AUDIT REPORT

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

Audit Report on the New York City Economic Development Corporation's Compliance with Its Lease Agreement for the Brooklyn Army Terminal

FR08-065A

June 6, 2008

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 responsibilities of the Comptroller contained in Chapter 5, § 93, of the New York City Charter, my office has audited the compliance of the New York City Economic Development Corporation, with provisions of its lease agreement with the City to manage the Brooklyn Army Terminal.

Under the terms of the agreement, EDC is required to pay the City proceeds received from sub-tenants, charges for water and sewer, and other assessments. Audits such as this provide a means of ensuring that EDC complies with the terms of its agreement, properly reports revenue, and pays all fees due the City.

The results of our audit, which are presented in this report, have been discussed with officials of EDC and their comments have been considered in preparing this report. Their complete written responses are attached to this report.

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,

William C. Thompson, Jr.

WCT/fh

Report: **FR08-065A**
Filed: **June 6, 2008**

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Audit Report on the New York City Economic Development Corporation's Compliance with Its Lease Agreement for the Brooklyn Army Terminal

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AUDIT REPORT IN BRIEF

We performed an audit of the lease agreement between the City and the Economic Development Corporation (EDC) to mange the 97-acre Brooklyn Army Terminal (Terminal) in Sunset Park. According to the lease agreement, EDC is required to pay the City: an amount equal to 100 percent of net operating income; all proceeds received, less those used or to be used to restore the premises, and; all other amounts which EDC is obligated to pay pursuant to the provisions of the lease. The lease requires EDC to provide financial statements to the City 90 days after the end of each lease year and "maintain adequate systems of internal control . . ." The lease permits EDC to enter into sub-leases in accordance with a City approved sub-leasing plan. Furthermore, the lease requires EDC to agree to pay, or to include in sub-leases to be paid by sub-tenants, charges for water, water meter and sewer rents; real property assessments; excises; levies; and fines. In addition, the lease requires EDC to maintain a $500,000 reserve fund, and to develop the Terminal in accordance with one or more development plans approved by the City.

The audit determined whether the Economic Development Corporation complied with the major terms of the Terminal lease agreement with the City; collected appropriate rents and fees from sub-tenants; and ensured that sub-tenants complied with major terms of their sub-lease agreements.

EDC's certified financial statements for the year ended June 30, 2007 reported Terminal total operating revenues of $18,777,935; total operating expenses of $11,405,171, and operating income of $7,372,764.

<u>Audit Findings and Conclusions</u>

We concluded that EDC ensured that sub-tenants complied with major terms of their lease agreements pertaining to paying rent on time, submitting required security deposits, and maintaining proper insurance coverage. In addition, EDC maintained separate books and records for the Terminal; maintained the required $500,000 reserve fund, and; developed the Terminal in accordance with an approved development plan.

However, EDC did not comply with certain lease stipulations by not collecting appropriate rents and fees from all its sub-tenants, thereby resulting in lost rental fees totaling at least $211,500. Moreover, EDC did not charge certain sub-tenants rents in accordance with market appraisals, again forgoing potential rental payments totaling almost $300,000. In addition, EDC did not itself pay the City for water and sewer use, nor did it charge sub-tenants for water and sewer use as part of their sub-leases. Furthermore, EDC did not maintain records to properly substantiate more than $37,000 in employee expenses.

Audit Recommendations

This report makes a total of ten recommendations as follows:

EDC should:

- Arrange to collect fair market rental income from Turner Construction Company for space occupied at the Terminal.

- In the future, record in the Terminal's financial statements revenue obtained from Turner Construction Company.

- Cease its practice of providing rentable space at the Terminal to entities free-of-charge.

- Prepare a formal written agreement to document the terms by which the Mayor's Office is allowed to occupy space at the Terminal without paying rent.

- Ensure that rental rates are consistent with fair market appraisal values.

- Consult with DEP to undertake immediate steps to gain access to the Terminal's water meters.

- Pay all required water and sewer charges.

- Ensure that it obtains billing statements from DEP in order to bill sub-tenants for water and sewer charges for Fiscal Year 2007 and for a four-year retroactive period.

- Provide adequate documentation to substantiate items expensed for the Terminal's travel and meals account.

- Remit 100 percent of the Terminal's net operating income to the City on a quarterly basis, in accordance with the lease agreement.

INTRODUCTION

Background

EDC is responsible for promoting economic growth in the City's five boroughs by providing commercial and industrial real estate development and financial services, managing the City's wholesale food markets and transport systems, and developing and managing waterfront properties.

EDC manages the 97-acre Brooklyn Army Terminal (Terminal) in Sunset Park, consisting of two major buildings that comprise commercial and industrial sub-tenants. The federal government constructed the Terminal in 1919 as a military staging area, decommissioned it in 1970, and sold the property to the City of New York. A February 1, 1986 lease agreement between the City and the New York City Public Development Corporation, subsequently the EDC, required the EDC to renovate the buildings and associated port and rail facilities as an industrial park.[1] The most recent renovation completed in 2004, increased the total renovated area to approximately 3.1 million of the Terminal's 4 million square feet. More than 70 companies including light manufacturers, distributors and financial back-office tenants occupy the renovated portions of the Terminal. EDC is responsible for leasing, lease administration, and daily management. Apple Industrial Development Corporation, a unit of EDC, provides management and maintenance services for the Terminal, as well as for other properties that EDC leases from the City.

According to the lease agreement, EDC is required to pay the City: an amount equal to 100 percent of net operating income; all proceeds received, less those used or to be used to restore the premises, and; all other amounts which EDC is obligated to pay pursuant to the provisions of the lease. The lease stipulates that payments be received on the 30th day of each January, April, July and October for the quarter ended the previous December 31, March 31, June 30, or September 30.

The lease requires EDC to provide to the City 90 days after the end of each lease year, financial statements showing Terminal gross operating income, operating expenses, and other deductions from gross and net operating income. EDC is required to provide the City with interim statements of its financial data at least quarterly. In addition, EDC is required to "maintain adequate systems of internal control and . . .complete and accurate records, books of account and data . . . Such books and records . . . shall be conveniently segregated from other business matters of [EDC]."

The lease permits EDC to enter into sub-leases in accordance with a City approved sub-leasing plan. The sub-leasing plan must specify the space to be sublet, the proposed sub-tenant or class of sub-tenant, and the proposed terms or range of terms for the financial provisions of the proposed sub-lease.

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[1] The New York City Public Development Corporation merged with other City agencies to become the New York City Economic Development Corporation on July 1, 1991. The current lease expires on January 31, 2085.

Furthermore, the lease requires EDC to agree to pay, or to include in sub-leases to be paid by sub-tenants, charges for water, water meter and sewer rents; real property assessments; excises; levies; and fines. In addition, the lease requires EDC to maintain a $500,000 reserve fund, and to develop the Terminal in accordance with one or more development plans approved by the City.

EDC's certified financial statements for the year ended June 30, 2007 reported Terminal total operating revenues of $18,777,935; total operating expenses of $11,405,171, and operating income of $7,372,764. Total reported Terminal net assets at the beginning and end of fiscal year 2007 were $500,000. EDC officials advised that for the Terminal they paid the City $0 for 2007.

Objectives

The objectives of this audit were to determine whether the Economic Development Corporation:

- complied with the major terms of the Terminal lease agreement with the City;
- collected appropriate rents and fees from sub-tenants; and
- ensured that sub-tenants complied with major terms of their sub-lease agreements.

Scope and Methodology

This audit covered the period July 1, 2006, through June 30, 2007 (Fiscal Year 2007). To achieve our audit objectives, we reviewed the lease agreement for the Terminal between the City of New York and the New York City Public Development Corporation. We also reviewed the Amended and Restated Contract between The City of New York and New York City Economic Development Corporation dated June 30, 2006, which governs EDC's overall responsibilities with respect to certain properties it leases from the City.

On July 25, 2007, we conducted a walkthrough with EDC officials to understand its process for leasing space and collecting rent from sub-tenants. In order to assess EDC's internal controls at the Terminal, we interviewed EDC's senior vice president and vice president of accounting, the vice president who oversees the Terminal's management, and the senior and assistant vice presidents of asset management in charge of rentals at the Terminal.

We obtained from EDC on July 27, 2007, a listing of all 80 sub-tenants at the Terminal, which collectively have 134 sub-leases. To ascertain the reliability of this listing, we conducted a walkthrough of the Terminal on August 10, 2007, to observe the layout of the premises, to determine whether all spaces were occupied in accordance with the sub-tenant list, and to verify that spaces noted as vacant were unoccupied.

On October 4, 2007, we conducted a walkthrough of EDC's information technology system, which is called the Management Reporting International system, to understand how EDC processes sub-lease information and rent payments. On November 1, 2007, we conducted a second walkthrough of the Terminal to view occupied sub-tenant spaces and to verify that the space was occupied by light manufacturers, distributors and financial back-office tenants, as required by the lease agreement.

We selected a random sample of sub-tenant sub-lease files for review. Of the 134 files, we chose to review 45 files (34% of the population) comprising 31 of the 80 sub-tenants. We examined each of the sampled files to ensure that EDC complied with the terms of the lease with the City. In this regard, we reviewed the terms of each sub-lease to determine whether sub-tenants occupied their respective spaces solely for industrial or commercial purposes, and whether all such sub-leases were carried out in accordance with a City-approved sub-leasing plan. To verify the brokerage expenses as necessary and properly expensed against gross receipts, we reviewed EDC's sub-tenant leases and abstracts to determine whether sub-tenants obtained their space through a brokerage firm or obtained them through direct negotiation with EDC.

To determine whether sub-tenants complied with other major terms of their sub-leases, for our sample we examined copies of security deposit checks, security deposit ledgers, and copies of insurance certificates. We determined whether the correct security deposits were paid to EDC and whether each sub-tenant maintained the proper insurance coverage as required by their respective sub-leases.

As part of our tests of EDC Terminal revenue, we determined whether all occupied spaces were revenue-generating. We interviewed EDC officials and reviewed our sampled sub-tenant lease files. We also obtained documentation from EDC officials for cases in which occupied spaces were not revenue-generating and documented our understanding in memoranda.

To ascertain whether sub-tenants were being charged appropriate rents, in accordance with the lease agreement, we obtained approved EDC Board of Directors' minutes from February 1988 to May 2006, which outlined rents to be charged sub-tenants. In addition, we obtained the two most recent EDC-commissioned real estate appraisals, dated October 21, 2002, and March 17, 2006, which calculated fair market values for the Terminal's rentable space. We reviewed each sampled sub-lease file and compared the square foot rent charged to each sub-tenant at the beginning of its respective lease with the corresponding Board minutes to ascertain whether all rents charged were consistent with the rates described in the minutes. To determine whether the rates charged were consistent and reasonable, we compared the square-foot rental rate charged each sub-tenant to the market appraisal values.

To ascertain whether sub-tenant payment checks, lock box receipts, and electronic fund transfers were received and covered the required fees (heat, maintenance, electricity, payments-in-lieu-of-taxes, etc.) for each rent category due from each sub-tenant, we randomly chose one month (April 2007) for testing from our sample files; total receipts for April 2007 were $1,142,751 for our sampled sub-tenants. In this regard, we reviewed the Management Reporting International sub-tenant payment histories, lease abstracts, payment checks and supporting documentation, the monthly bank statement, and check log. To determine whether the payments covered the charges stipulated in each sub-lease, we reviewed each payment check and supporting documentation and compared that information to the individual sub-lease abstracts. We documented the method by which payment was received and any corresponding deposit slips, where applicable. In instances where payment was sent directly to EDC, we verified that such payment was recorded in the check log. We traced the deposit slips and lock box receipts to bank statements to verify that all rental income was deposited and accounted for.

We placed reliance on EDC's certified combined financial statements for the years ended June 30, 2007 and 2006. We also performed additional procedures. We vouched operating revenues and expenses for fiscal year 2007 to the trial balance. We then vouched all revenue and expense accounts over $250,000 from the trial balance to the general ledger.

To determine whether operating expenses were reasonable, we reviewed a random sample of the operating expense accounts and supporting documentation, such as account breakdowns, contracts, invoices, time sheets, and receipts, totaling $7,046,218 of the $11,405,171 reported on the certified financial statements for 2007. To ascertain whether operating expenses were solely for operations at the Terminal, we questioned EDC officials regarding the nature of certain expense accounts.

To determine whether EDC paid 100 percent of net operating income to the City on a quarterly basis, we interviewed EDC officials and reviewed the general ledger, financial statements, and both Apple Industrial Development Corporation's and EDC's bank statements.

To understand the billing and payment of water and sewer charges for the Terminal, we interviewed EDC and Department of Environmental Protection (DEP) officials. We reviewed sub-tenant leases and billing statements and documented our understanding in memoranda. In addition, to determine compliance with sub-lease terms governing utilities, such as electricity and gas, we reviewed billing statements and payments for the month of April 2007.

The results of the above tests, while not statistically projected to their respective populations, provided a reasonable basis for us to satisfy our audit objectives.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included all tests considered necessary. The audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

Discussion of Audit Results

The matters covered in this report were discussed with EDC officials during and at the conclusion of this audit. A preliminary draft report was sent to EDC on March 12, 2008, and was discussed at an exit conference on March 26, 2008. On April 7, 2008, we submitted a draft report to EDC officials with a request for comments; EDC provided a written response on April 17, 2008. EDC agreed with seven out of ten recommendations. EDC disagreed with recommendations to: arrange to collect fair market rental income from Turner Construction Company for space occupied at the Terminal; cease its practice of providing rentable space at the Terminal to entities free-of-charge; and, remit 100 percent of the Terminal's net operating income to the City on a quarterly basis, in accordance with the lease agreement.

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

FINDINGS AND RECOMMENDATIONS

EDC ensured that sub-tenants complied with major terms of their lease agreements pertaining to paying rent on time, submitting required security deposits, and maintaining proper insurance coverage. In addition, EDC maintained separate books and records for the Terminal that were properly segregated from other EDC business matters. EDC also maintained the required $500,000 reserve fund, and developed the Terminal in accordance with an approved development plan.

However, EDC did not comply with certain stipulations of its lease with the City. Specifically, it did not collect appropriate rents and fees from all its sub-tenants, thereby resulting in lost rental fees totaling at least $211,500. Moreover, EDC did not charge certain sub-tenants rents in accordance with market appraisals, again forgoing potential rental payments totaling almost $300,000. In addition, EDC did not itself pay the City for water and sewer use, nor did it charge sub-tenants for water and sewer use as part of their sub-leases. The City has, therefore, not received water and sewer fees for services provided to the Terminal since 1986. Furthermore, EDC did not maintain records to properly substantiate more than $37,000 in employee expenses.

These matters are discussed in greater detail in the following sections.

Over $200,000 in Forgone Rent

EDC permitted Turner Construction Company to occupy 7,200 square feet of rentable space in the Terminal without paying rent. As a result, we calculated the amount of forgone rent, based on EDC market value appraisals, to be at least $211,500. According to the lease agreement, the Terminal was to be developed "in order to provide and retain industrial employment opportunities and *provide revenues to the City*." [Emphasis added.]

EDC officials contended that "EDC offered the space as part of a request for proposals for facilities management services . . . The purpose of providing office space is to reduce overhead costs that would be reflected in a higher multiplier on the salaries of personnel assigned by the consultant to the facilities management contract." However, EDC's contract with Turner Construction Company for facilities management services does not reflect any such reduction in overhead costs. Moreover, contract §IV Part C, Appendix A, states only that "the Corporation may, but is not required to provide a site office for the Consultant at Properties where such services are performed."

Thus, the contract does not expressly relieve EDC of its obligation to charge Turner Construction Company a fair market rent for space it occupies at the Terminal. Accordingly, we calculated that EDC could have collected $211,500 from Turner Construction Company for its occupation of space since the inception of the contract on August 10, 2003, to the end of Fiscal Year 2007.[2]

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[2] We calculated the lost rent revenue based on 7,200 sq. ft. x appraisal rate for 2002 of $6.50 per sq. ft. = $46,800/12 X 30 months = $117,000; *plus* 7,200 sq. ft X appraisal rate for 2006 of $10.50 per sq. ft. =

EDC's practice of providing rentable space without charge runs counter to the lease agreement's requirement to provide revenue to the City. Moreover, it leads to questions about the transparency of EDC's methods for marketing rental space at the Terminal.

In a related matter, EDC also permitted the Mayor's Office to occupy 9,000 square feet of rentable space in the Terminal without paying rent. In contrast with the arrangement between EDC and Turner Construction Company— a private organization— granting space at the Terminal to City agencies may indeed serve the City's interests. However, there was no written agreement or memorandum to document the terms of this arrangement. A formal agreement between EDC and the City is a necessary internal control for those City agencies that oversee budgetary and accounting matters.

Recommendations

EDC should:

1. Arrange to collect fair market rental income from Turner Construction Company for space occupied at the Terminal. In this regard, EDC should bill and collect from Turner Construction Company $211,500 for occupying space at the Terminal from the inception of its contract with EDC to the end of Fiscal Year 2007.

EDC Response: "EDC disagrees. EDC provides this space to Turner Construction Company in-lieu of being charged for the cost of Turner providing its own onsite accommodations as may be required by the contract. In addition, Turner only occupies approximately one-third of the space in question, EDC uses the remaining space as a disaster and business continuity facility and a central repository for plans and specs for all of EDC's projects management services."

Auditor Comment: EDC's contract with Turner Construction Company does not require Turner to provide "its own onsite accommodations." Therefore, EDC should collect fair market rental income from Turner, notwithstanding EDC's contention that it uses one-third of the space. (We asked EDC officials at the exit conference to substantiate its use of the rentable space, but EDC did not provide any supporting documentation.)

2. In the future, record in the Terminal's financial statements revenue obtained from Turner Construction Company.

EDC Response: "EDC agrees. In the event we enter into an agreement that requires Turner to pay rental revenue for space located at BAT, it will be recorded in the Terminal's financial statements."

$75,600/12 X 15 months = $94,500. The total lost rent for Turner = $117,000 + $94,500 = $211,500.

Auditor Comment: As previously discussed, EDC should already be collecting and recording fair market rental income from Turner Construction Company for occupied space at the Terminal.

3. Cease its practice of providing rentable space at the Terminal to entities free-of-charge.

EDC Response: "EDC disagrees. EDC is not in the practice of providing rentable space free-of-charge. On occasion EDC is asked to provide space to assist other City agencies and will document all such requests."

Auditor Comment: As previously stated, our objection is with providing rentable space free-of-charge to private organizations such as Turner Construction Company—and not to City agencies.

4. Prepare a formal written agreement to document the terms by which the Mayor's Office is allowed to occupy space at the Terminal without paying rent.

EDC Response: "EDC agrees. We will seek to get a formal written agreement from The Mayor's Office."

Sub-Tenant Rental Prices Are Lower Than Market Appraisals

EDC negotiated leases that enabled seven of the sampled sub-tenants to pay rents that were lower than appraised market values. The actual rents ranged from $0.83 to $5.00 a square foot less than the market values that were ascertained by EDC appraisals in 2002 and 2006. Overall, for Fiscal Year 2007, the seven sub-tenants paid $295,943 less than market rates for leases that commenced between 2002 and 2007.[3] (See Table I on page 11.)

[3] We limited our review to tenants whose leases commenced in 2002 to fairly reflect the discrepancy between market appraisals for 2002 and 2006 and rent charged in 2007.

Table I

Summary Schedule of 2007 Rent Charges Not Equivalent to Market Appraisal Values

#	Tenant Name	Leased Square Feet (a)	Rate Per Square Foot Currently Charged (b)	Market Appraisal Value Per Square Foot (c)	Between Current Rate Charged and Appraisal Value (c - b)= (d)	Difference (a)(d)
Comparison between 2002 Appraisals and Rent Paid in 2007						
1	Alliance Transfer Corp. Beginning Date of Lease: 12/01/03	37,500	$ 5.50	$ 6.50	$ 1.00	$ 37,500
2	Bendiner & Schlesinger, Inc. Beginning Date of Lease: 05/01/04	39,500	$ 4.94	$ 6.50	$ 1.56	$ 61,620
3	Camelot Sample Group, Inc. Beginning Date of Lease: 06/01/02	37,500	$ 5.67	$ 6.50	$ 0.83	$ 31,125
4	Gamla Enterprises North America Inc. Beginning Date of Lease: 08/01/05	29,900	$ 5.60	$ 6.50	$ 0.90	$ 26,910
5	Plazatex Textile Import Corp. Beginning Date of Lease: 02/01/04	18,800	$ 4.89	$ 6.50	$ 1.61	$ 30,268
Comparison between 2006 Appraisals and Rent Paid in 2007						
1`	HPI International, Inc. Beginning Date of Lease: 06/01/06	15,500	$ 8.66	$ 10.50	$ 1.84	$ 28,520
2	Mizco International Inc. Beginning Date of Lease: 10/01/06	16,000	$ 5.50	$ 10.50	$ 5.00	$ 80,000
					TOTALS	**$ 295,943**

File documentation lacked any evidence to indicate why the rents for the sampled sub-leases were inconsistent with EDC's market appraisals. Appraisals are an important means by which to establish bona fide rental rates and are recognized benchmarks by which the public and potential tenants can judge the cost-reasonableness of rents. Accordingly, EDC should provide adequate documentation to substantiate the discrepancy in rental and market rates for the above noted sub-leases, and should ensure that rents for all future sub-lease agreements be consistent with market appraisals.

Recommendation

5. EDC should ensure that rental rates are consistent with fair market appraisal values. Furthermore, if EDC deems that extenuating circumstances make it necessary to negotiate rates that are lower than market appraisals, it should document in writing the reasons for the lower rental rate.

EDC Response: "EDC agrees. If we deem extenuating circumstances make it necessary to negotiate rates lower then market it will be documented in writing."

Auditor Comment: If EDC concurs with our recommendation about negotiating fair market rents, it should justify the reason that rents for the seven sampled sub-tenants were lower than appraised market rates. Furthermore, if EDC deems the seven cases "extenuating circumstances" it should immediately document in writing those particular circumstances.

Water and Sewer Use Not Paid

EDC did not pay or bill its sub-tenants for water and sewer use, as required by lease agreement §4.01, which states that "Tenant agrees to pay or to include in Subleases to be paid by Subtenants . . . water, water meter and sewer rents, rates and charges." Although all the sampled sub-leases required that sub-tenants pay water and sewer charges, no such charges were assessed the sub-tenants during Fiscal Year 2007.

In fact, our review of EDC's billing and payment history in DEP customer information system indicated that water and sewer bills have not been generated for the Terminal since 1986. We attribute this problem to EDC's failure to contact DEP and inquire why EDC was not being billed for water and sewer use.

When we contacted DEP about this situation, we were told that bills were not being generated for the Terminal because DEP was unaware that the premises had ever been leased to EDC. Moreover, DEP is still unable to assess water and sewer bills because the Terminal's existing water meters are located in an unsanitary vault that must be remediated of hazardous material. After we brought this matter to the attention of EDC officials, we were informed that EDC is "working with DEP to rectify the situation."

New York City Water Board rules preclude DEP from billing customers for water and sewer use that is more than four years old. Accordingly, the City will be unable to recoup any payments for water and sewer use from 1986 to 2003—a period of 17 years. EDC was aware of its obligation to pay for water and sewer use, as the terms are clearly stated in its lease agreement with the City and in the terms of its sub-tenant sub-leases. Nevertheless, EDC did not attempt to obtain billing statements from DEP since 1989.

Recommendations

EDC should:

6. Consult with DEP to undertake immediate steps to gain access to the Terminal's water meters.

EDC Response: "EDC agrees. We are currently working with DEP to obtain accurate water and sewer charges for the Brooklyn Army Terminal."

7. Pay all required water and sewer charges.

EDC Response: "EDC agrees. We have recently been notified by DEP that a bill for water and sewer charges is forthcoming and will be paid accordingly."

8. Ensure that it obtains billing statements from DEP in order to bill sub-tenants for water and sewer charges for Fiscal Year 2007 and for a four-year retroactive period.

EDC Response: "EDC agrees. It is EDC's intent to bill sub-tenants for water and sewer charges upon receipt of the bill from DEP.

Questionable Expenses

Our review of 100 percent of the Terminal's travel and meals expense account indicates questionable expenses totaling $37,004 for Fiscal Year 2007. The expenses comprised gas purchases totaling $33,734.83, petty cash totaling $3,015.70, and "various" purchases totaling $254.38. We obtained a list of employees and license plate numbers for vehicles driven, receipts for gas purchases, and an invoice and payment for total gas purchases for the month of May 2007. Nevertheless, this documentation was insufficient to substantiate the amount expended.

EDC was unable to provide us with additional requested information that would have enabled us to ascertain whether the expenses were business-related or for personal use. In addition, we were not provided with documentation to ascertain the nature of the petty cash and the purchases entitled "various." Accordingly, we cannot attest to the reasonableness of these charges or whether they were properly expensed to the travel and meals account.

Recommendation

9. EDC should provide adequate documentation to substantiate items expensed for the Terminal's travel and meals account.

EDC Response: "EDC agrees. We will institute a better method to allocate gasoline expenses to the appropriate EDC properties."

Other Issue

More Than $7 Million in Net Operating Income Not Remitted to the City

Lease agreement §3.01 requires that "on each January 30, April 30, July 30 and October 30 throughout the Term . . .Tenant (i.e., EDC) shall pay to Landlord (i.e., the City), without any notice, demand, abatement, counterclaim, deduction or setoff . . . an amount equal to one-hundred (100%) per cent of Net Operating Income." Our review of the Terminal's financial records indicated that for Fiscal Year 2007, EDC attained a net operating income totaling $7,362,179.[4] In addition, for Fiscal Year 2006 EDC attained a net operating income totaling $5,962,758.[5] Yet none of these funds were remitted to the City, which, according to EDC is a practice sanctioned by §3.07 of EDC's Amended and Restated Contract with the City. According to contract §3.07, EDC may retain certain funds it collects, including net operating income.

Although it remains questionable if EDC may, in fact, retain these funds according to the Amended and Restated Contract, it is our belief that this practice would circumvent the intent of the lease agreement, which was to provide a source of revenue to the City. Moreover, §3.07 provides a loophole by which EDC can obtain a major revenue source that circumvents the City's normal budgeting process and the appropriation powers vested in the City Council. Finally, the retention of the Terminal's net operating income precludes appropriate public oversight and accountability for the disposition and use of this revenue by EDC.

Additionally, the Amended and Restated Contract does not require EDC to retain the Terminal's net operating income. Thus, as a matter of public policy, EDC should fulfill the original intent of the lease agreement by remitting these funds to the City treasury on a quarterly basis.

Recommendation

10. EDC should remit 100 percent of the Terminal's net operating income to the City on a quarterly basis, in accordance with the lease agreement.

EDC Response: "EDC disagrees. The Lease was entered into in 1986 and provides for the payment to the City of certain revenue from the Lease. However, the Amended and Restated Contract was entered into subsequent to the Lease with the existence of the Lease known and taken into account. The Amended and Restated Contract provides for EDC to retain certain funds (up to a cap) from the Lease, rather than the Lease funds being paid by EDC to the City and then repaid by the City to EDC. This was done for administrative ease and to enable EDC to use the funds more quickly in furtherance of its duties under the Amended and Restated Contract. The funds are subject to the same

[4] Net operating income excludes interest totaling $10,585.

[5] We did not review the financial statements for Fiscal Year 2006.

procurement rules and approvals as other funds EDC receives under the Amended and Restated Contract."

Auditor Comment: The Amended and Restated Contract does not *expressly* require that Terminal operating income be retained. Therefore, although EDC asserts that it uses this income in accordance with its procurement rules, our primary concern is that using this funding source at all circumvents the City's normal budgeting and appropriation process. Therefore, we contend that EDC should remit all of the Terminal's net operating income to the City.

New York City
Economic Development
Corporation

110 William Street
New York, NY 10038
212.619.5000

www.nycedc.com

April 17, 2008

John Graham, Deputy Comptroller
Audits, Accountancy & Contracts
The City of New York
Office of the Comptroller
1 Centre Street
New York, New York 10007-2341

Re: Response to Audit Report on the New York City Economic Development Corporation's Compliance with Its Lease Agreement For the Brooklyn Army Terminal
FR08-065A

Dear Mr. Graham:

Below is our response to the above referenced draft audit report:

Recommendation 1: Arrange to collect fair market rental income from Turner Construction Company for space occupied at the Terminal. In this regard, EDC should bill and collect from Turner Construction Company $211,500 for occupying space at the Terminal from the inception of its contract with EDC to the end of Fiscal Year 2007.

EDC's Response: EDC disagrees. EDC provides this space to Turner Construction Company in-lieu of being charged for the cost of Turner providing its own onsite accommodations as may be required by the contract. In addition, Turner only occupies approximately one-third of the space in question, EDC uses the remaining space as a disaster and business continuity facility and a central repository for plans and specs for all of EDC's projects management services.

Recommendation 2: In the future, record in the Terminal's financial statements revenue obtained from Turner Construction Company.

EDC's Response: EDC agrees. In the event we enter into an agreement that requires Turner to pay rental revenue for space located at BAT, it will be recorded in the Terminal's financial statements.

Recommendation 3: Cease its practice of providing rentable space at the Terminal to entities free-of-charge.

EDC's Response: EDC disagrees. EDC is not in the practice of providing rentable space free-of-charge. On occasion EDC is asked to provide space to assist other City agencies and will document all such requests.

Recommendation 4: Prepare a formal written agreement to document the terms by which the Mayor's Office is allowed to occupy space at the Terminal without paying rent.

EDC's Response: EDC agrees. We will seek to get a formal written agreement from The Mayor's Office.

Recommendation 5: EDC should ensure that rental rates are consistent with fair market appraisal values. Furthermore, if EDC deems that extenuating circumstances make it necessary to negotiate rates that are lower than market appraisals it should document in writing the reasons for the lower rental rate.

EDC's Response: EDC agrees. If we deem extenuating circumstances make it necessary to negotiate rates lower than market it will be documented in writing.

Recommendation 6: EDC should consult with DEP to undertake immediate steps to gain access to the Terminal's water meters.

EDC's Response: EDC agrees. We are currently working with DEP to obtain accurate water and sewer charges for the Brooklyn Army Terminal.

Recommendation 7: EDC should pay all required water and sewer charges.

EDC's Response: EDC agrees. We have recently been notified by DEP that a bill for water and sewer charges is forthcoming and will be paid accordingly.

Recommendation 8: EDC should ensure that it obtains billing statements from DEP in order to bill sub-tenants for water and sewer charges for Fiscal Year 2007 and for a four-year retroactive period.

EDC's Response: EDC agrees. It is EDC's intent to bill sub-tenants for water and sewer charges upon receipt of the bill from DEP.

Recommendation 9: EDC should provide adequate documentation to substantiate items expensed for the Terminal's travel and meals account.

EDC's Response: EDC agrees. We will institute a better method to allocate gasoline expenses to the appropriate EDC properties.

Recommendation 10: EDC should remit 100 percent of the Terminal's net operating income to the City on a quarterly basis, in accordance with the lease agreement.

EDC's Response: EDC disagrees. The Lease was entered into in 1986 and provides for the payment to the City of certain revenue from the Lease. However, the Amended and Restated Contract was entered into subsequent to the Lease with the existence of the Lease known and taken into account. The Amended and Restated Contract provides for EDC to retain certain funds (up to a cap) from the Lease, rather than the Lease funds being paid by EDC to the City and then repaid by the City to EDC. This was done for administrative ease and to enable EDC to use the funds more quickly in furtherance of its duties under the Amended and Restated Contract. The funds are subject to the same procurement rules and approvals as other funds EDC receives under the Amended and Restated Contract.

Thank you for the opportunity to respond to the recommendations in the audit report.

Very truly yours,

Chris Malin

Christopher Malin
Controller

cc: Seth Pinsky
Jason Wright
Lee Benedict
Hope Mallari