AUDIT REPORT

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

Audit Report on Granting of Tax Abatements by the Department of Finance under the Industrial and Commercial Incentive Program

FR03-169A

June 3, 2005

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:

Pursuant to Chapter 5, Section 93 of the New York City Charter, we have examined whether the Department of Finance is properly granting tax abatement benefits to property owners under the Industrial and Commercial Incentive Program. The results of our audit, which are presented in this report, have been discussed with agency officials, and their comments have been considered in preparing this report.

Audits such as this provide a means of ensuring that tax abatement programs are being administered in accordance with applicable laws and regulations.

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

Very truly yours,

William C. Thompson, Jr.

WCT/gr

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Table of Contents

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AUDIT REPORT IN BRIEF

We performed an audit on the granting of tax abatements by the Department of Finance (Department) under the Industrial and Commercial Incentive Program. The program was created by Local Law 71 on November 5, 1984, as authorized by the New York State Real Property Tax Law (Title 2-D). Under the program, the Department offers property tax exemptions and abatements to qualified property owners. A tax exemption is a reduction in the assessed value of a property; an abatement is a credit against the tax due. According to the Rules of the City of New York (Rules), to obtain an exemption or abatement, applicants must perform eligible construction work by making permanent capital improvements that create or enhance the value of a property. In addition, applicants must, within specific time periods, make a "minimum required expenditure" in carrying out the eligible improvements.

Audit Findings and Conclusions

The Department improperly granted tax abatements to owners of 128 properties. These abatements were granted even though the work on which they were predicated did not merit a tax exemption, and the improvements made to these properties did not result in physical increases to the properties' assessed values. As a result of granting these abatements, the Department did not collect $8,063,047 in taxes on these properties for Tax Years 1996/1997 to 2003/2004. Moreover, since the abatements granted under this program extend over a 12-year period, the Department will forgo approximately $5,717,831 in additional property taxes on the properties in future years.[1]

Our review of file documentation for the 128 properties that received abatements indicated that in seven cases, there was no evidence that work was performed at all. In another 68 of these cases, notwithstanding the fact that the properties' assessed values did not increase,

[1]Department officials stated that property owners are required to submit annual financial statements of reported net income. The amount of net income could affect a property's assessed value, thereby reducing or increasing the amount of property taxes.

the Department granted abatements for repair or replacement work even though the Rules provide that "ordinary repairs, replacements, or redecoration" do not qualify for abatements. In addition, our review indicated that 36 of the 128 cases that received abatements involved various upgrades to the properties that in our opinion fall short of the Rules requirement of a "substantial renovation." In contrast to the above-mentioned 75 cases for which work was for repairs or replacements or was not done, the files for these 36 cases did not indicate that the work involved repairs or replacements, nor did they contain evidence that substantial renovation work was performed. For the remaining 17 cases that had no increase in assessed value, the file documentation was insufficient for us to accurately evaluate the nature of the work involved.

The Department was unable to provide written policies or guidelines documenting its reasons for considering these types of projects to be eligible for abatements in contradiction of the Rules that govern the program. Department officials told us that its informal policy, based on its interpretation of the legislation, was to grant abatements to applicants who spend the equivalent of the required 25 percent minimum required expenditure for work that is a permanent, capital improvement with a useful life of at least three years, even if the property's assessed value is not increased. However, the Department's disregard of the current Rules governing the program along with its failure to promulgate new Rules or other publicly available standards for evaluating work before granting abatements leaves the program susceptible to fraud and abuse.

Audit Recommendations

This report makes a total of four recommendations, as follows:

The Department should:

- Immediately discontinue its practice of granting tax abatements to properties for which improvement work is only "ordinary repairs, replacement or redecoration" or does not include a substantial renovation, and does not increase their assessed values.

- Review and reconcile Department records to identify which properties received abatements without achieving an increase in assessed value. For those properties that are not entitled to abatements, the Department should revoke the incorrectly granted abatement benefits and recoup the improperly abated taxes.

- Assign appropriate personnel to review and analyze work descriptions in applications to determine whether the work is indeed eligible for program benefits.

- Prepare and adopt formal written policies and guidelines for granting abatements that conform to program Rules.

INTRODUCTION

Background

The Department of Finance (Department) administers and enforces the tax laws; collects taxes, judgments, and other charges; educates the public about its rights and responsibilities with regard to taxes and tax benefit programs in order to achieve the highest level of voluntary compliance; provides service to the public by assisting in customer problem resolution; and protects the confidentiality of tax returns. The Department processes parking summonses and provides an adjudicative forum for motorists who wish to contest them. The Department also provides collection enforcement services for court-ordered private and public sector debt.

The Department offers property tax exemptions and abatements to qualified property owners under the Industrial and Commercial Incentive Program (program). The program was created by Local Law 71 on November 5, 1984, as authorized by the New York State Real Property Tax Law (Title 2-D). The program initially offered solely tax exemptions for capital improvements made by qualified owners of industrial and commercial properties. However, the legislation was amended in 1995 to also include tax abatements for industrial properties.

In Fiscal Year 2003, the program provided $248 million in real estate tax exemptions and abatements to owners of industrial or commercial buildings. A tax exemption is a reduction in the assessed value of a property; an abatement is a credit against the tax due. Exemptions are granted on a sliding scale for periods of up to 25 years, based on the type and location of the improvement. Abatements are also granted on a sliding scale, but for a maximum period of 12 years.

According to Chapter 14, Title 19, of the Rules of the City of New York (Rules), to obtain an exemption or abatement, applicants must perform eligible construction work by making permanent capital improvements that create or enhance the value of a property. In addition, applicants must, within specific time periods, make a "minimum required expenditure" on the eligible improvements. The minimum required expenditure is a percentage of a property's assessed value before improvement. For industrial projects the minimum required expenditure is 10 percent for exemptions, and 25 percent for abatements.

Participation in the program requires an applicant to file two separate applications with the Department's Exemptions Unit—a preliminary application before obtaining a building permit or before commencing construction if no permit is required, and a final application within 30 days of beginning construction. The Exemptions Unit typically reviews the preliminary application within 20 days of receipt and determines whether the applicant is eligible to participate in the program. If the applicant is deemed eligible by the Exemptions Unit, assessors of the Property Tax Unit are to conduct a preliminary inspection of the property within 10 days to verify its existing physical condition and confirm that improvement work has not started. Fifteen days before beginning construction, applicants must notify the Exemptions Unit in writing of the starting date. The applicant then files a final application within 30 days after starting construction. After the Exemptions Unit receives and reviews an applicant's final

application and deems it satisfactory, the Department issues a preliminary certificate-of-eligibility.

While construction of projects costing more than $1 million are under way, the applicants must file biannual interim construction reports with the Department. All applicants must submit documentation to substantiate that the minimum required expenditure has been met. Department assessors conduct annual inspections of a property to determine whether the property's assessed value has increased. These inspections must be completed by January 5. Within 15 days of the completion of the improvements, an applicant must notify the Department of the completion and must submit a final construction report within 60 days of completion. Once an applicant has completed these steps, the Department issues a final certificate-of-eligibility, which is recorded in the *City Register*. However, according to §14-10 of the Rules, for an applicant to in fact receive an exemption or an abatement, the eligible construction work must enhance the value of the property.

To obtain benefits in successive years, applicants must file annual certificates-of-continuing-use with the Department.

Objectives

Our audit objectives were to determine:

- whether the Department properly reviews and approves applications for program exemptions and abatements;
- whether the program is administered to ensure that applicants remain eligible for program benefits; and
- whether exemptions and abatements are properly calculated.

However, during fieldwork we determined that one issue—the granting of abatements—one part of the foregoing objectives—was so significant as to warrant issuance of a report devoted solely to that subject. A separate report will be issued to cover the other issues related to our audit objectives.

Scope and Methodology

The scope of this audit report covered all properties that were receiving exemptions and/or abatements in February 2004.

We reviewed:

- Applicable provisions of **§489 of the New York State Real Property Tax Law**,

- The **Rules (in particular §14-10),** and

- **Department policies and procedures**.

We interviewed Department officials to obtain an understanding of the process for granting abatements to program applicants. We documented our understanding of this process in flowcharts and written narratives. In addition, we consulted the Comptroller's General Counsel to obtain a legal opinion on the requirements for granting abatements outlined in the legislation and Rules.

We obtained electronic files from the Department. These files contained a list of approved applications for all properties that were receiving exemptions and/or abatements as of February 2004. We sorted the application data as follows: properties receiving both exemptions and abatements, properties receiving exemptions only, and properties receiving abatements only. The Department refers to properties that are receiving only abatements as properties with "zero dollar" exemptions. The abatements-only file contained records for applications associated with 146 properties. Further examination indicated that 11 of the 146 properties were tax exempt and had never received an abatement.

We then reviewed information from the Department's mainframe database to determine whether the remaining 135 properties (i.e., 146 less 11) received "zero dollar" tax exemptions in their first benefit year. According to Department officials, "zero dollar" tax exemptions in the first benefit year would indicate that the improvements made did not result in a "physical" increase to the properties' assessed values. A "physical" increase is one that results from the physical enhancement of a property. Our review determined that there was no physical increase in the assessed values of 128 of the 135 properties.

We reviewed file documentation for the applications associated with the 128 properties that did not show a physical increase in assessed value. We checked narratives and work descriptions to determine whether improvements were eligible, and whether the minimum required expenditures were met.

The Department provided records indicating the biannual abatement amounts for each of the properties. Based on this information, we calculated the amount of taxes abated for the properties associated with the applications from the date the abatement was granted through Tax Year 2003/2004 (July 1, 2002, through June 30, 2003). We also calculated the amount of future abatements that these properties would receive based on the properties' remaining in the program for the balance of the 12-year abatement period. We used the assessed value of the properties for the current Tax Year 2003/2004 as a basis for our calculations of future abatements.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. This 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 Department officials during and at the conclusion of this audit. A preliminary draft report was sent to Department officials and discussed at an exit conference held on August 19, 2004. On September 9, 2004, we submitted a draft report to Department officials with a request for comments. We received written comments from the Department on September 28, 2004.

In their response, Department officials stated that the Department "strongly disagrees with the Report's findings, recommendations and conclusions," and finds the report "misleading and unhelpful." Specifically, the Department disagreed with the report's "premise that the granting of abatements on properties that did not qualify for a tax exemption was improper." The Department also claimed that "the entire Report is based on the misapplication of exemption program rules to the abatement program and, more generally, a lack of understanding of the abatement program."

The Department disagreed with three of the report's four recommendations. It agreed with the recommendation to prepare and adopt formal written policies and guidelines for granting abatements.

We find the Department's response without merit. Contrary to the Department's response, the existing Industrial and Commercial Incentive Program Rules are directly applicable to the statutory requirements for both abatements and exemptions. In addition, the Department has failed to adopt new Rules, and has not developed any other written policies, procedures, or guidelines for the abatement benefit. Finally, the Appellate Division for the First Department has already ruled, in a context other than abatements, that the Department is bound to apply its own Rules as written until and unless the Department adopts new Rules in their stead.

Even if one were to take the Department's defense at face value, it would only serve to highlight a serious breakdown in proper agency procedure: the Department has conducted the abatement program for years without creating or adhering to a single documented rule, guideline, or procedure. Indeed, despite the Department's argument that the Report "is based on the misapplication of exemption program rules to the abatement program and . . . a lack of understanding of the abatement program," Department legal staff, in two separate meetings with Comptroller's Office staff, volunteered the admission that the report's position that the Rules are applicable to abatements is "reasonable."

In sum, the Department's response leaves intact the conclusion of the audit report. That is, at worst, the Department has acted in intentional disregard of lawfully binding Rules; or at the least, it has failed for almost a decade to establish documented standards to safeguard the integrity of a multimillion dollar program.

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

FINDINGS AND RECOMMENDATIONS

The Department improperly granted tax abatements to owners of 128 properties. These tax abatements were granted even though the work on which they were predicated did not merit a tax exemption and were termed by the Department as having zero-dollar tax exemptions. As a result of granting these abatements, the Department did not collect $8,063,047 in taxes on these properties for Tax Years 1996/1997 to 2003/2004.[2] Moreover, since the abatements granted under this program extend over a 12-year period, the Department will forgo approximately $5,717,831 in additional property taxes on the properties in future years.[3]

The improvements made to these properties did not result in physical increases to the properties' assessed values. The Rules themselves, in §14-10, expressly provide that for purposes of both abatements and exemptions, "construction work shall be eligible construction work" only if it "*creates or enhances* the value of eligible, industrial or commercial property." (Emphasis added.) One would, therefore, reasonably expect construction work, if it were "eligible," to result in an increase in the assessed value of a building. A review of the statute and its legislative history shows a consistent emphasis on conditioning the receipt of benefits under the program upon an increase in the assessed value of the property. New York State Real Property Tax Law §489 and its legislative history have consistently demonstrated a legislative intent to reward owners for actions that increased the value of a property, and not for actions that simply maintained the value of the property.

Department Response: "The origin of the abatement program is particularly significant. It was created in response to hardships raised by manufacturers and industrial owners who found that while they made substantial investments to upgrade and modernize their industrial properties, these improvements, due to valuation methodology, did not result in 'physical' increases to their building's assessed value and therefore, did not qualify for tax exemptions. . . . As a result, the Legislature created the abatement program to provide a more predictable, tangible incentive for upgrading these properties."

Auditor Comment: Strikingly, while the Department's response claims that the intent of the Legislature in creating the abatement program was to do away with the requirement that the work create or enhance value, it can quote no legislative history to that effect. In fact, in its initial meetings with Comptroller's Office staff, Department officials actually went to great lengths to explain that these properties were entitled to an abatement because they had qualified for "Zero Dollar Exemptions." Reciting the differences in

[2]Because we received incomplete information for two of the 128 properties, we were unable to calculate the full abatement amounts granted on these two properties.

[3]We did not calculate future abatement amounts for five of the 128 properties because they are currently tax exempt. Insofar as the amounts of forgone taxes for the remaining properties are concerned, Department officials stated that property owners are required to submit annual financial statements of reported net income. The amount of net income could affect a property's assessed value, thereby reducing or increasing the amount of property taxes.

other aspects of how abatements and exemptions are awarded does not remove their key similarity: creation or enhancement of value is a requisite for both abatements and exemptions and as such is in no way inconsistent with any part of the legislative record.

Conclusive evidence that the Department's position is unsupportable is provided by the Department's website, on which are found the Department's 1999 draft ICIP Rules for both abatements and exemptions, which it issued for public comment, but never adopted. In those draft Rules, the Department expressly made Rule §14-10 (renumbered as §14-08) fully applicable to both abatements and exemptions, and continued to limit "Eligible construction work" for both abatements and exemptions to work that "***creates or enhances the value of eligible, industrial or commercial property.***"

The draft Rules, while never adopted, explicitly embody the Department's own understanding that for abatements, just as for exemptions, no benefit may be granted unless the work creates or enhances value.

Improper Abatements Granted for Repair and Replacement Work or Where There Was No Evidence of Work Performed

Our review of file documentation for the 128 properties that received abatements indicated that in seven cases, there was no evidence that work was performed at all. In another 68 of these cases, the Department granted program benefits for repair or replacement work even though Rules §14-10 provides that "ordinary repairs, replacements, or redecoration" do not qualify for abatements. For example, the Department granted $106,371 in abatements to a property associated with application No. 6847. The project's original description was to replace the roof with a rubberized system. The applicant added other repair work to "remove loose bricks along wall. . . .[and] re-brick this affected area." In addition, the applicant added six new roof drains "since some . . . roof drains were improperly positioned." Clearly, this work involved repairs and replacements and therefore should not have been approved for benefits.

Department Response: "The description of the work appears to draw on multiple documents submitted by the applicant. The description contained in the Report clearly fails to reference all work that was done."

Auditor Comment: All of the work items presented in the report were obtained directly from each application's file. The work description in our report was the basis of the Department's recommendation to approve the application. The cost of this work (to "replace the roof with rubberized APP 170 roofing system" and add new roof drains) totaled $153,637.50. We believe that the Department's response is referring to additional minor repairs and miscellaneous work items (i.e., removing loose bricks and brick-face, reinforcing existing lentil, installing aluminum awning and security fence, and laying asphalt paving) performed by the owner of the property to attempt to meet the 25 percent minimum required expenditure (i.e., $176,175). These items, which totaled $25,150, were not included in the application and were therefore unrelated to the approval of

program benefits. Moreover, even if these items were included on the application, the property would not have qualified for program benefits based on the nature of the work performed.

In another case, the Department granted $116,886 in abatements to a property associated with application No. 7369. The applicant stated in a letter to the Department that "this is a request to start making emergency repairs to the roof. . . .The reason for the repairs is that the roof is leaking and is ruining product and packaging materials."

Department Response: "The description of this work is a direct quote from a letter in which the applicant alerted the ICIP of an emergency situation that requires immediate remedial action. . . . In truth, the project that qualified for abatement benefits consisted of the following. 1. Replacement of the entire roof membrane with torch down roofing. 2. Replacement of security wiring including barbwire, razor wire and fencing on all roofs. 3. Repair and replacement of ceiling tiles in offices. 4. Modernization of bathrooms. 5. Construct conference room. The total cost of this project was $268,000; this amount certainly covers more than the emergency roof repair contained in the Report's description of completed work."

Auditor Comment: The Department's response contradicts information in the application file. Documentation indicates that the only work performed was the replacement of the roof, costing $143,750. In fact, a July 19, 2000, letter from the applicant to the Department refers to the completed roofing work stating that "I had notified ICIP that we have met the threshold of 25% of assessment ($143,750.00) for capital expenditures." The files contain no evidence that the additional work referred to in the Department's response was actually performed.

Finally, the Department granted $24,794 in abatements to properties associated with application No. 6664. According to the applicant's certified narrative, the project "replaced the roof. . . and repaired the building's walls, doors, shop and office work areas, lounge and bathrooms." Moreover, the applicant "repaired the bathroom sinks, unclogged or replaced clogged pipes . . . [and] replaced rotting floor." Once again, the work was clearly for repairs and therefore does not qualify for benefits under the program.

Department Response: "The description of the work is drawn from the applicant's certified narrative but is presented to illustrate components of the overall work as separate and unrelated items. For example, the unclogging of a sink is clearly a repair item when viewed as an independent action. However, when viewed in the context of a dilapidated bathroom, where sinks were broken, pipes were clogged or otherwise broken, tiles were missing, and the floor was broken, the unclogging of the sink is merely one facet of a major upgrade of the industrial facility."

Auditor Comment: It is ludicrous that Department officials consider repairs to a "dilapidated" bathroom as a "major upgrade" of the facility. In fact, an examination of the improvement costs indicates that almost $52,233 of the project's $68,168 cost was to replace the roofing and do associated preparatory work. There was no evidence in the

files indicating that Department staff had either reviewed the work scope or obtained information demonstrating that the work actually constituted a major upgrade—clearly a requirement of the program's Rules.

As a result of this practice, from Tax Years 1996/1997 to 2003/2004, the Department collected at least $3,673,124 less in property taxes on 75 properties for which Department records indicate that work was for repairs or replacements or was not done. Moreover, since the abatements granted under this program benefit properties for 12 years, the Department will forgo approximately $3,386,421 in additional taxes on the properties in future years.[4]

There was no documentation in the files to indicate why the Department deemed the work in these cases to be eligible since the nature of the work clearly failed to comply with program Rules. Had the Department properly reviewed these cases, it should have excluded work that was for "ordinary repairs, replacement, or redecoration." Department officials stated that they consider certain work to be eligible for abatement—even though the work does not raise the property's assessed value—as long as its cost meets the appropriate minimum required expenditure.

Department Response: "The Report identified three applications to support its conclusions and Finance fundamentally disagrees with the Report's characterization of the contents of the applications. The Report consistently 'cherry picks' specific components of ICIP projects to support its conclusion that ordinary repairs have been permitted to qualify for abatement benefits. However, the Report conveniently ignores the fact that these 'repairs' do not reflect the entire scope of the ICIP construction projects but are merely one aspect of a major rehabilitation effort.

"In these cases the granting of abatement benefits reflects the applicants' substantial investment in upgrading industrial property with the resultant retention and expansion of manufacturing jobs in the City. Moreover, the Report mischaracterizes certain construction work as repair based solely upon general pre-construction descriptions provided in the application. The ICIP Unit's determinations of eligibility for abatement are based upon a review of the entire scope of construction viewed upon completion of the entire project."

Auditor Comment: Our report conclusions were based on a review of all 128 applications and not simply the three applications that were cited as examples. The Department's assertion that the repair work described in the sampled applications is "one aspect of a major rehabilitation effort" is not supported by the Department's files, engineering standards, or the Rules governing the program. Moreover, file documentation did not contain any evidence to support the Department's claim that staff had reviewed the entire scope of construction work to ascertain the project's eligibility for abatement. Had Department staff actually reviewed the projects associated with the applications by applying consistent engineering standards and the Rules, they would not

[4]We did not calculate future abatement amounts for three of the 75 properties because they are currently tax exempt.

have approved construction work that merely involves repairs or replacements that make a building or structure functional. For example, in accordance with engineering standards, replacing damaged windows would not be considered a renovation, whereas replacing windows with special shatter-proof glass to accommodate high-pressure machinery could be considered a renovation, as the underlying intent of the work is to change the purpose for which the building was originally designed. This clearly was not the case in the applications cited in this report, which indicate that the intent of the work performed was simply to make the structures functional rather than to enhance them as the program's Rules require.

Recommendation

1. The Department should immediately discontinue its practice of granting tax abatements to properties for which improvement work is only "ordinary repairs, replacement or redecoration" or does not include a substantial renovation, and does not increase their assessed values.

Department Response: "Finance disagrees. Finance has made clear that the program allows for an abatement for work that improves the property but does not result in an increase in assessed value, based on how Finance values the property for Real Property Tax purposes. . . . Finance's abatement policies are consistent with both the language of the statute and the legislative intent of the program. Accordingly, Finance will not discontinue this practice, as it is in accordance with the law and intent of the incentive program."

Auditor Comment: Contrary to the Department's response, key sections of the Rules apply directly to abatements. Most notably, the Rules implement the *minimum required expenditure* provisions of New York State Real Property Tax Law §489-aaaa(14) that are explicitly applicable to *both* exemptions and abatements. While the New York State Real Property Tax Law definition of "minimum required expenditure" originally applied to exemptions, the 1995 amendment of §489-aaaa(14) expressly applied those same minimum expenditure requirements to the new abatement program as well, changing just the amount of the expenditure as a percentage of assessed value, and permitting further increases in that percentage. Similarly, under §§489aaaa (14), (5), (10) and (23), identical definitions of the commercial, industrial, and renovation construction work that can satisfy the minimum required expenditure are made applicable to both abatements and exemptions.

Rules §§14-05 and 14-10 explain what is needed to satisfy the minimum required expenditure set by RPTL §489aaaa (14). Rule §14-05(h) provides:

> "Only such construction work as qualifies under the provisions of § 14-10(a) shall be eligible construction work for purposes of the computation of the exemption base and *satisfaction of the minimum expenditure requirements*." (Emphasis added.)

Rule § 14-10(a) provides:

> "(1) For purposes of determining the *minimum required expenditure* [emphasis added] the exemption base and all other purposes, construction work shall be eligible construction work if
>
> (i) it creates or enhances the value of eligible, industrial or commercial property."

Reading the abatement statute and the Rules together, it is, therefore, clear that to satisfy the minimum required expenditure for abatements, construction work must create or enhance the value of the property. That requirement was repeatedly cited in the legislative history of the program before 1995, when the exemption program was being created. Not one line in the legislative history for the abatement program renounces that longstanding requirement.

The Department further acknowledged that eligible work must create or enhance the value of property when in 1999 it promulgated draft Rules. (The Rules were never adopted.) The 1999 draft Rules contained a provision, §14-08(a)(2), which provided "Alterations which are deemed to add value and shall be eligible construction…" The eligible alterations cited by the Department as examples (i.e., alterations which increase the square footage of the existing building, modernization of core facilities) are all ones that would create or enhance value, in contrast to ordinary repairs and replacements. Repairs and replacements, such as those we found in the Department files we examined, would not be eligible for abatements under the 1999 draft Rules. Indeed, draft Rule §14-08(a)(3)(i) would continue to provide that "Eligible construction work does not include ordinary repairs, replacements or redecoration."

Improper Abatements Granted for Property Upgrades That Fall Short of Program Requirements

In addition, our review of file documentation indicated that 36 of the 128 cases that received abatements involved various upgrades to the properties that in our opinion fall short of the Rules §14-10 requirement of a substantial renovation. For example, many of the improvements were to install co-generation systems, which involves the installation of dual-fuel boilers to produce electricity and heat energy from the same source. In another example (application No. 4629), the Department granted abatement benefits for an installation of a new cement floor. In fact, according to a letter from this applicant's contractor, "all of the work was minor." In contrast to the above-mentioned 75 cases for which work was for repairs or replacements or was not done, the files for these 36 cases did not indicate that the work involved repairs or replacements; neither did they contain evidence that substantial renovation work was performed.

The property taxes not collected to date in these 36 cases amount to $2,212,918—and an additional $1,204,798 will be forgone in future years.[5]

For the remaining 17 cases that had no increase in assessed value, the file documentation was insufficient for us to accurately evaluate the nature of the work involved. Without other evidence that the work complied with the Rules, these properties also would not be eligible. The property taxes not collected to date in these cases amount to $2,177,005—and an additional $1,126,612 will be forgone in future years.[6]

Recommendations

The Department should:

2. Review and reconcile Department records to identify which of the 135 properties received abatements without achieving an increase in assessed value. For those properties that are not entitled to abatements, the Department should revoke the incorrectly granted abatement benefits and recoup the improperly abated taxes.

Department Response: "Finance disagrees. . . . Specific to the granting of abatements for cogeneration plants, the New York State Appellate Division has held that 'generators are . . . structures affixed to the land' and 'power generating apparatus' and therefore are improvements to real property within the meaning of the New York State Real Property Tax Law. . . . In fact, the KIAC case specifically held that Finance was without authority to revoke the ICIP benefits granted for a free standing independent cogeneration plant because the work constituted tax-exempt commercial construction work within the meaning of the ICIP program.

"As to the recommendation that Finance should retroactively revoke abatements previously granted in reliance on the Report's dubious interpretation of the statute would not likely be upheld by the courts, *assuming arguendo* that Finance's policy was inconsistent with the enabling law. These applicants would argue that Finance was stopped from revoking benefits previously granted in reliance on Finance's well-established policy regarding abatements in instances where no exemption had been granted."

Auditor Comment: In regard to improvements for co-generation systems, Department officials told us during the course of the audit that there is no "rule of thumb" regarding the assessment of co-generation systems because these systems vary in size, complexity, and effect. In fact, as Department officials stated, some co-generation systems are very small and insignificant. In contrast to the large generators housed in their own

[5]We did not calculate future abatement amounts for one of the 36 properties because it is currently tax exempt.

[6]We did not calculate future abatement amounts for one of the 17 properties because it is currently tax exempt.

multimillion dollar building in the *KIAC Partners* case cited in the Department's response, the co-generation projects we cited in our report were not deemed by the Department to be significant enough to warrant an increase in assessed value and therefore should not have been approved for abatement.

3. Assign appropriate personnel to review and analyze work descriptions in applications to determine whether the work is indeed eligible for program benefits. Maintain written documentation of these reviews in application files.

Department Response: "Finance disagrees. Finance maintains that the abatements were received based on applications describing eligible work that met all program requirements. The Unit is staffed with appropriate personnel to review and analyze applications."

Auditor Comment: As noted previously, the Department's contention that the applications reviewed met all program requirements is baseless. Furthermore, the nature of the Department's response leads us to conclude that these problems are much more serious since they stem from the failure of the Department's senior management to apply the program's Rules or to document their standards. We maintain that having appropriate staff to review and analyze work descriptions as well as to maintain written documentation of these reviews is critical to ensuring the integrity of the program.

Lack of Written Policies and Procedures

The Department was unable to provide written policies or guidelines documenting its reasons for considering these types of projects to be eligible for abatements in contradiction of the Rules that govern the program. Department officials told us that its informal policy, based on its interpretation of the legislation, was to grant abatements to applicants who spend the equivalent of the required 25 percent minimum required expenditure for work that is a permanent, capital improvement with a useful life of at least three years, even if the property's assessed value is not increased. However, the Department's position in this matter contradicts Rules §14-41(b)(3), which states, "In every case, the Department shall adopt the most reasonable interpretation of any provision of law . . . when two interpretations are equally reasonable, the Department shall adopt the interpretation which results in the least amount of exemption."

In fact, Rules §14-10(a)(1) indicates that there is no doubt or uncertainty about either the requirement for creation or enhancement of property value or its applicability to the determination of "the minimum required expenditure, the exemption base and *all other purposes*." Moreover, §14-41(c)(7) repeats the pertinent language of §14-10(a): "The inducement of construction work is to be achieved by relieving the *property created or enhanced by* such construction work from part of the additional real property tax burden which it would otherwise bear." (Emphases added.)

The Department's disregard of the current Rules governing the program along with its failure to adopt new Rules or documented procedures for evaluating work before granting abatements leaves the program susceptible to fraud and abuse.

Department Response: "In reality, Finance's administration of the program was neither informal policy nor was it based solely on statutory interpretation. When the ICIP abatement program was initiated in 1995, the City already had several decades of experience administering the J-51 housing rehabilitation program that consists of both abatement and exemption provisions. The administrative agency for J-51 is the Department of Housing Preservation and Development (HPD). HPD has neither required an increase in assessed value, nor a grant of a tax exemption as a prerequisite, or co-requisite, for the grant of a J-51 abatement. As the statutory language for the ICIP abatement and J-51 abatement provisions are virtually identical, Finance emulated HPD's policy. . . .

"It is important to note that the Report expresses concern that Finance's interpretation of the abatement requirements and the lack of formal policies and guidelines 'leave the program susceptible to fraud and abuse.' However, the audit report does not cite any specific instances of such fraud and abuse, and, in fact, did not even contain any practical operational recommendations that would improve the administration of the program."

Auditor Comment: In addition to failing to promulgate up-dated Rules, the Department has not developed any written policies or procedures for administering the abatement benefit. In fact, in meetings with us, Department officials admitted that they relied instead on their own subjective views, unwritten policies, and undocumented office precedents.

The Department claims it fills in gaps by looking to the "City['s] . . . several decades of experience administering the J-51 . . . program." But since only Department staff know what aspects of this unrelated program they "emulate," the Department's standards and procedures continue to remain completely undocumented.

A critical lack of fairness and proper oversight must result. As long as the Department refuses to recognize the current Rules as applicable to abatements, and as long as it produces no written guidelines, neither the benefit applicant nor Department staff nor any court reviewing Department determinations has fixed standards on which to rely. The lack of documented standards leaves abatement applicants with no basis on which to appeal a Department decision under the program, and no way to prove that they were unfairly or improperly treated. It also leaves regulators with no standards by which to determine whether an applicant unlawfully benefited from favoritism.

Administering a program without following statutes and without establishing associated standards is unacceptable for the management of any government benefit program. It is especially intolerable when the program has provided and continues to provide millions of dollars in benefits and directly impacts the monies the City could be collecting in taxes. Although the report did not cite specific instances of program fraud

and abuse, the lack of documented standards *ipso facto* leaves the program highly susceptible to mismanagement, fraud, and abuse. The Department has failed to follow the current Rules and to establish formal written guidelines that would protect the integrity of a program upon which the Department itself and the public could rely.

Recommendation

4. The Department should prepare and adopt formal written policies and guidelines for granting abatements that conform to program Rules.

Department Response: "Finance agrees. Finance is in the process of submitting rules to the Law Department for their review and approval. The law has been amended several times since Finance's original rules were promulgated. Finance is now drafting the rules and will go through the promulgation process, which involves publication in the City Record and providing an opportunity for the public to comment on the proposed regulations."

Auditor Comment: The Legislature has required that the Department not only administer the program, but also promulgate regulations to carry out the enabling legislation's purposes (New York State Real Property Tax Law § 489hhhh(1)(g)). Yet in spite of its legislative mandate, the Department has failed to adopt new rules in the ten years since the abatement benefit was added. In meetings, Department legal staff admitted the need for updated rules to comply with what the Department believes to be the intent of the abatement statute. In fact, the legal staff advised Comptroller's Office staff that a year after the 1995 enactment of the abatement legislation, they had drafted new rules, but have so far been unable to have their draft reviewed and approved for publication by the City's Law Department.

The Department's agreement with our recommendation only raises additional questions. It is unclear why the Department should first write that it is "in the process of submitting rules to the Law Department," and then state that the Department is "now drafting the rules," especially in light of the Department's verbal assertion that it had drafted new rules in 1996. Moreover, the Department never disclosed to us that in 1999 it had actually published draft Rules for comment, and therefore provided no insight as to why it neither adopted those Rules, nor persisted in seeking the Law Department's review and approval of any other draft Rules.

What is clear is that no matter what the excuse for the Department's not putting new rules in place, the existing Rules are binding on the Department until new rules are formally adopted. The Appellate Division recently held that the Department is compelled to follow its own Rules. *CDL W. 45th St. LLC v. City of NY Dep't of Finance*, 762 N.Y.S.2d 593, 598 (1st Dept.), *leave to appeal denied*, 100 NY2d 514 (2003). In that case, the Appellate Division held that the Department could not disregard its ICIP Rules so as to deny benefits, observing that "while generally entitled to deference in interpreting its regulations," an agency such as Finance cannot "*by administrative fiat*

and without observing the legal niceties for promulgating new agency regulations" fail to follow its own regulations. (Emphasis added.)

The same reasoning must apply to any Department effort to grant benefits by disregarding the only published Rules in existence, Rules that on their face implement the core minimum expenditure requirement that the statute sets for abatements and that are consistent with the legislative history. The Department must apply the existing Rules to all benefits available under the program until and unless the Department amends them.

Finally, we note that if legislative intent for the program was truly as the Department claims, the Department's failure to put in place regulations that implement that intent would be all the more serious.

FINANCE
NEW • YORK
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

BY HAND
and
VIA FAX DELIVERY (212) 669-8878

September 28, 2004

Mr. Greg Brooks
Deputy Comptroller
Policy, Audits, Accountancy & Contracts
Office of the Comptroller
Executive Office
1 Centre Street
New York, NY 10007

Re: Audit # FR03-169A
Audit Report on Granting of Tax Abatements
by the Department of Finance Under the
Industrial and Commercial Incentive Program
Dated September 9, 2004

Dear Mr. Brooks,

This letter is the New York City Department of Finance's ("Finance") response to the City of New York Office of the Comptroller ("Comptroller") Draft Audit Report on the Granting of Tax Abatements by the Department of Finance Under the Industrial and Commercial Incentive Program ("Report").

Before responding in detail to the specific recommendations contained in the Report, we want to state that Finance disagrees with the Report's premise that the granting of abatements on properties that did not qualify for a tax exemption was improper. The Report is based on the erroneous premise that granting abatement benefits for industrial construction work is conditioned upon and triggered by construction work that results in physical increases in value that are reflected in the properties' assessed value, the same condition required by exemption benefits for all commercial and industrial construction

work. As a result, the Report concludes that Finance has improperly granted abatement benefits to properties that have not also qualified for exemption benefits.

The Report ignores the legislative history and objectives of the program and misstates the provisions of section 14-10 of the Industrial and Commercial Incentive Program ("ICIP") Rules to support its conclusions. Furthermore, the Report fails to acknowledge the substantial discretionary authority expressly granted to Finance by the Legislature and basic rules of statutory construction that empower a municipal taxing authority to reasonably interpret and implement enabling legislation to effectively fulfill the objectives of the tax incentive program.

Finance strongly disagrees with the Report's findings, recommendations and conclusions, citing the following factors in support thereof:

The ICIP Statute's (RPTL 489-aaaa et seq) Legislative History Supports Finance's Policy To Encourage Investment In New Construction, Improvements, Alterations And Expansion Of Commercial and Industrial Properties.[1]

The origin of the abatement program is particularly significant. It was created in response to hardships raised by manufacturers and industrial owners who found that while they made substantial investments to upgrade and modernize their industrial properties, these improvements, due to valuation methodology, did not result in "physical" increases to their building's assessed value and therefore, did not qualify for tax exemptions. To understand this, it is important to note that unlike the cost basis for depreciation used for income tax purposes, most commercial and industrial properties are valued using the income approach. Consequently, if net operating income for the property does not increase, the value for real property tax purposes will not increase and no exemption will be granted. As a result, the Legislature created the abatement program to provide a more predictable, tangible incentive for upgrading these properties.

The City's legislative Memoranda in Support of amendments to the law in 1992 and 1995 explain that the ICIP program was created in 1984 to encourage the "improvement of commercial and industrial facilities to protect and expand the City's tax base." (1995 Sponsor's Memorandum in Support). Substantive amendments were made to the statutes in 1992 and 1995. The 1995 amendment added a tax abatement benefit applicable solely to qualifying industrial construction work that would further reduce their tax liability for a period of 12 years. (See Chapter 661 of the Laws of 1995, section 1).

The City's Memorandum in Support of the 1995 amendments explained the objectives of the new abatement benefit as follows: "By extending the exemption schedule in both

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[1] On page 4 of the Report, in the *Scope and Methodology* section, the auditors state that they have "reviewed §489 of the New York State Real Property Tax Law." We have pointed out on numerous occasions that the legal citation "§489" is for the law governing the J-51 program. The correct citation for the ICIP program is RPTL 489-aaaa et. seq.

regular and special exemption areas and creating an abatement program targeted specifically for industrial properties, the City believes the program will assist smaller industrial and commercial development projects that were thwarted by the City's weak economic climate over the past five years and attract those manufacturers that have sought other locations back to New York City."

The Audit Report Misstates Section 14-10 Of The Rules.

The Rules were promulgated in 1986 and the abatement program was created in 1995. Obviously, the provision could not have been intended to govern the abatement program since no such program (and the conditions that created the need for it) could reasonably have been foreseen nearly ten years earlier.

Section 14-10 is cited throughout the Report to support the auditors' interpretation of the law that construction work that results in physical increases is a condition precedent to the granting of both the exemption and abatement benefits. The draft cites section 14-10 to "expressly provide" that, for the purposes of both abatements and exemptions, construction work shall be eligible construction work only if it "creates or enhances the value of eligible, industrial or commercial property." This is a deliberate misstatement of that rule. In fact, the term abatement does not appear anywhere in the text as previously explained above.

Express Provisions Of The Enabling Laws Consistently Characterize Exemption And Abatement Benefits As Separate And Distinct And Evince No Intent To Link The Criteria For The Granting Of Each Benefit.

There is nothing in the statute preconditioning the granting of an abatement benefit to a property qualifying for an exemption. In fact, the statute is quite clear that a property may receive an abatement or an exemption:

- Section 489-aaaa: Defines "applicant" to mean any person obligated to pay real property taxes on the property for which an exemption from or abatement or deferral of real property tax payment is sought. (Emphasis added).

- Section 489-bbbb: In the preamble, the Legislature authorizes a city having a population of one million or more (i.e., New York City) to determine that incentives in the form of exemption from or abatement or deferral of payment of real property taxes are necessary to encourage industrial and commercial development. (Emphasis added).

Clearly, the language of the governing statute demonstrates that the Legislature intended for properties to be able to receive an abatement or an exemption.

The Enabling Statutes Create Separate Standards For Exemptions And Abatements.

There are numerous differences between the language of the exemption statue (489-aaaa (9) (c)) and the abatement statute (489-bbbb (1) (c)); the most significant distinctions include the following:

(1) the exemption benefits are conditioned upon a physical increase in the assessed value while there is no similar requirement for the abatement;

(2) the exemption cannot include equalization changes arising from increases in the value of the land portion of the assessment while the determination of the abatement includes the land portion of the tax and may be applied to it in the future;

(3) the abatement may begin only after construction has been completed while the exemption begins as soon as construction results in a physical assessment increase. This enables Finance to review the industrial construction project in its totality to determine whether the manufacturing facility has been significantly upgraded and enhanced and therefore warrant(s) abatement benefits; and

(4) the exemption is entirely conditioned upon the assessor's determination that construction work is a capital improvement that has increased the property's value and his/her characterization of that increase as a "physical" change. In contrast, the abatement is not subject to an individual's judgment but is simply determined as a fixed percentage of the pre-construction tax on both land and building(s).

Nowhere in the Report do the auditors acknowledge these fundamental differences between the exemption and abatement programs. The entire Report is based on the misapplication of exemption program rules to the abatement program and, more generally, a lack of understanding of the abatement program. Accordingly, we must disagree with every aspect of the Report that relies on this misapplication of the laws purported to govern the abatement program.

The Legislature Granted Finance Discretionary Authority To Administer ICIP And Interpret Enabling Laws In A Manner It Determines Best Fulfills The Legislature's Objectives.

The stated scope of the audit was to "determine whether the Department properly reviews and approves applications for program exemptions and abatements; whether the program is administered to ensure that applicants remain eligible for program benefits; and

whether exemptions and abatements are properly calculated." (Report, p. 4). In essence, this was an operational review. It is now 16 months after the original audit was commenced. Rather than issue a report on the administration of the exemption and abatement program, what has been issued is an uninformed legal opinion which challenges the interpretation of Real Property Tax Laws by Finance's real estate attorneys. These attorneys have decades of experience working almost exclusively on issues related to Real Property Tax Laws. Not only is Finance's interpretation of the governing statues being challenged, but so is the Legislature's grant of authority to Finance to administer the program.

The following three provisions grant Finance the necessary discretion to effectively administer the program:

- Section 489-bbbb: "Any city ....acting through its local legislative body, is authorized and empowered to determine that incentives in the form of exemption from or abatement or deferral of payment of real estate taxes are necessary to encourage industrial and commercial development."

- Section 489-hhhh(1): With regard to administration of these incentives, the Legislature authorized Finance to "make and promulgate regulations to carry out the purposes of this title," including but not limited to, "nature of work for which expenses may be included in the minimum required expenditures." (Emphasis added).

- Section 489-aaaa(13): This provision authorizes Finance, after consultation with the deputy mayor for finance and economic development, to determine(s)- that a greater expenditure is required to encourage significant industrial and commercial development and (it) may establish, by rule a higher percentage of initial assessed value not to exceed 50 percent.

Based on the above, the Legislature explicitly delegated to Finance the authority to administer the abatement program, including the ability to adjust the minimum required expenditure and to determine the nature of the qualifying work. It would have been more helpful if the Report adhered to the original scope of the audit, rather than supply erroneous legal advice.

Under General Principles Of Statutory Construction, Finance Is Authorized To Interpret Enabling Laws In A Manner That Is Reasonably Calculated To Effectuate The Legislature's Stated Purposes.

The Report is founded upon an extremely superficial reading of the statute that completely ignores the overriding legislative and economic development objectives of the program. Moreover, the Report refers to Finance's administration of the abatement program as "informal policy," based upon Finance's interpretation of the legislation. In

reality, Finance's administration of the program was neither informal policy nor was it based solely on statutory interpretation. When the ICIP abatement program was initiated in 1995, the City already had several decades of experience administering the J-51 housing rehabilitation program that consists of both abatement and exemption provisions. The administrative agency for J-51 is the Department of Housing Preservation and Development (HPD). HPD has neither required an increase in assessed value, nor a grant of a tax exemption as a prerequisite, or co-requisite, for the grant of a J-51 abatement. As the statutory language for the ICIP abatement and J-51 abatement provisions are virtually identical, Finance emulated HPD's policy. In previous meetings with Comptroller's Office staff, we apprised them of the J-51 model, but the Report neither acknowledges nor offers comments in response.

"It is well settled that the construction given statutes and regulations by the agency responsible for their administration, if not irrational or unreasonable, should be upheld." (Matter of Howard v. Wyman of New York, 28 NY2d 434, 438 (1971)). Accordingly, Finance's legal and programmatic interpretation of the ICIP abatement program – which is supported in statute, intent and legislative history, clearly should be given deference to the reading now set forth in the Report, nine years after the abatement program was enacted.

Moreover, Finance wishes to remind the audit staff of the basic principles of statutory construction:

- McKinney's Consolidated Laws of New York, Statutes, Chapter 6: General principles of statutory construction include:

  - Intent should be given to the legislation. In this case, the intent was clearly to retain the City's industrial base and manufacturing jobs.
  - A statute must be construed as a whole and its particular sections must be considered together.
  - All parts must be harmonized and effect and meaning given to the entire statute.
  - Where provisions are conflicting, the paramount intention must be preserved.
  - In a proper case in which the situation here could qualify the literal letter of the statute can be departed from to sustain the legislative intent.
  - Literal meanings of words are not to be adhered to where they defeat the general purpose and manifest policy intended to be promoted.

To require a property owner or lessee to expend a higher minimum required expenditure to qualify for abatement but deny the abatement on the grounds that the property's

assessed value did not increase as a result of the expenditures would clearly defeat the general purpose of the abatement provisions.

The Report suggests that Finance implement four recommendations. Below are the recommendations made in the Report, and Finance's comments:

Recommendation 1: The Department should immediately discontinue its practice of granting tax abatements to properties for which improvement work is only "ordinary repairs, replacement or redecoration" or does not include a substantial renovation, and does not increase their assessed values.

Finance's Response: Finance disagrees.

Finance has made clear that the program allows for an abatement for work that improves the property but does not result in an increase in assessed value, based on how Finance values the property for Real Property Tax purposes. This point has been made clear in our meeting and at the exit conference. Finance's lawyers, the Director of Real Property Tax and Exemption Policy and Deputy Director, even met with Comptroller's Office legal staff to explain that the 1995 amendments to the statute specifically provided for an abatement for just these types of improvements to property. Both these Finance lawyers have held high-level positions at Finance for many years and throughout their careers at Finance have been involved in all aspects of the ICIP legislation and policy during the time that it was enacted and later amended. Finance's abatement policies are consistent with both the language of the statute and the legislative intent of the program. Accordingly, Finance will not discontinue this practice, as it is in accordance with the law and intent of the incentive program.

Recommendation 2: Review and reconcile Department records to identify which of the 135 properties received abatements without achieving an increase in assessed value. For those properties that are not entitled to abatements, the Department should revoke the incorrectly granted abatement benefits and recoup the improperly abated taxes.

Finance's Response: Finance disagrees.

As part of the finding for this recommendation the Report specifically states, "...36 of the 128 cases that received abatements involved various upgrades to the properties that in our opinion fall short of the Rules §14-10 requirement of a substantial renovation. For example, many of the improvements were to install co-generation systems...") (Report, p. 6). Specific to the granting of abatements for cogeneration plants, the New York State Appellate Division has held that "generators are . . . 'structures affixed to the land' and 'power generating apparatus" and therefore are improvements to real property within the meaning of the New York State Real Property Tax Law. (*KIAC v. Cerullo*, 687 N.Y.S.2d 692

(2d 1999)(citations omitted). In fact, the KIAC case specifically held that Finance was without authority to revoke the ICIP benefits granted for a free standing independent cogeneration plant because the work constituted tax-exempt commercial construction work within the meaning of the ICIP program. Id. Accordingly, Finance disagrees with the recommendation to revoke these benefits.

As to the recommendation that Finance should retroactively revoke abatements previously granted in reliance on the Report's dubious interpretation of the statute would not likely be upheld by the courts, *assuming arguendo* that Finance's policy was inconsistent with the enabling law. These applicants would argue that Finance was estopped from revoking benefits previously granted in reliance on Finance's well-established policy regarding abatements in instances where no exemption had been granted.

Recommendation 3: Assign appropriate personnel to review and analyze work descriptions in applications to determine whether the work is indeed eligible for program benefits. Maintain written documentation of these reviews in application files.

Finance's Response: Finance disagrees.

Finance maintains that the abatements were received based on applications describing eligible work that met all program requirements. The Unit is staffed with appropriate personnel to review and analyze applications.

Recommendation 4: The Department should prepare and adopt formal written policies and guidelines for granting abatements that conform to program rules.

Finance's Response: Finance agrees.

Finance is in the process of submitting rules to the Law Department for their review and approval. The law has been amended several times since Finance's original rules were promulgated. Finance is now drafting the rules and will go through the promulgation process, which involves publication in the City Record and providing an opportunity for the public to comments on the proposed regulations.

The Report identified three applications to support its conclusions and Finance fundamentally disagrees with the Report's characterization of the contents of the applications. The Report consistently "cherry picks" specific components of ICIP projects to support its conclusion that ordinary repairs have been permitted to qualify for abatement benefits. However, the Report conveniently ignores the fact that these "repairs" do not reflect the entire scope of the ICIP construction projects but are merely

one aspect of a major rehabilitation effort. In these cases the granting of abatement benefits reflects the applicants' substantial investment in upgrading industrial property with the resultant retention and expansion of manufacturing jobs in the City. Moreover, the Report mischaracterizes certain construction work as repair based solely upon general pre-construction descriptions provided in the application. The ICIP Unit's determinations of eligibility for abatement are based upon a review of the entire scope of construction viewed upon completion of the entire project. The following statements cited in the audit report illustrate this rather disingenuous process of choosing items of construction out of context to support the Report's baseless conclusions.

Application No. 6847

Audit Report: The project's original description was to replace the roof with a rubberized system. The applicant added other repair work to "remove loose bricks along wall.... [and] re-brick this affected area. In addition, the applicant added six new roof drains "since some .... Roof drains were improperly positioned." (Report, p. 6).

Finance's Response: The description of the work appears to draw on multiple documents submitted by the applicant. The description contained in the Report clearly fails to reference all work that was done. The entire scope of the project included:

1. Re-roof by cutting and sealing blisters on old roof membrane followed by the installation of one ply base sheet, nailed dry with cap nails. Over this prepared roof, apply a new rubber membrane by heat fusing to roof with each course overlapping to obtain a uniform weld. After membrane is complete, field flash and fabric inner parapet wall and apply protective aluminum coating to membrane.

2. To better manage rainwater drainage and as a requirement for warranty install six new roof drains.

3. Removal of loose bricks along wall. Re-brick the affected area. Approximately 52' x 8' high (416 sq. ft.). Brick-face in front of existing 2 garage door openings 8'6" x 8'.

4. Reinforce existing lentil over loading dock door. Supply & install an aluminum awning 52' x 5' along entire eastern shop wall.

5. Installation of a new security fence measuring 152 linear feet by six feet high and the second was the laying of an asphalt driveway.

Application No. 7369

Audit Report: The applicant stated in a letter to the Department that "this is a request to start making emergency repairs to the roof .... The reason for the repairs is that the roof is leaking and is ruining product and packaging materials." (Report, p. 7).

Finance's Response: The description of this work is a direct quote from a letter in which the applicant alerted the ICIP of an emergency situation that requires immediate remedial action. Applicants are required to notify Finance within 15 days prior to commencement of construction. As this emergency construction work required immediate attention, the applicant diligently notified Finance to ensure that this remedial work would not be deemed construction work commenced prior to the required notice of commencement. In truth, the project that qualified for abatement benefits consisted of the following:

1. Replacement of the entire roof membrane with torch down roofing.
2. Replacement of security wiring including barbwire, razor wire and fencing on all roofs.
3. Repair and replacement of ceiling tiles in offices.
4. Modernization of bathrooms.
5. Construct conference room.

The total cost of this project was $268,000; this amount certainly covers more than the emergency roof repair contained in the Report's description of completed work.

Application No. 6664

Audit Report: According to the applicant's certified narrative, the project "replaced the roof .... And repaired the building's walls, doors, shop and office work areas, lounge and bathrooms." Moreover, the applicant "repaired the bathroom sinks, unclogged or replaced clogged pipes ... [and] replace rotting floor." (Report, p. 7).

Finance's Response: The description of the work is drawn from the applicant's certified narrative but is presented to illustrate components of the overall work as separate and unrelated items. For example, the unclogging of a sink is clearly a repair item when viewed as an independent action. However, when viewed in the context of an dilapidated bathroom, where sinks were broken, pipes were clogged or otherwise broken, tiles were missing, and the floor was broken, the unclogging of the sink is merely one facet of a major upgrade of the industrial facility.

Finance found the Report misleading and unhelpful. Rather than experiment with legal interpretation of the statute governing the abatement program, perhaps the audit staff should focus their resources on the audit's original scope of reviewing the operational administration of the program. Moreover, the Report failed to discuss the relevant public policy considerations that provide the context for the program. The findings, recommendations and conclusions contained in the Report fail to recognize that the abatement program has helped to retain the City's industrial base. Based on economic analyses performed by Finance's Tax Policy Division, each manufacturing job generates $2,705 of non-property taxes (personal income tax, sales tax, business income taxes, etc.)

for the City. While difficult to measure, job creation and retention directly translates into improved conditions for the workers' families and for the communities they live in. The Report fails to acknowledge these important economic and public policy considerations.

In closing, it is important to note that the Report expresses concern that Finance's interpretation of the abatement requirements and the lack of formal policies and guidelines "leave the program susceptible to fraud and abuse." However, the audit report does not cite any specific instances of such fraud and abuse, and, in fact, did not even contain any practical operational recommendations that would improve the administration of the program.

If you have any questions concerning this response, please feel free to call me at (212) 669-4878.

Sincerely,

Carla Van de Walle
Senior Director
Internal Audit & Special Projects

cc: Martha E. Stark, Commissioner, Department of Finance
Susan Kupferman, Director, Mayor's Office of Operations