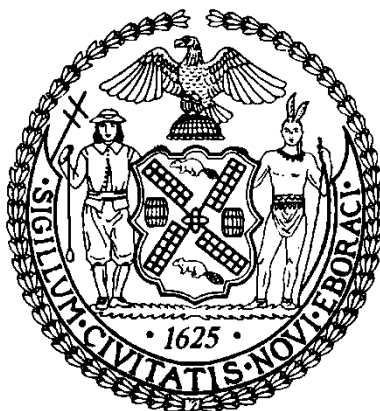


**CITY OF NEW YORK
OFFICE OF THE COMPTROLLER**

**John C. Liu
Comptroller**

**FINANCIAL AUDIT
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Deputy Comptroller for Audit**



**Audit Report
on the Calculation and Application of
J-51 Tax Benefits for Properties in Brooklyn by
the Department of Finance**

FP09-138A



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

John C. Liu
COMPTROLLER

March 18, 2011

To the Residents of the City of New York:

My office has audited the calculation and application of the J-51 Tax Benefits for Properties in Brooklyn by the Department of Finance (DOF). We audit City agencies such as these as a means of ensuring that they comply with applicable laws and result in the correct determination of revenues due the City.

The J-51 program provides tax exemption and abatement benefits to owners of residential real property who rehabilitate their buildings and to owners of non-residential properties who convert their buildings to residential use.

DOF is not appropriately implementing tax exemption benefits under the J-51 program. We identified errors in calculating and applying tax exemption benefits for 50 of the 57 sampled properties. As a result, the City lost more than \$4 million of tax revenue for the properties from the first year in which tax benefits were obtained through June 30, 2010. DOF, however, accurately calculated tax abatements and appropriately ceased granting abatements to properties whose benefit periods expired.

The audit recommendations addressed the weaknesses identified in the report and, if implemented, will result in compliance with applicable laws, thus resulting in the correct determination of revenues due the City.

The results of the audit have been discussed with DOF officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov.

Sincerely,

A handwritten signature in black ink, appearing to read "JCL", written over the printed name "John C. Liu".

John C. Liu

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*The City of New York
Office of the Comptroller
Financial Audit*

**Audit Report on the
Calculation and Application of J-51 Tax Benefits for
Properties in Brooklyn by the Department of Finance**

FP09-138A

AUDIT REPORT IN BRIEF

The J-51 program provides tax exemption and abatement benefits to owners of residential real property who rehabilitate their buildings and to owners of non-residential properties who convert their buildings to residential use. The Department of Finance (DOF) is responsible for implementing and monitoring tax benefits granted under the program.

This audit determined whether DOF is properly calculating and applying J-51 tax exemption and tax abatement benefits. The scope of this audit covered tax assessments for properties in the borough of Brooklyn for Fiscal Year 2010.

Audit Findings and Conclusions

DOF is not appropriately implementing tax exemption benefits under the J-51 program. We identified errors in calculating and applying tax exemption benefits for 50 of the 57 sampled properties. As a result, the City lost more than \$4 million of tax revenue for the properties from the first year in which tax benefits were obtained through June 30, 2010. DOF, however, accurately calculated tax abatements and appropriately ceased granting abatements to properties whose benefit periods expired.

Of \$4,043,660 in lost revenue, \$2,275,606 has been attributed to systematic errors in calculation exemptions for 36 sampled properties. An additional \$1,768,054 in tax revenue was forgone for 14 sampled properties because DOF calculated exemptions based on assessed property values long after improvement work was completed. If these problems are not corrected, we estimate that the City will lose an additional \$9,568,938 in tax revenue throughout the remaining terms of the exemption benefits. We also found that DOF may have used an inconsistent methodology to calculate exemptions as well as problems with the maintenance of file documentation.

Audit Recommendations

We make 13 recommendations to the DOF concerning the calculation and application of J-51 tax exemption benefits in the borough of Brooklyn. Compliance with these recommendations will ensure that DOF applies the exemption benefits in a consistent manner and collects all the real estate taxes due. Among the major recommendations are that DOF should:

- Review and recalculate tax exemption amounts and taxable values for the properties for which first-year exemption amounts were incorrectly calculated; any future taxes should be based on the recalculated exemptions.
- Ensure that all exemption calculations are based on accurate information in the Real Property Assessment Division (RPAD) database; recalculate improperly granted exemptions and ensure that any future taxes are based on the recalculated exemptions.
- Institute procedures to ensure that J-51 exemptions be based on the properties' assessed values at the time that the improvement work was completed. Specifically, DOF should calculate the first-year tax exemptions on the basis of a property's assessed value for the year immediately following the completion of improvements.
- Ensure that properties are inspected and assessed promptly after improvement work is completed.

Agency Response

DOF officials strongly disagreed with the report's findings. Specifically, DOF stated, "We disagree with almost all of the audit findings because they are based on a misinterpretation of the J-51 law, leading to the draft audit's mistaken conclusion that DOF has failed to impose taxes of \$6.7 million."

It is our belief that much of our disagreement with DOF stems from DOF's lack of written policies and procedures regarding the J-51 program. This issue was brought to DOF's attention in 2008. At that time, they stated they would work to "draft a new Statement of Exemption Procedure to bring further clarity to the J-51 program." However, two years later, when asked to provide these procedures, DOF stated, "There are no departmental manuals."

DOF also asserted that "The methodology in this audit raises concerns. The J-51 auditors did not randomly select their sample of properties." Judgmental sampling by definition does not involve a random sample or the projection of results. It is a well recognized sampling technique used by audit organizations including the Government Accountability Office who promulgates Generally Accepted Government Audit Standards. Further, this methodology was previously used in our prior audit of DOF's J-51 program (No. FP06-141A issued May 15, 2009) without any concerns raised by DOF.

INTRODUCTION

Background

The J-51 program provides tax exemption and abatement benefits to owners of residential real properties who rehabilitate their buildings and to owners of non-residential properties who convert their buildings to residential use. The Department of Housing Preservation and Development (HPD) is responsible for administering the program, computing the “certified reasonable cost” of the improvement work, and issuing a certificate-of-eligibility to property owners who meet program requirements. DOF is responsible for implementing and monitoring tax benefits granted under the program.

The program was created in 1955 under legislation authorized by §489 of the New York State Real Property Tax Law and is further governed by §11-243 of the New York City Administrative Code. In addition, Chapter 5, Title 28, of the Rules of the City of New York states that to obtain an exemption or abatement, an applicant must, within a specific time period (36 months, or 60 months if work is government-financed), perform eligible construction work (such as a major capital improvement) for a specific project type. Exemptions are granted for a period of either 14 or 34 years based on the type of project. Abatements are granted for a period of up to 20 years.¹ According to DOF’s Fiscal Year 2009 “Annual Report on Tax Expenditures,” 15,093 properties received \$140.3 million in tax exemptions, and 137,386 properties received \$103.1 million in tax abatements.

A tax exemption temporarily exempts a property from incurring additional property taxes if eligible improvement work increases the property’s taxable assessed value.² A tax abatement is a credit against the tax due and is calculated by reducing a property’s existing tax by various percentages of the certified reasonable cost.³ DOF calculates the amount of an assessment of any increase in property value on the basis of a physical inspection and the value of income generated by the property. All assessed-value increases made during the first three years after J-51 benefits commence are fully tax exempt. The values of subsequent year exemptions are calculated on the basis of the first three-year exemption amounts, except for government-financed work, which is fully exempt beyond three years.

¹ A certificate-of-eligibility specifies the length of time for which exemptions and abatements are granted.

² A property’s taxable assessed value is derived by calculating a percentage of its market value and consists of economic components and physical changes to the property. However, since New York State law limits assessment increases except for physical changes, any assessed value changes based on increases in the economic component of the market value must be phased in over a five-year period (“equalization”). During this period, a property’s assessed value is known as its “transitional assessed value.” For purposes of tax collections, taxable assessed value is the lower of the actual or transitional assessed values less actual or transitional exemptions.

³ Specific project types receive abatement benefits of 50, 90, or 100 percent. Government-financed projects receive abatements of 150 percent of the certified reasonable cost.

A property owner must submit a certificate-of-eligibility to DOF to actually obtain tax benefits. DOF's exemption unit records the information in the J-51 Tax Exemption-Tax Abatement (TETA) database. Active (i.e., not expired or revoked) abatement and exemption information must remain in the TETA database. After DOF receives a certificate-of-eligibility, property division assessors inspect the property to verify that improvements have been completed and to ascertain the property's new assessed value.

In Fiscal Year 2009, we performed a similar audit entitled *The Calculation and Application of J-51 Tax Benefits for Properties in Manhattan by the Department of Finance* (No. FP06-141A issued May 15, 2009). That audit identified weaknesses in the administration of key aspects of the J-51 program and found that \$2,619,577 in real estate tax revenue had been forgone.

Objective

The objective of this audit was to determine whether DOF is properly calculating and applying J-51 tax exemption and tax abatement benefits for properties in the borough of Brooklyn.

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit included properties covered under the J-51 program in the borough of Brooklyn that had tax exemptions or abatements in Fiscal Year 2010. We obtained from DOF a list of all J-51 abatements and exemptions granted for Brooklyn properties in Fiscal Year 2010.⁴ The list contained 1,094 properties that were granted exemptions, 688 of which used government financing and were thereby fully exempt from paying property taxes.⁵ Of the remaining 406 properties that were granted exemptions, 356 were also granted tax abatements. We compared the amount of the exemptions granted by DOF with the certified reasonable costs computed by HPD. Although not specifically related, the comparison provided a basis to judgmentally select those properties for which there was no reasonable correlation between the DOF and HPD figures. We selected a judgmental sample of 60 of the 356 properties. DOF could not provide certificates-of-eligibility for 22 of these properties. However, we obtained data from HPD that enabled us to review exemption and abatement amounts for 19 of the 22

⁴ The list included properties for which abatements and exemptions were granted in either Fiscal Year 2010 or at an earlier date but that were still valid in Fiscal Year 2010.

⁵ Each property represents an entire building (not individual apartments, condos, or co-ops).

properties. Accordingly, our sample contained 57 properties that had active tax exemptions in Fiscal Year 2010. (See Appendix I for a list of sampled properties.)

For each of the 57 properties, we examined the J-51 abatement-exemption history listing, the history of actual and transitional values, and the history of assessed value changes from Fiscal Years 1981-1982 through 2009-2010 recorded in DOF's computer system. We also reviewed DOF memoranda explaining procedures for calculating abatements and exemptions, compared these to the above noted laws and regulations, and checked the accuracy of DOF calculations. In addition, we reviewed program procedures in HPD's "J-51 Guidebook." Finally, we examined DOF files for the required certificates-of-eligibility.

To verify the accuracy of the data recorded in the TETA database, we compared the information recorded on DOF J-51 abatement-exemption history listing generated from the DOF TETA database to the information on the certificates-of-eligibility issued by HPD. To determine whether properties were receiving the appropriate abatement amounts for Fiscal Year 2009-2010, we compared the certified reasonable costs indicated on the certificates-of-eligibility with the certified reasonable costs recorded in the TETA database, recalculated the abatement amounts, and compared them to the abatement amounts calculated by DOF's computer system.

To verify the accuracy of the tax exemptions granted by DOF to each property, we recalculated each property's exemption amounts in accordance with the laws and regulations that govern the J-51 program. We compared our exemption calculations to DOF's calculations for the entire period, commencing with a property's benefit start date through June 30, 2010.

The results of the above tests, while not statistically projected to the population from which the sample was drawn, provide a reasonable basis for us to determine whether DOF is properly calculating and applying J-51 tax exemption and abatement benefits.

Discussion of Audit Results

The matters covered in this report were discussed with DOF officials during and at the conclusion of this audit. A preliminary draft report was sent to DOF and was discussed at an exit conference held on October 7, 2010. On November 3, 2010, we submitted a draft report to DOF officials with a request for comments. We received written comments from DOF on November 19, 2010. In its response, DOF officials strongly disagreed with the report's findings. Specifically, DOF stated, "We disagree with almost all of the audit findings because they are based on a misinterpretation of the J-51 law, leading to the draft audit's mistaken conclusion that DOF has failed to impose taxes of \$6.7 million."

It is our belief that much of our disagreement with DOF stems from DOF's lack of written policies and procedures regarding the J-51 program. This issue was brought to DOF's attention in 2008. At that time, they stated they would work to "draft a new Statement of Exemption Procedure to bring further clarity to the J-51 program." However, two years later, when asked to provide these procedures, DOF stated, "There are no departmental manuals." Lack of such a basic component of a good internal control system places DOF at risk of an unfavorable event occurring. As stated in the Standards of Internal Control in New York State Government:

Documentation of policies and procedures is critical to the daily operations of an organization. These documents set forth the fundamental framework and the underlying methods and processes all employees rely on to do their jobs. They provide specific direction to and help form the basis for decisions made every day by employees. Without this framework of understanding by employees, conflict can occur, poor decisions can be made and serious harm can be done to the organization's reputation. Further, the efficiency and effectiveness of operations can be adversely affected.

In its response, DOF also asserted that "The methodology in this audit raises concerns. The J-51 auditors did not randomly select their sample of properties." Judgmental sampling by definition does not involve a random sample or the projection of results. It is a well recognized sampling technique used by audit organizations including the Government Accountability Office who promulgates Generally Accepted Government Audit Standards. Further, this methodology was previously used in our prior audit of DOF's J-51 program (No. FP06-141A issued May 15, 2009) without any concerns raised by DOF.

The full text of DOF's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

DOF is not appropriately implementing tax exemption benefits under the J-51 program. We identified errors in calculating and applying tax exemption benefits for 50 of the 57 sampled properties. As a result, the City lost more than \$4 million of tax revenue for the properties from the first year in which tax benefits were obtained through June 30, 2010. DOF, however, accurately calculated tax abatements and appropriately ceased granting abatements to properties whose benefit periods expired.

Of \$4,043,660 in lost revenue, \$2,275,606 has been attributed to systematic errors in calculation exemptions for 36 sampled properties. An additional \$1,768,054 in tax revenue was forgone for 14 sampled properties because DOF calculated exemptions based on assessed property values long after improvement work was completed. If these problems are not corrected, we estimate that the City will lose an additional \$9,568,938 in tax revenue throughout the remaining terms of the exemption benefits. We also found that DOF may have used an inconsistent methodology to calculate exemptions as well as problems with the maintenance of file documentation.

These matters are discussed in the following sections of this report. Appendix II lists the exceptions we identified.

\$2,275,606 of Tax Revenue Forgone

DOF improperly calculated the exemption amounts and taxable assessed values for 36 of 57 sampled properties. As a result, \$2,275,606 in real estate tax revenue was forgone from the first year in which the properties obtained tax benefits through the end of Fiscal Year 2010. Of the forgone revenue, \$849,651 was attributed to improper calculations of taxable assessed values, and we attribute \$1,425,955 in lost revenue to the use of incorrect data to calculate exemptions.

Taxable Assessed Values Improperly Calculated

A property's taxable assessed value for the first year of the exemption period should be calculated by subtracting either the actual exemption from the actual assessed value or the transitional exemption from the transitional assessed value. The subsequent calculation that renders the lowest taxable assessed value is to be used in determining the real estate tax. In the case of 19 of 36 sampled properties, DOF accurately calculated actual and transitional exemption amounts. However, DOF failed to consistently subtract actual exemptions from actual values and transitional exemptions from transitional values. In these cases, DOF chose to subtract the higher of the exemption amounts (actual or transitional) from the lower of the assessed value amounts (actual or transitional), thus commingling actual and transitional amounts for the first year only. After the first year of the exemption period, DOF consistently subtracted actual exemptions from actual values and transitional exemptions from transitional values for these same properties. DOF did not provide any documentation to justify the inconsistent manner for

calculating the first-year exemption. Consequently, real estate taxes for the 19 properties were undervalued by \$849,651. (See Appendix II, Errors in Calculations.)

For example, a 250-apartment cooperative building (Block 2058, Lots 1002-1266) was granted an exemption in Fiscal Year 2009-2010. We calculated the exemption amount and taxable value for one apartment (Block 2058, Lot 1002) and compared our calculations with DOF-recorded amounts. We found that DOF correctly calculated the actual and transitional exemption amounts. However, the transitional exemption of \$68,277 was incorrectly deducted from the actual assessed value of \$72,433 instead of being deducted from the transitional assessed value of \$78,927. Therefore, the taxable value calculated by DOF was understated by \$6,494, causing that taxpayer to be underbilled \$860 for that year.

Based on our analysis, we calculated that the amount of additional tax due for that entire building in Fiscal Year 2009-2010 is \$253,799. Moreover, since the exemptions continue for a 13-year benefit period, the potential revenue for future fiscal years totals \$3,299,385.⁶ (We note that an apartment in the building was sold for \$916,425 in October 2009, and is currently paying no real estate taxes because of a J-51 exemption and abatement.)

Below is a current photograph of this specific property, which is in downtown Brooklyn.



⁶ This amount of future forgone revenue is included in our overall estimate of \$9.6 million. Our estimate does not take into consideration the effect of any changes in future tax rates and assessed values.

Recommendations

DOF should:

1. Review and recalculate tax exemption amounts and taxable values for the properties for which first-year exemption amounts were incorrectly calculated; any future taxes should be based on the recalculated exemptions.
2. Ensure that data for properties entitled to J-51 benefits is properly and accurately recorded in the DOF database.
3. Recoup any improperly granted reduction in real estate taxes from properties for which the first-year exemption amounts were incorrectly recorded.

DOF Response: “**Finance disagrees.** We have reviewed our calculations for the properties in the sample and we stand by them. In calculating J-51 benefits, Finance does not commingle actual and transitional values. It has been Finance’s consistent practice in implementing the J-51 law to start the exemption from the value that will yield the greatest benefit to the property owner. This well-established practice is consistent with the J-51 statute.

“For this reason, the Comptroller is wrong to find an \$850,000 in alleged revenue loss.”

Auditor Comment: We disagree. As noted in the audit, DOF did, in fact, commingle actual and transitional amounts for 19 of 36 sampled properties, thereby yielding assessed values and exemption amounts that caused the City to forgo over \$800,000 in property taxes. We are puzzled by DOF’s position as, in our prior audit of the J-51 program, DOF provided us with the methodology our audit team employed to make these calculations. Further, DOF’s audit liaison confirmed in writing on December 10, 2009, that we should use this methodology in our current audit.

As a result of its improper methodology for calculating the exemption amount, DOF in many cases is reducing the assessed value below the value prior to construction. That effect was never the intention of the real property tax law Section 489(1), which provides that in New York City, increases in assessed value resulting from construction are exempt. The law does not authorize DOF to reduce the value below the value prior to construction. Accordingly, DOF should review and recalculate the improper exemption amounts and taxes for the sampled properties.

Inconsistent Methodology Used to Calculate Exemptions

In one case (Block 36, Lots 1004-1090) DOF calculated the first-year exemption amount solely on the basis of increases in physical assessed values, while decreases in physical assessed

value were disregarded.⁷ However, in another case (Block 476, Lots 19), DOF calculated the exemption based on increases on net physical assessed value. (See Appendix II, Inconsistent Methodology to Calculate Exemptions.)

We reviewed DOF exemption calculations for one apartment (Block 36, Lot 1065) in the first building, recalculated the exemption amount, and applied the results to all 87 apartments in the building.⁸ In Fiscal Year 2000-2001, the year before improvements commenced, the actual and transitional assessed values of the apartment were \$97,865 and \$93,941, respectively. The building improvements were completed in Fiscal Year 2002-2003, the year in which HPD issued a certificate-of-eligibility. The following Fiscal Year 2003-2004, the first year of the exemption period, actual and transitional assessed values were recorded as \$74,052 and \$73,677, respectively. These values incorporated the following physical changes assessed that year—a \$74,504 physical decrease and a \$48,097 physical increase.

We found that DOF calculated the first-year exemption by using the physical increase in assessed value and ignoring the physical decrease. Similarly, in the second year, an additional physical increase of \$103,325 prompted the granting of a \$151,422 exemption. Once again, the physical decrease was not factored in the calculation. Below is a current photograph of this building located in the Brooklyn neighborhood of DUMBO (Down Under the Manhattan Bridge Overpass).

⁷ The first year exemption amount is the difference between the building's assessed value at the benefit start date and the assessed value in the year before the project commenced.

⁸ We projected our calculated results to the entire building by using the ratio (0.020824617), which represents the common interest of this apartment.



Brooklyn property at Block 36, Lot 1065

We reviewed DOF exemption calculations for an apartment building (Block 476, Lot 19) and found that DOF factored the physical increases as well as the physical decreases to this property. In Fiscal Year 1999-2000, the year before improvements commenced, the actual and transitional assessed values of the apartment were \$322,425 and \$306,475, respectively. The building improvements were completed in Fiscal Year 2001-2002, the year in which HPD issued a certificate-of-eligibility. The following Fiscal Year 2002-2003, the first year of the exemption

period, actual and transitional assessed values were recorded as \$2,623,500 and \$2,611,172, respectively. These values incorporated the following physical changes assessed that year—a \$202,500 physical decrease and a \$2,457,900 physical increase.

In the second case, we found DOF calculated the first-year exemption by using an exemption amount that used the combined net result of both the physical increase and decrease in assessed value. The exemption amount for 2003-2004 through 2009-2010 continued to be based on the combined net result of both the physical increase and decrease in assessed value. For this property, DOF factored both the physical increase and decrease in the calculation.

DOF is clearly applying an inconsistent methodology to calculate the exemption amounts that it applied to two properties in our sample. The inconsistent methodology is in part caused by a lack of written procedures.

Recommendations

DOF should:

4. Provide written procedures to staff regarding calculation of exemption amounts and consistently apply those procedures.
5. Review and recalculate exemptions in real estate tax assessments that may have been improperly calculated for properties with both actual increases and decreases in physical changes.

DOF Response: “**Finance disagrees.** As our lawyers explained to the audit staff, the law does not allow the agency to base a J-51 benefit on a ‘net’ physical change, as the draft audit recommends. Real Property Tax Law (RPTL) section 489(1) provides that in New York City, increases in assessed value resulting from construction are exempt. The statute does not authorize any offset for physical decreases. Further, another section of the law, RPTL section 489 (9), has been interpreted by the courts since 1982 to provide that increases in value must be accepted in full and cannot be reduced to reflect a partial demolition of the property. Consequently, we stand by the guidance of counsel that we are required to implement the statute by granting an exemption based at a minimum on the *increase* in value resulting from physical changes.

“For this reason, the Comptroller is wrong to find an alleged \$2.7 million revenue loss.”

Auditor Comment: Our initial opinion was based on a review of DOF’s own documents including a memo to DOF’s senior counsel in June 2003 which states, “In your memo of April 2000 you stated that ‘The purpose of J-51 law is not to reduce taxable assessment but to remove the development disincentive of increased taxation, by exempting increases that relate to developments made.’” This interpretation is reiterated in a letter from the J-51 administrator from August 2003 which states, “After review with legal counsel I have

confirmed that a J-51 parcel is only exempt from the changes in assessed value which result in the increase of the ‘valuation of the previously existing dwelling appearing on the assessment roll...preceding the commencement of alteration...’

DOF appears to have changed its interpretation of the statute in November 2004, stating in an internal memo, “The Department has interpreted 111 Fourth Avenue and the J51 statutes to require a net increase in building assessment, measured from the year prior to commencement of construction to the immediately following completion of J51 eligible construction, to trigger J51 exemption. The language of the statute does not support this interpretation.” Based on a review of the statutes and regulations by our counsel, we agree with DOF’s current interpretation and we have revised our audit report correspondingly. According to DOF, the courts have supported this interpretation since 1982; DOF may have incorrectly calculated J-51 benefits for some property owners from 1982 to 2004. These calculations appear not to have been corrected as our review found that DOF granted another sample property an exemption based on net physical change and has not revised the taxpayers’ exemption based on the change in interpretation. We therefore recommend that DOF review and recalculate exemptions in real estate tax assessments that may have been improperly calculated based on their previous erroneous interpretation.

Inaccurate Data Used

In 17 cases, taxable assessed values were calculated on the basis of incorrect data that did not match the data contained in the Real Property Assessment Division database. Nine cases of improper computations resulted in \$1,818,399 in underbillings, and eight cases resulted in \$392,444 in overbillings. The net revenue loss to the City totaled \$1,425,955. (See Appendix II, Errors Caused by Incorrect RPAD Data Calculations.)

Recommendations

DOF should:

6. Ensure that all exemption calculations are based on accurate information in the RPAD database and recalculate improperly granted exemptions for the 17 properties cited in this report; ensure that any future taxes are based on the recalculated exemptions.
7. Recoup any improperly granted reduction in real estate taxes from properties that were not correctly billed.

DOF Response: “**Finance disagrees.** We stand by the accuracy of our data and disagree with the findings. In our RPAD and Fairtax databases, condo buildings get apportioned into smaller ‘child’ lots. The value of the larger ‘parent’ lot is not always retained on the agency databases after apportionment, but it is not necessary for implementation of the J-51 benefit applied to the child lots. The J-51 benefit was accurately calculated for the child lot in each instance cited.

“For this reason, the Comptroller is wrong to find a \$1.425 million revenue loss.”

Auditor Comment: During the course of the audit, DOF officials were unable to substantiate the basis for their exemption calculations for these 17 properties. According to DOF, the initial calculation of the child lot assessment is based on the parent tax lot value. However, as DOF does not keep the data on the parent lot “for the apportioned year [they] cannot duplicate” the calculation. It also appears that DOF did not use the appropriate assessment values as recorded in its own system to calculate the exemption amounts citing that “the AVHS [Assessed Value History Screen] numbers have not proven to be reliable.” As these numbers are an integral component of assessed value calculations, we again urge DOF to review and correct the data used in its exemption calculations.

\$1.76 Million in Potential Revenue Unrealized Due to Property Assessments Not Performed Timely

DOF calculated exemption benefits for 14 sampled properties using assessed values that were determined one to four years after improvements were completed. The large increase in real estate values during our audit period meant that the higher assessed values for the 14 sampled properties were not necessarily dependent on the completion of J-51 improvements. If the reassessed values had been based on the assessed values of the properties at the conclusion of improvement work and were based solely on the improvement work and not market conditions, the City could have obtained an additional \$1,768,054 in real estate tax revenue for the 14 properties. (See Appendix II, Timing Issue.)

After improvements are completed, DOF procedures require an inspector to reassess a property’s value in order to calculate the amount of the first-year tax exemption. In many of these cases, DOF did not receive the certificate-of-eligibility when the improvements were completed because HPD did not issue the certificate until one to three years after improvements were completed. DOF officials also speculated that properties were not inspected promptly because some property owners did not submit all required documentation to HPD, thereby delaying HPD’s issuance of the certificate-of-eligibility, or because property owners did not submit certificates-of-eligibility to DOF promptly. We note that when market values are increasing, property owners who neglect to submit promptly the required documentation that would eventually trigger an assessment inspection may be able to manipulate the amount of a tax exemption.

For example, an improvement that commenced in Fiscal Year 2000-2001 for Block 3225, Lot 41, was completed by Fiscal Year 2002-2003—within the required 36-month period. The property was inspected in Fiscal Year 2002-2003. However, the certificate-of-eligibility was not issued by HPD until June 4, 2007 (Fiscal Year 2006-2007). Consequently, the property’s Fiscal Year 2008-2009 assessed value of \$2,112,750 was used as the basis for calculating the tax exemption instead of the lower Fiscal Year 2004-2005 assessed value of \$1,256,850 (this amount includes a \$306,000 physical change assessed by DOF in Fiscal Year 2002-2003). Had the Fiscal Year 2004-2005 assessed value been used to calculate the exemption, the total exemption amount for the first two years would have been \$2,142,900, instead of \$3,665,700. The

\$1,522,800 difference in exemption amounts led DOF to bill the property owner \$196,113 less in real estate taxes through Fiscal Year 2009-2010. As this property will continue to receive a tax exemption for another 12 years, the City will forego \$1.06 million in future tax revenues from this property.

In our prior audit, issued on May 15, 2009, pertaining to J-51 tax benefits for properties in Manhattan, we also found that DOF calculated J-51 exemptions on the basis of changes in value from the prior year to the time it actually conducts a reassessment, which is often done long after improvements were completed. That audit found that DOF may have realized \$3.4 million in additional revenue if the Manhattan properties in our sample would have been reassessed when the improvement work was completed.

During that audit, we brought this matter to the attention of DOF officials. According to DOF, the J-51 legislation, the New York City Administrative Code, and the Rules of the City of New York do not clearly spell out when properties should be reassessed for any changes to their taxable values. However, according to J-51 program rules, reassessments should be based on any change in a property's value that resulted from improvement work from the tax period before the improvement to the tax period following its completion. In response to that audit, DOF officials agreed to consult with Counsel to seek changes in the J-51 statute stating that "the State statute needs updating."

Accordingly, we believe that DOF should immediately institute procedures to ensure that J-51 exemptions be based on the properties' assessed values at the time that the improvement work was completed. This would reflect a timely matching of exemptions granted for improvement work completed. Further, DOF should continue to seek legislative changes that stipulate how and when exemptions should be calculated to ensure timely reassessment of properties become mandatory.

Recommendations

DOF should:

8. Institute procedures to ensure that J-51 exemptions be based on the properties' assessed values at the time that the improvement work was completed. Specifically, DOF should calculate the first-year tax exemptions on the basis of a property's assessed value for the year immediately following the completion of improvements.
9. Ensure that properties are inspected and assessed promptly after improvement work is completed.
10. Apply our methodology by reviewing and recalculating exemptions for the 14 properties whose assessments were not based on the value of improvements at the time they were completed; ensure that any future taxes are based on the recalculated exemptions.

11. Recoup any inappropriately granted reduction in real estate taxes based on the recalculated exemptions. Continue to seek changes in the J-51 legislation and other City rules to require that the assessed value of a property at the conclusion of improvement work be the basis for calculating exemptions.

DOF Response: “**Finance disagrees.** The auditors’ recommendation that Finance calculate the first-year exemption on the basis of a property’s assessed value for the year immediately following the completion of improvements is impossible under HPD rules. Finance cannot implement the exemption until we receive the Certificate of Eligibility from HPD and this process can take years. HPD rules (with some exceptions) give owners four years from construction commencement to apply. Moreover, we cannot start benefits until we receive the Certificate of Completion from HPD. Applicants have an additional two years from filing to complete their applications. Finally, the draft audit does not mention the importance of the assessment calendar and the taxable status date, which further slows the timeline of getting physical changes recorded. In order for the physical increase and exemption to be included in the earlier fiscal year, the project must have been completed and assessed on or before the taxable status date (January 5th). If the project is completed after that date, then the first tentative assessment roll that it appears on will be for the following fiscal year.”

Auditor Comment: We did not state that DOF acted improperly nor advocate the granting of benefits before obtaining a certificate-of-eligibility. Our recommendation is for DOF to ensure that exemptions are based on a property’s assessed value at the time that improvements are completed—not up to four years after work is completed. In our prior audit, DOF agreed with a similar recommendation. Notwithstanding the January 5 taxable status date, J-51 program rules require that re-assessments be based on any change in a property’s value that resulted from improvement work from the tax period before the improvement to the tax period following its completion. We contend that our position is supported by the previously cited court ruling (i.e., *111 Fourth Avenue Associates v. Finance Administration of the City of New York*). In that case, the court ruled that the assessed valuation initially recorded by the assessor in the year prior to construction was the proper point of reference in determining the amount of the exemption to be allowed. The amount of the J-51 exemption was to be determined by computing the assessed valuation on the taxable status date immediately following the completion of the qualified rehabilitation and determining how much, if any, of the increase in assessed value resulted from rehabilitation.

Other Issue

Missing Documentation

DOF granted tax benefits to 25 sampled properties although there were no final certificates-of-eligibility in file documentation (22 had no certificates and three had only temporary certificates; see Appendix I). DOF policy requires that final certificates-of-eligibility be filed before granting tax benefits. DOF claims that many of the certificates-of-eligibility were

missing because the Brooklyn office sustained a few floods over the years. Despite the lack of file certificates, we obtained data from HPD that enabled us to review exemption and abatement amounts for 19 of the 22 properties. The absence of final certificates-of-eligibility prevented us from determining whether the properties were entitled to any tax benefits, or, in the case of those with temporary certificates, whether the properties were entitled to benefits beyond the two-year period for which they were granted.

Recommendations

DOF should:

12. Obtain all missing final certificates-of-eligibility. In this regard, DOF should review and ensure the accuracy of any tax benefits granted to the associated properties and should revoke any benefits that have been granted to properties without valid certificates-of-eligibility or with expired temporary certificates.
13. Ensure that final certificates-of-eligibility are maintained in all file documentation.

DOF Response: “**Finance agrees.** We agree that our exemption and abatement files should be complete. Unfortunately, as the audit notes, a flood earlier this decade in the basement of 210 Joralemon Street in Brooklyn led to the loss of many of the paper records that auditors sought in their sample.

“Of the 22 files where Certificates of Eligibility could not be located, we were grateful that HPD supplied us with copies for nineteen of them. Those files now have the Certificates of Eligibility.”

Schedule of Sampled Properties Receiving J-51 Tax Benefits

No.	Block	Lot	Comments
1	27	1003-1126	No COE in DOF's file. We obtained COE from HPD.
2	28	1003-1015	
3	36	16	
4	36	1004-1090	
5	51	1	No COE in DOF's file (not tested).
6	55	1003-1039	
7	265	50	No COE in DOF's file. We obtained COE from HPD.
8	280	1102-1115	No COE in DOF's file. We obtained COE from HPD.
9	284	17	
10	286	8	
11	300	1002-1124	
12	320	1235-1305	
13	326	1101-1104	
14	349	25	
15	384	1201-1209	No COE in DOF's file. We obtained COE from HPD.
16	396	1002	No COE in DOF's file. We obtained COE from HPD.
17	396	1101-1103	
18	476	19	No COE in DOF's file. We obtained COE from HPD.
19	870	1001-1008	
20	873	1001-1006	
21	939	1101-1147	
22	942	1001-1010	No COE in DOF's file. We obtained COE from HPD.
23	960	1002-1008	
24	1058	1101-1108	No COE in DOF's file (not tested).
25	1072	1101-1104	No COE in DOF's file. We obtained COE from HPD.
26	1093	1101-1127	No COE in DOF's file. We obtained COE from HPD.
27	1098	1301-1334	No COE in DOF's file. We obtained COE from HPD.
28	1124	1001-1016	
29	1128	1144-1174	
30	1170	5	No COE in DOF's file. We obtained COE from HPD.
31	1252	1001-1011	
32	1270	1101-1112	
33	1610	49	
34	1948	42	
35	1966	1201-1213	
36	2013	1101-1111	
37	2058	1002-1266	

No.	Block	Lot	Comments
38	2073	15	No COE in DOF's file. We obtained COE from HPD.
39	2101	1201-1213	
40	2130	1003-1132	
41	2131	26	Temporary COE.
42	2131	27	Temporary COE.
43	2147	1401-1412	No COE in DOF's file (not tested).
44	2237	1601-1604	No COE in DOF's file. We obtained COE from HPD.
45	2297	1001-1045	
46	2396	1	No COE in DOF's file. We obtained COE from HPD.
47	2418	18	Temporary COE.
48	3106	15	
49	3225	41	
50	4652	8	
51	5026	313	
52	5082	79	No COE in DOF's file. We obtained COE from HPD.
53	5468	1202-1228	No COE in DOF's file. We obtained COE from HPD.
54	5613	41	
55	5670	1101-1109	No COE in DOF's file. We obtained COE from HPD.
56	5942	7	No COE in DOF's file. We obtained COE from HPD.
57	6034	41	
58	6100	1	
59	6653	34	
60	7282	62	No COE in DOF's file. We obtained COE from HPD.

SUMMARY OF J-51 EXEMPTION DISCREPANCIES IDENTIFIED FOR SAMPLED PROPERTIES

No.	Block	Lot	Exemption Start Year (FY)	Remaining Number of Years	Additional (Overstated) Taxes Due (for One Unit)	Allocation Percentage	Additional Taxes Due through 6/30/10 (for the Entire Building)	Overstated Tax Liability through 6/30/10	FY 09/10 Estimated Additional (Overstated) Tax Liability for the Unit	Estimated Potential Additional (Overstated) Tax Revenue for the Remaining Years of Exemption	Comments	
ERRORS IN CALCULATIONS												
Incorrect First Year Exemption Amounts												
1	286	8	08/09	12	\$ -	-	\$58,806	\$ -	\$26,161	\$ -	313,936	
2	300	1002-1124	06/07	10	\$317	0.018439	17,171	-	50	5	-	
3	349	25	05/06	9	-	-	\$8,133	\$ -	\$159	\$ -	1,427	
4	476	19	02/03	6	5	-	\$18,240	-	\$1,813	\$ -	10,881	Also included under "Inconsistent Methodology to Calculate Exemptions"
5	939	1101-1147	09/10	13	\$1,097	0.0087096	125,940	-	\$1,097	\$ -	1,637,217	
6	1098	1301-1334	01/02	5	\$117	0.00957	12,207	-	\$2	\$ -	972	
7	1124	1001-1016	06/07	10	\$668	0.077	8,576	-	\$9	5	1,212	
8	1252	1001-1011	08/09	12	\$303	0.044522	6,785	-	\$175	\$ -	46,932	
9	1610	49	09/10	13	-	-	\$10,517	-	\$10,517	\$ -	136,717	
10	2058	1002-1266	09/10	13	\$860	0.003388	253,799	-	\$860	\$ -	3,299,385	
11	2073	15	01/02	5	-	-	\$51,419	-	\$14,265	\$ -	71,323	
12	2101	1201-1213	09/10	13	\$1,352	0.0818	16,512	-	\$1,352	\$ -	214,787	
13	2297	1001-1045	08/09	12	\$2,872	0.03169611	90,608	-	\$1,110	\$ -	420,138	
14	2396	1	03/04	7	-	-	\$145,032	-	\$52,774	\$ -	369,417	
15	2418	18	07/08	11	-	-	\$552	-	\$0	\$ -	-	Temporary COE.
16	5468	1202-1228	00/01	4	\$439	0.03778	11,616	-	\$213	\$ -	22,600	
17	5613	41	04/05	8	-	-	\$6,773	-	50	5	-	
18	5942	7	03/04	7	-	-	\$5,366	-	\$2,408	\$ -	16,857	
19	7282	62	08/09	12	-	-	\$1,481	-	(\$4,290)	\$ -	(\$1,481)	
Subtotal Incorrect First Year Exemption Amounts							\$849,651		\$108,624	\$ -	6,512,320	
Errors Caused by Incorrect RPAD DATA												
Errors in Calculations of Exemption Amounts and Taxable Values (Understated Tax Liabilities)												
1	27	1003-1126	99/00	3	\$9,171	0.00628209	1,459,834	\$ -	(\$270)	\$ -	(129,169)	
2	284	17	05/06	9	\$ -	-	\$5,193	-	\$3,608	\$ -	32,473	
3	326	1101-1104	04/05	8	\$218	0.353691	615	-	\$110	\$ -	2,495	
4	1072	1101-1104	06/01	4	\$6,589	0.315432	20,887	-	\$2,281	\$ -	28,927	
5	1948	42	00/01	4	-	-	\$74,897	-	\$34,668	\$ -	138,673	
6	2237	1601-1604	00/01	4	\$674	0.308141	2,187	-	\$332	\$ -	4,311	
7	3106	15	04/05	8	-	-	\$6,725	-	\$1,391	\$ -	11,129	
8	5670	1101-1109	02/03	6	\$462	0.089265	5,179	-	\$201	\$ -	13,481	
9	6034	41	01/02	5	-	-	\$192,881	-	\$44,258	\$ -	221,292	
Subtotal Errors in Calculations of Exemption Amounts and Taxable Values (Understated Tax Liabilities)							\$1,818,399		\$86,580	\$ -	323,612	

No.	Block	Lot	Exemption Start Year (FY)	Remaining Number of Years	Additional (Overstated) Taxes Due (for One Unit)	Allocation Percentage %	Additional Taxes Due through 6/30/10 (for the Entire Building)	Overstated Tax Liability through 6/30/10	FY 09/10 Estimated Additional (Overstated) Tax Liability for the Unit	Estimated Potential Additional (Overstated) Tax Revenue for the Entire Property for the Remaining Years of Exemption	Comments	
Errors in Calculations of Exemption Amounts and Taxable Values (Overstated Tax Liabilities)												
1	36	16	00/01	4	\$ -	-	-	(\$113,795)	(\$56)	\$ (225)		
2	55	1003-1039	04/05	8	(\$222)	0.0164755	-	(13,446)	(\$1)	(\$672)		
3	280	1102-1115	03/04	7	(\$5,329)	0.07289865	\$	(86,826)	(\$2,644)	(253,846)		
4	384	1201-1209	02/03	6	(\$927)	0.125127	\$	(7,408)	\$102	4,869		
5	396	1002	03/04	7	-	-	\$	(\$36,322)	(\$370)	(2,592)		
6	873	1001-1006	05/06	9	(\$876)	0.12878	\$	(6,802)	\$42	2,925		
7	1093	1101-1127	03/04	7	(\$1,476)	0.026488	\$	(55,741)	(\$182)	(48,219)		
8	2130	1003-1132	06/07	10	(\$240)	0.003324	\$	(72,106)	\$30	88,889		
Subtotal Errors in Calculations of Exemption Amounts and Taxable Values (Overstated Tax Liabilities)												
								\$ (392,444)	(\$3,081)	\$ (208,872)	Subtotal Unrealized Revenue from Errors Caused by Incorrect TETA Data Calculations through 6/30/10 \$1,425,955.	
TOTAL ERRORS IN CALCULATIONS												
								\$2,668,050	(\$392,444)	\$192,122	\$6,627,060	Total Unrealized Revenue from Errors in Calculations through 6/30/10 \$2,275,606
TIMING ISSUE												
1	281	1003-1015	06/07	10	\$24,970	0.04501669	\$	554,690	\$420	\$ 93,338		
2	265	50	02/03	6	-	-	\$	\$125,994	\$13,345	\$ 80,071		
3	396	1101-1103	07/08	11	\$2,874	0.25	\$	11,493	\$1,416	\$ 62,291		
4	942	1001-1010	01/02	5	\$4,987	0.10301549	\$	48,413	\$721	\$ 35,013		
5	1128	1144-1174	07/08	11	\$5,303	0.01559248	\$	340,069	\$613	\$ 432,306		
6	1170	5	99/00	3	-	-	\$	\$306,551	\$5,823	\$ 17,469		
7	1270	1101-1112	07/08	11	\$2,816	0.056539	\$	49,812	\$509	\$ 99,103		
8	1966	1201-1213	09/10	13	\$2,571	0.1064	\$	24,162	\$2,571	\$ 314,110		
9	2013	1101-1111	09/10	13	\$7,370	0.108054	\$	68,205	\$7,370	\$ 886,666		
12	3225	41	08/09	12	-	-	\$	\$196,113	\$88,304	\$ 1,059,651		
10	4552	8	06/07	10	-	-	\$	\$10,841	(\$3,174)	(\$1,741)		
11	5026	313	06/07	10	-	-	\$	\$11,561	\$206	\$ 2,061		
13	5082	79	06/07	10	-	-	\$	\$31,892	\$14,716	\$ 147,157		
14	6653	34	07/08	11	-	-	\$	(\$11,743)	(\$33,238)	(\$25,618)		
TOTAL TIMING ISSUE								\$ 1,779,797	(\$11,743)	\$109,603	\$2,941,878	Total Unrealized Revenue from Timing Issue through 6/30/10 \$1,768,054

No.	Block	Lot	Exemption Start Year (FY)	Remaining Number of Years	Additional (Overstated) Taxes Due (for One Unit)	Allocation Percentage %	Additional Taxes Due through 6/30/10 (for the Entire Building)	Overstated Tax Liability through 6/30/10	FY 09/10 Estimated Additional (Overstated) Tax Liability for the Unit	Estimated Potential Additional (Overstated) Tax Revenue for the Entire Property for the Remaining Years of Exemption	Comments	
Inconsistent Methodology To Calculate Exemptions												
1	36	1004-1090	03/04	7							Only physical increase was used in calculation of J-51 exemption amounts.	
2	476	19	02/03	6							Both physical increase and physical decrease were used in calculation of J-51 exemption amounts. Also included under "Incorrect First Year Exemption Amounts"	
Properties that Do Not Have Discrepancies												
1	320	1295-1305	00/01	4	\$0	0.01397637	\$	-	\$0	\$	OK. We accepted DOF's calculations of J-51 exemptions because the other exemption (Charitable Housing) was also granted.	
2	870	1001-1008	06/07	10	0	0.13169	\$0	-	\$0	\$	OK	
3	960	1002-1008	07/08	11	\$0	0.139331	\$	-	\$0	\$	OK	
4	2131	26	06/07	10			\$0		\$0	\$	Temporary COE. We accepted DOF's calculations of J-51 exemptions because other exemption (DAMP) was also granted.	
5	2131	27	06/07	10			\$0		\$0	\$	Temporary COE. We accepted DOF's calculations of J-51 exemptions because other exemptions (Veteran, STAR basic, STAR Enhanced) were also granted.	
6	6100	1	04/05	8			\$0		\$0	\$	Temporary COE. We accepted DOF's calculations of J-51 exemptions because other exemptions (Veteran, STAR basic, STAR Enhanced) were also granted.	
Properties Without Certificates of Eligibility												
1	51	1									NO COE	
2	1058	1101-1108									No current COE on file	
3	2147	1401-1412									Incorrect COE was provided	
TOTAL							\$4,447,847	\$ (404,187)	\$301,725	\$	9,568,938	TOTAL Unrealized Revenue through 6/30/10 \$4,043,660



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Elizabeth Botwin
Deputy Commissioner

November 19, 2010

Tina Kim
Deputy Comptroller for Audit
Office of the City Comptroller
1 Centre Street, Room 1100N
New York, NY 10007
Via e-mail: tkim@comptroller.nyc.gov

**Re: Audit Report on the Calculation and
Application of J-51 Tax Benefits for Properties
in Brooklyn by the Department of Finance
(FP09-138A)**

Dear Ms. Kim:

This letter serves as the Department of Finance's response to the above audit, dated November 3, 2010, addressing the calculation and application of the J-51 exemption and abatement in the borough of Brooklyn. Before addressing each of the thirteen recommendations contained in the audit, let me first thank you for this opportunity to respond.

We disagree with almost all of the audit findings because they are based on a misinterpretation of the J-51 law, leading to the draft audit's mistaken conclusion that DOF has failed to impose taxes of \$6.7 million. Finance's interpretation of the law was explained in our response to the similar errors in your audit of the application of the J-51 program in Manhattan. When we met with your audit team, we offered to have the DOF lawyers who have years of experience in working with and interpreting the J-51 statute meet with City Comptroller attorneys to explain the law and our agency's long-standing interpretations of the J-51 statute. While it has not yet been accepted, that offer of course still stands.

I. Recommendations

A. \$5,005,628 of Tax Revenue Forgone

Taxable Assessed Values Improperly Calculated

1. Review and recalculate tax exemption amounts and taxable values for the properties for which first year exemption amounts were incorrectly calculated; any future taxes should be based on the recalculated exemptions.
2. Ensure that data for properties entitled to J-51 benefits is properly and accurately recorded in the DOF database.
3. Recoup any improperly granted reduction in real estate taxes from properties for which the first year exemption amounts were incorrectly recorded.

Finance disagrees. We have reviewed our calculations for the properties in the sample and we stand by them. In calculating J-51 benefits, Finance does not commingle actual and transitional values. It has been Finance's consistent practice in implementing the J-51 law to start the exemption from the value that will yield the greatest benefit to the property owner. This well-established practice is consistent with the J-51 statute.

For this reason, the Comptroller is wrong to find an \$850,000 in alleged revenue loss.

Exemption Amount Overstated

4. Review and recalculate exemption amounts for this property so that only an actual increase in assessed value would be exempt from taxation.
5. Recoup any reductions in real estate tax assessments that may have been improperly granted for this property.

Finance disagrees. As our lawyers explained to the audit staff, the law does not allow the agency to base a J-51 benefit on a "net" physical change, as the draft audit recommends. Real Property Tax Law (RPTL) section 489(1) provides that in New York City, increases in assessed value resulting from construction are exempt. The statute does not authorize any offset for physical decreases. Further, another section of the law, RPTL section 489 (9), has been interpreted by the courts since 1982 to provide that increases in value must be accepted in full and cannot be reduced to reflect a partial demolition of the property. Consequently, we stand by the guidance of counsel that we are required to implement the statute by granting an exemption based at a minimum on the *increase* in value resulting from physical changes.

For this reason, the Comptroller is wrong to find an alleged \$2.7 million revenue loss.

Inaccurate Data Used

6. Ensure that all exemption calculations are based on accurate information in the RPAD database and recalculate improperly granted exemptions for the 17 properties cited in this report; ensure that any future taxes are based on the recalculated exemptions.
7. Recoup any improperly granted reduction in real estate taxes from properties that were not correctly billed.

Finance disagrees. We stand by the accuracy of our data and disagree with the findings. In our RPAD and Fairtax databases, condo buildings get apportioned into smaller “child” lots. The value of the larger “parent” lot is not always retained on the agency databases after apportionment, but it is not necessary for implementation of the J-51 benefit applied to the child lots. The J-51 benefit was accurately calculated for the child lot in each instance cited.

For this reason, the Comptroller is wrong to find a \$1.425 million revenue loss.

B. \$1.76 Million in Potential Revenue Due to Property Assessments Not Performed Timely

8. Institute procedures to ensure that J-51 exemptions be based on the properties’ assessed values at the time that the improvement work was completed. Specifically, DOF should calculate the first-year tax exemptions on the basis of a property’s assessed value for the year immediately following the completion of improvements.
9. Ensure that properties are inspected and assessed promptly after improvement work is completed.
10. Apply our methodology by reviewing and recalculating exemptions for the 14 properties whose assessments were not based on the value of improvements at the time they were completed; ensure that any future taxes are based on the recalculated exemptions.
11. Recoup any inappropriately granted reduction in real estate taxes based on the recalculated exemptions. Continue to seek changes in the J-51 legislation and other City rules to require that the assessed value of a property at the conclusion of improvement work be the basis for calculating exemptions.

Finance disagrees. The auditors’ recommendation that Finance calculate the first-year exemption on the basis of a property’s assessed value for the year immediately following the completion of improvements is impossible under HPD rules. Finance cannot implement the exemption until we receive the Certificate of Eligibility from HPD and this process can take years. HPD rules (with some exceptions) give owners four years from construction commencement to apply. Moreover, we cannot start benefits until we receive the Certificate of Completion from the HPD. Applicants have an

additional two years from filing to complete their applications. Finally, the draft audit does not mention the importance of the assessment calendar and the taxable status date, which further slows the timeline of getting physical changes recorded. In order for the physical increase and exemption to be included in the earlier fiscal year, the project must have been completed and assessed on or before the taxable status date (January 5th). If the project is completed after that date, then the first tentative assessment roll that it appears on will be for the following fiscal year.

C. Missing Documentation

12. Obtain all missing final certificates-of-eligibility. In this regard, DOF should review and ensure the accuracy of any tax benefits granted to the associated properties and should revoke any benefits that have been granted to properties without valid certificates-of-eligibility or with expired temporary certificates.
13. Ensure that final certificates-of-eligibility are maintained in all file documentation.

Finance agrees. We agree that our exemption and abatement files should be complete. Unfortunately, as the audit notes, a flood earlier this decade in the basement of 210 Joralemon Street in Brooklyn led to the loss of many of the paper records that auditors sought in their sample.

Of the 22 files where Certificates of Eligibility could not be located, we were grateful that HPD supplied us with copies for nineteen of them. Those files now have the Certificates of Eligibility.

II. Conclusion

The methodology in this audit raises concerns. The J-51 auditors did not randomly select their sample of properties. Instead, auditors selected a sample of sixty properties from a list that compared the exemption amount granted by DOF to the certified reasonable cost calculated by HPD – and chose properties high on both lists. The audit even notes that these two factors are not specifically related, so we do question making them the basis of choosing the sample. We are especially concerned that the audit is so focused on condominiums – 34 of 60, or 57% of the properties sampled. Any audit that specifically chooses more valuable properties will by its nature skew audit results and make problems – such as they are -- seem larger and more prevalent.

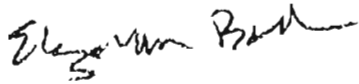
The second point is a related one: on pages 7 and 8, the draft audit identifies and provides a full-page photo of a condo building in Brooklyn's Dumbo neighborhood that receives J-51 benefits. It notes that a single unit in the building is on the market for an asking price of \$2.7 million. The audit notes that the unit is on the current tax rolls as

entirely tax-exempt, even though “the purpose [of J-51] is to encourage building development...[and] not to reduce taxable assessments.”

As the administrative agency responsible for implementing J-51, Finance must grant or deny benefits as the law provides, which we have done in each instance noted in this audit. The complaint that the J-51 statute has the effect of subsidizing the development of luxury properties is one that is far better suited to an entirely different political or legislative forum.

Once again, thank you, and please get back to me if you have any further questions regarding this response.

Sincerely,



Elizabeth Botwin

C: George Davis III, Mayor's Office of Operations