



City of New York

OFFICE OF THE COMPTROLLER

John C. Liu
COMPTROLLER



FINANCIAL AUDIT

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Deputy Comptroller for Audit

Audit Report of the Howard Hughes
Corporation's Compliance with Its City
Leases for the South Street Seaport
Marketplace and Theatre

FK12-070A

July 25, 2013

<http://comptroller.nyc.gov>



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

John C. Liu
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July 25, 2013

To the Residents of the City of New York:

My office has audited the compliance of Howard Hughes Corporation (HHC) with its City lease agreements. We audit entities such as HHC to ensure that they accurately report revenues, pay the City all money due it, and comply with other significant lease terms.

Under the terms of its agreements and subsequent amendments, HHC was required to maintain and operate the South Street Seaport Marketplace premises as a first-class, specialty retail marketplace and the Theatre premises as either a theater, a venue for other customary theater activities, or a first-class, specialty retail marketplace. In exchange for the use of the Marketplace and Theatre premises, HHC agreed to pay the City Marketplace and Theatre rents that are the greater of a Minimum Base Rent, which is based on the Gross Leaseable Area square footage or an Alternative Base Rent of 15 percent of Gross Receipts exclusive of certain operating and administrative expenses and offset by a portion of its real estate obligation. HHC also agreed to pay supplemental rents if certain financial conditions were met.

The audit found that HHC improperly calculated Marketplace Minimum Base Rent and Theatre Retail Minimum Base Rent because it understated square footage upon which rents were based. We could not determine the total Marketplace Lease and Theatre Lease premises square footage and thus total minimum base rents due the City because the Economic Development Corporation (EDC) did not commission an independent certified engineering survey of the premises. However, based on an HHC survey, HHC may owe the City as much as \$1,222,751 for unpaid rents, plus accrued interest, for the period January 1, 2007, through December 31, 2012.

HHC also improperly calculated its Marketplace Alternative Base Rent due the City and, therefore, may owe the City additional rent. Specifically, when calculating Marketplace Alternative Base Rent for the period January 1, 2011, through June 30, 2011, HHC did not generate or report income, improperly calculated imputed reimbursement rates because it overstated expenses and understated square footage, deducted from Gross Receipts direct reimbursements that were not supported by Subleases and Subtenant invoices, and deducted duplicative explicit and imputed reimbursements.

Additionally, for the year ending June 30, 2011, HHC reported Theatre income of only \$2,000, and consequently, the City did not realize any Theatre Retail Alternative Base Rent or Retail Supplemental Rent. Since 2001, HHC allowed certain groups to use the Theatre generally rent free. While this may have been civic-minded, HHC was supposed to generate income from this property—not donate it.

Finally, HHC inappropriately conducted business in the name of the South Street Seaport Merchants Association, Inc. (the Merchants Association) because the Merchants Association was solely represented and managed by the landlord—and not largely by the merchants as intended. Therefore, the Merchants Association is a defunct organization and HHC should not have assessed dues, conducted business, and filed tax returns in its name.

Our review also determined that EDC did not adequately monitor HHC to ensure its compliance with lease terms. As the agency with oversight responsibility over the lease, EDC should have ensured that HHC complied with financial reporting and rental terms. Additionally, we noted that the City and EDC entered an agreement that proved not to be in the City's best interests because it provided HHC more favorable rent terms.

Lastly, the City did not ensure that a wholesale fish market operated in the South Street Seaport and thus did not preserve the historic and cultural importance of the historic district in fulfillment of the South Street Seaport Project.

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

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

Sincerely,

John C. Liu

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL AUDIT

Audit Report of the Howard Hughes Corporation's Compliance with Its City Leases for the South Street Seaport Marketplace and Theatre

FK12-070A

AUDIT REPORT IN BRIEF

The New York City Economic Development Corporation (EDC) is responsible for the management of select industrial and commercial spaces throughout the five boroughs as well as several retail and wholesale food markets. Part of EDC's management responsibilities include leasing space to and collecting rent from tenants occupying the historic South Street Seaport Marketplace (the Seaport Marketplace) and Theatre located in lower Manhattan along the East River.

The City and the Howard Hughes Corporation (HHC) are parties to a December 15, 1981, lease, as amended and supplemented, for designated spaces within the South Street Seaport (the Marketplace Lease), and a July 27, 1983, lease for the Seaport Theatre located at 133 Beekman Street (the Theatre Lease). Under the terms of these leases, HHC is required to maintain and operate: the Marketplace premises as a first-class, specialty retail marketplace and the Theatre premises as either: a theater, a venue for other customary theater activities, or a first-class, specialty retail marketplace. In exchange for the use of the Marketplace and Theatre premises, HHC agreed to pay the City Marketplace and Theatre base rents that are the greater of: a Minimum Base Rent that is generally equal to the product of \$3.50 and Gross Leasable Area square footage or an Alternative Base Rent of 15 percent of Gross Receipts exclusive of certain operating and administrative expenses and offset by a portion of its real estate obligation. HHC also agreed to pay supplemental rents if certain financial conditions were met.

For the year ending June 30, 2011, HHC reported:

- **Marketplace Gross Receipts** of \$7.5 million for which HHC paid Minimum Base Rent of \$1.3 million and no Supplemental Rent, and
- **Theatre Gross Receipts** of \$2,000 for which HHC paid Retail Minimum Base Rent of \$22,866 and no Retail Supplemental Rent.

Audit Findings and Conclusions

HHC improperly calculated Marketplace Minimum Base Rent and Theatre Retail Minimum Base Rent because it understated square footage upon which rents were based. We could not determine the total Marketplace Lease and Theatre Lease premises square footage and thus total minimum base rents due the City because EDC did not commission an independent certified engineering survey of the premises. However, based on an HHC survey, HHC may owe the City as much as \$1,222,751 for unpaid rents, plus accrued interest, for the period January 1, 2007, through December 31, 2012.

HHC also improperly calculated its Marketplace Alternative Base Rent due the City and, therefore, may owe the City additional rent. Specifically, when calculating Marketplace Alternative Base Rent for the period January 1, 2011, through June 30, 2011, HHC did not generate or report income, improperly calculated imputed reimbursement rates because it overstated expenses and understated square footage, deducted from Gross Receipts direct reimbursements that were not supported by Subleases and Subtenant invoices, and deducted duplicative explicit and imputed reimbursements.

Additionally, for the year-ending June 30, 2011, HHC reported Theatre income of only \$2,000, and consequently, the City did not realize any Theatre Retail Alternative Base Rent or Retail Supplemental Rent. Since 2001, HHC allowed certain groups to use the Theatre generally rent free. While this may have been civic-minded, HHC was supposed to generate income from this property—not donate it.

Finally, HHC inappropriately conducted business in the name of the South Street Seaport Merchants Association, Inc. (the Merchants Association) because the Merchants Association was solely represented and managed by the landlord—and not largely by the merchants as intended. Therefore, the Merchants Association is a defunct organization and HHC should not have assessed dues, conducted business, and filed tax returns in its name.

Our review also determined that EDC did not adequately monitor HHC to ensure its compliance with lease terms. As the agency with oversight responsibility over the lease, EDC should have ensured that HHC complied with financial reporting and rental terms. Additionally, we noted that the City and EDC entered an agreement that proved not to be in the City's best interests because it provided HHC more favorable rent terms.

Lastly, the City did not ensure that a wholesale fish market operated in the South Street Seaport and thus, did not preserve the historic and cultural importance of the historic district in fulfillment of the South Street Seaport Project.

Audit Recommendations

To address these issues, we make 19 recommendations—9 to HHC and 10 to EDC—including that HHC should:

- Upon notification, remit to the City EDC-assessed Marketplace Minimum Base Rent and Theatre Retail Minimum Base Rent and accrued interest resulting from understated square footage for the period January 1, 2007, through December 31, 2012.
- Sublease Marketplace Lease and Theatre Lease spaces at market rate.
- When calculating imputed reimbursement rates, calculate Landlord's Qualifying Floor Area square footage based on an EDC-commissioned independent certified engineering survey of the Marketplace Lease premises.

- Deduct either explicit reimbursements or imputed reimbursements.
- Immediately operate the Merchants Association in accordance with its Articles of Incorporation and By-Laws or dissolve it.

With regard to HHC, EDC should:

- Immediately commission an independent certified engineering survey to determine and document the Gross Leasable Area square footage, total square footage, and Landlord's Qualifying Floor Area square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises.
- Calculate Marketplace Minimum Base Rent and Theatre Retail Minimum Base Rent and accrued interest owed the City resulting from understated square footage for the period January 1, 2007, through December 31, 2012.
- Send written notice to HHC advising it that unpaid Marketplace Minimum Base Rent and Theatre Retail Minimum Base Rent and accrued interest charges are to be paid in full immediately and that a failure to pay these charges in full within 15 days of written notice constitutes an Event of Default under Article 24 of the lease.
- Routinely review quarterly and annual reports submitted by HHC to ensure the accuracy of the calculation of Alternative Base Rent.
- Ensure that HHC's redevelopment plan provides that the Fish Market Premises be continually used for wholesale fish market purposes and work with HHC to find a year-round wholesale fish market operator.

Auditee Responses

In their response, HHC officials generally disputed the report's findings and maintained they report revenues and expenses, and calculate rents due the City in accordance with the terms of its leases as amended and supplemented. Most notably, based on a recent survey and a review of the lease terms, HHC officials asserted that HHC "remitted all rents due to the City as of December 31, 2012 and may be due a refund for minimum base rent overpayments of approximately \$74,198 since its emergence from bankruptcy in November 2010." However, the survey proffered by HHC does not cover a significant portion of the Marketplace Lease premises, i.e., Pier 17 and the Fish Market Stalls. More importantly, this survey is not reliable because it is not consistent with an earlier survey performed by the same firm.

HHC officials also maintained that a Stipulation and Agreed Order dated October 21, 2010, settled "all claims and obligations through October, 21, 2010." However, it appears that this Stipulation and Agreed Order settled only certain specified issues regarding Marketplace ABR, i.e., the methodology for calculating the Telco Credit and Gross Receipts. Additionally, the Stipulation and Agreed Order appears to have been limited to the period 2002 to 2008 and does not appear to settle or waive any claims that may arise after that period.

Lastly, HHC officials argued that HHC is not obligated to pay minimum base rents resulting from understated square footage until it became aware of such understatements in 2013. However, HHC provided no evidentiary or other support for its position.

In their response, EDC officials agreed in principle with most of the report's findings and recommendations related to HHC and EDC lessees that pay income-based rent and detailed steps they took or will take to implement the recommendations. EDC did not agree to pursue

collection of rents for the period January 1, 2007, through October 21, 2010, on the basis that the Stipulation and Agreed Order dated October 21, 2010, settled “[a]ll outstanding issues concerning rent payments.” However, as noted, it appears that this Stipulation and Agreed Order settled only certain specified issues regarding Marketplace ABR, i.e., the methodology for calculating the Telco Credit and Gross Receipts and for the period of 2002 to 2008.

EDC also disagreed with two recommendations regarding HHC’s leasing practices and ensuring that HHC’s redevelopment plan provides for a wholesale fish market.

INTRODUCTION

Background

EDC is responsible for the management of select industrial and commercial spaces throughout the five boroughs as well as several retail and wholesale food markets. Part of EDC's management responsibilities include leasing space to and collecting rent from tenants occupying the historic Seaport Marketplace and Theatre located in lower Manhattan along the East River.

The City, as successor-in-interest to the South Street Seaport Corporation, and HHCⁱ, as successor-in-interest to Seaport Marketplace Incorporated, are parties to the December 15, 1981, Marketplace Lease, as amended and supplemented, for designated spaces within the South Street Seaport. Those spaces are: Pier 17, the Commercial Areasⁱⁱ, the Fish Market Stalls, and the Market, Museum, Schermerhorn, and Telcoⁱⁱⁱ Blocks. Under the terms of the Marketplace Lease, HHC is required to maintain and operate the Marketplace premises as a first-class, specialty retail marketplace and pay the City:

- **Base Rent** that is the greater of: a Minimum Base Rent that is generally the product of \$3.50 and Gross Leasable Area^{iv} square footage or an Alternative Base Rent of 15 percent of Gross Receipts^v exclusive of subtenant reimbursements of certain operating and administrative expenses^{vi}, and offset by a portion of its real estate obligation^{vii}. Minimum Base Rent is due, in advance, in equal monthly installments on the first of each month. If applicable, Alternative Base Rent is due within 45 days after the end of each quarter.
- **Supplemental Rent** is equal to 50 percent of all Remaining Net Cash^{viii}, if any, and due within 45 days after the end of each quarter.

Additionally, the City and HHC are parties to the July 27, 1983, Theatre Lease for the Seaport Theatre located at 133 Beekman Street. Under the terms of the Theatre Lease, HHC is required to maintain and operate the Theatre premises as either: a theater; a venue for other customary theater activities such as exhibits, meetings, and concerts; or a first-class, specialty retail marketplace. In exchange for the use of the Theatre premises, HHC agreed to pay the City:

- **Base rent** that is the greater of: Retail Minimum Base Rent equal to the product of \$3.50 and Gross Leasable Area square footage or Retail Alternative Base Rent of 15 percent of all Gross Receipts^{ix} exclusive of reimbursements payable for certain operating and administrative expenses^x and certain other amounts receivable^{xi}. Retail Minimum Base Rent is due, in advance, in equal monthly installments on the first of each month. And if applicable, Retail Alternative Base Rent is due within 45 days after the end of each quarter.
- **Retail Supplemental Rent** is equal to 50 percent of all Net Cash^{xii}, if any, and due within 45 days after the end of each quarter.

Accordingly, HHC was required to: submit to the City certified quarterly and annual statements detailing Gross Receipts and other factors relevant to the computation of rents, keep complete and accurate books of account and records to enable the City to confirm the accuracy of certified statements, and retain such books and records for at least six years and make them available for inspection and audit. HHC was also required to pay Seaport Marketplace and Theatre Impositions and utilities charges.

For the year-ending June 30, 2011, HHC reported:

- **Marketplace Gross Receipts** of \$7.5 million for which HHC paid Minimum Base Rent of \$1.3 million and no Supplemental Rent, and
- **Theatre Gross Receipts** of \$2,000 for which HHC paid Retail Minimum Base Rent of \$22,866 and no Retail Supplemental Rent.

Objectives

The objectives of this audit were to determine whether:

- HHC accurately reported Gross Receipts, properly calculated rents, and complied with other major requirements of its lease agreements.
- EDC adequately monitored HHC to ensure its compliance with lease agreement terms.

Scope and Methodology Statement

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

The scope of this audit was Fiscal Year ending June 30, 2011. We extended our audit scope to cover the period January 1, 2007, through December 31, 2012, to expand on the effect of HHC improperly calculating its rents. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

Discussion of Audit Results

The matters covered in this report were discussed with HHC and EDC officials during and at the conclusion of this audit. A preliminary draft report was sent to HHC and EDC officials and was discussed at an exit conference held on May 31, 2013. On June 5, 2013, we submitted a draft report to HHC and EDC officials with a request for comments. We received written responses from HHC and EDC officials on June 20, 2013, and June 19, 2013, respectively.

In their response, HHC officials generally disputed the report's findings and maintained they report revenues and expenses, and calculate rents due the City in accordance with the terms of its leases as amended and supplemented. Most notably, HHC officials asserted that HHC "remitted all rents due to the City as of December 31, 2012 and may be due a refund for minimum base rent overpayments of approximately \$74,198 since its emergence from bankruptcy in November 2010." Specifically, HHC officials maintained that based on a recent survey and a review of the lease terms, it determined "the 2013 GLA for the premises to [be] 325,633 square feet. The annual minimum base rent for the revised GLA is estimated to be \$1,264,959." Additionally, HHC officials maintained that the Stipulation and Agreed Order dated October 21, 2010, settled "all claims and obligations through October, 21, 2010." Moreover,

HHC is not obligated to pay minimum base rents resulting from understated square footage until it became aware of such understatements in 2013.

During the course of the audit, HHC provided us a survey which detailed square footage for certain spaces within the Marketplace Lease Premises. HHC now disavows this survey and proffers a more recent survey performed by the same firm. However, this new survey does not cover a significant portion of the Marketplace Lease premises, i.e., Pier 17 and the Fish Market Stalls. More importantly, although spaces did not appear to be altered, square footages on the original and new survey were not consistent. Therefore, we cannot place any reliance on these surveys.

Additionally, contrary to HHC's assertion, the Stipulation and Agreed Order did not resolve "all claims and obligations through October, 21, 2010." Rather, this Stipulation and Agreed Order appeared to have settled only certain specified issues regarding Marketplace ABR, i.e., the methodology for calculating the Telco Credit and Gross Receipts and only for the period from 2002 to 2008. Lastly, HHC provides no evidentiary or other support for maintaining that it is allowed to pay the City lesser minimum base rents until it reports or EDC discovers changes to square footage.

In their response, EDC officials agreed in principle with most of the report's findings and recommendations related to HHC and EDC lessees that pay income-based rent and detailed steps they took or will take to implement the recommendations. EDC did not agree to pursue collection of rents for the period January 1, 2007, through October 21, 2010. EDC officials maintained that the Stipulation and Agreed Order dated October 21, 2010, settled "[a]ll outstanding issues concerning rent payments." However, this Stipulation and Agreed Order appeared to have settled only certain specified issues regarding Marketplace Alternative Base Rent, i.e., the methodology for calculating the Telco Credit and Gross Receipts and did not relieve HHC of all Tenant obligations under the lease prior to October 21, 2010. Additionally, the Stipulation and Agreed Order appears to have been limited to the period 2002 to 2008 and does not appear to settle or waive any claims that may arise after that period.

EDC disagreed with two recommendations regarding HHC's leasing practices and ensuring that HHC's redevelopment plan provides for a wholesale fish market. EDC stated that it cannot ensure that HHC subleases Marketplace and Theatre Lease spaces at market rate because it is not authorized to approve Subtenant leases. Clearly, the intent of the Marketplace Lease and Theatre Lease is for HHC to generate revenue by subleasing City space and for the City to share in HHC revenues. As the lease administrator, EDC is responsible for ensuring that HHC performs its obligations. At minimum, EDC should ensure that HHC ceases its practice of granting Subtenants the long-term use of retail space essentially rent-free.

With regard to the fish market, EDC maintained that the New Fulton Fish Market lease "prohibits the establishment of another City sponsored fish market." However, the City's obligation to ensure that the South Street Seaport Fish Market Premises are occupied and continually used for wholesale fish market purposes dates back to 1981—20 years before the City entered the New Fulton Fish Market lease. If the City no longer wanted a fish market to operate in the South Street Seaport, it should have amended the Seaport Marketplace lease.

EDC also disagreed that the City and EDC entered an agreement that proved not to be in the City's best interest largely on the basis that the "Agreement in question was approved by the Comptroller in 2010." The Comptroller's approval was granted based on information and documentation provided by EDC and Corporation Counsel and Corporation Counsel's assertion that the amendment protected and possibly improved the manner in which rent would be calculated for the remaining decades of the Marketplace Lease term and would be in the best interests of the City. However, the agreement allowed HHC to receive a Telco Tax Credit in

excess of its net expense incurred and claim amounts as both a tax credit and as a Capital Expense. More important, it allowed HHC to exclude from Gross Receipts imputed reimbursements. For the six-month period ending June 30, 2011, HHC deducted imputed reimbursements totaling \$3,645,224, and in turn, reduced its Base Rent obligation by \$330,637. It is for these reasons that we state that the City and EDC entered into an agreement that proved not to be in the City's best interest.

FINDINGS

HHC improperly calculated Marketplace Minimum Base Rent and Theatre Retail Minimum Base Rent because it understated square footage upon which rents were based. We could not determine the total Marketplace Lease and Theatre Lease premises square footage and thus total minimum base rents due the City because EDC did not commission an independent certified engineering survey of the premises. However, based on an HHC survey, HHC may owe the City as much as \$1,222,751 for unpaid rents, plus accrued interest, for the period January 1, 2007, through December 31, 2012.

HHC also improperly calculated its Marketplace Alternative Base Rent due the City and, therefore, may owe the City additional rent. Specifically, when calculating Marketplace Alternative Base Rent for the period January 1, 2011, through June 30, 2011, HHC did not generate or report income, improperly calculated imputed reimbursement rates because it overstated expenses and understated square footage, deducted from Gross Receipts direct reimbursements that were not supported by Subleases and Subtenant invoices, and deducted duplicative explicit and imputed reimbursements.

Additionally, for the year-ending June 30, 2011, HHC reported Theatre income of only \$2,000, and consequently, the City did not realize any Theatre Retail Alternative Base Rent or Retail Supplemental Rent. Under the terms of the Theatre Lease, HHC was to operate the Theatre Premises as either: a theater, a venue for other customary theater activities, or a first-class and specialty retail marketplace. In exchange for the use of this space, HHC was to pay the City rents that were based, in part, on income generated from these activities. However, since 2001, HHC allowed certain groups to use the above space rent free. While this may have been civic-minded, HHC was supposed to generate income from this property—not donate it.

Finally, HHC inappropriately conducted business in the name of the Merchants Association. An HHC official informed us that he served as the Board's sole Director because the former merchant Directors were involved in litigation, evicted for non-payment of rent, and were not replaced. Because the Merchants Association is solely represented and managed by the landlord—and not largely by the merchants as intended—this is a defunct organization and HHC should not have assessed dues, conducted business, and filed tax returns in its name.

Our review also determined that EDC did not adequately monitor HHC to ensure its compliance with lease terms. As the agency with oversight responsibility over the lease, EDC should have ensured that HHC complied with financial reporting and rental terms. Additionally, we noted that the City and EDC entered an agreement that was proved not to be in the City's best interests because it provided HHC more favorable rent terms.

Lastly, the City did not ensure that a wholesale fish market operated in the South Street Seaport and thus, did not preserve the historic and cultural importance of the historic district in fulfillment of the South Street Seaport Project.

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

HHC Owes the City Additional Marketplace Minimum Base Rent and Accrued Interest

HHC improperly calculated Marketplace Minimum Base Rent (MMBR) and, therefore, owes the City additional MMBR and accrued interest^{xiii}. According to its lease agreement, HHC was required to pay the City MMBR, which is generally calculated by multiplying \$3.50 by Gross

Leasable Area square footage. However, when calculating MMBR, HHC understated its square footage. We could not determine the total Marketplace Lease Premises square footage and thus total MMBR due the City because EDC did not commission an independent certified engineering survey to determine the Gross Leasable Area square footage and total square footage of designated spaces within the Marketplace Lease Premises. During the course of the audit, HHC provided us a survey which detailed square footage for certain spaces within the Marketplace Lease Premises. According to this survey, HHC understated Marketplace Lease Premises square footage by at least 41,859 square feet, which would result in unpaid MMBR of \$190,086 for Calendar Year 2011 as follows:

Marketplace Minimum Base Rent Due the City Resulting from Understated Square Footage
January 1, 2011, through December 31, 2011

Space	A Annual Minimum Base Rent Calculation Per Lease	B Sq. Ft. Per HHC Certified Statements	C Sq. Ft. Per HHC Lease Plan or Lease	D Sq. Ft. Under-Statement (Column C – Column B)	E Min. Base Rent Per HHC Certified Statements (Based on Columns A and B)	F Min. Base Rent Per Auditors (Generally Based on Columns A and C)	G Min. Base Rent Due the City (Column F – Column E)
Pier 17	\$3.50 x GLA	124,458	123,449	See Note	\$435,603	\$435,603	\$0
Market	\$3.50 x GLA	87,949	93,118	5,169	\$307,822	\$325,913	\$18,092
Museum	\$3.50 x GLA	18,399	28,311	9,912	\$64,397	\$99,089	\$34,692
Schermerhorn	\$3.50 x GLA	28,313	39,716	11,403	\$99,096	\$139,006	\$39,911
Telco	\$3.50 x GLA	23,487	33,765	10,278	\$82,205	\$118,178	\$35,973
Fish Market Stalls	\$12.05 x GLA	16,430	21,527	5,097	\$197,982	\$259,400	\$61,419
Commercial Areas	\$3.50 x (Applicable Fraction x Total Sq. Ft.)	13,057	13,057	0	\$45,700	\$45,700	\$0
Carts		1,690	1,690	See Note	\$5,915	\$5,915	\$0
Outdoor Cafes		3,742	3,742	See Note	\$13,097	\$13,097	\$0
Mgmt Offices	\$3.50 x GLA	3,344	3,344	See Note	\$11,704	\$11,704	\$0
Total		320,869	361,719	41,859	\$1,263,518	\$1,453,604	\$190,086

Note: The HHC lease plan dated March 2011 did not account for all Pier 17 Gross Leasable Area square footage and it did not indicate Cart, Outdoor Cafes, and Management Offices Gross Leasable Area square footage. Therefore, we calculated Minimum Base Rent for these spaces based on Gross Leasable Area square footage reported in HHC's certified Statement of Minimum Base Rent.

Moreover, based on the above analysis and HHC Certified Statements of MMBR for the period January 1, 2007, through December 31, 2012, we estimate that, in total, HHC may owe the City as much as \$1,625,902—\$1,099,568 unpaid MMBR and \$526,334 for accrued interest as follows:

Marketplace Minimum Base Rent and Accrued Interest Due the City
Resulting from Understated Square Footage
January 1, 2007, through December 31, 2012

	A	B	C
Period	Minimum Base Rent Per Auditors	Minimum Base Rent Per HHC's Certified Financial Statements	Minimum Base Rent Due the City (Column A – Column B)
CY 2012	\$1,453,604	\$1,263,518	\$190,086
CY 2011	\$1,453,604	\$1,263,518	\$190,086
CY 2010	\$1,453,604	\$1,263,518	\$190,086
CY 2009	\$1,453,604	\$1,263,518	\$190,086
CY 2008	\$1,453,604	\$1,263,520	\$190,084
CY 2007	\$1,280,671 ^{xiv}	\$1,131,531	\$149,140
Marketplace Minimum Base Rent			\$1,099,568
Interest of 15% Per Annum through March 31, 2013			\$526,334
Total Marketplace Minimum Base Rent and Interest Due the City			\$1,625,902

At our exit conference on May 31, 2013, HHC acknowledged that it understated Marketplace Lease Premises square footage, but stated that it did so by only 10,196 square feet. Although HHC's name appeared on the above-referenced survey, HHC maintained that it did not know who commissioned the survey or for what purpose it was commissioned. Further, HHC maintained that this survey overstated square footage for certain spaces. HHC provided us a more recent survey completed by the same firm. However, this survey did not cover a significant portion of the Marketplace Lease premises. Specifically, the new survey did not cover Pier 17 and the Fish Market Stalls. More importantly, although spaces did not appear to be altered, square footages on the original and new survey were not consistent. Therefore, we cannot place any reliance on these surveys.

Additionally, HHC did not always make MMBR payments in a timely manner. As noted, such payments were due, in advance, in equal monthly installments on the first of each month. However, for the period January 1, 2012, to December 31, 2012, HHC paid monthly MMBR late nine times. These payments were up to 24 days late.

HHC Response: "SSSLP has paid all rent due the City as of December 31, 2012 and may be due a refund for minimum base rent overpayments of approximately \$74,198 since its emergence from bankruptcy in November 2010.

"Based on the partial AutoCAD Backgrounds provided by Rothschild Downes and a detailed review of the lease terms related to the Commercial Areas, SSSLP revised the 2013 GLA for the premises to 325,633 square feet. The annual minimum base rent for the revised GLA is estimated to be \$1,264,959."

Auditor Comment: As previously noted and as acknowledged by HHC, the newly provided survey covered only part of the Marketplace lease premises. Specifically, the new survey did not cover Pier 17 and the Fish Market Stalls. More importantly, although spaces did not appear to be altered, square footages on the original and new survey were not consistent. Therefore, we cannot place any reliance on these surveys.

HHC Response: “SSSLP has been overstating its GLA by 5,432 square feet and thus overstating its annual rent by \$19,012 due to the double counting of outdoor café and cart square footage in its GLA.”

Auditor Comment: EDC should immediately commission an independent certified engineering survey to determine and document the Gross Leasable Area square footage, total square footage, and Landlord’s Qualifying Floor Area square footage of designated spaces—including the Commercial Areas—within the Marketplace Lease and Theatre Lease Premises.

HHC Response: “SSSLP is only required to pay rent the total number of square feet of the Commercial Areas multiplied by the greater of (A) a fraction, representing the percent of a 365 day year for which such Commercial Areas were leased and (b) 2/3 which is approximately 8 months. This lease term explicitly acknowledges that the Street Merchandising Area may not be utilized during the winter months due to weather. SSSLP management confirms that since emergence from bankruptcy, the carts have operated from April 1 to October 31 which is 7 months. As a result, SSSLP has been overstating its rent by \$15,233 per year because it has been paying 12 months of rent in error.”

Auditor Comment: Minimum Base Rent for the Commercial Areas shall be “the product of \$3.50 and the total number of square feet of the Commercial Areas multiplied by the greater of (A) a fraction, the numerator of which is the number of days in such Fiscal Year for which such Commercial Areas or any part thereof shall have been leased or licensed to any Marketplace Subtenant or used by Tenant and the denominator of which is 365, and (B) 2/3.” While HHC indicates that its carts operated for only seven months of the year, HHC does not indicate the number of days that any part of the Commercial Areas were leased to Subtenants or utilized by HHC. Moreover, although HHC maintains that this area “may not be utilized during the winter months,” it operated a holiday market in the Commercial Areas in November and December 2011. Therefore, EDC should review all Commercial Areas Subleases and sublicenses to determine the number of days that any part of the Commercial Areas were utilized by Subtenants. Further, EDC should also determine the number of days that any part of the Commercial Areas were utilized by HHC.

HHC Response: “The Rothschild Downes AutoCAD Backgrounds which were certified by an architect in 2012 reported an increase in SSSLP premise square footage of 10,196 which is equivalent to annual rent of \$35,686. The lease agreement does not explicitly state how changes in GLA are to be identified. However, per Article 3 Section 3.01(a)(i) “Minimum Base Rent”, which term shall mean the aggregate of (x) the product of \$3.50 and the total number of square feet of Gross Leasable Area included, as of the beginning of such Fiscal Year. SSSLP did not become officially aware of the increase in GLA until October 2012, and therefore, will adjust the GLA as of January 1, 2013 in accordance with the terms of the lease. We will adjust our rent during the second quarter of 2013 to include the changes in GLA.”

Auditor Comment: Under the terms of the Marketplace Lease, Minimum Base Rent is the product of \$3.50 and the total number of square feet of Gross Leasable Area included, as of the beginning of such Fiscal Year. The purpose of this provision is to simplify the calculation of Minimum Base Rent, i.e., not to have to continually adjust for alterations of retail space throughout the lease year. This provision is not intended to allow HHC to pay lesser Minimum Base Rents until it reports or EDC discovers changes

to square footage.

HHC Owes the City Additional Theatre Retail Minimum Base Rent and Accrued Interest

HHC improperly calculated Theatre Retail Minimum Base Rent (TRMBR) payments and, therefore, owes the City additional TRMBR and accrued interest^{xv}. As noted, HHC was required to pay the City TRMBR, which is “an amount equal to the product of Three and 50/100 Dollars (\$3.50) multiplied by the total number of square feet of Gross Leasable Area.” However, when calculating TRMBR, HHC understated its square footage. We could not determine the total Theatre Lease Premises square footage and thus total TRMBR due the City because EDC did not commission an independent certified engineering survey to determine the Theatre Lease Premises Gross Leasable Area square footage. During the course of the audit, HHC provided us a survey which detailed square footage for the Theatre Lease Premises. According to this survey, the Theatre Gross Leasable Area was 12,399 square feet and, therefore, HHC should have paid the City annual TRMBR of \$43,397 (i.e., \$3.50 x 12,399). However, HHC paid only \$22,866—an effective square foot rate of \$1.84—because it calculated rent based on an outdated Gross Leasable Area figure—6,533 square feet—from 1983^{xvi}. Consequently, we estimate that HHC may owe the City TRMBR and accrued interest of \$143,934 as follows:

Theatre Retail Minimum Base Rent and Accrued Interest Due the City
Resulting from Understated Square Footage
January 1, 2007, through December 31, 2012

	A	B	C
Period	Theatre Retail Minimum Base Rent Per Auditors	Theatre Retail Minimum Base Rent Per HHC’s Certified Financial Statements	Theatre Retail Minimum Base Rent Due the City (Column A – Column B)
CY 2012	\$43,396.50	\$22,866.00	\$20,530.50
CY 2011	\$43,396.50	\$22,866.00	\$20,530.50
CY 2010	\$43,396.50	\$22,866.00	\$20,530.50
CY 2009	\$43,396.50	\$22,866.00	\$20,530.50
CY 2008	\$43,396.50	\$22,866.00	\$20,530.50
CY 2007	\$43,396.50	\$22,866.00	\$20,530.50
Theatre Retail Minimum Base Rent			\$123,183.00
Prime Rate Interest through March 31, 2013			\$20,751.46
Total Theatre Retail Minimum Base Rent and Interest Due the City			\$143,934.46

At our exit conference on May 31, 2013, HHC acknowledged that it understated Theatre Lease Premises square footage, but stated that it did so by only 2,657 square feet. Although HHC’s name appeared on the above-referenced survey, HHC maintained that it did not know who commissioned the survey or for what purpose it was commissioned. Further, HHC maintained that this survey overstated Theatre square footage. HHC provided us a more recent survey completed by the same firm. However, the original and new survey were not consistent. Therefore, we cannot place any reliance on these surveys.

Additionally, HHC did not make TRMBR payments in a timely manner. As noted, such payments were due, in advance, in equal monthly installments on the first of each month. However, for the period January 1, 2012, to December 31, 2012, HHC paid monthly TRMBR late nine times.

These payments were up to 24 days late.

HHC Response: “Rothschild Downes certified the total gross leasable area of this space to be 9,900 square feet.”

Auditor Comment: As previously noted, HHC provided us two surveys completed by the same firm. However, the original survey and the new survey were not consistent. Therefore, we cannot place any reliance on these surveys.

HHC Response: “On November 9, 2010, The Howard Hughes Corporation (“HHC”) completed its spin-off from GGP, Inc., formerly known as General Growth Properties, Inc. (“GGP”) in connection with GGP’s emergence from bankruptcy. On the date of the spin-off, HHC became the owner of the South Street Seaport Limited Partnership, the Seaport Marketplace, Inc. and the South Street Theater Associates Limited Partnership which are parties to leases with South Street Seaport Corporation....

“On October 21, 2010, the executed Stipulation and Agreed Order Resolving Dispute Regarding Cure Amounts Relating to Assumed Nonresidential Real Property Leases at South Street Seaport; and Adopting Modification of Lease Provision and Agreed Upon Methodology for the Calculation of Gross Receipts was filed with the United States Bankruptcy Court’s Southern District of New York. This Stipulation Agreement resolved all claims and obligations through October, 21, 2010...

“As a result of the emergence from bankruptcy in 2010, the Theatre’s obligation is limited to the time period from October 21, 2010 to December 31, 2012.”

Auditor Comment: Contrary to HHC’s assertion, the Stipulation and Agreed Order dated October 21, 2010, did not resolve “all claims and obligations through October, 21, 2010.” Rather, this Stipulation and Agreed Order appears to have settled only certain specified issues regarding Marketplace ABR, i.e., the methodology for calculating the Telco Credit and Gross Receipts and for the period 2002 to 2008.

HHC Response: “The Theatre will adjust its rent during the second quarter of 2013 to include the changes in GLA.”

Auditor Comment: Under the terms of the Theatre Lease, Theatre Retail Minimum Base Rent is the product of \$3.50 and the total number of square feet of Gross Leasable Area as of the beginning of such Fiscal Year. The purpose of this provision is to simplify the calculation of Minimum Base Rent, i.e., not to have to continually adjust for alterations of retail space throughout the lease year. This provision is not intended to allow HHC to pay lesser Theatre Retail Minimum Base Rents until it reports or EDC discovers changes to square footage.

Marketplace Alternative Base Rent

HHC improperly calculated Alternative Base Rent (ABR) due the City because it did not include in Gross Receipts all required rent and other income and it deducted from Gross Receipts expenses that were improper or insufficiently supported. As a result, HHC may have significantly understated its Gross Receipts and HHC may, in fact, owe the City ABR and Supplemental Rent. As noted, HHC was required to pay the City ABR that is the greater of: MMBR based on square footage or an ABR of 15 percent of Gross Receipts exclusive of subtenant reimbursements of certain operating and administrative expenses, and offset by a portion of its real estate obligation. However, when calculating ABR for the period January 1, 2011, through

June 30, 2011, HHC did not generate or report income of at least \$399,266 for certain spaces as follows:

- *Subtenant rental and other income:* Based on our review of 19 sampled Subtenant leases and charges for the period January 1, 2011, through June 30, 2011, we estimate that HHC did not charge Subtenants rent or report Subtenant rental and other income totaling at least \$199,368 for 13 sampled Subleases as follows:

For three of 19 sampled Subleases, HHC did not generate Subtenant rental income of at least \$149,938. Most notably, HHC allowed two Subtenants the long-term use of two spaces, essentially rent-free, as a venue for an exhibition and an artist studio. Respectively, these spaces were 2,584 square feet and 1,980 square feet, and HHC charged neighboring Subtenants base rents of at least \$59.50 and \$68.80 per square foot plus percentage rent and other charges. Therefore, for these two spaces, we estimate that HHC did not generate Subtenant rental income of at least \$144,986.

HHC Response: “SSSLP is a for-profit entity, and in order to maximize shareholder return, management continuously operates in a manner to achieve the highest rents possible.

“Two leases were identified in the Audit Report as high value and not paying market rent. One lease, located in the Schermerhorn Building, was an extension of the GGP management office and was operated as a customer information center for Seaport history and future planning.”

Auditor Comment: Under the terms of the Marketplace Lease, HHC is allowed to use up to 5,000 square feet of Gross Leasable Area “to provide supporting clerical, administrative and executive offices.” According to HHC’s certified Statement of Minimum Base Rent, HHC utilizes 3,344 square feet for such purposes. HHC is not permitted to set aside an additional 2,584 square feet. More important, this space was not an extension of HHC’s management offices and was not used to provide supporting clerical, administrative, and executive offices.

HHC Response: “The second lease is located at the 3rd level of the pier building. The space is raw and un-leasable with no storefront or finishes. Further, it is not suitable for storage because it is on the upper level with no elevator access.”

Auditor Comment: Under the terms of the Marketplace Lease, HHC is required to maintain and operate the Marketplace premises as a first-class, specialty retail marketplace. At the most basic level, these responsibilities include finishing and altering space and subleasing space to Subtenants.

HHC also failed to generate Subtenant rental income of \$4,952 because it improperly calculated a Subtenant’s rent escalation.

Additionally, for June 2011, HHC reported that 27,740 of 261,557 square feet—10.6 percent—of Marketplace spaces were vacant and thus generated no income.

HHC Response: “Occupancy of 89.4% was consistent with the retail leasing industry’s performance in 2010 and 2011.”

Auditor Comment: It appears that HHC is citing national vacancy rates and not New York market rates, which are significantly lower. According to CoStar, New York City retail vacancies for the third and fourth quarters of 2011 were 2.1 percent and 1.9

percent, respectively. (<http://www.costar.com/News/Article/Market-Trend-New-York-City-Retail-Vacancy-Decreases-to-19/135356>)

For 10 of 19 sampled Subleases, HHC did not report Subtenant rental and other income of \$49,430. For seven sampled Subleases, HHC did not report Subtenant rental income of \$24,488. And for four sampled Subleases, HHC failed to report other Subtenant income of \$24,942. Generally, this income related to recurring monthly charges for real estate taxes, visual merchandising, maintenance, and electric. While HHC may ultimately exclude from Gross Receipts reimbursements for Specified Costs, it must still report all such charges to ensure that they do not exceed actual costs and represent additional rent.

- *Dining Voucher Program, Special Events, Advertising, and Vending Income:* Based on our review of HHC records, including revenue schedules and records, agreements, and special event calendars, for the period January 1, 2011, through June 30, 2011, we estimate that HHC did not report income of at least \$199,898 as follows:

Based on HHC's records, it did not report to the City Marketplace Food Voucher Program income of \$150,423 because it maintained that they are pass-through charges and do not constitute revenue. HHC sells tour operators dining vouchers,^{xvii} which can be redeemed at participating Marketplace restaurants. HHC maintained that it only administers this program and, in that capacity, collects payments which it then passes on to merchants upon redemption. However, HHC retains a portion of payments as administrative fees. Moreover, not all vouchers are redeemed. Therefore, program charges payable constitute "revenues receivable by the Tenant...from the conduct of other businesses and/or transactions in, on, or from the Project premises" and HHC should report such revenue to the City after deduction of associated direct costs and expenses payable.

HHC Response: "The City Marketplace Food Voucher program is administered by the Seaport Merchant's Association ("Association"), and the operations of the Seaport Merchant's Association are excluded from the activities of Seaport Marketplace Inc."

Auditor Comment: The Merchants Association is solely represented and managed by the landlord—and not largely by the merchants as intended. This is a defunct organization, and there is no distinction between the Merchants Association and HHC.

Additionally, HHC did not report special events income of *at least* \$49,475 for the period January 1, 2011, through June 30, 2011. These understatements stem largely from HHC's not reporting any income for 37 events and underreporting income for two events which included: film and photography shoots, concerts and school performances, and private events. Based on HHC records, HHC did not report income of \$49,475^{xviii} for 28 of these 39 events. We could not quantify unreported income for the remaining 11 events.

HHC Response: "...the City is duplicating certain special events. SSSLP management confirms that the special events income per the general ledger of \$270,125 is correctly stated."

Auditor Comment: We compared special events and event income reported on HHC's 2011 General Ledger to events and event income reported on HHC's Seaport Alternative Revenue Income schedule for the period January 1, 2011, to June 30,

Auditor Comment: On June 13, 2013, HHC submitted to the Comptroller's Office supporting documentation initially requested between February 7, 2013, and February 15, 2013, and not previously made available to us. Additionally, HHC clarified some previously provided documentation. Because this documentation was provided to us four months after it was initially requested, we can only place limited reliance on it.

Based on this new information, of the expenses totaling \$141,510 that were cited as not supported, we consider \$84,469 to be supported and \$53,221 to be insufficiently supported, and \$3,820 remains unsupported.

- **Improper Expenses:** HHC reported expenses totaling \$129,304 that were: not allowable, such as administrative salaries, administrative office carpeting, and travel; not related to the premises; or not incurred during the period. Most notably, HHC deducted administrative salaries totaling \$90,300.

HHC Response: "Administrative salaries are included in CAM and are billed to the tenants in accordance with the terms of the subleases. SSSLP confirms that the deduction of administrative salaries of \$90,300 is a valid deduction from Gross Receipts because they are included in CAM which is reimbursable by the subtenant."

Auditor Comment: Under the terms of the Marketplace Lease, HHC may deduct from Gross Receipts "a reasonable administrative charge." However, such charges should be reported discretely and not "exceed fifteen (15%) percent of the cost of common area maintenance...actually being performed by Tenant."

- **Insufficiently Supported Expenses:** HHC reported expenses totaling \$90,983 that were not adequately supported by formal agreements or contracts stipulating services to be provided, service location, rate and method of compensation, and period covered. Therefore, we could not verify that expenditures were reasonable and appropriate.

HHC Response: "SSSLP engaged Mayne Construction for general repairs and maintenance services during 2010 and 2011. The most significant services performed by Mayne related to the repair of the wood bongossi deck that surrounds piers 16 and 17 for life safety issues. Since the work was ongoing, SSSLP did not enter into a formal contract with Mayne.

"SSLP engaged Nouveau Elevator to refurbish the elevators and escalators on the premises. Prior to any work being done, SSSLP obtained a proposal from Nouveau due to the dollar amount of the expected services.

"SSSLP engaged Tom Davidson as an independent contractor during 2011 to perform visual merchandising activities for the specialty leasing department on an as needed basis. Since these services were performed on an as needed basis and the amounts paid were immaterial, SSSLP did not enter into a contract."

Auditor Comment: As noted, we could not verify that expenditures were reasonable and appropriate because, as acknowledged by HHC, they were not supported by contracts stipulating services to be provided, service location, rate and method of compensation, and period covered.

HHC also improperly calculated Specified Cost imputed reimbursement rates because it understated Landlord's Qualifying Floor Area Square Footage. (As previously noted, we could not determine the total Marketplace Lease Premises square footage. However, according to an

HHC-commissioned lease plan dated March 2011, HHC understated Marketplace Lease Premises square footage by at least 41,859 square feet.) HHC further reduced Landlord's Qualifying Floor Area Square Footage by between 10 and 15 percent to account for vacancies.

HHC Response: "Per the lease agreements executed by SSSLP, the Tenant pays a proportionate share of the SSSLP's operating costs which is calculated by multiplying SSSLP's operating costs by a fraction, which is Tenant's floor area divided by SSSLP's leased floor area. The Stipulation Agreement refers to the Landlord's Qualifying Floor Space which is defined in the subtenant lease agreements. Thus, the GLA for the premises is not relevant in computing the common area maintenance Imputed Reimbursement rate."

Auditor Comment: As noted, under the terms of the Stipulation and Agreed Order, HHC was to calculate imputed reimbursement rates for each Specified Cost as follows:

Specified Cost Rate = Estimated or Actual Expenses ÷ Landlord's Qualifying Floor Area Square Footage

HHC Subleases define Landlord's Qualifying Floor Area to mean Landlord's Floor Area, i.e., "the aggregate number of square feet of leasable floor area." However, when calculating Specified Cost Rates, HHC erroneously applied Landlord's Leased Floor Area i.e., "the monthly average of the aggregate number of square feet of Landlord's Floor Area leased to tenants...as of the first day of each calendar month...but not less than ninety (90%) of Landlord's Qualifying Floor Area."

Overstating costs (i.e., increasing the numerator) and understating square footage (i.e., decreasing the denominator) both serve to increase Specified Cost reimbursement rates and imputed reimbursements deducted from Gross Receipts and, ultimately, serve to reduce payments to the City.

Finally, based on our review of 19 sampled Subleases, HHC improperly deducted from Gross Receipts:

- Explicit reimbursements totaling \$1,204,115 related to 12 Subleases that were not supported by Subleases and Subtenant invoices, and

HHC Response: "The 11 Subleases identified in the Audit Report that were not supported by Subleases and Subtenant invoices are Special Deals because the lease terms provide for the express reimbursement of some, but not all, of the items comprising Specified Costs (see Special Deals above). Consistent with the Stipulation Agreement, SSSLP computed the Attributable Costs for each subtenant and re-characterized some or all of the subtenant's base rent as Imputed Reimbursement for purposes of Gross Receipts. SSSLP management has re-reviewed the calculations for the identified tenants and reconfirms that the Imputed Reimbursements of \$1,204,115 are valid deductions."

Auditor Comment: Under the terms of the Marketplace Lease, HHC may deduct from Gross Receipts "sums payable to Tenant pursuant to such Marketplace Subleases as reimbursements" for Specified Costs. We are citing HHC for improperly deducting explicit reimbursement amounts that were not supported by Subleases. For example, HHC deducted from Gross Receipts \$5,770 per month as an explicit Subtenant

reimbursement of heating, ventilation, and air conditioning costs (HVAC). However, HHC did not provide us documentation evidencing that this amount was determined pursuant to the Sublease, which stipulated that in each calendar month, the Subtenant should pay HHC its “proportionate share of (i) the cost of utilities ...and (ii) the cost of maintenance, repair and operation of such equipment and system” which shall be based on an external consultant’s review of data and information regarding the relationship between “(x) the mechanical capacity of the equipment and system which is required for ventilating and air-conditioning the Premises and (y) the total mechanical capacity of such equipment and system which is available for ventilating and air-conditioning Landlord’s Floor Area,” and HHC’s actual consultant and HVAC utilities, operation, maintenance, and repair costs.

- Both explicit and imputed reimbursements for eight sampled Subleases, resulting in improper deductions totaling \$423,277.

HHC Response: “The eight Subleases identified in the Audit Report that contain both explicit and Imputed Reimbursements are Special Deals because the lease terms provide for the express reimbursement of some, but not all, of the items comprising Specified Costs (see Special Deals above). Consistent with the Stipulation Agreement, SSSLP computed the Attributable Costs for each subtenant and re-characterized some or all of the subtenant’s base rent as Imputed Reimbursement for purposes of Gross Receipts. SSSLP management has re-reviewed the calculations for the identified tenants and reconfirms that the explicit and Imputed Reimbursements of \$423,277 are valid deductions.”

Auditor Comment: For each Specified Cost, the Stipulation and Agreed Order allowed HHC to deduct from Gross Receipts *either* an explicit or an imputed reimbursement. However, HHC deducted both. For example, HHC deducted from Gross Receipts \$3,162 per month as an explicit reimbursement of Subtenant common area maintenance (CAM) costs calculated pursuant to the terms of the Sublease. HHC then deducted an additional \$53,762 per month as an imputed reimbursement.

Because HHC: did not generate or report income, improperly calculated imputed reimbursements because it overstated expenses and understated square footage, deducted from Gross Receipts direct reimbursements that were not supported by Subleases and Subtenant invoices, and deducted both explicit and imputed reimbursements, HHC may have significantly understated its Gross Receipts and HHC may, in fact, owe the City ABR Supplemental Rent.

HHC Did Not Sublease the Theatre Lease Premises and Generate Income and Additional Rents

For the Fiscal Year ending June 30, 2011, HHC reported Theatre income of only \$2,000. HHC also reported only nominal income of \$94,066 for the seven-year period January 1, 2007, through December 31, 2013. Under the terms of the Theatre Lease, HHC is to maintain and operate the Theatre Premises as either: a theater, a venue for other customary theater activities, or a first-class, specialty retail marketplace. And under the terms of the Theatre Lease, HHC is to pay the City rents that are based, in part, on income generated from these activities as follows:

- **Base rent** that is the greater of: Retail Minimum Base Rent equal to the product of \$3.50 and Gross Leasable Area square footage or Retail Alternative Base Rent of 15 percent of all Gross Receipts exclusive of reimbursements payable for certain operating and administrative expenses and certain other amounts receivable.
- **Retail Supplemental Rent** equal to 50 percent of all Net Cash, i.e., Gross Receipts less Operating Expenses.

HHC previously subleased the Theatre Premises to a retail operator. However, HHC approximated that this Subtenant vacated the Theatre Premises in 2001 and maintained that, since then, it allows certain groups to use the Theatre Premises, generally rent-free, as a venue for activities such as exhibits. While this may have been civic-minded, HHC was supposed to generate income from this property—not donate it. Consequently, for the period January 1, 2007, through December 31, 2013, the City did not realize any Theatre Retail Alternative Base Rent or Retail Supplemental Rent. Instead, the City received only Retail Minimum Base Rent, which as previously noted, HHC understated and, therefore, HHC may owe the City as much as \$143,934.

HHC Response: “Following the expiration of the Liz Claiborne lease in 2006, SSSLP has been unsuccessful in leasing the vacant premise on a long term basis to a subtenant. The lack of success is related to the remaining term under the Theatre lease which expires in November 2013. SSSLP and or subtenant would have to make a significant capital investment in the improvements to the Theatre premise which is not feasible based on the upcoming November 2013 lease expiration. SSSLP created the brand “@SEAPORT” to promote special events in the Theatre in order to mitigate its inability to secure a long term lease.”

Auditor Comment: Under the terms of the Theatre Lease, HHC is required to maintain and operate the Theatre premises as either: a theater; a venue for other customary theater activities such as exhibits, meetings, and concerts; or a first-class, specialty retail marketplace. At the most basic level, these responsibilities include finishing and altering space and subleasing space to Subtenants. As noted, HHC approximated that this Subtenant vacated the Theatre Premises in 2001, and therefore, has had ample time to sublease this space. At our exit conference held on May 31, 2013, HHC stated that it would provide us evidence of its efforts to lease this space. In response to a follow-up request for such documentation, on June 6, 2013, HHC informed us that this documentation was forthcoming. However, HHC did not provide us any documentation.

HHC Inappropriately Conducted Business in the South Street Seaport Merchants Association’s Name

HHC inappropriately assessed annual dues totaling \$96,496, conducted business, and filed tax returns in the name of the Merchants Association. In 1986, the Merchants Association was formed, as a 501 (c) (6) non-profit, solely to promote the general business interests of the South Street Seaport Merchants. To that end, the Merchants Association Articles of Incorporation and By-Laws provided that:

- The Board of Directors shall manage the Merchants Association business and affairs and be composed of 11 Directors as follows: three to represent restaurant categories, three to represent retail categories, three to represent market and specialty categories, one to represent the merchants’ landlord, and one elected by the membership;

- The Merchants Association shall hold annual, monthly, and special meetings to elect Directors and transact business;
- Each and every business in the South Street Seaport shall be eligible for Merchants Association membership, pay dues, and be entitled to one vote for every dollar paid to the Merchants Association; and
- The merchants' landlord shall also be a full Merchants Association member, have the right to attend and participate in all member meetings, and be entitled to one vote for every dollar contributed or paid to the Merchants Association.

However, an HHC official informed us that he served as the Board's sole Director because the former merchant Directors were involved in litigation, evicted for non-payment of rent, and were not replaced. Because the Merchants Association is solely represented and managed by the landlord—and not largely by the merchants as intended—this is a defunct organization and HHC should not have assessed dues, conducted business, and filed tax returns in its name. Moreover, assessed charges do not constitute dues. Rather, they are additional rents.

HHC Response: “Many of the tenants who were members of the South Street Seaport Merchant's Association (the “Association”) refused to pay their contractually obligated dues. To make up for the budget shortfall, SSSLP voluntarily made contributions to the Association. The Association does not function in the traditional sense because collections and expenditures are at the sole discretion of SSSLP, and is expressly set forth and agreed to in the tenant leases. SSSLP management is in the process of legally dissolving this entity, and we expect the entity to be dissolved in 2013.”

Auditor Comment: During the course of the audit and at our exit conference held on May 31, 2013, HHC informed us that it intended to dissolve the Merchants Association, anticipated that it would be dissolved effective June 2013, and would provide us documentation to evidence this. In response to a follow-up request for such documentation, on June 6, 2013, HHC informed us that this documentation was forthcoming. However, to date, HHC has not provided us any documentation of its efforts to dissolve the Merchants Association.

EDC Did Not Adequately Monitor HHC to Ensure Compliance with the Lease

EDC did not adequately monitor HHC to ensure its compliance with significant lease terms. As the agency responsible for administering the lease, EDC should have ensured that HHC complied with rent and other significant lease terms. However, our review found that EDC did not:

- Commission an independent certified engineering survey to determine the Gross Leasable Area square footage and total square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises and, subsequently, minimum base rents due it.
- Itself conduct routine financial reviews or audits to determine whether HHC accurately reported Gross Receipts, excluded only allowable reimbursements for actual expenses incurred, and properly calculated minimum, alternative, and supplemental rents. In January 2009, EDC did engage an independent Certified Public Accounting (CPA) firm to perform a Marketplace Lease compliance review for the period January 21, 2006, through December

31, 2008. However, this review did not identify MMBR underpayments resulting from understated square footage and ABR underpayments resulting from unreported income and improper deductions.

Consequently, EDC did not identify significant payments due the City. As noted, we estimate that for the period January 1, 2007, through December 31, 2012, HHC may owe the City MMBR of \$1,099,568 and TRMBR of \$123,183, plus accrued interest. Additionally, because HHC: did not generate or report income, improperly calculated imputed reimbursements, deducted from Gross Receipts direct reimbursements that were not supported by Subleases and Subtenant invoices, and deducted duplicative explicit and imputed reimbursements, HHC may have significantly understated its Gross Receipts and HHC may, in fact, owe the City Alternative Base Rent Supplemental Rent.

Other Matters

The City and EDC Entered an Agreement That Proved Not to Be in the City's Best Interest

The City and EDC entered into an agreement that proved not to be in the City's best interest because it provided HHC more favorable rent terms. In April 2009, South Street Seaport Limited Partnership (the successor-in-interest to the original Marketplace Lease signatory and Tenant, Seaport Marketplace, Inc.) and its ultimate parent, General Growth Properties, Incorporated (GGP), commenced bankruptcy proceedings under Chapter 11 of Title 11 of the United States Code. In connection with this, in October 2009, GGP and the City entered into a Lease Assumption Stipulation under which GGP assumed the Marketplace Lease and Theatre Lease and, in October 2010, the City and EDC entered into a Stipulation and Agreed Order, which provided GGP more favorable rent terms effective January 1, 2009. Specifically, the Stipulation and Agreed Order allowed HHC to deduct from Gross Receipts imputed reimbursements and receive a tax credit that may exceed real estate tax expenses incurred. (See Appendix I.)

Moreover, the City and EDC did not evaluate whether GGP or its successor-in-interest to the Marketplace Lease and Seaport Lease, HHC, were fully capable of fulfilling existing or modified lease terms. As noted, GGP filed for bankruptcy in April 2009, its restructuring plan was approved in October 2010, and completed in November 2010, when GGP split into two separate publically traded companies—"new" GGP and HHC. The City and EDC's failure to consider whether a company emerging from bankruptcy was fully capable of developing and operating the South Street Seaport Marketplace and Theatre is especially troubling in light of the South Street Seaport's history of unfilled development.

EDC Response: "The Agreement in question was approved by the Comptroller in 2010, and because of this and other reasons EDC strongly disagrees with this characterization. Following an independent audit conducted by Marks Paneth & Shron, LLP, EDC raised issues with the tenant concerning the payment of alternative base rent. The issues were then brought to Corporation Counsel to be pursued in the Federal Bankruptcy Court in Manhattan. After extensive negotiations between the parties, a settlement was reached resulting in payment of \$300,000, which was believed to be favorable to the City. The subsequent approval of this settlement by the Comptroller would suggest agreement that it was in the City's best interest."

Auditor Comment: The Comptroller’s approval was granted based on information and documentation provided by EDC and Corporation Counsel and Corporation Counsel’s assertion that the amendment protected and possibly improved the manner in which rent would be calculated for the remaining decades of the Marketplace Lease term and would be in the best interests of the City. However, the agreement allowed HHC to receive a Telco Tax Credit in excess of its net expense incurred and claim amounts as both a tax credit and as a Capital Expense. More important, it allowed HHC to exclude from Gross Receipts imputed reimbursements. For the six-month period ending June 30, 2011, HHC deducted imputed reimbursements totaling \$3,645,224, and in turn, reduced its Base Rent obligation by \$330,637. It is for these reasons that we state that the City and EDC entered into an agreement that proved not to be in the City’s best interest.

The City Did Not Ensure that a Wholesale Fish Market Continually Operated at the Fish Market Premises

The City did not ensure that the Fish Market Premises were continually used for wholesale fish market purposes. Section 23.04 of the lease states:

“In further recognition of the historic and cultural importance of the South Street Seaport, Landlord agrees to use reasonable efforts to insure that the Fish Market Premises, at street level, are occupied and used continuously throughout the Term by fish merchants for wholesale fish market purposes, which may include, without limitation, the incidental retail sale of fresh (i.e., uncooked) and frozen fish and other seafood.”^{xix}

The Fulton Street Fish Market space formerly occupied this space and operated a year-round wholesale fish market. However, the Fulton Street Fish Market vacated the premises in 2005 and the City did not ensure that a replacement operator was found. Currently, the site is used only on a limited basis to operate specialty markets offering food, artwork, and other items. Consequently, the City is not preserving the historic and cultural importance of the South Street Seaport Historic district in fulfillment of the South Street Seaport Project.

RECOMMENDATIONS

HHC should:

1. Upon notification, remit to the City EDC-assessed MMBR and TRMBR and accrued interest resulting from understated square footage for the period January 1, 2007, through December 31, 2012.

HHC Response: “SSSLP has remitted all rents due to the City as of December 31, 2012 and may be due a refund for minimum base rent overpayments of approximately \$74,198 since its emergence from bankruptcy in November 2010. SSSLP has commissioned Rothchild Downes to certify the GLA for all premises under the lease, and we expect the certifications to be complete by July 2013. Upon completion of the GLA certifications, SSSLP will adjust the annual minimum rent in accordance with the terms of the lease.

“In addition, the City may owe SSSLP for unreimbursed premiums related to Pier 17. The total amount of insurance premiums paid by SSSLP since 2007 were \$1.1 million.”

Auditor Comment: We reiterate that, upon notification, HHC should remit to the City EDC-assessed MMBR and TRMBR and accrued interest resulting from understated square footage for the period January 1, 2007, through December 31, 2012. EDC, and not HHC, should determine amounts owed to the City. As the lease administrator, EDC should: commission an independent certified engineering survey; establish the Gross Leasable Area square footage, total square footage, and Landlord’s Qualifying Floor Area square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises; calculate annual MMBR and TRMBR based on lease terms and certified Gross Leasable Area square footage and total square footage; and send written notice to HHC advising it that unpaid MMBR and TRMBR and accrued interest charges are to be paid in full immediately and that a failure to pay these charges in full within 15 days of written notice constitutes an Event of Default under Article 24 of the lease.

2. Pay the City MMBR and TRMBR, as calculated by EDC, in advance, on the first of each month.

HHC Response: “As noted above, upon completion of the GLA certifications, SSSLP will adjust the annual minimum rent in accordance with the terms of the lease and remit any amounts due, if any.”

Auditor Comment: Again, EDC, not HHC, should determine amounts owed to the City.

3. Sublease Marketplace Lease and Theatre Lease spaces at market rate.

HHC Response: “SSSLP will continue to actively operate the premises in a manner to achieve the highest rents.”

4. Report to the City all Subtenant rental and other income.

HHC Response: SSSLP will continue to report all subtenant rental and other income in its financial statements and leasing schedules.”

5. When calculating imputed reimbursement rates and deducting expenses, include only expenses that are related to the premises, allowable, adequately supported, and incurred in the period.

HHC Response: “SSSLP will continue to only include expenses that are related to the premise, allowable, adequately supported and incurred in the period.”

6. When calculating imputed reimbursement rates, calculate Landlord’s Qualifying Floor Area square footage based on an EDC-commissioned independent certified engineering survey of the Marketplace Lease premises.

HHC Response: “The lease plan dated March 2011 indicates the gross leasable area, and as noted above, this lease plan is not certified. However, when calculating the Imputed reimbursement rates, the Landlord’s qualifying floor area is based on SSSLP’s leased floor area. Thus, the GLA for the premises is not relevant in computing common area maintenance imputed reimbursement rate.”

Auditor Comment: As noted, under the terms of the Stipulation and Agreed Order, HHC was to calculate imputed reimbursement rates for each Specified Cost as follows:

Specified Cost Rate = Estimated or Actual Expenses ÷ Landlord’s Qualifying Floor Area Square Footage

HHC Subleases define Landlord’s Qualifying Floor Area to mean Landlord’s Floor Area, i.e., “the aggregate number of square feet of *leasable* floor area.” Therefore, we reiterate that when calculating imputed reimbursement rates, HHC should calculate Landlord’s Qualifying Floor Area square footage based on an EDC-commissioned independent certified engineering survey of the Marketplace Lease premises.

7. Deduct from Gross Receipts only Subtenant direct reimbursements that are supported by Subtenant invoices and, more important, Subleases that stipulate reimbursed amounts or rates.

HHC Response: “Footnote 7 in the Stipulation Agreement clarifies that some Special Deal Subleases may provide for the express reimbursement of some, but not all, of the items comprising Specified Costs. We will continue to Impute Reimbursements in accordance with the Stipulation Agreement.”

Auditor Comment: To clarify, this recommendation pertains to explicit reimbursements. HHC should deduct from Gross Receipts “sums payable to Tenant pursuant to such Marketplace Subleases as reimbursements” and such sums should be supported by Subtenant invoices and, more important, Subleases that stipulate reimbursed amounts or rates.

8. Deduct either explicit reimbursements or imputed reimbursements.

HHC Response: “Footnote 7 in the Stipulation Agreement clarifies that some Special Deal Subleases may provide for the express reimbursement of some, but

not all, of the items comprising Specified Costs. We will continue to Impute Reimbursements in accordance with the Stipulation Agreement.”

Auditor Comment: To clarify, for each Specified Cost, HHC should deduct either explicit reimbursements or imputed reimbursements.

9. Immediately operate the Merchants Association in accordance with its Articles of Incorporation and By-Laws or dissolve it.

HHC Response: “SSSLP management is in the process of legally dissolving this entity.”

With regard to HHC, EDC should:

10. Immediately commission an independent certified engineering survey to determine and document the Gross Leasable Area square footage, total square footage, and Landlord’s Qualifying Floor Area square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises.

EDC Response: “The Howard Hughes Corporation is in the process of completing an independent architecturally certified survey by Rothschild Downes which will include the lease defined Gross Leasable Area of both the Marketplace and Theatre lease. Additionally, this survey will now include Pier 17. Once completed, EDC will engage an independent architect to review the survey for accuracy and completeness. EDC will then resolve any differences with The Howard Hughes Corporation and come to agreement on a definitive Total Gross Leasable Area for both leases and the total MMBR and TRMBR from the time The Howard Hughes Corporation emerged from bankruptcy to the present.”

Auditor Comment: As noted, two previous HHC-commissioned surveys performed by this same firm were not consistent. Therefore, we reiterate that EDC itself should: commission an independent certified engineering survey; establish the Gross Leasable Area square footage, total square footage, and Landlord’s Qualifying Floor Area square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises; and calculate annual MMBR and TRMBR based on lease terms and certified Gross Leasable Area square footage and total square footage.

11. Calculate annual MMBR and TRMBR based on lease terms and certified Gross Leasable Area square footage and total square footage.

EDC Response: “EDC agrees with this recommendation based on the process outlined in the response to recommendation #10.”

Auditor Comment: See Auditor Comment for Recommendation # 10.

12. Calculate MMBR and TRMBR and accrued interest owed the City resulting from understated square footage for the period January 1, 2007, through December 31, 2012.

EDC Response: “All outstanding issues concerning rent payments with the tenant were settled in Federal Bankruptcy Court in Manhattan in October 2010. Therefore, EDC cannot pursue collection of MMBR and TRMBR prior to this

date. However, EDC does intend to reach an agreement with The Howard Hughes Corporation for any MMBR and TRMBR based on the procedure outlined in response to recommendation #10.”

Auditor Comment: EDC is not precluded from pursuing collection of MMBR and TRMBR for the period January 1, 2007, through October 21, 2010. Contrary to EDC’s assertion, the Stipulation and Agreed Order dated October 21, 2010, did not settle “[a]ll outstanding issues concerning rent payments.” Rather, it appears that this Stipulation and Agreed Order settled only certain specified issues regarding Marketplace ABR, i.e., the methodology for calculating the Telco Credit and Gross Receipts. Additionally, the Stipulation and Agreed Order appears to have been limited to the period 2002 to 2008 and does not appear to settle or waive any claims that may arise after that period. Therefore, we reiterate that EDC should calculate MMBR and TRMBR and accrued interest owed the City resulting from understated square footage for the period January 1, 2007, through December 31, 2012.

13. Send written notice to HHC advising it that unpaid MMBR and TRMBR and accrued interest charges are to be paid in full immediately and that a failure to pay these charges in full within 15 days of written notice constitutes an Event of Default under Article 24 of the lease.

EDC Response: “EDC intends to proceed in resolution of MMBR and TRMBR based on the process outlined in the response to recommendation #10.”

14. **Auditor Comment:** EDC should not “come to agreement” with HHC as to Marketplace Lease and Theatre Lease square footage and rent and accrued interest charges due the City. As the lease administrator, EDC should: commission an independent certified engineering survey; establish the Gross Leasable Area square footage, total square footage, and Landlord’s Qualifying Floor Area square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises; calculate annual MMBR and TRMBR based on lease terms and certified Gross Leasable Area square footage and total square footage; and send written notice to HHC advising it that unpaid MMBR and TRMBR and accrued interest charges are to be paid in full immediately and that a failure to pay these charges in full within 15 days of written notice constitutes an Event of Default under Article 24 of the lease.

15. Take other appropriate enforcement action.

EDC Response: “EDC will take appropriate action as necessary.”

16. Routinely review quarterly and annual reports submitted by HHC to ensure the accuracy of the calculation of Alternative Base Rent.

EDC Response: “EDC regularly reviews quarterly and annual audited reports submitted by The Howard Hughes Corporation.”

17. Ensure that HHC subleases Marketplace Lease and Theatre Lease spaces at market rate.

EDC Response: “EDC has no approval rights over subleasing of space under the Marketplace and Theatre leases and therefore cannot ensure that spaces are being leased at the market rate.”

Auditor Comment: The intent of the Marketplace Lease and Theatre Lease is for HHC to generate revenue by subleasing City space and for the City to share in HHC revenues. As the lease administrator, EDC is responsible for ensuring that HHC performs its obligations. Moreover, since the City and EDC granted HHC more favorable rent terms because the leased premises were not profitable, EDC should have the right to question HHC leasing practices. At minimum, EDC should ensure that HHC ceases its practice of granting Subtenants the long-term use of retail space essentially rent-free.

18. Ensure that HHC’s redevelopment plan provides that the Fish Market Premises be continually used for wholesale fish market purposes and work with HHC to find a year-round wholesale fish market operator.

EDC Response: “This recommendation is not permissible. In Section 20.04 of The City of New York lease with The New Fulton Fish Market located at the Hunts Point Food Distribution Center in the Bronx, it states that The City of NY ‘shall not actively promote or develop in The City of NY any other ‘public wholesale markets’ for the wholesale distribution of seafood.’ This provision prohibits the establishment of another City sponsored fish market.”

Auditor Comment: The City’s obligation to ensure that the South Street Seaport Fish Market Premises are occupied and continually used for wholesale fish market purposes and to preserve the historic and cultural importance of the South Street Seaport Historic district in fulfillment of the South Street Seaport Project predates and preempts the New Fulton Fish Market lease. The South Street Seaport lease dates back to 1981—20 years before the City entered the New Fulton Fish Market lease. If the City no longer wanted a fish market to operate in the South Street Seaport, it should have amended the Seaport Marketplace lease.

19. Ensure that HHC immediately operates the Merchants Association in accordance with its Articles of Incorporation and By-Laws or dissolve it.

EDC Response: “The Howard Hughes Corporation has notified EDC that it intends to dissolve the Merchants Association.”

Auditor Comment: During the course of the audit and at our exit conference held on May 31, 2013, HHC informed us that it intended to dissolve the Merchants Association, anticipated that it would be dissolved effective June 2013, and would provide us documentation to evidence this. In response to a follow-up request for such documentation, on June 6, 2013, HHC informed us that this documentation was forthcoming. However, to date, HHC has not provided us any documentation of its efforts to dissolve the Merchants Association. Therefore, we reiterate that EDC should ensure that HHC immediately operates the Merchants Association in accordance with its Articles of Incorporation and By-Laws or dissolve it.

With regard to its lessees that pay income-based rents, EDC should:

20. Conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report income, properly calculate rent, and pay the City all money due it.

EDC Response: “EDC has established procedures for auditing leases with income participation clauses. In fact, Marks Paneth & Shron, LLP audited the Seaport Marketplace lease in 2010 in which the findings resulted in a \$300,000 payment to EDC.”

Auditor Comment: As noted, the external CPA firm engaged by EDC did not identify MMBR underpayments resulting from understated square footage and ABR underpayments resulting from unreported income and improper deductions. As a lease administrator, EDC is in a better position to conduct audits and reviews of its highly complex leases. Therefore, we reiterate that EDC itself should conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report income, properly calculate rent, and pay the City all money due it.

DETAILED SCOPE AND METHODOLOGY

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

The scope of this audit was Fiscal Year ending June 30, 2011. We extended our audit scope to cover the period January 1, 2007, through December 31, 2012, to expand on the effect of HHC improperly calculating its rents.

To identify and understand HHC's and the City's rights and responsibilities, we reviewed the terms of: the Marketplace Lease, subsequent Marketplace Lease supplements and amendments, the Supplemental Stipulation and Agreed Order dated February 17, 2010, the Stipulation and Agreed Order dated October 21, 2010, the Theatre Lease, and subsequent Theatre Lease supplements and amendments. We also toured the Marketplace Lease and Theatre Lease premises and reviewed property maps.

To obtain an understanding of HHC's controls over and procedures for receiving, recording, and reporting gross income, we interviewed HHC officials and reviewed HHC: Subleases; Invoices; General Ledger, Accounts Receivable Sales Journal, and Cash Receipts Journal; Deposit Statements and Bank Statements; Certified Quarterly Financial Reports and Rent Rolls submitted to EDC for the quarters ending March 31, 2010, through June 30, 2011; and Certified Financial Statements for Fiscal Year ending December 31, 2011.

Minimum Base Rent

To determine whether HHC accurately calculated Marketplace Minimum Base Rent and the Theatre Retail Minimum Base Rent for the period January 1, 2007, through December 31, 2012, we calculated rents based on lease-stipulated rates and square footage indicated on the HHC-commissioned lease plan dated March 2011 or in the Marketplace Lease. As noted, the HHC lease plan dated March 2011 did not account for all Pier 17 Gross Leasable Area square footage and it did not indicate Cart, Outdoor Cafes, and Management Offices Gross Leasable Area square footage. Therefore, we calculated Marketplace Minimum Base Rent for these spaces based on Gross Leasable Area square footage reported in HHC's certified Statement of Minimum Base Rent. We then compared our calculated rent and square footage calculations to those reported by HHC on its certified Statement of Minimum Base Rent and certified Schedule of Gross Receipts and Retail Alternative Base Rent and quantified underpayments.

Based on the above-detailed analysis, we estimated underpayments for Calendar Years 2007 through 2012 and assessed interest in accordance with Article 6 of the Marketplace Lease and Theatre Lease. Specifically, we assessed 15 percent interest on outstanding Marketplace charges from the date they were due through March 31, 2013, and prime rate interest on outstanding Theatre charges from the date they were due through March 31, 2013.

Alternative Base Rent

Gross Receipts

Subtenant Rent

To determine whether HHC reported Subtenant rent payable for all spaces covered by the Marketplace Lease and Theatre Lease, we first identified and compiled a list of spaces by touring the Marketplace Lease and Theatre Lease premises on December 22, 2011, January 24, 2012, and February 2, 2012, and reviewing property maps. We then determined whether HHC reported Subtenant rent payable for each Leaseable space on its Annual Charges Billed Report and, ultimately, on its Certified Financial Statements submitted to EDC. For those spaces for which HHC did not report Subtenant rent payable, we determined whether spaces were occupied based on Subleases, property maps, and observations.

To determine whether HHC accurately reported Subtenant rent and other charges payable for sampled Subtenants, we compared amounts reported on HHC's Annual Charges Billed Report and, ultimately, on its Certified Financial Statements submitted to EDC, to applicable Sublease payment terms and copies of checks supporting the amounts paid to HHC by Subtenants.

Other Income

Special Events

To determine whether HHC reported all Marketplace and Theatre special events revenue generated from events including charity walks, concerts and other performances, film and photography shoots, and private events, we compared the events and event income reported on HHC's 2011 General Ledger to events and event income reported on HHC's Seaport Alternative Revenue Income schedule for the period January 1, 2011, to June 30, 2011, event calendars, and claimed security expenses. We quantified the number of events that were not reported and quantified unreported or under-reported revenue when possible.

Advertising and Vending

To determine whether HHC reported all advertising and vending charges payable, we first identified all sources of advertising and vending income. We did so by touring the Marketplace Lease premises on December 22, 2011, January 24, 2012, and February 2, 2012, and by reviewing HHC's Alternative Revenue Income schedule and advertising and vending contracts. We then calculated advertising and vending charges payable based on contract rates and sales reports or HHC's Alternative Revenue Income schedule. We compared these amounts to amounts reported on HHC's Annual Charges Billed Report and quantified discrepancies.

Dining Voucher Program

EXCLUSIONS

To determine whether HHC complied with and fulfilled lease insurance terms, we reviewed the HHC's insurance policies, certificates, and schedules. Specifically, we verified whether the HHC maintained required coverage amounts and types of insurance and named the City as an additional insured.

To determine whether HHC complied with and fulfilled lease impositions terms, we reviewed EDC's receivables ledger and determined whether HHC paid charges in full and on a timely basis.

Monitoring

To determine whether EDC adequately monitored the HHC's performance and enforced lease terms in a timely manner, we interviewed EDC officials regarding their lease administration roles and responsibilities, reviewed lease files and receivables ledger, and requested prior audits and other financial or compliance reviews.

APPENDIX I

Comparison of Original and Modified or Documented Lease Terms

Term	Per December 15, 1981 Lease, as amended and supplemented	As Modified or Documented by the October 2010 Stipulation and Agreed Order	Adverse Effect
<p>Calculation of Alternative Base Rent (ABR)</p>	<p>ABR = 15% of all Gross Receipts</p> <p>With regard to Subtenant rental and other payables, Tenant may exclude from Gross Receipts only additional rents explicitly designated as reimbursements for Specified Costs pursuant to Subleases.</p> <p>Specified Costs include Base Rent payable by Tenant, Impositions, costs of finishing or altering Subtenant spaces, common area or other maintenance charges, utilities, promotion and other expenses of operation, and a reasonable administrative charge not to exceed 15 percent of the cost of common area maintenance (limited to the cost of such maintenance actually being performed by Tenant).</p>	<p>Broadens exclusions from Gross Receipts to include imputed reimbursements pursuant to Special Deals Subleases and prescribes methodology for calculating such imputed reimbursements. First, a rate is determined for each item of Specified Cost:</p> <p>Rate = Estimated or Actual Expense ÷ Landlord's Qualifying Floor Area</p> <p>For each Special Deal Sublease, imputed reimbursements are then calculated as follows:</p> <p>Attributable Costs* = Specified Cost Rate x Special Deal Sublease Square Feet</p> <p>*Not to exceed Subtenant rent paid</p>	<p>For the six-month period ending June 30, 2011, HHC deducted imputed reimbursements totaling \$3,645,224.</p> <p>These deductions reduced HHC's Base Rent obligation by \$330,637.</p>
<p>Telco Credit – Change in Calculation, Effective January 1, 2009</p>	<p>Credit = Telco Taxes payable – Subtenant Reimbursements – Amounts claimed as Capital Expenses</p>	<p>Credit = 50 % of Telco Taxes</p>	<p>Allows Tenant to (i) receive a credit in excess of net expense incurred (ii) claim amounts as both a tax credit and as a Capital Expense</p>

APPENDIX II: Footnotes

i In November 2010, HHC assumed responsibility for the lease as part of a bankruptcy restructuring plan.

ii Article 1 of the December 15, 1981 lease defines the Commercial Areas as the portions of streets designated for pushcarts, other mobile vending activities, and unenclosed sidewalk cafes as follows: Fulton Street between South Street and Water Street; Front Street between Fulton Street and Beekman Street, and between John Street and Fulton Street; Water Street between Beekman Street and Fulton Street; and the approximately 18 foot wide strip located on the northwesterly side of South Street between Beekman Street and John Street.

iii The Telco building is not a City-owned property. HHC leases the first two levels of the Telco building from a private landlord. In turn, HHC subleases the leased premises to subtenants. HHC manages the Marketplace Lease premises and Telco lease premises on a unified basis and treats them as a single property. Accordingly, Telco income is reportable under the Marketplace Lease.

iv Article 3.01 (a) of the December 15, 1981 lease stipulates that for Pier 17, and the Market, Museum, Schermerhorn, and Telco Blocks Minimum Base Rent shall be the product of \$3.50 and Gross Leasable Area square footage. And for the Commercial Areas, Minimum Base Rent shall be the product of \$3.50 and the applicable fraction of the Commercial Areas total square footage. The applicable fraction shall be the greater of: two-thirds, or the number of days within the Fiscal Year that the Commercial Areas, or any part thereof, were leased divided by 365.

The September 1, 2007 third amendment to the December 15, 1981 lease expands the demised premises to include the Fish Market Stalls and modifies Minimum Base Rent as it applies to the Fish Market Stalls to be the product of \$12.05 and the Fish Market Stalls Gross Leasable Area square footage.

v Article 3.02 (a) of the December 15, 1981 lease stipulates that Gross Receipts shall mean and include, for any Fiscal Year, all sums payable to Tenant for such Fiscal Year by Marketplace Subtenants, including, without limitation, annual basic rental or minimum rental pursuant to Marketplace Subleases, percentage rental payable to Tenant based on gross sales of Marketplace Subtenants, all other rental payable to Tenant by Marketplace Subtenants, HVAC services and equipment charges and sprinkler charges payable to Tenant pursuant to Marketplace Subleases; rental value insurance proceeds; condemnation awards or payments; plus any and all revenues receivable by Tenant or any Affiliate of Tenant for such Fiscal Year from the conduct of other businesses and/or transactions in, on, or from the Project Premises after deduction therefrom of the direct costs and expenses payable by Tenant or such Affiliate for such Fiscal Year in connection with such other businesses and/or transactions, provided however that such deductions for any Fiscal Year shall not exceed revenues receivable from such other businesses and/or transactions for such Fiscal Year.

vi Article 3.02 (a) of the December 15, 1981 lease allowed the Tenant to exclude from Gross Receipts all sums payable to Tenant pursuant to Marketplace Subleases as explicit reimbursements for: Base Rent payable by Tenant to Landlord; Impositions; costs of finishing or altering space for subtenants; common area and other maintenance charges; utilities; promotion and other expenses of operation; and reasonable administrative charges. And for those Marketplace Subleases that do not contain explicit obligations to reimburse Tenant for Specified Costs, an October 21, 2010 Stipulation and Agreed Order allowed the Tenant to exclude from Gross Receipts imputed reimbursements for these expenses. However, such exclusions cannot exceed subtenant rent paid.

Under the terms of the Stipulation and Agreed Order, HHC was to calculate imputed reimbursement rates for each Specified Cost as follows:

Specified Cost Rate = Estimated or Actual Expenses ÷ Landlord's Qualifying Floor Area Square Footage

HHC was to then calculate imputed reimbursement for each Subtenant as follows:

Subtenant Imputed Reimbursement = Specified Cost Rate x Sublease Square Feet.

vii The October 21, 2010 Stipulation and Agreed Order amends section 3.05 of the lease effective January 1, 2009 and stipulates that when calculating Alternative Base Rent, the Tenant shall receive a credit in the amount of 50 percent of real estate taxes attributable to the Telco Space and payable by the Tenant. The Telco Space is spaced leased, occupied, or used by Tenant in the Telco Block which is bounded by Water, Front, Fulton, and John Streets.

viii Article 3.02 (c) of the lease stipulates that Remaining Net Cash shall mean, for any Fiscal Year, the remainder, if any, of all Net Cash (i.e., Gross Receipts less Operating Expenses) for such Fiscal Year after deduction therefrom of specified payments including those related to Base Rent paid to the City and Operating Losses.

ix Article 1 of the November 9, 1983 Amended and Restated Theatre Lease stipulates that Gross Receipts shall mean and include, for any Fiscal Year or partial Fiscal Year, the gross amount of all money, money's worth and anything else of value payable or otherwise to be given by any Subtenant or other occupant of the Premises for use and occupancy of all or any part of the Premises or for any services, equipment or furnishings provided therewith, including, without limitation, annual basic rental or minimum rental, percentage rental based on gross sales and all other rental, HVAC services and equipment charges and sprinkler charges; plus any and all revenues receivable by Tenant or any Affiliate of Tenant for such Fiscal Year from the conduct of other businesses and/or transactions in, on, or from the Premises after deduction therefrom of the direct costs and expenses payable by Tenant or such Affiliate for such Fiscal Year in connection with such other businesses and or transactions, provided however that such deductions for any Fiscal Year shall not exceed revenues receivable from such other businesses and/or transactions for such Fiscal Year.

^x Article 1 of the November 9, 1983 Amended and Restated Theatre Lease allowed for the exclusion from Gross Receipts of all sums payable to Tenant pursuant to Subleases as reimbursements for: Rent payable by Tenant under the Theatre Lease; Impositions; costs of finishing or altering space for Subtenants; common area and other maintenance charges; utilities; promotion and other expenses of operation; and reasonable administrative charges. However, such exclusions cannot exceed the reasonable direct and actual on-site and off-site costs and expenses payable by Tenant, or allocated to Tenant by an Affiliate of Tenant.

^{xi} Article 1 of the November 9, 1983 Amended and Restated Theatre Lease stipulates that Gross Receipts shall also exclude amounts receivable by Tenant which constitute: insurance proceeds (other than business interruption or rent insurance proceeds, condemnation awards (other than compensation in connection with temporary taking), financing or refinancing proceeds, or consideration receivable for an assignment of the leasehold interest.

^{xii} Article 1 of the November 9, 1983 Amended and Restated Theatre Lease stipulates that Net Cash shall mean, for each Fiscal Quarter or partial Fiscal Quarter, the amount, if any, by which Gross Receipts exceed Operating Expenses.

^{xiii} Article 6 of the December 15, 1981 lease stipulates "If payment of any item of Rental shall become overdue for fifteen (15) days beyond the date on which it is due and payable as in this Lease provided, a late charge at the Lease Interest Rate on the sums so overdue shall accrue from the due date and immediately shall become due and payable to Landlord as liquidated damages for the administrative costs and expenses incurred by Landlord by reason of Tenant's failure to make prompt payment." The lease defines the Lease Interest Rate as "interest at the rate of fifteen (15%) percent per annum, but not in excess of the highest annual rate permitted by law."

^{xiv} The September 1, 2007 third amendment to the December 15, 1981 lease expanded the demised premises to include the Fish Market Stalls effective as of the amendment date. Therefore, for the period January 1, 2007 through August 30, 2007, we estimated monthly Minimum Base Rent to be \$99,517 i.e., (Minimum Base Rent per auditors of \$1,453,604 less Fish Stall Minimum Base Rent per auditors \$259,400) divided by 12. And for the period September 1, 2007 through December 31, 2007, we estimated monthly Minimum Base Rent to be \$121,134 i.e., Minimum Base Rent per auditors of \$1,453,604 divided by 12.

^{xv} Article 6 of the November 9, 1983 Amended and Restated Theatre Lease stipulates that if Tenant shall fail to pay any Rental for 20 days after the date Rent shall fall due, Tenant "shall pay interest thereon at the base or prime rate of interest from time to time as publicly announced in New York City by Citibank, N.A., or its successors...from the date on which such payment fell due to the date of payment thereof." We assessed interest at the bank prime loan rate effective on the date on which payments became due. We used historical prime rates published by the United States Federal Reserve Bank on its website <http://www.federalreserve.gov/releases/h15/data.htm>.

^{xvi} According to the amended and restated Theatre Lease dated November 9, 1983, "As of the date hereof, the Gross Leasable Area of the Premises is 6,533 square feet."

^{xvii} HHC sells dining vouchers for \$9 and offers one complimentary voucher for every 50 vouchers purchased. Tour operators may pick vouchers up or have them shipped for an additional charge of \$20.

^{xviii} Based on HHC's records, 20 of the 28 events were school performances for which HHC charges only an application processing fee of \$150. The remaining eight events were primarily for film and photography shoots, and special events for which HHC charges ranged from \$500 to \$23,330.

^{xix} The leases defines the Fish Market Premises as (i) the Buildings, including the fish stalls, located or to be located on portions of the Entire Project Premises that are commonly known as the Tin Building and the New Fish Market Building, and (ii) the Fish Market Stalls, and (iii) the rights for the use of certain street and sidewalk areas for fish market purposes, pursuant to City-issued permits.

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S. Brooks Trisler
Controller

June 19, 2013

Ms. H. Tina Kim
Deputy Comptroller
City of New York
Office of Comptroller
One Centre Street Room 1100
New York, N.Y. 10007-2341

RE: Audit Report of The South Street Seaport Limited Partnership's
Compliance with Its City Leases for the
South Street Seaport Marketplace and Theatre
FK12-070A

Dear Ms. Kim:

The Staff of the Bureau of Audit from the Office of the Comptroller issued its draft Audit Report to The South Street Seaport Limited Partnership ("SSSLP") on June 5, 2013 with respect to SSSLP's compliance with the City Leases for the South Street Seaport Marketplace and Theatre. SSSLP's responses to the findings and recommendations from the Audit Report related to SSSLP management are set forth in red font below, and each finding and recommendation has been set forth immediately prior to the response.

Additional Background:

On November 9, 2010, The Howard Hughes Corporation ("HHC") completed its spin-off from GGP, Inc., formerly known as General Growth Properties, Inc. ("GGP") in connection with GGP's emergence from bankruptcy. On the date of the spin-off, HHC became the owner of the South Street Seaport Limited Partnership, the Seaport Marketplace, Inc. and the South Street Theater Associates Limited Partnership which are parties to leases with South Street Seaport Corporation. GGP no longer holds any interest in these entities.

On October 21, 2010, the executed Stipulation and Agreed Order Resolving Dispute Regarding Cure Amounts Relating to Assumed Nonresidential Real Property Leases at South Street Seaport; and Adopting Modification of Lease Provision and Agreed Upon Methodology for the Calculation of Gross Receipts was filed with the United States Bankruptcy Court's Southern District of New York. This Stipulation Agreement resolved all claims and obligations through October 21, 2010 [Docket #6237].

The significant finding noted in the Audit Report relates to the square footage reported on a survey obtained from SSSLP management. The survey has a print date of March 2011 and was prepared by Gary Kubicek, an employee of GGP responsible for tenant coordination at Seaport. Per conversation with Gary on May 24, 2013, the survey referenced in this Audit Report is actually a lease plan and does not necessarily represent the actual footprint square footage of each space. This lease plan was not certified by an architect, and, in general, it is not uncommon for lease plans to contain square footage discrepancies. In October 2012, as part of SSSLP's re-leasing strategy, management commissioned Rothschild Downes who specializes in retail tenant coordination services including CAD, design and project management to provide an As-Built Set of AutoCad Backgrounds and Gross Leasable Area ("GLA") for retail spaces within the Telco, Museum, Fulton Market (including Fish Stalls) and Schermerhorn buildings. The preliminary results of the remeasurements are discussed below under Findings.

In accordance with Section 7.04 of the lease, Landlord agrees to reimburse Tenant for 50% of all premiums paid by Tenant for the insurance coverage required to be carried by Tenant under subsection (a)(i) of Section 7.01 with respect to Pier 17. SSSLP has not previously requested reimbursement for these premiums, and the estimated total premiums subject to the reimbursement since 2007 were \$1.1 million.

Findings:

SSSLP may owe the City as much as \$1,625,902 consisting of minimum base rent of \$1,099,568 and accrued interest of \$526,334 million.

SSSLP has paid all rent due to the City as of December 31, 2012 and may be due a refund for minimum base rent overpayments of approximately \$74,198 since its emergence from bankruptcy in November 2010.

Under Section 3.01(a)(i) of the Seaport Marketplace Inc. lease, the Minimum Base Rent is stated as the aggregate of the product of \$3.50 and the total number of Gross Leasable Area included as of the beginning of such fiscal year. Per a letter dated September 25, 2003, from Michael Piazzola, the then Vice President and General Manager of Seaport Marketplace LLC, informed Ms. Jennifer Friedman at the New York City Economic Development Corporation of an increase in the premises GLA from 282,108 square feet to 304,439 square feet. On September 1, 2007, the GLA was increased as a result of the Third Amendment which added 16,430 square feet for the Fish Market Stalls to the premises at a rate of \$12.05 per square foot. Subsequent to the addition of the Fish Stalls, the total GLA for the premises was computed to be 320,869. The annual minimum base rent of \$1,263,518 has been computed in accordance with the lease terms using the 320,869 GLA for the years 2007 through 2012, and there have been no significant structural or other changes to the premises that would have resulted in material changes to the GLA.

Based on the partial AutoCAD Backgrounds provided by Rothschild Downes and a detailed review of the lease terms related to the Commercial Areas, SSSLP revised the 2013 GLA for the premises to 325,633 square feet. The annual minimum base rent for the revised GLA is estimated to be \$1,264,959.

The adjustments to GLA are as follows:

- Per Exhibit C-1 Section 6(ii)(c)(1) declares the Street Merchandising Areas to contain 13,057 square feet and is referred to as the "Commercial Area". Within the Commercial Area a maximum of 4,000 square feet may be used for unenclosed sidewalk cafes. (2) Tenant may operate up to 34 pushcart or other mobile or impermanent vending units within the Street Merchandising Units. Certifications provided by Officers of SSSLP included 13,057 square feet for Commercial Area, 3,742 square feet of Outdoor Cafes and 1,690 square feet of cart space. SSSLP has been overstating its GLA by 5,432 square feet and thus overstating its annual rent by \$19,012 due to the double counting of outdoor café and cart square footage in its GLA.
- In addition to overstating the GLA as noted above, per Article 3 Section 3.01(a)(i)(y) of the lease, SSSLP is only required to pay rent the total number of square feet of the Commercial Areas multiplied by the greater of (A) a fraction, representing the percent of a 365 day year for which such Commercial Areas were leased and (b) 2/3 which is approximately 8 months. This lease term explicitly acknowledges that the Street Merchandising Area may not be utilized during the winter months due to weather. SSSLP management confirms that since emergence from bankruptcy, the carts have operated from April 1 to October 31 which is 7 months. As a result, SSSLP has been overstating its rent by \$15,233 per year because it has been paying 12 months of rent in error.
- The Rothschild Downes AutoCAD Backgrounds which were certified by an architect in 2012 reported an increase in SSSLP premise square footage of 10,196 which is equivalent to annual rent of \$35,686. The lease agreement does not explicitly state how changes in GLA are to be identified. However, per Article 3 Section 3.01(a)(i) "Minimum Base Rent", which term shall mean the aggregate of (x) the product of \$3.50 and the total number of square feet of Gross Leasable Area included, as of the beginning of such Fiscal Year. SSSLP did not become officially aware of the increase in GLA until October 2012, and therefore, will adjust the GLA as of January 1, 2013, in accordance with the terms of the lease. We will adjust our rent during the second quarter of 2013 to include the changes in GLA.

HHC may owe the City additional Theatre Retail minimum base rent and accrued interest of \$143,934:

The Theatre disclosed in Note 2 of its audited Statement of Operations for the periods ending December 31, 2012 and 2011, accrued contingent rent due of \$21,835 and \$11,881, respectively. Accrued interest for the periods ending December 31, 2012 and 2011 associated with the contingent rent was \$675 and \$184, respectively. The accrued interest was based on the prime interest rate which was 3.25% for both periods. The contingent rent was computed based on 2,844 of additional square footage for the mezzanine level. Rothschild Downes certified the total gross leasable area of this space to be 9,900 square feet. As a result of the emergence from bankruptcy in 2010, the Theatre's obligation is limited to the time period from October 21, 2010 to December 31, 2012 [Docket #6237]. The Theatre will adjust its rent during the second quarter of 2013 to include the changes in GLA.

Marketplace Alternative Base Rent:

Subtenant rental and other income. We estimate that HHC did not charge Subtenants rent or report Subtenant rental and other income totaling at least \$199,368 for 13 sampled Subleases as follows:

SSSLP is a for-profit entity, and in order to maximize shareholder return, management continuously operates in a manner to achieve the highest rents possible.

Two leases were identified in the Audit Report as high value and not paying market rent. One lease, located in the Schermerhorn Building, was an extension of the GGP management office and was operated as a customer information center for Seaport history and future planning. The second lease is located at the 3rd level of the pier building. The space is raw and un-leasable with no storefront or finishes. Further, it is not suitable for storage because it is on the upper level with no elevator access.

For June 2011, HHC reported that 27,740 of 261,557 square feet – 10.6 percent of Marketplace spaces were vacant and generated no income.

Occupancy of 89.4% was consistent with the retail leasing industry's performance in 2010 and 2011. See graph of retail property vacancy rates below:



Dining Voucher Program, Special Events, Advertising and Vending Income. For the period January 1, 2011 through June 30, 2011, we estimate that HHC did not report income of at least \$214,998.

The City Marketplace Food Voucher program is administered by the Seaport Merchant's Association ("Association"), and the operations of the Seaport Merchant's Association are excluded from the activities of Seaport Marketplace Inc. Additionally, amounts received by the Association for the purchase of food vouchers are recorded as deferred revenue on the Association's balance sheet. As the vouchers are used, the deferred revenue is reclassified

into net income. Prior the spin-off from GGP in 2010, the food vouchers were issued without an expiration date. The amount noted in the audit report of \$150,423 is being recognized into income as vouchers are redeemed.

The amount of special events income per the general ledger was \$270,125 and is \$6,205 higher than the amount per the detail schedule of \$263,920. The difference is immaterial and does not impact the amount of rent owed to the City. SSSLP management reviewed the detail support of the \$64,575 noted in the Audit Report and discovered that the City is duplicating certain special events. SSSLP management confirms that the special events income per the general ledger of \$270,125 is correctly stated.

When calculating alternative base rent, HHC deducted from Gross Receipts significant improper and insufficiently supported expense.

Unsupported Expenses: HHC reported expenses totaling \$141,510 that were not supported by any documents such as contracts, invoices and canceled checks to demonstrate that such expenses were incurred for the premises.

SSSLP management reviewed the information previously submitted to the City Comptroller's office and noted that the expenses were properly supported. Management organized the supporting documentation and resubmitted to the Comptroller's office on June 13, 2013. No additional responses have been provided to SSSLP by the Comptroller's Office regarding the resubmitted documentation.

Improper expenses: HHC reported expenses totaling \$129,304 that were not allowable, such as administrative salaries, administrative office carpeting and travel not related to the premises or not incurred during the period. Most notably, HHC deducted administrative salaries totaling \$90,300.

According to Section 3.02(a) of the lease, it clearly states that there shall be excluded from Gross Receipts all such sums payable to Tenant pursuant to such Marketplace Subleases as reimbursements for the foregoing items (but only to the extent that such reimbursements and such administrative charges do not exceed the reasonable direct and actual on-site and off-site costs and expenses payable by tenant, or allocated to tenant by an Affiliate of Tenant, for such items). Administrative salaries are included in CAM and are billed to the tenants in accordance with the terms of the subleases. SSSLP confirms that the deduction of administrative salaries of \$90,300 is a valid deduction from Gross Receipts because they are included in CAM which is reimbursable by the subtenant.

Insufficiently Supported expenses: HHC reported expenses totaling \$90,983 that were not adequately supported by formal agreements or contracts stipulating services to be provided, service location, rate and method of compensation and period covered. Therefore, we could not verify that expenditures were reasonable and appropriate.

SSSLP engaged Mayne Construction for general repairs and maintenance services during 2010 and 2011. The most significant services performed by Mayne related to the repair of the wood bongossi deck that surrounds piers 16 and 17 for life safety issues. Since the work was ongoing, SSSLP did not enter into a formal contract with Mayne. Of the \$90,383 in expenses noted above, \$44,748 is related to Mayne.

SSLP engaged Nouveau Elevator to refurbish the elevators and escalators on the premises. Prior to any work being done, SSSLP obtained a proposal from Nouveau due to the dollar amount of the expected services. Of the \$90,383 in expenses noted above, \$34,535 is related to Nouveau.

SSSLP engaged Tom Davidson as an independent contractor during 2011 to perform visual merchandising activities for the specialty leasing department on an as needed basis. Since these services were performed on an as needed basis and the amounts paid were immaterial, SSSLP did not enter into a contract. Of the \$90,383 in expenses noted above, \$11,700 related to Tom Davidson.

HHC also improperly calculated Specified Cost imputed reimbursement rates because it understated Landlord's Qualifying Floor area Square footage.

Per the lease agreements executed by SSSLP, the Tenant pays a proportionate share of the SSSLP's operating costs which is calculated by multiplying SSSLP's operating costs by a fraction, which is Tenant's floor area divided by SSSLP's leased floor area. The Stipulation Agreement refers to the Landlord's Qualifying Floor Space which is defined in the subtenant lease agreements. Thus, the GLA for the premises is not relevant in computing the common area maintenance Imputed Reimbursement rate.

HHC improperly deducted from Gross Receipts: Explicit reimbursements totaling \$1,204,115 related to 12 Subleases that were not supported by Subleases and Subtenant invoices.

Per Appendix A of the Stipulation and Agreed Order Resolving Dispute Regarding Cure Amounts Relating to Assumed Nonresidential Real Property Leases at South Street Seaport; and Adopting Modification of Lease Provisions and Agreed Upon Methodology for the Calculation of Gross Receipts filed on October 21, 2010, certain subleases expressly provide for the payment of base rent plus an additional rent amount explicitly designated as reimbursement for some or all of the items of costs and expenses specified in Section 3.02 ("Specified Costs")(when reimbursed, the "Explicit Reimbursements"). Such Explicit Reimbursements qualify for deduction from Gross Receipts.

Certain other Market Subleases, however, do not contain an explicit obligation to reimburse the Tenant for all Specified Costs, but only contain a base rent provision. Such arrangements are referred to as "Special Deals". Footnote 7 in the Stipulation Agreement clarifies that some Special Deal Subleases may provide for the express reimbursement of some, but not all, of the items comprising Specified Costs. This varies on a subtenant by subtenant basis.

The City and Tenant have agreed to apply the provisions of Section 3.02 for Special Deal subtenants to implicitly re-characterize some or all of the base rent as imputed reimbursement for Specified Costs (an "Imputed Reimbursement"), based upon a calculation of costs attributable to the space covered by each Special Deal sublease.

Under the Original Methodology, this calculation is performed as follows: the estimated or actual expenditure for each item of Specified Costs was divided by Landlord's Qualifying Floor Area, to obtain a "per-square-foot" rate for that item; then, for each Special Deal sublease, the per-square-foot rates were multiplied by the number of square feet covered

by that sublease, to obtain the costs attributable to that space (the "Attributable Costs").

For the Tenant's unprofitable Special Deal subleases, the base rent paid will be less than the Attributable Costs (i.e. the Tenant does not make back its costs for such a sublease).

For such an unprofitable Subtenant, the full amount of base rent such Subtenant actually paid the Tenant is re-characterized as Imputed Reimbursement for the purpose of Gross Receipts, but any Attributable Costs relating to that sublease that were not covered by the base rent (the "Uncovered Attributable Costs") were not treated as Imputed Reimbursement as a Subtenant cannot be said to have "reimbursed" the Tenant for more than it actually paid it.

The 11 Subleases identified in the Audit Report that were not supported by Subleases and Subtenant invoices are Special Deals because the lease terms provide for the express reimbursement of some, but not all, of the items comprising Specified Costs (see Special Deals above). Consistent with the Stipulation Agreement, SSSLP computed the Attributable Costs for each subtenant and re-characterized some or all of the subtenant's base rent as Imputed Reimbursement for purposes of Gross Receipts. SSSLP management has re-reviewed the calculations for the identified tenants and reconfirms that the Imputed Reimbursements of \$1,204,115 are valid deductions.

Both explicit and imputed reimbursements for eight sampled Subleases, resulting in improper deductions totaling \$423,277.

The eight Subleases identified in the Audit Report that contain both explicit and Imputed Reimbursements are Special Deals because the lease terms provide for the express reimbursement of some, but not all, of the items comprising Specified Costs (see Special Deals above). Consistent with the Stipulation Agreement, SSSLP computed the Attributable Costs for each subtenant and re-characterized some or all of the subtenant's base rent as Imputed Reimbursement for purposes of Gross Receipts. SSSLP management has re-reviewed the calculations for the identified tenants and reconfirms that the explicit and Imputed Reimbursements of \$423,277 are valid deductions.

HHC Did Not Sublease the Theatre Lease Premises and Generate Income and Additional Rents.

Following the expiration of the Liz Claiborne lease in 2006, SSSLP has been unsuccessful in leasing the vacant premise on a long term basis to a sub-tenant. The lack of success is related to the remaining term under the Theatre lease which expires in November 2013. SSSLP and or subtenant would have to make a significant capital investment in the improvements to the Theatre premise which is not feasible based on the upcoming November 2013 lease expiration. SSSLP created the brand "@SEAPORT" to promote special events in the Theatre in order to mitigate its inability to secure a long term lease.

HHC Inappropriately Conducted Business in the South Street Seaport Merchants Association's Name.

Many of the tenants who were members of the South Street Seaport Merchant's Association (the "Association") refused to pay their contractually obligated dues. To make up for the budget shortfall, SSSLP voluntarily made contributions to the Association. The Association does not function in the traditional sense because collections and expenditures

are at the sole discretion of SSSLP, and is expressly set forth and agreed to in the tenant leases. SSSLP management is in the process of legally dissolving this entity, and we expect the entity to be dissolved in 2013.

Recommendations:

SSSLP should:

1. Upon notification, remit to the City EDC-assessed MMBR and TRMBR and accrued interest resulting from understated square footage for the period January 1, 2007, through December 31, 2012.

SSSLP has remitted all rents due to the City as of December 31, 2012 and may be due a refund for minimum base rent overpayments of approximately \$74,198 since its emergence from bankruptcy in November 2010. SSSLP has commissioned Rothschild Downes to certify the GLA for all premises under the lease, and we expect the certifications to be complete by July 2013. Upon completion of the GLA certifications, SSSLP will adjust the annual minimum rent in accordance with the terms of the lease.

In addition, the City may owe SSSLP for unreimbursed premiums related to Pier 17. The total amount of insurance premiums paid by SSSLP since 2007 was \$1.1 million.

2. Pay the City MMBR and TRMBR, as calculated by EDC, in advance, on the first of each month.

As noted above, upon completion of the GLA certifications, SSSLP will adjust the annual minimum rent in accordance with the terms of the lease and remit any amounts due, if any.

3. Sublease Marketplace Lease and Theatre Lease spaces at market rate.

SSSLP will continue to actively operate the premises in a manner to achieve the highest rents.

4. Report to the City all Subtenant rental and other income.

SSSLP will continue to report all subtenant rental and other income in its financial statements and leasing schedules.

5. When calculating imputed reimbursement rates and deducting expenses, include only expenses that are related to the premises, allowable, adequately supported, and incurred in the period.

SSSLP will continue to only include expenses that are related to the premise, allowable, adequately supported and incurred in the period.

6. When calculating imputed reimbursement rates, calculate Landlord's Qualifying Floor Area square footage based on an EDC-commissioned independent certified engineering survey of the Marketplace Lease premises.

The lease plan dated March 2011 indicates the gross leasable area, and as noted above, this lease plan is not certified. However, when calculating the Imputed reimbursement rates, the Landlord's qualifying floor area is based on SSSLP's leased floor area. Thus, the GLA

for the premises is not relevant in computing common area maintenance Imputed Reimbursement rate.

7. Deduct from Gross Receipts only Subtenant direct reimbursements that are supported by Subtenant invoices and, more important, Subleases that stipulate reimbursed amounts or rates.

Footnote 7 in the Stipulation Agreement clarifies that some Special Deal Subleases may provide for the express reimbursement of some, but not all, of the items comprising Specified Costs. We will continue to Impute Reimbursements in accordance with the Stipulation Agreement.

8. Deduct either explicit reimbursements or imputed reimbursements.

Footnote 7 in the Stipulation Agreement clarifies that some Special Deal Subleases may provide for the express reimbursement of some, but not all, of the items comprising Specified Costs. We will continue to Impute Reimbursements in accordance with the Stipulation Agreement.

9. Immediately operate the Merchants Association in accordance with its Articles of Incorporation and By-Laws or dissolve it.

SSSLP management is in the process of legally dissolving this entity.

Sincerely,



S. Brooks Trisler
Controller

cc: Grant Herlitz, The Howard Hughes Corporation
Andrew C. Richardson, The Howard Hughes Corporation
Peter F. Riley, The Howard Hughes Corporation



June 18, 2013

New York City Comptroller's Office
One Centre Street, Room 1100
New York, NY 10007-2341
Municipal Building
Attn: H. Tina Kim, Deputy Comptroller

Re: Response to Audit Report of the Compliance of Howard Hughes Corporation's with Its City Leases for the South Street Seaport Marketplace and Theatre (FK12-070A)

Dear Ms. Kim:

New York City Economic Development Corporation ("EDC") has reviewed the draft of the above-referenced audit report, dated June 5, 2013, and responds to the recommendations directed in the audit as follows:

With regard to HHC, EDC should:

10. Immediately commission an independent certified engineering survey to determine and document the Gross Leasable Area square footage, total square footage, and Landlord's Qualifying Floor Area square footage of designated spaces within the Marketplace Lease and Theatre Lease Premises.

Response: The Howard Hughes Corporation is in the process of completing an independent architecturally certified survey by Rothschild Downes which will include the lease defined Gross Leasable Area of both the Marketplace and Theatre lease. Additionally, this survey will now include Pier 17. Once completed, EDC will engage an independent architect to review the survey for accuracy and completeness. EDC will then resolve any differences with The Howard Hughes Corporation and come to agreement on a definitive Total Gross Leasable Area for both leases and the total MMBR and TRMBR from the time The Howard Hughes Corporation emerged from bankruptcy to the present.

11. Calculate annual MMBR and TRMBR based on lease terms and certified Gross Leasable Area square footage and total square footage.

Response: EDC agrees with this recommendation based on the process outlined in the response to recommendation #10.

12. Calculate MMBR and TRMBR and accrued interest owed the City resulting from understated square footage for the period January 1, 2007, through December 31, 2012.

Response: All outstanding issues concerning rent payments with the tenant were settled in Federal Bankruptcy Court in Manhattan in October 2010. Therefore, EDC cannot pursue collection of MMBR and TRMBR prior to this date. However, EDC does intend to reach an agreement with The Howard Hughes Corporation for any MMBR and TRMBR based on the procedure outlined in response to recommendation # 10.

13. Send written notice to HHC advising it that unpaid MMBR and TRMBR and accrued interest charges are to be paid in full immediately and that a failure to pay these charges in full within 15 days of written notice constitutes an Event of Default under Article 24 of the lease.

Response: EDC intends to proceed in resolution of MMBR and TRMBR based on the process outlined in the response to recommendation #10.

14. Take other appropriate enforcement action.

Response: EDC will take appropriate action as necessary.

15. Routinely review quarterly and annual reports submitted by HHC to ensure the accuracy of the calculation of Alternative Base Rent.

Response: EDC regularly reviews quarterly and annual audited reports submitted by The Howard Hughes Corporation.

16. Ensure that HHC subleases Marketplace Lease and Theatre Lease spaces at market rate.

Response: EDC has no approval rights over subleasing of space under the Marketplace and Theatre leases and therefore cannot ensure that spaces are being leased at the market rate.

17. Ensure that HHC's redevelopment plan provides that the Fish Market Premises be continually used for wholesale fish market purposes and work with HHC to find a year-round wholesale fish market operator.

Response: This recommendation is not permissible. In Section 20.04 of The City of New York lease with The New Fulton Fish Market located at the Hunts Point Food Distribution Center in the Bronx, it states that The City of NY "shall not actively promote or develop in The City of NY any other 'public wholesale markets' for the wholesale distribution of seafood." This provision prohibits the establishment of another City sponsored fish market.

18. Ensure that HHC immediately operates the Merchants Association in accordance with its Articles of Incorporation and By-Laws or dissolve it.

Response: The Howard Hughes Corporation has notified EDC that it intends to dissolve the Merchants Association.

With regard to its lessees that pay income-based rents, EDC should:

19. Conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report income, properly calculate rent, and pay the City all money due it.

Response: EDC has established procedures for auditing leases with income participation clauses. In fact, Marks Paneth & Shron, LLP audited the Seaport Marketplace lease in 2010 in which the findings resulted in a \$300,000 payment to EDC.

With regard to Other Matters:

The audit lists in Other Matters that the City and EDC entered into an Agreement that was not in the City's best interest.

The Agreement in question was approved by the Comptroller in 2010, and because of this and other reasons EDC strongly disagrees with this characterization. Following an independent audit conducted by Marks Paneth & Shron, LLP, EDC raised issues with the tenant concerning the payment of alternative base rent. The issues were then brought to Corporation Counsel to be pursued in the Federal Bankruptcy Court in Manhattan. After extensive negotiations between the parties, a settlement was reached

resulting in payment of \$300,000, which was believed to be favorable to the City. The subsequent approval of this settlement by the Comptroller would suggest agreement that it was in the City's best interest.

Additionally, the Comptroller's audit raises the issue of terminating the Marketplace Lease and Theatre Lease and seeking a new tenant. Because the tenant was protected under bankruptcy law, this course of action was not permissible.

Should you have any questions or concerns regarding EDC's responses to the recommendations provided in the audit report, please feel free to contact Dean Bodnar at 212-312-3746 or via e-mail at dbodnar@nycedc.com.

Sincerely,



Kim Vaccari
Chief Financial Officer