



# City of New York

## OFFICE OF THE COMPTROLLER

Scott M. Stringer  
COMPTROLLER



## FINANCIAL AUDIT

**Marjorie Landa**

Deputy Comptroller for Audit

Audit Report on the Administration of  
the Payments In Lieu of Taxes Program  
by the New York City Department of  
Finance

FM15-125A

June 21, 2016

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
1 CENTRE STREET  
NEW YORK, NY 10007

SCOTT M. STRINGER  
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June 21, 2016

To the Residents of the City of New York:

My office has audited the New York City Department of Finance (DOF) to determine whether DOF accurately calculates Payments in Lieu of Taxes (PILOT) and bills property owners in accordance with the terms of related agreements, and whether DOF ensures that properties with PILOTs that have ended are promptly placed on the City's tax roll. We perform audits of City agencies such as DOF as a means of increasing accountability and ensuring that City resources are used effectively, efficiently and in the best interest of the public.

The audit found that DOF failed to accurately bill a total of \$3.5 million in PILOT-related revenue. Of this amount, DOF underbilled a total of \$1.3 million for four Industrial Development Agency PILOT projects and failed to place the properties of two terminated projects back onto the City tax roll in a timely manner, which resulted in \$478,533 in additional uncollected tax revenue. Further, DOF miscalculated the PILOT for two projects and overbilled those property owners approximately \$1.7 million.

The audit recommends that DOF determine whether the underbilled revenue can be recovered by the City and whether any refunds are due to property owners. The audit also recommends that DOF assess property owners for the portion of land utilized by any subtenants and identify all components of the methodology specified in the project agreements to ensure PILOT calculations are accurate. Finally, the audit recommends that DOF consider utilizing its Property Tax System to perform its PILOT calculations and improve its processes to ensure that all PILOT properties are immediately returned to the City's tax roll when projects' PILOTs expire or are terminated.

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 email my Audit Bureau at [audit@comptroller.nyc.gov](mailto:audit@comptroller.nyc.gov).

Sincerely,

Scott M. Stringer

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# **THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL AUDIT**

## **Audit Report on the Administration of the Payments In Lieu of Taxes Program by the New York City Department of Finance**

**FM15-125A**

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### **EXECUTIVE SUMMARY**

The City of New York offers incentives to induce commercial, industrial and manufacturing businesses to undertake major capital investments that are expected to result in the creation and retention of jobs in New York City. Payments in Lieu of Taxes (PILOT) are a property tax incentive that can be obtained through a project agreement with the City. Under such an agreement, the City exempts property holders from paying real property taxes and instead agrees to accept a set payment (less than the expected real estate tax) for a period of years.

The New York City Department of Finance (DOF) is responsible for calculating PILOTs and issuing bills to property owners pursuant to a 1992 Amended Memorandum of Understanding between the New York City Office of Management and Budget (OMB), the New York City Economic Development Corporation (EDC), the New York City Industrial Development Agency (IDA) and DOF. Currently, DOF manually calculates and bills the PILOT amount due based on the PILOT terms negotiated between IDA and individual project owners.

IDA is empowered by the New York State Industrial Development Act (Article 18A, Title 1 of the New York State General Municipal Law) to provide benefits to induce business owners to remain, establish or expand their businesses in New York City. It provides companies with access to financing or tax benefits to strengthen and diversify the City's tax and employment base, helps businesses locate and expand their operations within New York City, and encourages economic development by retaining jobs and creating new ones.

When a project's PILOT benefit terminates because the property owner opts out or the property owner defaults due to non-compliance with the terms of the agreement, IDA issues a Tax Directive Letter (TDL) notifying DOF of the project benefit's end. The TDL alerts DOF to record the property on the City's property tax roll and reestablish the levy of the real property tax.

### **Audit Findings and Conclusion**

The audit found that DOF failed to accurately bill a total of \$3.5 million in PILOT-related revenue during the period under review. Of this amount, DOF underbilled a total of \$1.3 million for four IDA PILOT projects and failed to place the properties of two terminated projects back onto the

City tax roll in a timely manner, which resulted in \$478,533 in additional uncollected tax revenue. Further, we found that DOF miscalculated the PILOT for two projects and overbilled those property owners approximately \$1.7 million.

## Recommendations

To address these issues, we recommend that DOF:

- Determine whether the four sampled PILOT projects' approximately \$1.3 million in underbilled revenue can be recovered by the City and take all appropriate steps to recover all funds due.
- Determine whether any refunds are due to property owners who were overbilled and take all appropriate steps to notify the property owners of the overbilling.
- As part of its PILOT calculation, assess project owners for the portion of land utilized by any subtenants.
- Review all project agreements to identify and assess all the components of the methodology to ensure PILOT calculations are accurate.
- Consider utilizing its Property Tax System to perform its PILOT calculations.
- Request EDC provide DOF with annual submissions of Subtenant Occupancy Surveys. Then ensure that all PILOT calculations are adjusted accordingly to reflect current subtenant occupancy.
- Improve its processes to ensure that all PILOT properties are immediately returned to the City's tax roll when projects' PILOTs expire or are terminated.

## DOF Response

DOF officials agreed with the findings related to the two terminated PILOTs that were not returned timely to the tax roll, but disagreed with most of the findings related to its inability to consistently apply the correct methodology when calculating PILOTs and stated that EDC officials either explicitly agreed with DOF's calculations at the exit conference or did not object to them. DOF officials also disagreed with the audit finding that Project # 861 was overbilled by \$1.7 million because they claim that DOF has no way of determining if the methodology utilized to compute this figure is correct. In total, of the seven recommendations, DOF agreed with three, partially agreed with two, and disagreed with two.

In objecting to certain audit findings, DOF took issue with our interpretation of certain lease terms, stating that "[t]he Comptroller's Office drew inferences based upon literal translation of lease language, rather than seek clarification with the drafter of the lease(s) and the Law Department." DOF further stated that "[t]he Comptroller's Office did not engage the Economic Development Corporation (EDC) for this audit. . . . [or] the Law Department, the City agency charged with litigating disputes that arise from leases that default due to non-payment of Payments In Lieu of Taxes (PILOT) or violation of other lease terms." In addition, DOF stated that "after review with DOF's legal team, we have determined that the Comptroller's Office went outside the scope of its own audit (which was limited to the period 2010 – 2015), as well as the statute of limitations, to formulate findings and recommendations."

DOF's arguments, however, are belied by the facts of the audit, which are described in detail in this report. Moreover, to the extent that DOF's objections to the audit findings are based on the



notion that the public and the parties cannot rely on the “literal translation of lease language,” they are deeply troubling. The language of the signed agreements between EDC and the lessees that DOF now selectively contends cannot be relied on, is supposed to represent the terms agreed to and binding on the parties. To the extent that DOF comes to believe those terms do not actually reflect the parties’ intentions, it is incumbent on DOF to obtain written documents that clearly set forth the actual terms of the agreements. The PILOT agreements must be based on clear and complete writings in order to ensure transparency, accountability and to protect the City’s interests. If there is a drafting error or a change in the terms of the agreements, those agreements should be amended.

Additionally, DOF’s assertion that the auditors did not consult with EDC in connection with this audit is incorrect. As the primary source of information for the PILOT agreements and related information, EDC was involved in the initial and subsequent audit discussions. In fact, we had numerous meetings with EDC and sent EDC officials copies of both the preliminary draft and draft audit reports. In addition, EDC officials attended the exit conference at which the preliminary draft audit report was discussed.

Further, DOF’s contention that the audit exceeded its stated scope and the statute of limitations reflects a fundamental misunderstanding of the audit process and the Generally Accepted Government Auditing Standards (GAGAS) that govern our work. While the audit was designed to cover Fiscal Years 2011 through 2015, much of the information analyzed from this scope period resulted from decisions and activities that occurred prior to Fiscal Year 2011. Therefore, pursuant to GAGAS, we have appropriately considered relevant information outside the audit scope period where necessary.

# AUDIT REPORT

## Background

The City of New York offers incentives to induce commercial, industrial and manufacturing businesses to undertake major capital investments that are expected to result in the creation and retention of jobs in New York City. In connection with establishing or expanding businesses, property owners can obtain various types of benefits including special financing, property tax incentives, and exemptions from City and State mortgage recording tax, sales and use tax and property tax. PILOT is a property tax incentive that can be obtained through a project agreement with the City, generally in connection with an economic development project.<sup>1</sup> Under such an agreement, the City exempts property holders from paying real property taxes and instead agrees to accept a set payment (less than the expected real estate tax) for a period of years. PILOT payments are generally established at a fixed amount based on the property's real estate taxes the year before entering into the project agreement, or on a formula determined by components set forth within the individual agreement. These components include: the assessed value of the land and building; the assessed value of subsequent building improvements; existing property tax rates; the PILOT commencement and termination dates; subtenant information; building square footage; and an aggregate employment number that may include jobs created by the project or a combination of jobs created and jobs retained as a result of the project.

DOF is responsible for calculating PILOTs and issuing bills to property owners pursuant to a 1992 Amended Memorandum of Understanding between OMB, EDC, IDA, and DOF. Currently, DOF manually calculates and bills the PILOT amount due based on the PILOT terms negotiated between IDA and individual project owners. According to DOF officials, beginning in 2017, DOF will use the Property Tax System<sup>2</sup> to generate PILOT billings but continue to calculate PILOTs manually.

IDA is empowered by the New York State Industrial Development Act (Article 18A, Title 1 of the New York State General Municipal Law) to provide benefits to induce business owners to remain, establish or expand their businesses in New York City. It provides companies with access to financing or tax benefits to strengthen and diversify the City's tax and employment base, helps businesses locate and expand their operations within New York City, and encourages economic development by retaining jobs and creating new ones. IDA contracts with EDC for the management, reporting, and oversight of its programs. In this capacity, EDC collects annual employment and subtenant occupancy information, monitors agreement covenants, and coordinates termination of PILOTs for non-compliant projects and for compliant projects when they opt out.

When a project's PILOT benefit terminates because the property owner opts out or the property owner defaults due to non-compliance with the terms of the agreement, IDA issues a TDL notifying DOF of the project benefit's end. The TDL alerts DOF to record the property on the City's property

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<sup>1</sup> To qualify for a project agreement, the property owner must satisfy three basic requirements. First, the owner must demonstrate a need for the benefit. Second, the owner must make a substantial capital investment that will result in the retention of existing employees and the growth of employment opportunities. Third, the owner must agree to significant commitments, such as to retain/relocate/create jobs and to occupy a specific square footage of newly constructed space for the project term in return for benefits.

<sup>2</sup> The Property Tax System will replace DOF's FairTax system to process and maintain information related to all those who pay business, property and excise taxes (e.g., hotel room occupancy tax), along with parking ticket fines, penalties and judgements.

tax roll and reestablish the levy of the real property tax. During Fiscal Years 2011 through 2015, DOF billed approximately \$260 million for 309 IDA PILOT projects.

## Objectives

The objectives of this audit were to determine whether DOF:

- Accurately calculated PILOTs and billed project owners in accordance with the terms of the related agreements, and
- Ensured that properties with PILOTs that have ended were promptly placed on New York City's property tax roll.

## Scope and Methodology Statement

We conducted this audit in accordance with generally accepted government auditing standards (GAGAS). 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 covered Fiscal Years 2011 through 2015 (July 1, 2010, to June 30, 2015). The section of the report entitled Detailed Scope and Methodology provides a description of the specific procedures and tests that were conducted in connection with this audit.

## Independence Disclosure

In accordance with Article 18A, Title 2, §917 of the New York State General Municipal Law, the Comptroller is 1 of 15 members of the IDA Board. The Comptroller participates on the Board of IDA through a designee. Neither the Comptroller nor his designee were involved in planning or conducting this audit, or in writing or reviewing the audit report.

## 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 officials and was discussed at an exit conference on May 17, 2016. After that meeting, DOF officials provided us with additional information. We reviewed the new information and revised the draft report to reflect any necessary changes. On May 20, 2016, we submitted a draft report to DOF with a request for comments. We received a written response from DOF on June 6, 2016.

DOF agreed with the findings related to the two terminated PILOTs that were not returned timely to the tax roll, but disagreed with most of the findings related to its inability to always apply the correct methodology when calculating PILOT. DOF officials reasoned that EDC officials at the exit conference either explicitly agreed with DOF or never questioned DOF's PILOT calculations. DOF officials also disagreed with our finding that Project # 861 was overbilled by \$1.7 million because they claim that DOF has no way to determine if the methodology we used to calculate this figure is correct. In total, of the seven recommendations, DOF agreed with three, partially agreed with two, and disagreed with two.



In objecting to certain audit findings, DOF took issue with our interpretation of lease language, stating that “[t]he Comptroller’s Office drew inferences based upon literal translation of lease language, rather than seek clarification with the drafter of the lease(s) and the Law Department.” In addition, they claimed that “[t]he Comptroller’s Office did not engage the Economic Development Corporation (EDC) for this audit. . . . [or] the Law Department, the City agency charged with litigating disputes that arise from leases that default due to non-payment of Payments In Lieu of Taxes (PILOT) or violation of other lease terms.” In addition, DOF stated that “after review with DOF’s legal team, we have determined that the Comptroller’s Office went outside the scope of its own audit (which was limited to the period 2010 – 2015), as well as the statute of limitations, to formulate findings and recommendations.”

As discussed in detail below, DOF’s contentions are without merit. Preliminarily, DOF’s claim that the audit should have relied on an unwritten understanding of the PILOT terms rather than the plain language of the written agreements reflects a fundamental flaw in its operations, not a mistake on the part of the auditors. The PILOT agreements must be based on clear and complete writings in order to ensure transparency, accountability and to protect the City’s interests. If there is a drafting error or a change in the terms of the agreements, those agreements should be amended. Further, the audit did take the views of EDC into consideration based on multiple communications between the auditors and EDC officials. EDC officials received copies of the preliminary and draft audit reports and they attended the exit conference, where the preliminary draft findings were discussed. Finally, the scope of the audit report is entirely consistent with GAGAS. We appropriately followed the facts that we found and pursued information outside of the initial scope period where needed to fully, fairly and accurately complete the audit and present our conclusions.

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

## FINDINGS

Although DOF generally billed property owners timely for PILOT payments, it did not always properly calculate the PILOT amounts due. Specifically, our audit found that DOF failed to accurately bill approximately \$3.5 million in PILOT-related revenue during the period under review. Of this amount, DOF underbilled a total of \$1.3 million for four IDA PILOT projects and failed to place two terminated projects back onto the City tax roll in a timely manner, which resulted in \$478,533 in additional uncollected tax revenue. Further, we found that DOF miscalculated the PILOT for two projects and overbilled those property owners approximately \$1.7 million.

These matters are discussed in detail in the following sections of this report.

### DOF Did Not Always Apply the Correct Methodology When Calculating PILOT

DOF failed to correctly calculate PILOT payments for 6 of the 30 IDA projects we sampled; four property owners were underbilled and two property owners were overbilled. These errors resulted from DOF not always applying the correct methodology to calculate the PILOTs. According to the project agreements for each of our sampled projects, property owners pay PILOT for land and buildings based generally on a formula that includes historical and/or current assessed values of the land and buildings, allowable abatements and exemptions, historical and/or current tax rates, subtenant occupancy information, subsequent improvements to the buildings, and employment numbers. However, in our sample, we found that DOF sometimes failed to correctly factor in subtenancies or use the correct assessed values. These findings are discussed in detail below.

#### Four PILOT Projects Were Underbilled Approximately \$1.3 Million

We found that DOF underbilled four PILOT projects in the amount of approximately \$1.3 million as a result of the following billing errors. With regard to Project # 3057, our audit found that DOF applied an incorrect closing date to calculate the stabilized real estate taxes<sup>3</sup> for the building. Based on the amended project agreement, the closing date changed from January 4, 2007, to August 2, 2007. However, DOF did not incorporate the revised closing date into the project's PILOT calculation and instead continued to use the original closing date. This resulted in DOF applying an incorrect tax year rate and assessed values when calculating PILOT for the project's building, resulting in the PILOT being underbilled by \$61,404 for each fiscal year under review. As a result, we found that DOF underbilled Project # 3057 a total of approximately \$553,000 for Fiscal Years 2008 through 2016.

**DOF Response:** “The lease for this PILOT was executed on 1/4/2007. The Lease was amended 8/2/2007. The Comptroller determined that the PILOT should be calculated based on the amended lease date.

The calculation of the PILOT amount was consistent with the interpretation of EDC. We have never been contacted by EDC to indicate that the PILOT amount should be amended. During the course of the audit and at the exit conference, EDC confirmed

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<sup>3</sup> Stabilized real estate taxes (STRET) are a component for calculating the building portion of PILOT. It is defined in the lease agreement as the CRET (current real estate taxes) applicable on the closing date.

that PILOT was accurately computed for this project, and that the effective execution date of the lease was, in fact, 1/4/2007.”

**Auditor Comment:** For Project # 3057’s PILOT calculation, the language of the original and amended agreements specifically refers to the “closing date.” According to the amended project agreement, that “closing date” is expressly stated to be “August 2, 2007.” If the date to be relied on is something *other* than what is in writing, EDC should have made sure that the amended agreement reflected EDC’s intent. Absent that, DOF should have sought clarification in writing from EDC.

In addition, with regard to three of the sampled projects’ agreements (# 1664, # 807 and # 1789), the property owners are required to make additional PILOT payments equal to the full real estate taxes for any portion of the properties that have been subleased. The project agreements also require the property owners to submit an annual subtenant survey that identifies all of the subtenancies in effect at the project locations. DOF must use this survey information as a basis for the PILOT calculation. However, in these three sampled projects, DOF failed to factor in the portion of property used by the project owner’s subtenants. Based on our review, DOF did not utilize annual subtenant surveys to determine subtenant occupancy and make appropriate adjustments to calculate the PILOT and thus did not properly assess the PILOT for those projects.

Specifically, our review of the 2014 annual Subtenant Occupancy Survey submitted to IDA by the property owner of Project # 1664 found that the sub-sublessee occupied 50,000 square feet (41.67 percent of the 120,000 square feet) of the building. However, DOF’s records reflect that DOF did not factor in the sub-sublessee’s use of the property when calculating PILOT due. While the project owner submitted its annual Subtenant Occupancy Survey to IDA, DOF did not ensure that it obtained this information from IDA in order to properly calculate the PILOT payments. Had DOF obtained the Subtenant Occupancy Survey, it likely would have identified the sub-sublessee’s occupancy.<sup>4</sup> Because DOF was unaware of the sub-sublessee’s occupancy, it failed to calculate additional PILOT. As a result, DOF underbilled Project # 1664 approximately \$642,000 for Fiscal Years 2005 through 2016.

**DOF Response:** “The terms of the lease state that additional PILOT in an amount equal to full tax equivalent must be paid by the sub-sublessee. . . . DOF is aware of subtenants and is notified by IDA regarding subtenant occupancy. For the case in question, what the Comptroller’s Office considers a sub-sublessee is actually an affiliate of the lease. During the course of the audit and at the exit conference, EDC confirmed its interpretation that this affiliate should not be subject to subtenant charges. As such, the Comptroller’s Office finding is incorrect.”

**Auditor Comment:** Contrary to DOF and EDC officials’ interpretation and the terms of similar projects, Project # 1664’s agreement does not explicitly state that the project’s affiliate should not be subject to subtenant charges. Again, if EDC intended to have the affiliate also exempt from subtenant charges, it should have made it clear in the agreement, something that EDC has done on other projects. Absent that, DOF should have sought clarification in writing. However, neither of these things was done and, at best, the writing remains ambiguous.

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<sup>4</sup> Due to the sub-sublessee’s use of the project property, the land tax abatement to which the project owner otherwise would be entitled should also be prorated to reflect the land actually used by the project owner. The original abatement of \$18,750 would be reduced by 41.67 percent to reflect a revised land abatement of \$10,937 to account for the portion of the land used by the sub-sublessee.

Similarly, for both Projects # 807 and # 1789, DOF did not factor in the portion of land occupied by the subtenant to correctly determine PILOT due. Rather, we found that while DOF correctly applied the building portion of the subtenant occupancy to its PILOT calculation, it did not apply the corresponding percentage to the land portion to calculate the PILOT.<sup>5</sup> Since DOF did not apply the land portion to its PILOT calculation, it underbilled \$98,000 for both projects combined. Specifically, Project # 807 was underbilled by approximately \$57,000 and Project # 1789 was underbilled by approximately \$41,000.

**DOF Response:** “The terms of these leases state that additional PILOT in an amount equal to full tax equivalent must be paid on land and building for space occupied by a subtenant. However, there was a memo from EDC on January 6, 2011 (please see attached) which clarified its interpretation with respect to the applicability of subtenant PILOT. In this memo, it states that ‘*Based upon the sublet percentage, NYCDOF calculates a pro-rated increase in the PILOT payable for the project improvements.*’ DOF interpreted that it was EDC’s intent, based on this memo, that additional PILOT for subtenants be imposed only on the improvements (building) and not on land. However, we are now being informed by EDC that subtenant PILOT should have been imposed on land and building. We are requesting that EDC provide us with written clarification as to how subtenant PILOT should be calculated.”

**Auditor Comment:** We are glad that EDC agrees with our finding that subtenant PILOT should have been imposed on land and building and that in this case DOF is seeking a writing from EDC for clarification.

## Two PILOT Projects Were Overbilled Approximately \$1.7 Million

In calculating the PILOT amount due for Project # 861, we found that DOF failed to apply the proper methodology and correct assessed values involving two combined properties as reported in DOF’s FairTax system, and did not use the correct square footage applicable to the project property. Consequently, we found that DOF overbilled Project # 861 approximately \$1.7 million for Fiscal Years 2003 through 2016. Because PILOT calculations are not automated, but rather are manually calculated, it is more likely that the calculation could fail to include a second related property. However, were DOF to automate its PILOT calculations, the system can be programmed to retrieve the combined assessed values prior to the merge of the two properties and flag any PILOT calculation-related information to be updated.

**DOF Response:** “Section 1.17 of the Government Auditing Standards states that auditors should communicate with auditees in a constructive manner. This is not what happened. Of major concern is the fact that this finding was not disclosed to DOF at the exit conference. Further, in its draft report, the Comptroller’s Office does not explain its methodology of how they arrived at the approximately \$1.7 million overbilling. In an attempt to understand how the Comptroller’s Office arrived at the approximately \$1.7 million overbilling, DOF invited the auditors to two meetings on 5/17/2016 and 5/18/2016. The auditors accepted but did not attend the two meetings.”

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<sup>5</sup> Due to the subtenant’s use of the project property, the land tax abatement to which the project owner would be entitled should also be prorated to reflect the land actually used by the project owner.

**Auditor Comment:** DOF's response misstates the facts. Contrary to DOF's assertions that the auditors refused to meet with DOF officials and explain their calculations, the auditors met with DOF about this finding and explained their basis for the calculations. Specifically, in the preliminary draft report, and later, at the exit conference held on May 17, 2016, where the preliminary draft was discussed, DOF was informed of the finding. At that time, it was mutually agreed that the auditors would have a separate meeting with DOF officials to discuss the PILOT calculation for Project # 861 due to its complexity. Immediately following the exit conference, we met with two DOF officials for over an hour to discuss the information contained in the spreadsheets that we provided at the exit conference and the basis for our calculations. Thereafter, DOF officials recalculated the PILOT amount using its own spreadsheet, but in doing so, failed to include the terms of two major Exhibits of the PILOT agreement. On May 18, 2016, we informed DOF officials that the spreadsheet they prepared contained calculation errors and subsequently scheduled a meeting to discuss this on May 19, 2016, at DOF's office. However, on the morning of May 19, 2016, we contacted DOF's Director of Internal Audit and requested that the meeting be rescheduled and held at our office. In response, DOF's Director of Internal Audit stated, "We will wait for the draft report." DOF did not contact us thereafter.

In addition, we found that in determining the PILOT amount due for Project # 2701, DOF failed to apply the correct land tax abatement, which pursuant to an annual land tax abatement was \$15,500. However, our review of DOF's records indicated that DOF only applied an abatement of \$15,000, and thereby overbilled \$5,000 in total for 2007 through 2016. In addition, DOF did not apply the correct land assessed values for Fiscal Year 2016, which led to an underbilled Land PILOT of \$173. Overall, DOF overbilled Project # 2701 approximately \$4,800 for Fiscal Years 2007 through 2016. At the exit conference, DOF officials confirmed that Project # 2701 was credited for the amount overpaid.

**DOF Response:** "This issue was brought to DOF's attention during the audit and was immediately corrected. We made the correction for the six years under the statute of limitations. The Comptroller's Office draft report confirms that the overpayment was credited."

## DOF Did Not Return Projects to Tax Roll Timely

DOF failed to return two project properties to the City tax roll upon termination from the PILOT program, which resulted in uncollected revenue of \$478,533. We determined these errors through a review of 75 expired or terminated IDA PILOT projects.<sup>6</sup> According to the applicable project agreements, upon project termination dates, IDA is supposed to issue a Tax Directive Letter (TDL) notifying DOF of the project's close. After the TDL is issued, DOF is supposed to return the properties to the City tax roll in a timely manner.

We found, however, that DOF did not always ensure that PILOT properties were promptly returned to the City tax roll. In the case of Project # 2988, we found that the project was terminated from the PILOT on August 8, 2014, at which time DOF stopped billing for the PILOT. However, it did

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<sup>6</sup> Based on our reconciliation of the expired/terminated project lists provided, there were 74 expired/terminated projects during our audit scope. However, our review of a current list of properties under IDA PILOT exemption identified one additional project that was outside the scope of this audit that had not been returned to the tax roll. We provided this information to DOF in the course of the audit.



not begin to bill the owner regular taxes until November 2015, a gap of more than a year. As a result, DOF failed to collect \$410,072 in tax.

We also found in connection with Project # 2585 that although DOF attempted to place the property back on the tax roll after the project terminated, its FairTax system never processed the information that would allow it to revert the property's tax status.

As a result, DOF failed to collect a total of \$478,533 in regular tax revenue. Upon bringing this issue to DOF's attention in November 2015, DOF initiated a billing process to collect the \$478,533 from the two property owners. Based on DOF's billing records, the two property owners paid their respective bills in December 2015 and January 2016.

**DOF Response:** "As stated in the Comptroller's report, these issues were brought to DOF's attention during the audit and were immediately corrected."

# RECOMMENDATIONS

DOF should:

1. Determine whether the four sampled PILOT projects' approximately \$1.3 million in underbilled revenue can be recovered by the City and take all appropriate steps to recover all funds due.

**DOF Response:** "DOF disagrees. DOF demonstrated at the exit conference, and further demonstrates with the attached memo, that it computed each of the four PILOTs correctly. EDC verified at the exit conference that DOF computed each of the PILOTs in a manner consistent with the policies and interpretations that EDC had previously transmitted to DOF regarding the calculation of PILOTs. DOF will work with EDC to obtain written instructions as to how subtenant PILOT should be calculated."

**Auditor Comment:** We are pleased that DOF will seek written clarification of the language in the project agreement. We urge the parties to amend their agreements to accurately reflect their understandings.

2. Determine whether any refunds are due to property owners who were overbilled and take all appropriate steps to notify the property owners of the overbilling.

**DOF Response:** "DOF partially agrees. We disagree with the Comptroller's statement that there was '**approximately**' \$1.7 million in overbilling. Nowhere in its report does the Comptroller's Office explain how it arrived at the '**approximately**' \$1.7 million in overbilling. The Comptroller's Office did provide a hardcopy of a spreadsheet at the exit conference, but the amount that the Comptroller's Office indicated at that time **was** '**estimated**' to be \$682,389 in overpayments. DOF has no way of determining if the Comptroller's methodology is correct, both because it does not provide its methodology used to arrive at either of the figures and because it cannot with certainty define the amount of the alleged overbilling.

However, we do agree that DOF overbilled \$500 per year for a period of ten years, which totals \$5,000. We made the correction for the six years under the statute of limitations and the Comptroller's Office draft report confirms that the overpayment was credited."

**Auditor Comment:** We revised the overbilling amount based on the information provided by DOF at a meeting held after the exit conference. We are always available to provide DOF officials with any further information they now seek concerning the methodology we utilized to calculate the \$1.7 million we estimated was overbilled.

3. As part of its PILOT calculation, assess project owners for the portion of land utilized by any subtenants.

**DOF Response:** "DOF disagrees. The Comptroller's Office is incorrect in describing that this is a calculation error by DOF. There was a memo from EDC on January 6, 2011 (please see attached), which clarified its interpretation with respect to the applicability of subtenant PILOT. In this memo, it states that '*Based upon the sublet percentage, NYCDOF calculates a pro-rated increase in the PILOT payable for the project improvements.*' At the exit conference, EDC verified that DOF is not supposed to assess subtenant PILOT on project owners

for a portion of the land utilized by any subtenants. This was explained to the auditors during the course of the audit and confirmed by EDC at the exit conference. DOF verified in these cases that no subtenant PILOT was due on the land portion. EDC again verified this at the exit conference. DOF will work with EDC to obtain written instructions as to how subtenant PILOT should be calculated.”

**Auditor Comment:** As discussed in the Findings section of this report, EDC ultimately agreed with the audit that “subtenant PILOT should have been imposed on land and building” based on the lease language. DOF should seek written guidance from EDC officials or to have the agreements amended to the extent they find any parts ambiguous.

4. Review all project agreements to identify and assess all the components of the methodology to ensure PILOT calculations are accurate.

**DOF Response:** “DOF agrees. This has been standard practice for over six years, and is done every semiannual period when a PILOT is calculated.”

5. Consider utilizing its Property Tax System to perform its PILOT calculations.

**DOF Response:** “DOF agrees. DOF is already planning to extract assessed values from PTS [Property Tax System], and PTS will generate PILOT bills.”

6. Request EDC provide DOF with annual submissions of Subtenant Occupancy Surveys. Then ensure that all PILOT calculations are adjusted accordingly to reflect current subtenant occupancy.

**DOF Response:** “DOF partially agrees. At the exit conference, EDC and DOF explained that the current process actually identifies sublessee changes in real time, not months after the fact. Relying on annual Subtenant Occupancy Surveys alone would significantly delay the implementation of sublessee tenant changes with regard to PILOT billing.”

**Auditor Comment:** We appreciate EDC and DOF’s stated intention of real-time processing in order to identify subtenants for more accurate calculations of PILOT amounts due. However, as stated in the agreements, the Subtenant Occupancy Survey is part of the required documentation for the determination of the PILOT calculation. We continue to recommend that DOF consider the importance of this PILOT calculation requirement.

7. Improve its processes to ensure that all PILOT properties are immediately returned to the City’s tax roll when projects’ PILOTs expire or are terminated.

**DOF Response:** “DOF agrees. We already perform this function on an annual basis. The Comptroller’s auditors discovered the terminated PILOT between annual reviews. This would have been discovered by DOF during its normal annual cycle.”

**Auditor Comment:** We are glad that DOF agrees with this recommendation. Although DOF stated that it has been performing this function, due to the fact that one of the two terminated projects was not timely put back to the tax roll for 15 months, DOF needs to reassess its annual reviews to ensure all terminated PILOT properties are properly identified and timely put back on the tax roll.

## DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with GAGAS. 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 covers Fiscal Years 2011 through 2015 (July 1, 2010, to June 30, 2015). To achieve our audit objectives, we reviewed the Amended Memorandum of Understanding as of July 1, 1992, among IDA, EDC, DOF and OMB, Article 18-A of the General Municipal Law: “The New York State Industrial Development Act,” and other relevant rules and regulations applicable to the administration of the PILOT program.

To obtain an understanding of DOF’s roles and responsibilities for administering the PILOT program, we conducted walkthroughs with DOF officials including walkthroughs of DOF’s FairTax system. In addition, we obtained and reviewed DOF’s written policies and procedures and flowchart, and reviewed the 2010 PILOT Billing Assessment report prepared by a CPA firm, to obtain a better understanding of DOF’s PILOT calculation and billing practices. To obtain an understanding of EDC’s management of the PILOT program, including the application, approval and monitoring processes of IDA PILOT projects, we conducted walkthroughs with EDC officials. We documented our understanding of DOF’s and EDC’s processes of the PILOT program through memoranda and flowcharts.

To ascertain the total number of active and expired/terminated IDA PILOT projects during our scope period, we reconciled the lists of IDA PILOT projects independently provided by DOF and EDC. We then compared those two lists with data reported on the Public Authorities Reporting Information System from the New York State Office of the Comptroller for Fiscal Years 2010 through 2014 for accuracy.

For our review, we randomly sampled 30 (24 active and 6 expired/terminated) IDA PILOT projects, representing 10 percent of the 309 (235 active and 74 expired/terminated) IDA PILOTs during our scope period. For each of the items in our sample, we reviewed the PILOT-related documentation and recalculated PILOT amounts to determine whether DOF accurately billed PILOTs and that the billings were issued accurately and in a timely manner. Specifically, we obtained and reviewed the project agreements and their amendments, TDLs, historical assessed values of land, building and subsequent improvements from DOF’s FairTax system, DOF’s Notices of Calculation and PILOT billing records. To facilitate our PILOT recalculations, we also reviewed the submissions from projects, such as Subtenant Occupancy Surveys and Employment and Benefits Reports, as required by the project agreements. We developed methodology for recalculating PILOT payments based on the criteria stipulated in the agreements. We then recalculated the PILOT amounts for the latest active full-year for each sampled project and compared the resulting amounts to those on DOF’s Notices of Calculation and billing records for accuracy and consistency. For the projects that had calculation errors, we expanded our review to ascertain the PILOT calculation errors from the earliest fiscal periods provided in DOF’s records.

To determine whether expired or terminated IDA PILOTs were placed onto the City’s tax rolls in a timely manner, we requested TDLs and other related documents for 74 IDA PILOTs that expired or terminated during our audit scope period. We reviewed the termination documents to determine the date properties should be restored to the City’s property tax roll. We also reviewed

current information from DOF's FairTax system to identify whether any PILOT exemptions were maintained past their termination dates. As a result of this comparison, we identified one additional project that was outside the scope of this audit that had not been returned to the tax roll. We also obtained DOF's partial year calculation spreadsheets for IDA PILOTs terminated before the fiscal year-end and recomputed the amounts to determine whether DOF accurately calculated regular real estate taxes due for the interim periods. In addition, we reviewed DOF's billing records to determine whether the partial year tax amounts were properly billed to the property owners.

The results of the above tests, in conjunction with our other audit procedures, while not projected to the respective populations from which the samples were drawn, provided a reasonable basis to satisfy our audit objectives.





City of New York  
Department of Finance  
Nyc.gov/finance

Jacques Jiha, Ph.D.  
Finance Commissioner

1 Centre Street  
5<sup>th</sup> Floor  
New York, NY 10007

212-602-7018 tel  
212-669-2275 fax

June 6, 2016

Ms. Marjorie Landa  
Deputy Comptroller for Audit  
Office of the City Comptroller  
1 Centre Street, Room 1100 North  
New York, NY 10007

**Re: Audit Report on the Administration of the Payments In Lieu of Taxes Program  
by the New York City Department of Finance (FM15-125A)**

Dear Deputy Comptroller Landa:

The Department of Finance (DOF) hereby provides its response to the draft "*Audit Report on the Administration of the Payments In Lieu of Taxes Program by the New York City Department of Finance*"- FM15-125A (Draft Report) by the New York City Comptroller (the Comptroller) provided to DOF on May 20, 2016.

**Introduction**

We have reviewed the Draft Report's primary findings. The Comptroller's Office drew inferences based upon literal translation of lease language, rather than seek clarification with the drafter of the lease(s) and the Law Department.

The Comptroller's Office did not engage the Economic Development Corporation (EDC) for this audit. EDC is the entity which drafts the majority of leases, which by their terms provide for PILOT obligations. As a general rule DOF administers the PILOT program in conformity with the intentions of EDC in drafting the leases. During the exit conference, EDC indicated that many of the issues raised by the Comptroller's Office disregarded EDC policy and procedures for the PILOTs in question. Further, the Comptroller's Office did not engage the Law Department, the City agency charged with litigating disputes that arise from leases that default due to non-payment of Payments In

Lieu of Taxes (PILOT) or violation of other lease terms. Finally, after review with DOF's legal team, we have determined that the Comptroller's Office went outside the scope of its own audit (which was limited to the period 2010 – 2015), as well as the statute of limitations, to formulate findings and recommendations.

### **Background**

Manufacturing, industrial, and not-for-profit companies may receive property tax incentives through agreements with government agencies. The two City agencies that issue the majority of these agreements are the NYC Industrial Development Agency (IDA) and the NYC Economic Development Corporation (EDC). Through these agreements, properties are exempt from property taxes and instead make a Payment in Lieu of Taxes (PILOT).

A PILOT payment may be negotiated in specific circumstances, such as when an arrangement is made for a corporation or institution to build a facility on public land without the entity assuming ownership of the land. Whereas the underlying property is exempt because of government ownership, a PILOT Agreement is made to compensate the local government for some or all of the tax revenue that it loses because of the exemption.

In Fiscal Year 2015, the Department of Finance billed \$135 million for PILOT payments. This resulted in savings to PILOT payers of \$233 million.

The Draft Report contains three specific findings:

- Four PILOTs were underbilled
- Two PILOTs were overbilled
- Two terminated PILOTs were not returned to the tax rolls

### **Analysis of Findings**

- **Four PILOTs were underbilled**

- (3057) - Incorrect Closing Date**

The lease for this PILOT was executed on 1/4/2007. The Lease was amended 8/2/2007. The Comptroller determined that the PILOT should be calculated based on the amended lease date.

The calculation of the PILOT amount was consistent with the interpretation of EDC. We have never been contacted by EDC to indicate that the PILOT amount should be amended. During the course of the audit and at the exit conference, EDC confirmed

that PILOT was accurately computed for this project, and that the effective execution date of the lease was, in fact, 1/4/2007.

(1664) - Unreported sub-sublessee

The terms of the lease state that additional PILOT in an amount equal to full tax equivalent must be paid by the sub-sublessee. The Comptroller's Office indicates that DOF should have reviewed the Subtenant Occupancy Survey; if we had, we would have been alerted to the fact of the sub-sublessee.

DOF is aware of subtenants and is notified by IDA regarding subtenant occupancy. For the case in question, what the Comptroller's Office considers a sub-sublessee is actually an affiliate of the lease. During the course of the audit and at the exit conference, EDC confirmed its interpretation that this affiliate should not be subject to subtenant charges. As such, the Comptroller's Office finding is incorrect.

(807) - Subtenant Charged on Building Only

(1789) - Subtenant Charged on Building Only

The terms of these leases state that additional PILOT in an amount equal to full tax equivalent must be paid on land and building for space occupied by a subtenant. However, there was a memo from EDC on January 6, 2011 (please see attached) which clarified its interpretation with respect to the applicability of subtenant PILOT. In this memo, it states that *"Based upon the sublet percentage, NYCDOF calculates a pro-rated increase in the PILOT payable for the project improvements."* DOF interpreted that it was EDC's intent, based on this memo, that additional PILOT for subtenants be imposed only on the improvements (building) and not on land. However, we are now being informed by EDC that subtenant PILOT should have been imposed on land and building. We are requesting that EDC provide us with written clarification as to how subtenant PILOT should be calculated.

• **Two PILOTs were overbilled**

(861) - Assessed Value/Square Footage

In the draft report, the Comptroller states *"In calculating the PILOT amount due for Project # 861, we found that DOF failed to apply the proper methodology and correct assessed value involving two combined properties as reported in DOF's FairTax system, and did not use the correct square footage applicable to the project property."*

*Consequently, we found that DOF overbilled Project# 861 approximately \$1.7 million for Fiscal Years 2003 through 2016."*

Section 1.17 of the Government Auditing Standards states that auditors should communicate with auditees in a constructive manner. This is not what happened. Of major concern is the fact that this finding was not disclosed to DOF at the exit conference. Further, in its draft report, the Comptroller's Office does not explain its methodology of how they arrived at the approximately \$1.7 million overbilling. In an attempt to understand how the Comptroller's Office arrived at the approximately \$1.7 million overbilling, DOF invited the auditors to two meetings on 5/17/2016 and 5/18/2016. The auditors accepted but did not attend the two meetings.

(2701) - Incorrect Land Tax Abatement

The lease states that the annual land tax abatement is \$15,500. We had only granted \$15,000 annually. This issue was brought to DOF's attention during the audit and was immediately corrected. We made the correction for the six years under the statute of limitations. The Comptroller's Office draft report confirms that the overpayment was credited.

- **Two terminated PILOTs were not returned to the tax rolls**

(2988) - Terminated 8/8/14

(2585) - Terminated 7/17/15

As stated in the Comptroller's report, these issues were brought to DOF's attention during the audit and were immediately corrected.

**DOF RESPONSES TO RECOMMENDATIONS:**

1. DOF should determine whether the four sampled PILOT projects' approximately \$1.3 million in underbilled revenue can be recovered by the City and take all appropriate steps to recover all funds due.

DOF disagrees. DOF demonstrated at the exit conference, and further demonstrates with the attached memo, that it computed each of the four PILOTs correctly. EDC verified at the exit conference that DOF computed each of the PILOTs in a manner consistent with the policies and interpretations that EDC had previously transmitted to DOF regarding the calculation of PILOTs. DOF will work with EDC to obtain written instructions as to how subtenant PILOT should be calculated.

2. DOF should determine whether any refunds are due to property owners that were overbilled and take all appropriate steps to notify the property owners of the overbilling.

DOF partially agrees. We disagree with the Comptroller's statement that there was "**approximately**" \$1.7 million in overbilling. Nowhere in its report does the Comptroller's Office explain how it arrived at the "**approximately**" \$1.7 million in overbilling. The Comptroller's Office did provide a hardcopy of a spreadsheet at the exit conference, but the amount that the Comptroller's Office indicated at that time **was "estimated"** to be \$682,389 in overpayments. DOF has no way of determining if the Comptroller's methodology is correct, both because it does not provide its methodology used to arrive at either of the figures and because it cannot with certainty define the amount of the alleged overbilling.

However, we do agree that DOF overbilled \$500 per year for a period of ten years, which totals \$5,000. We made the correction for the six years under the statute of limitations and the Comptroller's Office draft report confirms that the overpayment was credited.

3. As part of its PILOT calculation, DOF should assess project owners for the portion of land utilized by any subtenants.

DOF disagrees. The Comptroller's Office is incorrect in describing that this is a calculation error by DOF. There was a memo from EDC on January 6, 2011 (please see attached), which clarified its interpretation with respect to the applicability of subtenant PILOT. In this memo, it states that "*Based upon the sublet percentage, NYCDOF calculates a pro-rated increase in the PILOT payable for the project improvements.*" At the exit conference, EDC verified that DOF is not supposed to assess subtenant PILOT on project owners for a portion of the land utilized by any subtenants. This was explained to the auditors during the course of the audit and confirmed by EDC at the exit conference. DOF verified in these cases that no subtenant PILOT was due on the land portion. EDC again verified this at the exit conference. DOF will work with EDC to obtain written instructions as to how subtenant PILOT should be calculated.

4. DOF should review all project agreements to identify and assess all the components of the methodology to ensure PILOT calculations are accurate.

DOF agrees. This has been standard practice for over six years, and is done every semiannual period when a PILOT is calculated.



5. DOF should consider utilizing its Property Tax System to perform its PILOT calculations.

DOF agrees. DOF is already planning to extract assessed values from PTS, and PTS will generate PILOT bills.

6. DOF should request EDC provide DOF with annual submissions of Subtenant Occupancy Surveys. Then ensure that all PILOT calculations are adjusted accordingly to reflect current subtenant occupancy.

DOF partially agrees. At the exit conference, EDC and DOF explained that the current process actually identifies sublessee changes in real time, not months after the fact. Relying on annual Subtenant Occupancy Surveys alone would significantly delay the implementation of sublessee tenant changes with regard to PILOT billing.

7. DOF should improve its processes to ensure that all PILOT properties are immediately returned to the City's tax roll when projects' PILOTs expire or are terminated.

DOF agrees. We already perform this function on an annual basis. The Comptroller's auditors discovered the terminated PILOT between annual reviews. This would have been discovered by DOF during its normal annual cycle.

Sincerely,



Pierre Dejean, Assistant Commissioner

C: Michael Hyman, First Deputy Commissioner  
Timothy Sheares, Deputy Commissioner  
Sam Mayer, Senior Director, Internal Audit  
John Ravalli, Deputy Director, Government Exemptions



## PILOT MEMORANDUM

To: John Ravalli  
New York City Department of Finance ("NYCDOF")

From: Howard Spieler  
New York City Economic Development Corporation ("NYCEDC")  
o/b/o New York City Industrial Development Agency ("NYCIDA")

Subject: Subtenant Occupancy Percentage for Purposes of Calculating PILOT

Date: January 6, 2011

CC: Krista Halpin, Ashley York-Kurtz, Andrea Margulies, Leslie Zimmerman

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As you know, NYCEDC (on behalf of NYCIDA) receives annual subtenant surveys from NYCIDA project companies (generally due each February 1). Project companies certify on these surveys the number of square feet that they sublet to tenants at the project facilities (other than for subleases to project operating companies).

As a consequence of this reporting, the following occurs:

- For each project facility, NYCEDC provides the sublet square footage amount to NYCDOF.
- NYCDOF calculates the per cent of the entire project facility that is subleased using, as the denominator, the square footage for the project facility as provided in NYCDOF's RPAD database.
- Based upon the sublet percentage, NYCDOF calculates a pro-rated increase in the PILOT payable for the project improvements.

Going forward, NYCEDC would like to modify this procedure as follows:

- NYCEDC will calculate the sublet percentage for each project facility and will provide the percentage to NYCDOF.
- To arrive at this percentage, NYCEDC will use, as the denominator, the square footage of each project facility as certified to NYCEDC by the project company.
- NYCDOF will use these sublet percentages (as provided by NYCEDC) to calculate the required pro-rated increases in PILOT.

In short, going forward, NYCEDC will use for both numerator and denominator the square footage numbers that have been certified to NYCIDA on subtenant surveys. NYCEDC will not use the RPAD number for the denominator.