment

In instances where funds are available in project operating accounts at final mortgage closings and those funds are the result of mortgage money advances, as was the case with Battery View and Community Haven, the Agency should take control of its 90 percent portion of such funds and utilize it as specified in Agency regulations and in accordance with bond convenants covering unused mortgage money. Further, the Agency should restrict the availability of funds for return on equity to the net cash flow from project operations, exclusive of any mortgage money advances which may be applied toward normal non-capital operating expenditures.

If the Agency had advanced mortgage money directly to the Battery View and Community Haven sponsor for return on equity, it would have violated its statutory limit of 90 percent funding for limited dividend projects. Furthermore, all future return on equity payments based upon the original equity amount, unadjusted to reflect the return, would be in violation of the statutory limit of 8 percent return on equity. In the opinion of this Commission, the mere fact that the Battery View and Community Haven mortgage money advances happened to pass through the project operating accounts prior to use as return on equity did not change the improper nature of this transaction.

C. Former Recommendations

As with the Commission's first report on the HFA, most of the questionable activities cited in this report occurred during the 1973-79 period. The first report concluded with a number of recommendations which targeted official misconduct as their primary objective. The Commission concedes, of course, that honesty and integrity cannot be achieved merely by prescribing it. However, certain steps can be taken to at least reduce the danger of a revival of the mismanagement that once marked the Agency. For this reason the Commission restates its support of certain recommendations proposed in its initial report on the HFA and urges their implementation:

1. Legislative Oversight

The Commission recommends that a provision be added to the law governing the HFA to require an inspection and review of the operations of the agency at least once during each two-year session of the Legislature by a bipartisan Legislative Oversight Committee, augmented by the Governor's chief counsel or a lawyer or certified public accountant designated by him. Such a review of the agency shall be required to begin prior to the conclusion of the first year of the Legislature's two-year session and shall be concluded within six months of the authorization of such a study, unless an extension of time is granted by both legislative houses.

Comment

As illustrated by both of the Commission's reports, internal misconduct at the HFA continued undetected for a prolonged period of time. A factor in the failure to reveal the numerous incidents of favoritism to certain project promoters, influence peddling pressures on behalf of a number of projects, and even acts of criminality or near-criminality, was the aura of respectability that the HFA enjoyed because of its public image as an aggressive producer of needed housing. However, the longer such an illusion persists, the more disastrous can be the sudden revelation that it had hidden from public view serious administrative and operational malfunctions. To prevent a recurrence of the HFA's adverse experience, the Commission endorses the trend in recent years toward legislative oversight of the programs lawmakers enact and strongly urges that this oversight be immediately extended to include the agency. Since the Executive Branch of State government also shares a responsibility for the HFA's proper performance, through appointive and administrative control over the HFA's governing board, it also should participate in any watchdog mechanism to assure the agency's good conduct.

2. **Fraud Audits**

The Commission recommends that spot audits of various projects be required by law with the additional proviso that such audits be required to include among their objectives the identification of fraud and that such findings be immediately reported to the Executive Director and the governing board for appropriate immediate resolution.

Comment

The HFA's internal audits of agency and project financial transactions have not made the identification of fraud a specific objective. Fraud audits are typically an expensive undertaking and performing them on all projects would not be justified. However, utilizing them on a spot basis, performed either by agency staff or an independent contractor, would add an important fiscal control mechanism to the present HFA auditing capability.