

AUDIT REPORT



CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF MANAGEMENT AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

Audit Report on Real Estate Tax Charges on Space Leased at 40 Rector Street By the Campaign Finance Board

MJ04-091A

March 3, 2004



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

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the Comptroller's responsibilities contained in Chapter 5, § 93, of the New York City Charter, my office has audited the real estate charges allocated to the Campaign Finance Board for space leased at 40 Rector Street to determine whether they were accurate and properly adjusted to account for any reassessments. The New 40 Rector Street Company provided the City the use of office space at 40 Rector Street pursuant to a written lease agreement, dated October 20, 1994, negotiated by the New York City Department of Citywide Administrative Services.

Our audit resulted in the findings and recommendations that are presented in this report. The findings and recommendations were discussed with City officials; their comments were considered in the preparation of this report.

Audits such as this provide a means of ensuring that City resources are used effectively, efficiently, and in the best interest of the public.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov or telephone my office at 212-669-3747.

Very truly yours,

A handwritten signature in cursive script that reads "William C. Thompson, Jr.".

William C. Thompson, Jr.

WCT/fh

Report: MJ04-091A
Filed: March 3, 2004

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*City of New York
Office of the Comptroller
Bureau of Management Audit*

**Audit Report on
Real Estate Tax Charges on Space
Leased at 40 Rector Street
By the Campaign Finance Board**

MJ04-091A

AUDIT REPORT IN BRIEF

This audit determined whether the landlord's real estate charges allocated to the Campaign Finance Board for space leased at 40 Rector Street were accurate and properly adjusted to account for any reassessments. The New 40 Rector Street Company (the landlord) provided the City the use of office space at 40 Rector Street pursuant to a written lease agreement (the lease), dated October 20, 1994, negotiated by the New York City Department of Citywide Administrative Services (DCAS). The Campaign Finance Board (the Board), the subject of this audit, occupies 12,796 (2.85%) of the 449,355 square feet at the property.

Audit Findings and Conclusions

Our examination of the landlord's bills maintained at the Board, along with the payment vouchers listed in the City's Financial Management System (FMS), reveals that the landlord did not allocate any additional real estate charges to the Board. During the period, the property was reassessed and the landlord received a reduction in the property's real estate taxes; however, according to the lease, the City was not entitled to a portion of the reduction because it brought the tax amount below that payable in the base year of the lease, Fiscal Year 1996. Accordingly, an adjustment of the tax charges or credits passed on to the Board is inapplicable. (The Board was not liable for any real estate tax escalation charges during the period reviewed, nor did the landlord bill the Board for any such charges.)

Nevertheless, a criminal prosecution now in process may establish that because of an improper under-assessment the real estate taxes for 40 Rector Street was lower than was to be expected. The market value for this property decreased 64 percent—from \$66.5 million to \$24.2 million—from Fiscal Year 1993 to Fiscal Year 2003. We sent a letter to the Department of Finance (DOF) in October 2003 requesting that it reassess this property and apprise us of any action it takes regarding this matter; DOF did not respond to our letter. Nevertheless, in January 2004, DOF reassessed the market value for this property and recorded the tentative Fiscal Year

2005 market value as \$49.9 million—a 94 percent increase over the Fiscal Year 2004 market value of \$25.7 million.

Audit Recommendation

We made one recommendation to DCAS. DCAS should:

- Ensure that future leases have no provision barring the City from receiving a refund or credit if the property's real estate tax bill is reduced below the amount payable in the base year of the lease.

INTRODUCTION

Background

The New 40 Rector Street Company (the landlord) provided the City the use of office space at 40 Rector Street pursuant to a written lease agreement (the lease), dated October 20, 1994. The lease was negotiated by the former Department of General Services, now the Department of Citywide Administrative Services (DCAS), on behalf of six New York City agencies: the Campaign Finance Board, Office of Labor Relations, the Commission on Human Rights, the Office of Collective Bargaining, the Office of Administrative Trials & Hearings, and the Civilian Complaint Review Board. The Campaign Finance Board (the Board), the subject of this audit, occupies 12,796 (2.85%) of the 449,355 square feet at the property.

The New York City Department of Finance (DOF) is responsible for setting assessments and collecting real property (real estate) taxes for properties throughout the City. Properties are divided into four classes:

- Classes 1 and 2 are primarily for residential properties
- Class 3 is for utility company equipment
- Class 4 is for all other property, including commercial property.

DOF determines the market value of a property in a number of ways, including determining the property's replacement value, recent selling prices of similar properties in the vicinity, and the property's revenue-generating value for the owner (rentals, sales, etc.). After determining the property's market value, DOF multiplies it by 45 percent (eight percent for Class 1 properties) to arrive at the property's taxable assessed value. Using the tax rate for that year (in Fiscal Year 2002, the rate was 9.7 percent), DOF calculates the real estate taxes for the property.

For its tenancy at 40 Rector Street, the Board (as well as the other City tenants) pays a base rent to the landlord. The base rent is intended to cover the Board's portion of, among other things, the property's real estate taxes. According to the lease terms, the Board is responsible for paying its proportionate share of any increase in the property's real estate taxes above the base year amount during the lease term. (The base year for this lease is Fiscal Year 1996, which covers the period July 1, 1995 through June 30, 1996.)

Objective

The objective of this audit was to determine whether the landlord's real estate charges allocated to the Campaign Finance Board for space leased at 40 Rector Street were accurate and properly adjusted to account for any reassessments.

Scope and Methodology

The scope of this audit was Fiscal Years 1996 through 2003—July 1, 1995, through June 30, 2003.

In conducting this audit, we interviewed Board personnel and requested that they provide us with copies of the lease of 40 Rector Street. We reviewed the Board's payments to the landlord under the lease to ascertain the total amount paid by the Board for the base rent and all escalation charges.

We reviewed lease folders and examined all documentation in the Board's possession (worksheets, invoices, landlord's bills, supporting documentation) that related to the lease payments, including escalation charges.

We reconciled the payment vouchers listed on the City's Financial Management System (FMS) to the vouchers in the Board's lease folders.

We read the lease and sought legal counsel to interpret certain sections.

We reviewed the database maintained by DOF to determine the history of the assessment of this property. We determined that this property was sold in 2001, calculated the selling price, and compared it to the market value as determined by DOF.

We interviewed a real estate assessor from the Tax Commission and learned the different methods used by DOF assessors to determine the market value of a property.

* * * * *

This audit was conducted in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and other auditing procedures that we considered necessary in the circumstances. The audit was performed pursuant to the responsibilities of the Comptroller set forth in Chapter 5, § 93 (b) and (i), of the New York City Charter.

Discussion of Audit Results

The findings in this report were discussed with Board officials during and at the conclusion of this audit. A preliminary draft was sent to Board, DOF, and DCAS officials, and was discussed at the exit conference on January 8, 2004. On January 26, 2004, we submitted a draft report to Board and DCAS officials with a request for comments. We received written responses from the Board and DCAS on February 12, 2004, and February 9, 2004, respectively. In its response, the Board had no comment on the report, as there were no recommendations relating to the Board. DCAS disagreed with the audit's recommendation that it ensure that leases do not contain a provision barring the City from receiving a refund or credit if real estate taxes are reduced below the lease's base year amount. The full texts of the Board and DCAS responses are included as addenda to this report.

FINDINGS AND RECOMMENDATIONS

Overview of Audit Findings

Our examination of the landlord's bills maintained at the Board, along with the payment vouchers listed in FMS, reveals that the landlord did not allocate any additional real estate charges to the Board for space leased at 40 Rector Street. During the period reviewed, the property was reassessed and the landlord received a reduction in the property's real estate taxes; however, according to the lease, the City was not entitled to a portion of the reduction because it brought the tax amount below that payable in the base year of the lease, Fiscal Year 1996. Accordingly an adjustment of the tax charges or credits passed on to the Board is inapplicable. (The Board was not liable for any real estate tax escalation charges during the period reviewed, nor did the landlord bill the Board for any such charges.)

Nevertheless, a criminal prosecution now in process may establish that the real estate taxes for 40 Rector Street may be lower than was to be expected because of an improper under-assessment. The property is identified in a case in which DOF tax assessors are charged with taking bribes to lower the assessed values of City properties. The market value for this property decreased 64 percent—from \$66.5 million to \$24.2 million—from Fiscal Year 1993 to Fiscal Year 2003. We sent a letter to DOF in October 2003 requesting that it reassess this property and apprise us of any action it takes regarding this matter; DOF did not respond to our letter. Nevertheless, in January 2004, DOF reassessed the market value for this property and recorded the tentative Fiscal Year 2005 market value as \$49.9 million—a 94 percent increase over the Fiscal Year 2004 market value of \$25.7 million.

City Not Entitled to Share of Real Estate Tax Reduction Due to Lease Clause

For Fiscal Years 1996 through 2003, the annual real estate taxes for 40 Rector Street went from \$1.64 million to \$1.16 million. As a result, the landlord's tax liability during the period was \$3.01 million less than it would have been had the taxes remained at the 1996 base year amount. However, due to a clause in its lease precluding such action, the Board is ineligible for a corresponding reduction or credit in the amount of its rent applied to real estate taxes.

In Fiscal Year 1996, the base year of the lease, the real estate taxes for the property were \$1,638,315; \$46,692 (2.85%) represented the Board's share, which was paid through the base rent. In the event that the real estate tax for the property increases above the base year amount during the term of the lease, the landlord pays the tax and then submits an invoice to the tenant and requests reimbursement for its portion of the escalation.

We reviewed the lease payments to the landlord during the period July 1995 to June 2003, and reviewed the controls put in place by the Board to ensure that only properly supported charges, including any real estate tax escalation charges, were paid. We obtained all documentation maintained by the Board to support the lease payments. During the eight-year period reviewed, the Board paid base rent totaling \$2,141,367. Of this amount, \$373,536 (\$46,692 per year) was to be allocated to pay the Board's share of the real estate taxes. We

determined that the Board had adequate controls to ensure that only properly supported charges were paid. Our review also revealed that the Board was not billed for real estate tax escalation charges. Nevertheless, it appears that the Board has paid in excess of its share of the real estate taxes. During Fiscal Years 1996 through 2003, the taxes for this property decreased in every year but two (Fiscal Years 2002 and 2003). Based on those reductions, the landlord's real estate tax liability was \$3,014,756 less than it would have been if the assessed value had not been reduced below the base year value. Of this amount, \$85,920 (2.85%) represents the portion applicable to the Board's tenancy. The real estate tax breakdown per year is shown in Table I, below.

Table I

The Trend of Reduction of the Real Estate Taxes for 40 Rector Street from FY 1996 - 2003

Fiscal Year A	Initial Tax Liability B	1996 Tax Liability (BaseYear Taxes) C	Difference D (C - B)	Amount Applicable to the Board (2.85%) E (D x 2.85%)
1996	1,638,315	1,638,315	-	
1997	1,328,659	1,638,315	309,656	8,825
1998	1,317,254	1,638,315	321,061	9,150
1999	1,243,674	1,638,315	394,641	11,247
2000	1,123,763	1,638,315	514,553	14,665
2001	1,117,362	1,638,315	520,953	14,847
2002	1,159,904	1,638,315	478,411	13,635
2003	1,162,834	1,638,315	475,481	13,551
Total Real Estate Tax	10,091,765	13,106,520	3,014,756	85,920

Since the taxes decreased over the lease term, the Board was not liable for any real estate escalation charges under the terms of the lease. However, neither was the Board entitled to share any portion of the reduction, because the provisions of Article 4(B)(iii) of the lease specifically precludes a reduction or credit if real estate taxes are reduced below those payable in the base year.

Article 4(B)(iii) of the lease states:

“The Real Estate Taxes for the Real Estate Tax Base Year shall be the annual Real Estate Taxes as finally determined and finally imposed or assessed on the Land and Building for the Real Estate Tax Base Year.

“Appropriate credit . . . shall be given for any refund obtained by reason of a reduction in the assessed valuation made by the assessors or the courts at any time during this Lease or at any time thereafter. . . . However, nothing in this Article shall be deemed or be construed to require Landlord to pay to Tenant any portion

of a refund paid to Landlord during any period that Tenant is in default hereunder or if, as a result of said reductions, **the Real Estate Taxes payable by Landlord are less than those payable during the Real Estate Tax Base Year of this Lease.**” (Emphasis added)

We question the necessity of inserting such a provision in the lease. The savings realized by the landlord are neither shared with the tenant (the Board) nor used as consideration for possible tax increases. If the taxes increase above the base year amount, the City is still responsible for paying escalation costs.

Recommendation

1. The Department of Citywide Administrative Services should ensure that future leases have no provision barring the City from receiving a refund or credit if the property’s real estate tax bill is reduced below the amount payable in the base year of the lease.

DCAS Response: DCAS disagreed with this recommendation and stated:

“Section 824(a) of the New York City Charter gives DCAS the statutory authority to lease real property for the City, subject to the Mayor’s approval. Thus, it is within this agency’s purview to negotiate the terms of all City leases. Although our leases usually contain a provision which provides for a credit if the property’s real estate taxes are reduced below the amount the landlord pays for the base year, there are occasions where we modify that provision because of certain circumstances or in exchange for other, more favorable terms for the City. For example, with respect to the premises at issue, we originally entered into a sublease that did not include our standard provision because the overlease did not contain such a provision. Under the circumstances, it was plainly rational and an appropriate exercise of our statutory authority to vary the terms of the relevant provision.

“We appreciate that the recommendation is driven by a desire to add revenue to the City’s coffers. However, we are always mindful of that important goal when we exercise our statutory authority to negotiate City leases and always act in the City’s best interest whenever we alter the standard terms of our leases. Accordingly, we simply cannot agree to a recommendation that would intrude on our statutory mandate to negotiate leases and prevent us from obtaining other, more valuable terms in those instances where we see fit to vary the language of the relevant provision.”

Auditor Comment: Regarding the statement that DCAS leases usually contain a standard provision that provides for a credit if a property’s real estate taxes are reduced below the base year amount, we reviewed a random sample of seven leases negotiated by DCAS to determine how many of them contained the provision. Only one of the seven had a provision explicitly allowing for a credit if real estate taxes fell below the base year amount. Of the remaining six leases, one contained a provision similar to the one in the 40 Rector Street lease, barring the City from obtaining a credit, and the other five were silent on the issue.

Regarding the lease in question, we do not understand DCAS's argument that the current lease does not contain a provision allowing the City to receive a credit if real estate taxes are reduced below the base year amount because a previous "overlease" and sublease did not contain such a provision. We asked DCAS for a copy of the two documents, which officials provided. Our review of the overlease and sublease found that they are silent on the issue; they neither allow nor bar the City from receiving a credit if the above-stated condition exists. However, the current lease explicitly bars the City from receiving the above-mentioned credit. Furthermore, irrespective of the language in the overlease and sublease, the current lease contains no provision requiring that the City abide by any prior agreement regarding a real estate tax credit. As shown in Table I, the landlord's real estate tax liability was \$3,014,756 less than it would have been if the taxes had not been reduced below the base year amount. The City agencies at 40 Rector Street occupy more than 41 percent of the rental space (the Board occupies 2.85 percent). By agreeing to include a provision barring the City from receiving a credit or refund if real estate taxes fall below the base year amount, the City is barred from receiving a credit totaling more than \$1.2 million (41 percent of \$3,014,756).

Finally, we disagree with DCAS' assertion that if it were to implement our recommendation it would intrude on the agency's statutory mandate to negotiate leases and prevent the agency from obtaining other, more valuable terms. We believe that it is in the City's best interest that it be protected in the event that an expense is significantly reduced for which the City is responsible for paying its proportionate share. During the period covering Fiscal Years 1996 through 2003, the landlord's real estate tax liability was 23 percent less than it would have been had the liability been equal to the base year amount (\$10,091,765 versus \$13,106,520, as shown in Table I). Nevertheless, the City experienced no corresponding adjustment in its rental payments (from which the City's share of the real estate taxes is derived).

Based on the above, we reaffirm our recommendation and ask DCAS to reconsider its position.

Other Issues

The real estate taxes for 40 Rector Street may be lower than was to be expected, due to an improper under-assessment of the property. The property is identified in a criminal case in which DOF tax assessors are charged with taking bribes to lower the assessed values of City properties. From Fiscal Year 1993 (three years prior to the base year of the Board's lease) to Fiscal Year 2003, the DOF market value for this property was reduced from \$66.5 million to \$24.2 million—a 64 percent decrease. Accordingly, we sent a letter to DOF requesting that the agency reassess this property.

As stated previously, DOF is responsible for setting the assessments for properties and collecting real estate taxes. In Fiscal Year 1996 (the lease base year), DOF recorded the market value for 40 Rector Street as \$35 million. In the subsequent seven years, DOF reduced the market value to \$24.2 million—a 31 percent decrease—thereby reducing the annual real estate

tax from \$1.6 million to \$1.1 million. There is an even more significant decrease if one goes back three years earlier, to Fiscal Year 1993. In that year, DOF assessed the market value as \$66.5 million and the tax amount was \$3.2 million. From that year through Fiscal Year 2003, DOF reduced the market value for 40 Rector Street by \$42.3 million—64 percent. A listing of the Fiscal Years and the corresponding real estate tax amounts is shown in Table II, below.

Table II

Market Value Trend History for 40 Rector Street
Fiscal Years 1993 - 2003

Fiscal Year	DOF Market Value	Assessed Value	Applicable Tax Rate	Real Estate Tax	% increase/ (decrease) from previous year
1993	\$66,520,000	\$29,934,000	0.10698	\$3,202,339	N/A
1994	\$58,400,300	\$26,280,135	0.10724	\$2,818,282	(13.6%)
1995	\$45,200,000	\$20,340,000	0.10608	\$2,157,667	(30.6%)
1996	\$35,000,000	\$15,750,000	0.10402	\$1,638,315	(31.7%)
1997	\$28,800,000	\$12,960,000	0.10252	\$1,328,659	(23.3%)
1998	\$28,800,000	\$12,960,000	0.10164	\$1,317,254	(0.9%)
1999	\$27,000,000	\$12,150,000	0.10236	\$1,243,674	(5.9%)
2000	\$25,000,000	\$11,250,000	0.09989	\$1,123,763	(10.7%)
2001	\$25,420,000	\$11,439,000	0.09768	\$1,117,362	(0.6%)
2002	\$26,540,000	\$11,943,000	0.09712	\$1,159,904	3.7%
2003*	\$24,200,000	\$10,890,000	0.09776, 0.11580	\$1,162,834	0.25%

* In Fiscal Year 2003, the tax rate increased in the middle of the year; from 7/1/02 through 12/31/02 the tax rate was 0.09776, from 1/1/03 through 6/30/03 the tax rate was 0.1158.

Based on DOF's action in reducing this property's market value, it would appear that 40 Rector Street's economic value decreased significantly during the period. However, it is noteworthy that during Fiscal Year 2001, the property was sold to its current owner for \$78 million—more than three times the DOF-assessed market value for that year. The assessed value of this property is further undermined by the fact that the previous DOF assessor for 40 Rector Street was indicted, along with 17 other persons, and charged with participating in a scheme whereby assessors accepted bribes to improperly reduce the assessed values of certain properties in the City, including 40 Rector Street. That scheme is estimated to have cost New York City approximately \$40 million a year in lost tax revenues during Fiscal Years 1998 through 2001 alone.

Based on the above information, we sent a letter to DOF in October 2003 requesting that it reassess this property and apprise us of any action it takes regarding this matter; DOF did not respond to our letter. However, it appears that DOF did take action regarding this property. At the exit conference, a DOF official stated that the property was reassessed (along with other properties throughout the City); the new value was made public on January 15, 2004. The

market values assessed by DOF for Fiscal Years 2002 through 2005 are shown in Table III, below.

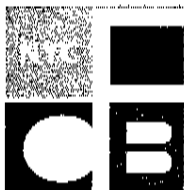
Table III

DOF Assessed Market Value for 40 Rector Street,
Fiscal Years 2003 through 2005

Fiscal Year	DOF Market Value	Percentage Increase (Decrease) from previous year
2002	\$26,540,000	
2003	\$24,200,000	(8.8%)
2004	\$25,700,000	6.2%
2005*	\$49,900,000	94.2%

*Tentative market value as of January 15, 2004

As shown in Table III, the tentative Fiscal Year 2005 market value for 40 Rector Street is \$49.9 million—a 94 percent increase from the Fiscal Year 2004 market value of \$25.7 million.



**New York City
Campaign Finance Board**

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ADDENDUM I

Page 1 of 1

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Chairman

Alfred C. Cerullo, III
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Joseph Potasnik
Alan N. Rechtschaffen
Members

Nicole A. Gordon
Executive Director

Carole Campolo
Deputy Executive Director

Sue Ellen Dodell
General Counsel

February 12, 2004

Hon. Greg Brooks
Deputy Comptroller
Policy, Audits, Accountancy & Contracts
Office of the Comptroller
Executive Offices
1 Centre Street
New York, New York 10007-2341

**Re: Draft Audit Report on Real Estate Tax
Charges on Space Leased at 40 Rector Street
by the Campaign Finance Board**

Dear Deputy Comptroller Brooks:

In response to your letter dated January 26, 2004, the New York City Campaign Finance Board has no comment on the report, as there were no recommendations made in the audit relating to the Campaign Finance Board.

If my staff or I can be of further assistance to you, please feel free to call us.

Sincerely,

A handwritten signature in cursive script, appearing to read "Nicole A. Gordon".

Nicole A. Gordon



DEPARTMENT OF CITYWIDE ADMINISTRATIVE SERVICES
OFFICE OF THE COMMISSIONER

ADDENDUM II
Page 1 of 2

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Martha K. Hirst
Commissioner

February 9, 2004

Citywide Personnel
Services

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Management &
Construction

Municipal Supply
Services

Real Estate Services

Citywide Equal
Employment
Opportunity

Citywide
Occupational Safety
& Health

Transportation
Services

The City Record

CityStore

Mr. Greg Brooks
Deputy Comptroller for Policy,
Audits, Accountancy and Contracts
1 Centre Street, Room 530
New York, NY 10007

Re: Audit Report on Real Estate Tax Charges
on Space Leased at 40 Rector Street by
the Campaign Finance board
(Audit MJ04-091A)

Dear Mr. Brooks:

We welcome the opportunity to comment on the recommendation that is addressed to DCAS in the above referenced Audit Report. For the reasons discussed below, we cannot accept that recommendation.

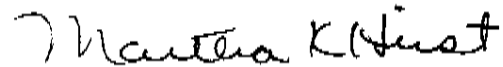
The Audit Report found that after entering into this lease, the real estate taxes for the subject building had been subsequently reduced below the lease's base year value, and that the City was not entitled to a portion of the reduction due to certain language in the lease. The Audit Report includes a recommendation stating that DCAS "should ensure that future leases have no provision barring the City from receiving a refund or credit if the property's real estate tax bill is reduced below the amount payable in the base year of the lease."

Section 824(a) of the New York City Charter gives DCAS the statutory authority to lease real property for the City, subject to the Mayor's approval. Thus, it is within this agency's purview to negotiate the terms of all City leases. Although our leases usually contain a provision which provides for a credit if the property's real estate taxes are reduced below the amount the landlord pays for the base year, there are occasions where we modify that provision because of certain circumstances or in exchange for other, more favorable terms for the City. For example, with respect to the premises at issue, we originally entered into a sublease that did not include our standard provision because the overlease did not

contain such a provision. Under the circumstances, it was plainly rational and an appropriate exercise of our statutory authority to vary the terms of the relevant provision.

We appreciate that the recommendation is driven by a desire to add revenue to the City's coffers. However, we are always mindful of that important goal when we exercise our statutory authority to negotiate City leases and always act in the City's best interest whenever we alter the standard terms of our leases. Accordingly, we simply cannot agree to a recommendation that would intrude on our statutory mandate to negotiate leases and prevent us from obtaining other, more valuable terms in those instances where we see fit to vary the language of the relevant provision.

Yours truly,



Martha K. Hirst

c: Lewis S. Finkelman
Lori Fierstein