



City of New York

OFFICE OF THE COMPTROLLER

John C. Liu
COMPTROLLER



FINANCIAL AUDIT

Tina Kim

Deputy Comptroller for Audit

Audit Report on the Compliance of
South Street Seaport Associates with
Its City Lease Agreements

FK12-069A

April 30, 2013

<http://comptroller.nyc.gov>



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

John C. Liu
COMPTROLLER

April 30, 2013

To the Residents of the City of New York:

My office has audited the compliance of South Street Seaport Associates (Seaport Associates) with its City lease agreements. We audit entities such as Seaport Associates 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, Seaport Associates was to develop, maintain, and operate designated spaces within the Seaport Historic District as first-class business offices. In exchange for the use of these spaces, Seaport Associates agreed to pay the City a Base Rent that is the greater of a Minimum Base Rent which is based on Gross Leasable Area square footage or an Alternative Base Rent of 20 percent of Gross Income. Accordingly, Seaport Associates was required to submit to the City certified quarterly and annual statements setting forth all rents and other income received and retain detailed books and records for at least six years.

The audit found that Seaport Associates improperly calculated rent payments and did not report all Subtenant rental income or other income and, therefore, owes the City at least \$1,294,836 — \$787,664 for unpaid rent and \$507,172 for accrued interest. As noted, Seaport Associates was required to pay the City the greater of a Minimum Base Rent, which is based on Gross Leasable Area square footage, or an Alternative Base Rent of 20 percent of Gross Income. However, Seaport Associates improperly calculated Alternative Base Rent as 20 percent of *net income, i.e., Gross Income after deduction therefrom of all Operating Expenses*, which include maintenance, operations, or Imposition expenses that were not reimbursed by Subtenants, and legal, accounting, and management expenses. Seaport Associates also did not report all Subtenant rental income or other income of at least \$24,490.

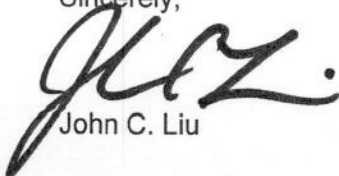
These issues occurred, in part, because the Economic Development Corporation (EDC) did not adequately monitor Seaport Associates to ensure its compliance with lease terms. As the agency responsible for administering the leases, EDC should have ensured that Seaport Associates complied with significant lease terms. EDC also improperly adjusted Seaport Associates' interest and rent charges totaling \$27,032.

Our review also found that an EDC Board Member, who is a former Seaport Associates principal and lease signatory, utilized Seaport Associates' office space rent-free in violation of EDC's conflict of interest code. Further, the EDC Board Member did not disclose his relationship with Seaport Associates or his use of office space on his certified 2010 and 2011 Disclosure Statements.

The results of our audit have been discussed with Seaport Associates 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 REPORTING

Audit Report on the Compliance of South Street Seaport Associates with Its City Lease Agreements

FK12-069A

AUDIT REPORT IN BRIEF

As the City's primary agent for economic development, 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. As part of its management responsibilities, EDC leases space to and collects rent from tenants occupying its industrial, commercial, and market spaces. These market spaces include the historic South Street Seaport located in lower Manhattan along the East River.

The City (as successor-in-interest to the South Street Seaport Corporation) and South Street Seaport Associates (Seaport Associates), a limited partnership, are parties to two leases for spaces within the South Street Seaport. Under the terms of these agreements and subsequent amendments, Seaport Associates was to: develop, maintain, and operate designated spaces within the Seaport Historic District as first-class business offices; maintain specified types and amounts of insurance coverage; and pay taxes and utilities charges. In exchange for the use of these spaces, Seaport Associates agreed to pay the City a Base Rent that is the greater of: a Minimum Base Rent which is based on Gross Leasable Area square footage or an Alternative Base Rent of 20 percent of Gross Income. Accordingly, Seaport Associates was required to: submit to the City certified quarterly and annual statements setting forth all rents and other income received; keep complete and accurate books of account and records to enable the City to confirm reported Gross Income; and retain such books and records for at least six years and make them available for inspection and audit.

For the year ending June 30, 2011, Seaport Associates reported income of \$991,131 for which it paid Alternative Base Rent of \$198,226.

Audit Findings and Conclusions

Seaport Associates improperly calculated rent payments and did not report all Subtenant rental income or other income and, therefore, owes the City at least \$1,294,836— \$787,664 for unpaid rent and \$507,172 for accrued interest. As noted, Seaport Associates was required to pay the

City the greater of a Minimum Base Rent, which is based on Gross Leasable Area square footage, or an Alternative Base Rent of 20 percent of Gross Income. However, Seaport Associates improperly calculated Alternative Base Rent as 20 percent of *net income, i.e., Gross Income after deduction therefrom of all Operating Expenses*, which include maintenance, operations, or Imposition expenses that were not reimbursed by Subtenants, and legal, accounting, and management expenses. Seaport Associates also did not report all Subtenant rental income or other income of at least \$24,490.

These issues occurred, in part, because EDC did not adequately monitor Seaport Associates to ensure its compliance with lease terms. As the agency responsible for administering the leases, EDC should have ensured that Seaport Associates complied with significant lease terms. EDC also improperly adjusted Seaport Associates' interest and rent charges totaling \$27,032.

Finally, an EDC Board Member, who is a former Seaport Associates principal and lease signatory, utilized Seaport Associates' office space rent-free in violation of EDC's conflict of interest code. Further, the EDC Board Member did not disclose his relationship with Seaport Associates or his use of office space on his certified 2010 and 2011 Disclosure Statements.

Audit Recommendations

To address these issues, we make 14 recommendations—three to Seaport Associates and 11 to EDC—including that Seaport Associates should:

- Immediately remit to EDC unpaid rent and interest charges totaling \$1,294,836 related to Subtenant rental income;
- Immediately pay EDC reinstated interest and rent charges totaling \$27,032; and
- Report all Subtenant rental income or other income from all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises and pay additional rent and unpaid interest due the City.

With regard to Seaport Associates, EDC should:

- Send written notice to Seaport Associates advising it that unpaid rent and interest charges totaling \$1,294,836 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 leases;
- Identify all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises; quantify any and all revenues received by Tenant or any Affiliate from such businesses and/or transactions net of related direct costs and expenses payable; and calculate additional rent and unpaid interest due the City;
- Reinstate interest and rent charges totaling \$27,032; and
- Send written notice to Seaport Associates advising it that interest and rent charges totaling \$27,032 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 leases.

With regard to its Board Member, EDC should:

- Immediately direct its Board Member to cease using space in EDC-leased premises regardless of whether the Board Member pays rent in consideration for such space;

- Direct its Board Member to make all facts known to EDC’s General Counsel regarding his relationship with Seaport Associates; and
- Direct its Board Member to detail any and all activities that would be considered in violation of the Code of Ethics for Directors of EDC on his certified Disclosure Statement for Directors.

Auditee Responses

In its formal response, Seaport Associates rejected the report’s findings and thus, its recommendations, in their entirety on the basis that they are politically motivated and the result of “[p]olitical infighting between the Comptroller’s Office and EDC.” However, EDC substantially agrees with the Comptroller’s Office on the report’s findings and recommendations.

Seaport Associate’s response offers no facts to refute the findings. If they wish to support their position they need to provide supporting documentation that shows that the findings are incorrect not unsupported conjecture that deflects attention away from the serious issues raised over their compliance with their lease with the City.

With regard to specific report findings, Seaport Associates disagreed that it improperly calculated rent payments and did not report all Subtenant rental income or other income and therefore owes the City at least \$1.3 million, stating:

“The Draft Audit Report, including the recommendations and conclusions set forth therein, cannot be reconciled with the plain language of the Lease Agreements or the parties’ long-standing prior course of dealing. The Draft Audit Report also is entirely inconsistent with the estoppel certificates that the City executed in 2010 and 2011, in which the City expressly represented without qualification that Seaport Associates had satisfied all of its rent obligations. The Draft Audit Report is also premised on an interpretation of the Lease Agreements that is contrary to the long standing shared-understanding reached between Seaport Associates and the EDC, the City’s designated agent under the Lease Agreements. Finally, the City has no legal claim to any unpaid rent from 2005 because the relevant statute of limitations has expired.”

Additionally, with regard to unreported Subtenant rental income or other income derived from Seaport Associates and related entities that conducted their businesses, in whole or in part, from the lease premises, Seaport Associates maintained that other income is limited to “revenue derived...by reason of Seaport Associates being a tenant in the South Street Seaport Historic District.” Further, Seaport Associates asserted that other income is limited to such revenues generated by “Seaport Associates’ then-existing corporate affiliates” as of “[w]hen parties entered into the Lease Agreements in the 1980’s.”

Seaport Associates has disregarded the unambiguous language of the leases, which stipulate that Alternative Base Rent “shall mean twenty percent (20%) of all Gross Income” and that Gross Income shall include “any and all revenues received by Tenant or any Affiliate.” (Emphasis added.) Instead, Seaport Associates offers an “interpretation” of the leases that reduces Gross Income by both providing for broad deductions rather than limited exclusions and limiting the types and sources of revenue to be included in other income, and thereby, reduces payments to the City.

Further, Seaport Associates' alternative arguments are without merit because: Seaport Associates did not provide us purported evidence that EDC accepted and adopted its alternative methodology for rent payment calculations; the City appropriately qualified its estoppels and, therefore, did not waive its right to contest payments due it; and Seaport Associates' breaches related to improper calculation and underpayment of Alternative Base Rent all occurred on or after May 3, 2007, and are within the Statute of Limitations.

In their response, EDC officials substantially agreed with all of the report's findings and recommendations and detailed steps they took or will take to implement the recommendations.

INTRODUCTION

Background

As the City's primary agent for economic development, 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. As part of its management responsibilities, EDC leases space to and collects rent from tenants occupying its industrial, commercial, and market spaces. These market spaces include the historic South Street Seaport located in lower Manhattan along the East River.

The City (as successor-in-interest to the South Street Seaport Corporation) and South Street Seaport Associates (Seaport Associates), a limited partnership, are parties to two leases for spaces within the South Street Seaport. Under the terms of these agreements, Seaport Associates was to: develop, maintain, and operate designated spaces within the Seaport Historic District as first-class business offices; maintain specified types and amounts of insurance coverage; and pay taxes and utilities charges. In exchange for the use of these spaces, Seaport Associates agreed to pay the City a Base Rent that is the greater of a Minimum Base Rent that is the product of \$2.60 and Gross Leasable Area square footage¹ or an Alternative Base Rent of 20 percent of Gross Income². Accordingly, Seaport Associates was required to: submit to the City certified quarterly and annual statements setting forth all rents and other income received; keep complete and accurate books of account and records to enable the City to confirm reported gross income; and retain such books and records for at least six years and make them available for inspection and audit.

For the year ending June 30, 2011, Seaport Associates reported income of \$991,131 for which it paid alternative base rent of \$198,226.

Objectives

The objectives of this audit were to determine whether:

- Seaport Associates accurately reported gross income and properly calculated rents, and complied with other major requirements of its lease agreements.
- EDC adequately monitored Seaport Associates to ensure its compliance with lease agreement terms.

¹ According to a property survey commissioned by Seaport Associates on August 18, 2009, the lease premises contains gross leasable square footage of 48,372. Based on this survey, we calculated minimum base rent to be \$125,767.20 (the product of \$2.60 and 48,372).

² Section 3.02 (a) of the leases stipulate that gross income shall mean and only include, for any Fiscal Year, all sums paid to Tenant for such Fiscal Year by Subtenants, including, without limitation, annual basic rental or minimum rental pursuant to Subleases, all other rental paid to Tenant by Subtenants, pursuant to subleases, other than amounts reimbursed to Tenant by Subtenant for actual costs of maintenance and operation of the Premises or for Impositions; rental value insurance proceeds; condemnation or eminent domain awards or payments; plus any and all revenues received 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 City Lease 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.

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 2011. 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 Seaport Associates and EDC officials during and at the conclusion of this audit. A preliminary draft report was sent to Seaport Associates and EDC officials and discussed at an exit conference held on March 20, 2013. On March 22, 2013, we submitted a draft report to Seaport Associates and EDC officials with a request for comments. We received written responses from Seaport Associates and EDC on April 5, 2013, and April 8, 2013, respectively.

Both Seaport Associates' counsel and management responded to the report. Seaport Associates indicated that the counsel response served as its formal response and that its management response served to explain "how the Comptroller's Office shortsighted findings and conclusions are not in the best interests of the City." In its formal response, Seaport Associates rejected the report's findings and thus, its recommendations, in their entirety on the basis that they are politically motivated and the result of "[p]olitical infighting between the Comptroller's Office and EDC." Findings in audit reports are based on evidence. Moreover, EDC in its response to the Audit substantially agreed with the report's findings and recommendations, and in fact issued a demand to Seaport Associates seeking unpaid rent.

Seaport Associates' response offers no facts to refute the findings. If Seaport Associates wishes to support its position, it needs to provide supporting documentation that shows that the findings are incorrect and not unsupported conjecture that deflects attention away from the serious issues raised over its compliance with its leases with the City.

With regard to specific report findings, Seaport Associates disagreed that it improperly calculated rent payments and did not report all Subtenant rental income or other income and, therefore, owes the City at least \$1.3 million, stating:

"The Draft Audit Report, including the recommendations and conclusions set forth therein, cannot be reconciled with the plain language of the Lease Agreements or the parties' long-standing prior course of dealing. The Draft Audit Report also is entirely inconsistent with the estoppel certificates that the City executed in 2010 and 2011, in which the City expressly represented without qualification that Seaport Associates had satisfied all of its rent obligations. The Draft Audit Report is also premised on an interpretation of the Lease Agreements that is contrary to the long standing shared-understanding reached between Seaport Associates and the EDC, the City's designated agent under the Lease

Agreements. Finally, the City has no legal claim to any unpaid rent from 2005 because the relevant statute of limitations has expired....”

Additionally, with regard to unreported Subtenant rental income or other income derived from Seaport Associates and related entities that conducted their businesses, in whole or in part, from the lease premises, Seaport Associates maintained that other income is limited to “revenue derived...by reason of Seaport Associates being a tenant in the South Street Seaport Historic District.” Further, Seaport Associates asserted that other income is limited to such revenues generated by “Seaport Associates’ then-existing corporate affiliates” as of “[w]hen parties entered into the Lease Agreements in the 1980’s.”

Seaport Associates has disregarded the unambiguous language of the leases which stipulate that Alternative Base Rent “shall mean twenty percent (20%) of all Gross Income” and that Gross Income shall include “any and all revenues received by Tenant or any Affiliate.” (Emphasis added.) Instead, Seaport Associates offers an “interpretation” of the leases that reduces Gross Income by both providing for broad deductions rather than limited exclusions and limiting the types and sources of revenue to be included in other income, and thereby, reduces payments to the City.

Further, Seaport Associates’ alternative arguments are without merit because: Seaport Associates did not provide us purported evidence that EDC accepted and adopted its alternative methodology for rent payment calculations; the City appropriately qualified its estoppels and, therefore, did not waive its right to contest payments due it; and Seaport Associates’ breaches related to improper calculation and underpayment of Alternative Base Rent all occurred on or after May 3, 2007, and are within the Statute of Limitations.

In their response, EDC officials substantially agreed with all of the report’s findings and recommendations and detailed steps they took or will take to implement recommendations.

The full text of Seaport Associates’ responses and EDC’s response are attached in their entirety as Addendum I and II to this report.

FINDINGS

Seaport Associates improperly calculated rent payments and did not report all Subtenant rental income or other income and, therefore, owes the City at least \$1,294,836— \$787,664 for unpaid rent and \$507,172 for accrued interest. As noted, Seaport Associates was required to pay the City the greater of a Minimum Base Rent, which is based on Gross Leasable Area square footage, or an Alternative Base Rent of 20 percent of Gross Income. However, Seaport Associates improperly calculated Alternative Base Rent as 20 percent of *net income, i.e., Gross Income after deduction therefrom of all Operating Expenses*, which include maintenance, operations, or Imposition expenses that were not reimbursed by Subtenants, and legal, accounting, and management expenses. Seaport Associates also did not report all Subtenant rental income or other income of at least \$24,490.

These issues occurred, in part, because EDC did not adequately monitor Seaport Associates to ensure its compliance with lease terms. As the agency responsible for administering the leases, EDC should have ensured that Seaport Associates complied with rent, mortgage, assignment, and other significant lease terms. EDC also improperly adjusted Seaport Associates' interest and rent charges totaling \$27,032.

Finally, an EDC Board Member and Chair of the Board's Real Estate and Finance Committee appears to have utilized Seaport Associates' office space rent-free. The EDC Board Member, a former Seaport Associates principal and lease signatory, previously leased a suite from Seaport Associates and paid monthly rent of nearly \$3,000. However, in the first quarter of 2008, the Board Member stopped leasing this suite and paying rent, but continued to list 19 Fulton Street as his sole New York City office location, appeared on the name plate as a tenant of 19 Fulton Street, and appeared to have started sharing office space with Seaport Associates for which he paid no rent. The EDC Board Member did not disclose his relationship with Seaport Associates or his use of office space on his certified 2010 and 2011 Disclosure Statements. (Note: The Audit period for this issue was 2010 to the present; accordingly, we do not have information regarding filings prior to 2010.)

EDC acknowledged the report's findings related to Seaport Associates' improper rent calculation and unreported income, EDC's Board Member's conflict of interest, and EDC's monitoring. Further, EDC indicated that it already took steps to address them. With regard to Seaport Associates, EDC indicated that it is pursuing collection of unpaid rent resulting from improper deductions and investigating unreported Subtenant rental and other income. Specifically, EDC executed a Fifteen (15) Day Notice to Tenant and Demand for Payment of Rent of \$770,478 for the period March 31, 2007, through September 30, 2012, and engaged an independent accounting firm to perform a compliance review of Seaport Associates' leases for the period January 1, 2007, through December 31, 2012. With regard to its Board Member's conflict of interest, EDC advised us that it spoke to the Board Member and, in response, the Board Member amended his 2011 Disclosure Report and, effective immediately, the Board Member will cease any connection with Seaport Associates' lease premises.

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

Seaport Associates Owes the City at Least \$1.3 Million

Seaport Associates improperly calculated rent payments and did not report all Subtenant rental income or other income and, therefore, owes the City at least \$1,294,836— \$787,664 for unpaid

rent and \$507,172 for accrued interest. As noted, Seaport Associates was required to pay the City the greater of a Minimum Base Rent, which is based on Gross Leasable Area square footage, or an Alternative Base Rent of 20 percent of Gross Income. Section 3.02 (a) of the leases stipulate that Gross Income shall include all sums paid to Tenant by subtenants including, without limitation:

- Annual basic rental or minimum rental pursuant to Subleases, and
- All other rental paid to Tenant by Subtenants, pursuant to Subleases, other than amounts reimbursed to Tenant by Subtenants for actual costs of maintenance and operation of the Premises or for Impositions.

Further, Gross Income includes any and all revenues received by Tenant or any Affiliate of Tenant from the conduct of other businesses and/or transactions in, on, or from the City Lease Premises after deduction therefrom of the direct costs and expenses payable in connection with such other businesses and/or transactions.

Because Seaport Associates reported only Subtenant rental income, it was permitted to exclude from Gross Income only Subtenant reimbursements for maintenance, operations, or Impositions. However, Seaport Associates improperly calculated Alternative Base Rent as 20 percent of *net income, i.e., Gross Income after deduction therefrom of all Operating Expenses*, which include maintenance, operations, or Imposition expenses that were not reimbursed by Subtenants, and legal, accounting, and management expenses. Based on Seaport Associates' certified quarterly and annual statements for the period January 1, 2005, through June 30, 2011, Seaport Associates improperly deducted from Gross Income \$3,913,825.

Seaport Associates also did not report all Subtenant rental income or other income. We could not determine total income for the period July 1, 2010, through June 30, 2011, because Seaport Associates did not provide us all Subtenant rental invoices and bank records. However, based on our review of available records for this period, Seaport Associates did not report:

- Subtenant rental income or other income of \$24,490 primarily from Subtenant security deposits that were not refunded and
- Any Subtenant rental income or other income derived from Seaport Associates and related entities, including Wolpert Associates and Belle Harbour Capital, LLC, that conducted their real estate and management consulting businesses, in whole or in part, from the lease premises.

As a result of these improper reductions to Gross Income of at least \$3,938,315 (i.e., improper deductions of \$3,913,825 for the period January 1, 2005, through June 30, 2011, and unreported income of at least \$24,490 for the period July 1, 2010, through June 30, 2011), Seaport Associates owes the City \$1,294,836 for unpaid rent and accrued interest as follows:

Unpaid Rent and Interest Due the City Related to
Improper Deductions and Unreported Subtenant Income
January 1, 2005, through June 30, 2011

	A	B	C	D	E	F
Period	Gross Income	Improper Reductions to Gross Income	Net Income	Alternative Base Rent per Auditors i.e., 20% of Gross Income (Column A)	Alternative Base Rent Calculated and Paid per Seaport Associates i.e., 20% of Net Income (Column C)	Alternative Base Rent Due the City (Column D – Column E)
July 2010 - Jun 2011	\$1,734,239	\$743,108	\$991,131	\$346,848	\$198,226	\$148,622
Jan 2010 – Jun 2010	\$860,034	\$348,066	\$511,968	\$172,007	\$102,394	\$69,613
CY 2009	\$1,742,389	\$588,204	\$1,154,185	\$348,478	\$230,837	\$117,641
CY 2008	\$1,705,663	\$543,150	\$1,162,513	\$341,133	\$232,503	\$108,630
CY 2007	\$1,450,873	\$758,914	\$691,959	\$290,175	\$138,392	\$151,783
CY 2006	\$1,106,378	\$519,300	\$587,078	\$221,276	\$117,416	\$103,860
CY 2005	\$1,222,280	\$437,573	\$784,707	\$244,456	\$156,941	\$87,515
Rent						\$787,664
Interest of 15% Per Annum³						\$507,172
Total Payments Due the City						\$1,294,836

Seaport Associates Response: “In calculating ‘Gross Income’ to be shared with the City, Seaport Associates properly...excluded the portion of its subtenants’ rental payments that reflects reimbursements for expenses and costs. As a result, the City shares only in Seaport Associates’ profits, which is what the parties’ intended when they entered the Lease Agreements. Given the plain language of the Lease Agreements, the Draft Audit Report’s conclusion that Seaport Associates did not satisfy all of its rental obligations to the City are without basis under the law....

“The Comptroller’s Office acknowledged that Seaport Associates was excluding actual expenses and costs from its calculation of ‘Gross Income,’ expenses and costs that were bona fide reimbursements from subtenants. Accordingly, the amount of expenses reimbursed is undisputed and there is no suggestion that these amounts do not reflect actually incurred expenses. In fact, the Comptroller’s Office instead argued that only “direct reimbursements” could be deducted from the ‘Gross Income’ calculation even though the Lease Agreements do not distinguish between ‘direct’ or ‘indirect’ reimbursements, and only mention ‘reimbursements’.”

³ Article 6 of the leases stipulate, “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 until paid and immediately shall become due and payable to Landlord as liquidated damages.” 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.”

Auditor Comment: If the parties intended for the City to share only in Seaport Associates' profits, the leases would simply state that Alternative Base Rent shall mean 20 percent of net income, i.e., Gross Income after deduction of expenses. However, it does not. Rather, the leases accurately reflect the parties' true intentions, that the City share in Gross Income less only certain expenses, by stating that Alternative Base Rent "shall mean twenty percent (20%) of all Gross Income" and defining Gross Income to include all other Subtenant rental pursuant to Subleases "other than amounts reimbursed to Tenant by Subtenants for actual costs of maintenance and operation of the Premises or for Impositions." (Emphasis added.) There is a clear distinction between exclusions and deductions. With respect to Subtenant rental and other income, the leases permit only limited exclusions, i.e., only Subtenant reimbursements for maintenance, operations, and impositions costs pursuant to Subleases and not broad deductions of all maintenance, operations, and impositions costs.

Additionally, the Comptroller's Office did not acknowledge that all deducted expenses and costs were bona fide reimbursements. Most important, the report cites Seaport Associates for improperly deducting legal, accounting, and management expenses. These administrative expenses accounted for a significant portion of improper deductions—\$929,544 of \$3,913,825—cited for the period January 1, 2005 through June 30, 2011. And Seaport Associates did not dispute that administrative expenses may not be excluded from Gross Income under the terms of the leases. Further, based on a review of Seaport Associates deducted expenses totaling \$334,828 for the period January 1, 2011 through June 30, 2011, Seaport Associates claimed improper or questionable expenses totaling \$150,311.

Seaport Associates Response: "Limiting 'Gross Income' to rental payment amounts that Seaport Associates actually keeps as profit after subtracting property-related expenses is not only commonsense, but the only fair and equitable reading of the Lease Agreements.⁶

"Seaport Associates retained the law firm Cadwalader Wickersham & Taft LLP ("Cadwalader") to provide an explanation of the proper application the relevant provisions of the Lease Agreements to share with EDC. On or about February 19, 2013, Cadwalader provided Seaport Associates with a memorandum explaining that the plain terms of the Lease Agreements limit "Gross Income" to rental payment amounts that Seaport Associates actually keeps as profit after subtracting property-related expenses. This memorandum was shared with the EDC by email, dated February 20, 2013....

"Not only is Seaport Associates' 'Gross Income' calculation methodology explicitly supported by the Lease Agreements, it is derived from an interpretation that was discussed with, and agreed upon by, the City's designated agent under the Lease Agreement, the EDC....

"In or around 2006, the EDC conducted an audit of Seaport Associates....

"Seaport Associates and the EDC agreed that the Alternative Base Rent owed by Seaport Associates to the City for that entire seven year period was only \$177,136.00....The \$177,136.00 that the EDC agreed was the amount owed by Seaport Associates was calculated using the very same Alternative Base Rent calculation methodology that the Comptroller is now challenging.⁸

'In connection with reaching their shared understanding about how to calculate rent going forward, the EDC provided Seaport Associates with an abstract of the Lease Agreements and a marked-up excerpt of the Lease Agreements. This written document further reflects that the EDC accepted and adopted the rent calculation methodology used by Seaport Associates to calculate rent payments from 2007 to 2012.'

Auditor Comment: Seaport Associates did not provide us "an abstract of the Lease Agreements and a marked-up excerpt of the Lease Agreements" which it maintains evidences EDC's acceptance and adoption of future rent payment calculations. Moreover, Seaport Associates' assertion of such a shared understanding—memorialized in writing—is contradicted by its own response, which simultaneously maintains that in 2006, Seaport Associates and EDC came to a shared understanding regarding how to calculate rent, and in 2013, Seaport Associates retained legal counsel to provide EDC "an explanation of the proper application" of lease rent provisions. This "shared understanding" is also belied by the fact that EDC issued a demand to recover unpaid rent from Seaport Associates.

Seaport Associates Response: "The City is estopped from claiming that Seaport Associates did not pay rent through at least September 8, 2011 when the City executed the second of two estoppel certificates (the 'Estoppel Certificates') in connection with Seaport Associates obtaining financing....

"To be sure, there is a representation in the 2010 and 2011 Estoppel Certificates that is qualified, in part, based on the City's knowledge: 'Each of Fee Owner and Tenant represents and warrants: (i) that the [Lease Agreement is] in full force and effect; (ii) to best of its knowledge after due investigation and inquiry, neither Fee Owner nor Tenant is in default of their respective obligations thereunder and no event, act or condition exists which with the giving of notice or the lapse of time or both would constitute a default thereunder or would allow Fee Owner to terminate [the Lease Agreement] together with all amendments and modifications with respect thereto have been delivered to [Lender].'(emphasis added).

"Importantly, the separate representation in the Estoppel Certificates concerning payment of rent contains no such qualification whatsoever. After all whether a party has paid its rent is not something that should require a 'knowledge qualification.' This is in contrast to other potential defaults, such as those of which the City could not possibly be aware. But making rent payments is not one of them. In any event, while the broader default provision contains a knowledge qualifier, it states that the City made the representation 'after due investigation and inquiry.' Given this 'clarification to the qualification,' there is no justification for the Comptroller's Office's complete disregard of the Estoppel Certificates."

Auditor Comment: These estoppels were executed in the context of specific transactions—the issuance of leasehold mortgages—and for the benefit of specified parties—mortgage lenders. They were issued to mortgage lenders to verify that, at the time of execution, Seaport Associates was party to certain leases which were in full force and effect and that, *to the best of the City's knowledge*, Seaport Associates had not defaulted on these leases. The estoppels do not waive the City's right to contest payments due it.

As acknowledged by Seaport Associates, the September 2010 and September 2011 estoppels both contain knowledge qualifiers which are, in fact, applicable to rent. Such qualifiers are necessary because Alternative Base Rent is based on self-reported Gross Income and expense data and the City would have to conduct an in-depth audit of Seaport Associates' books and records to determine the accuracy of financial reporting and whether additional Alternative Base Rent was due the City. With respect to other charges, investigation and inquiry identified outstanding water and sewer charges. As noted, the City held its September 2010 estoppel in escrow until these outstanding charges were paid.

Seaport Associates Response: "The Statute of Limitations in New York for breach of contract is six years....The statute of limitations begins to run from the date of the breach of the contract, not from discovery....As a result, the City is not entitled to recover any additional rent for 2005, which the Comptroller's Office claims is \$87,515 plus approximately \$91,889 in interest at 15% per annum."

Auditor Comment: Seaport Associates did not submit Calendar Year 2005 quarterly and annual certified statements of all rents and other income received, and all other factors relevant to the computation of Base Rent, and accompanying Alternative Base Rent payments as required. Consequently, on November 15, 2006, EDC advised Seaport Associates that

"To date, Landlord has not received any Alternative Base Rent, nor any of the written quarterly or year-end statements required by the Lease relative to the payment of Alternative Base Rent. Please submit to Landlord all of the required reports, along with any Base Rent that may be due and owing."

On January 29, 2007, and April 24, 2007, EDC sent follow-up requests for such statements and payments. In response to these repeated requests, on May 3, 2007, Seaport Associates provided EDC a year-end statement of 2005 Gross Income and Operating Expenses and resulting Alternative Base Rent due. As previously noted, Seaport Associates improperly calculated its 2005 Alternative Base Rent as 20 percent of net income and, in doing so, breached its leases. Because the breach occurred on May 3, 2007, it is within the Statute of Limitations and resulting underpayments and interest are recoverable.

Seaport Associates Response: "The parties only intended to capture revenue derived indirectly by Seaport Associates or its corporate principals by reason of Seaport Associates being a tenant in the South Street Seaport Historic District, and receiving the benefits that might be derived by reason of that particular tenancy as opposed to some other tenancy. For example, the parties intended for the City to profit from any South Street Seaport-related business that Seaport Associates conducted from the leased premises. If, for example, a Seaport Associates Corporate affiliate sold t-shirts or coffee mugs from the leased premises bearing a South Street Seaport logo, Seaport Associates' Affiliates had to share that revenue with the City.

"Moreover, Seaport Associates does not have any corporate affiliates that existed in 1988, which currently do business at, on, or in the leased premises. When the parties entered into the Lease Agreements in the 1980's, they only intended for Seaport Associates' then-existing corporate affiliates to share their revenue with the City. 'Absent explicit language demonstrating the parties' intent to bind future affiliates of the

contracting parties, the term 'affiliate' includes only those affiliates in existence at the time that the contract was executed.'...

"Finally, the City is not entitled to any additional rent based on any 'Affiliate' theory. The Draft Audit Report erroneously provides that Seaport Associates should have reported income derived from Seaport Associates' 'related entities, including Wolpert Associates and Belle Harbour Capital, LLC that conducted their real estate and management consulting businesses, in whole or in part, from the lease premises.'"

Auditor Comment: As previously noted, Seaport Associates is disregarding the unambiguous language of the leases, which broadly define Gross Income to include "any and all revenues received 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 City Lease Premises (including, without limitation but by way of illustration, revenues from the sale, lease or licensing of the name, trademarks, trade name, logo, copyrights and other similar interests in connection with the Project)." (Emphasis added.) There is nothing in the leases to suggest that the parties intended to limit the types of revenue to be included in Gross Income or Affiliate income to pertain only to Affiliates in existence at the time that the contract was executed.

To clarify, with respect to Seaport Associates' related entities that conduct their businesses, in whole or in part, from the lease premises, Seaport Associates should:

- Sublease space to non-Affiliates and include in Gross Income all sums paid to Seaport Associates other than amounts reimbursed for maintenance, operations, and Impositions expenses, and
- Include in Gross Income any and all revenues generated by Affiliates from the conduct of businesses and/or transactions in, on, or from the lease premises after deduction of direct costs and expenses payable in connection with such other businesses and/or transactions, provided that such deductions shall not exceed revenues.

As noted, EDC acknowledged the report's findings related to Seaport Associates' improper rent calculation and unreported income. In response, EDC indicated that it is pursuing collection of unpaid rent resulting from improper deductions and investigating unreported Subtenant rental and other income. Specifically, EDC executed a Fifteen (15) Day Notice to Tenant and Demand for Payment of Rent of \$770,478 for the period March 31, 2007, through September 30, 2012, and engaged an independent accounting firm to perform a compliance review of Seaport Associates' leases for the period January 1, 2007, through December 31, 2012.

EDC Improperly Adjusted Seaport Associates' Interest and Rent Charges Totaling \$27,032

EDC improperly adjusted Seaport Associates' interest and Alternative Base Rent charges totaling \$27,032 as follows:

- *Interest* On June 30, 2007, EDC back-billed Seaport Associates \$177,136 for unreported and unpaid CY2000 to CY 2006 Alternative Base Rent. In connection with this, on June 1, 2008, EDC assessed Seaport Associates interest of \$17,364 on Alternative Base Rent arrears. Seaport Associates did not dispute these charges and paid them—

Alternative Base Rent arrears were paid in installments and satisfied on April 22, 2010, and interest charges were paid in full on January 26, 2009. Nevertheless, on June 30, 2010, EDC reversed Seaport Associates' interest charges of \$17,364 and applied them to Seaport Associates' outstanding electric charges. EDC maintained that it reversed these interest charges because Seaport Associates agreed to pay back-billed water and sewer charges of \$84,714 for which collection may not have been fully enforceable. However, these charges are separate and independent. If outstanding water and sewer charges were not, in fact, collectible, EDC should have written them off rather than reverse previously paid interest charges. Moreover, Seaport Associates did not pay these water and sewer charges until September 29, 2010, and did so in response to the City holding its leasehold mortgage estoppel agreement in escrow pending receipt of the \$84,714.

- *Rent* On June 30, 2010, EDC reversed Second Quarter 2007 Alternative Base Rent charges of \$9,668 on the basis that they were duplicative charges. EDC maintained that Seaport Associates was billed for both estimated charges of \$9,668 on June 1, 2008, and actual charges of \$6,624 on June 30, 2010. However, the \$9,668 charge was, in fact, an additional assessment of Alternative Base Rent resulting from Seaport Associates underreporting Subtenant rental income and not an estimated charge.

Consequently, the City did not receive all money due it.

EDC Board Member Conflict of Interest

An EDC Board Member and Chair of the Board's Real Estate and Finance Committee obtained free services from Seaport Associates', including apparently free office space and other services to conduct, in part, his real estate brokerage business. The EDC Board Member, a former Seaport Associates principal and lease signatory, previously leased from Seaport Associates a suite for his sole use and paid monthly rent of nearly \$3,000. This lease was scheduled to expire in February 2010. However, in the first quarter of 2008, the Board Member stopped leasing this office space and paying rent but continued to list 19 Fulton Street as his sole New York City office location, appeared on the name plate as a tenant of 19 Fulton Street, and appeared to have started sharing office space with Seaport Associates for which he paid no rent. This is a conflict of interest and a clear violation of EDC's Code of Ethics for Directors of New York City Economic Development Corporation (the Code), which is intended to promote honest and ethical conduct and uphold public confidence and trust. The Code states:

"It is vitally important to the public trust that both the fact and the appearance of conflicting interests and improper corporate conduct be avoided....

"A Director must not be placed under actual or apparent obligation to anyone by accepting...gifts or other favors where it might appear that they were given for the purpose of improperly influencing the Director in the performance of his or her corporate duties. In addition, a Director should never use his or her official position to secure unwarranted privileges or exemptions; nor should a Director, by his or her conduct, give any reasonable basis for the impression that any person can improperly influence him or her or unduly enjoy his or her favor in the performance of his or her official duties or that he or she is affected by the kinship, rank, position or influence of any party or person."

Nevertheless, on his 2010 and 2011 certified Disclosure Statements, the EDC Board Member certified that he received and reviewed a copy of the Code of Ethics for Directors of New York

City Economic Development Corporation and advised that he was not involved in any activity that would be considered in violation of the aforesaid Code.

As noted, EDC acknowledged the report's findings and indicated that it already took steps to address them. Specifically, EDC advised us that it spoke to its Board Member regarding his conflict of interest and, in response, the Board Member amended his 2011 certified Disclosure Report. On his amended statement, the Board Member disclosed that he received a gift of a "free mail drop" from Seaport Associates, a "former business associate and close friend." Further, EDC informed us that effective immediately, the Board Member will cease any connection with Seaport Associates' lease premises.

EDC Did Not Adequately Monitor Seaport Associates to Ensure Compliance with Its Leases

EDC did not adequately monitor Seaport Associates to ensure its compliance with significant lease terms. As the agency responsible for administering the leases, EDC should have ensured that Seaport Associates complied with rent, mortgage, assignment, and other significant lease terms. EDC conducted routine financial reviews of Seaport Associates' certified quarterly and annual statements and identified additional rent, interest, and Impositions due the City. However, these reviews did not identify that Seaport Associates failed to report all Subtenant rental or other income and that Seaport Associates deducted significant ineligible operating, legal, accounting, and management expenses totaling \$3.9 million. As previously detailed, these improper deductions largely accounted for underpayments of at least \$787,664.

Additionally, when Seaport Associates requested that the City execute estoppel agreements in connection with September 2010 and September 2011 leasehold mortgages totaling \$2.8 million, EDC did not review mortgage agreements for substance, i.e., mortgage amounts, intended use of funds, and whether Seaport Associates had the ability to pay the mortgage. Further, the September 2010 estoppel agreement approved a reorganization of the Tenant—specifically, the withdrawal of Fulton Street General Corporation as co-general partner and the merger of Fulton Street Holdings LP into the Tenant. However, EDC did not determine whether these changes resulted in the transfer of a controlling interest in any general partner or the admission of new general partners. Such changes require EDC review and approval to ensure that the City does business with only qualified, reputable individuals fully capable of performing all lease obligations.

RECOMMENDATIONS

Seaport Associates should:

1. Immediately remit to EDC unpaid rent and interest charges totaling \$1,294,836 related to Subtenant rental income.

Seaport Associates Response: “**Seaport Associates Has Paid The city Everything It Is Owed** The Draft Audit Report, including the recommendations and conclusions set forth therein, cannot be reconciled with the plain language of the Lease Agreements or the parties’ long-standing prior course of dealing. The Draft Audit Report also is entirely inconsistent with the estoppel certificates that the City executed in 2010 and 2011, in which the City expressly represented without qualification that Seaport Associates had satisfied all of its rent obligations. The Draft Audit Report is also premised on an interpretation of the Lease Agreements that is contrary to the long standing shared-understanding reached between Seaport Associates and the EDC, the City’s designated agent under the Lease Agreements. Finally, the City has no legal claim to any unpaid rent from 2005 because the relevant statute of limitations has expired.”

Auditor Comment: As previously detailed, Seaport Associates has disregarded the unambiguous language of the leases which stipulate that Alternative Base Rent “shall mean twenty percent (20%) of all Gross Income” and that Gross Income shall include “any and all revenues received by Tenant or any Affiliate.” (Emphasis added.) Instead, Seaport Associates offers an “interpretation” of the leases that reduces Gross Income by both providing for broad deductions rather than limited exclusions from Subtenant rental income and limiting the types and sources of revenue to be included in other income, and thereby, reduces payments to the City.

Additionally, Seaport Associates’ other arguments are without merit because: Seaport Associates did not provide us purported evidence that EDC accepted and adopted its methodology for rent payment calculations; the City appropriately qualified its estoppels and, therefore, did not waive its right to contest payments due it; and Seaport Associates’ breaches related to improper calculation and underpayment of Alternative Base Rent all occurred on or after May 3, 2007, and are within the Statute of Limitations.

Finally, as noted, below EDC fully agrees with our recommendation that Seaport Associates remit the \$1,294,836 related to Subtenant rental income.

EDC Response: “EDC agrees with this recommendation.”

2. Immediately pay EDC reinstated interest and rent charges totaling \$27,032.

Seaport Associates Response: Seaport Associates did not address this recommendation.

EDC Response: “EDC view is discussed in 6 below.”

3. Report all Subtenant rental income or other income from all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises and pay additional rent and unpaid interest due the City.

Seaport Associates Response: Seaport Associates did not address this recommendation.

EDC Response: “EDC believes Seaport Associates should report all Subtenant Rent and income and all revenues received from all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises and pay any and all additional rent and unpaid interest due.”

With regard to Seaport Associates, EDC should:

4. Send written notice to Seaport Associates advising it that unpaid rent and interest charges totaling \$1,294,836 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 leases.

EDC Response: “EDC is grateful that the Comptroller's audit has corroborated EDC's internal findings and has lent the Comptroller's office support as EDC seeks payment for unpaid rent and interest. As stated in the audit report, EDC issued a rent demand to Seaport Associates on February 14, 2013 for \$770,478 for the period of March 31, 2007 to September 30, 2012. At this time, EDC and the City of New York are currently in litigation to collect unpaid rent and interest from Seaport Associates and we will continue to pursue this matter aggressively. EDC would appreciate any additional support the Comptroller's office can provide in this effort.”

5. Identify all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises; quantify any and all revenues received by Tenant or any Affiliate from such businesses and/or transactions net of related direct costs and expenses payable; and calculate additional rent and unpaid interest due the City.

EDC Response: “EDC has engaged Marks Paneth & Shron LLP to conduct an independent and thorough audit of the books and records of Seaport Associates to determine all outstanding rent and additional rent owed by the Tenant. A notice of demand for access of books and records for the past six years was sent to Seaport Associates on February 26, 2013.”

6. Reinstate interest and rent charges totaling \$27,032.

EDC Response: “With respect to the interest charges, EDC disagrees with the recommendation to re-institute the charges since these amounts are likely to be uncollectible. As the audit report notes, EDC was able to successfully collect \$84,714 in water charges instead of pursuing other charges of \$17,364. With respect to the \$9,668 in recommended adjustments for alternative rent, EDC will make this adjustment pending the outcome of the aforementioned audit EDC has commissioned.”

Auditor Comment: As previously reported, the water charges EDC collected are separate and independent from the interest charges they adjusted. Since the interest charges were paid in full by Seaport Associates on January 26, 2009, EDC should not have reversed these charges and applied them to Seaport Associates' outstanding electric charges.

Also, as previously noted, the \$9,668 charge was an additional assessment of Alternative Base Rent resulting from Seaport Associates underreporting Subtenant rental income.

Therefore, we reiterate our recommendation that EDC reverse these charges.

7. Send written notice to Seaport Associates advising it that interest and rent charges totaling \$27,032 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 leases.

EDC Response: “See response to Recommendation 6.”

8. Determine whether changes in Seaport Associates’ ownership throughout the lease term resulted in the transfer of a controlling interest in any general partner or the admission of new general partners.

EDC Response: “EDC is pursuing this matter.”

9. Take other appropriate enforcement action as needed.

EDC Response: “In addition to the aggressive measures outlined above, EDC, together with the City of New York, will take whatever enforcement action is necessary.”

With regard to its Board Member, EDC should:

10. Immediately direct its Board Member to cease using space in EDC-leased premises regardless of whether the Board Member pays rent in consideration for such space.

EDC Response: “EDC directed the Board Member to cease any connection with the leased premises and the Board Member immediately complied.”

11. Direct its Board Member to make all facts known to EDC’s General Counsel regarding his relationship with Seaport Associates.

EDC Response: “EDC’s General Counsel and Board Member have had several conversations regarding the relationship of the Board Member and Seaport Associates. As a result of these conversations, EDC believes it has learned all material facts relating to such relationship.”

12. Direct its Board Member to detail any and all activities that would be considered to be in violation of the Code of Ethics for Directors of EDC on his certified Disclosure Statement for Directors.

EDC Response: “The most recent Disclosure Statement the Board Member submitted in accordance with EDC’s Code of Ethics for Directors states that the Board member’s company did not occupy any space in the leased premises but as an extended courtesy from management, the company did have a mail drop at the premises where the company’s name was listed on the building directory. Because it did not occupy space at the premises, the company did not make any lease payments to Seaport Associates during this time; however, the company paid the costs of forwarding its mail.”

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

13. 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 an extensive audit program in place for participation leases and will continue this program of conducting routine audits and other reviews of leases it administers.”

With regard to its lessees that request that the City execute estoppel agreements in connection with leasehold mortgages, EDC should:

14. Conduct substantive reviews of mortgage agreements, including but not limited to, reviewing mortgage amounts and the intended use of funds, and assessing lessees risk of default and, thus, the risk of lease assignment.

EDC Response: “EDC agrees to conduct ongoing reviews in the future.”

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 2011.

To identify and understand Seaport Associates' and the City's rights and responsibilities, we reviewed the terms of: the Improvement and Operation Agreement, the original leases, and subsequent lease supplements and amendments. We also reviewed Seaport property maps detailing leased premises and interviewed EDC officials regarding their lease administration roles and responsibilities.

To obtain an understanding of Seaport Associates' controls over and procedures for receiving, recording, and reporting gross income, we interviewed Seaport Associates officials and reviewed Seaport Associates':

- Subleases;
- Invoices;
- General Ledger, Accounts Receivable Sales Journal, and Cash Receipts Journal;
- Deposit Tickets and Bank Statements;
- 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, 2010.

To determine whether Seaport Associates reported Subtenant rental income for all spaces covered by the leases, we first identified and compiled a list of spaces by reviewing lease terms, EDC property maps, and a property survey commissioned by Seaport Associates. We also conducted a physical walk-through of the lease premises. We then determined whether Seaport Associates reported Subtenant rent for each leasable space on Monthly Rent Rolls submitted to EDC.

To determine whether Seaport Associates accurately reported rents for these spaces, we compared rents reported to EDC on Monthly Rent Rolls for the period July 2010 to June 2011 to: applicable sublease payment terms; amounts billed on tenant invoices and recorded in Seaport Associates' Accounts Receivable Sales Journal; and amounts paid as evidenced by copies of checks, bank deposit tickets, and bank statements and recorded in Seaport Associates' Cash Receipts Journal. We also sent confirmation letters to all Subtenants to confirm rent and other charges paid for the period July 2010 to June 2011.

For those spaces for which Seaport Associates did not report Subtenant rental income, we determined whether spaces were occupied and, if so, whether they were occupied by Subtenants or Seaport Associates or its affiliates. We identified occupants from Seaport Associates' tenant directories. We then obtained and reviewed Dun & Bradstreet and

LexisNexis reports to determine whether occupants were affiliated with Seaport Associates, and to identify the location, business conducted, and estimated income generated by occupants.

We determined whether Seaport Associates properly calculated rent payments. Seaport Associates was required to pay the greater of a minimum base rent that is the product of \$2.60 and gross leasable square footage or an alternative base rent of 20 percent of gross income. We calculated minimum payments based on gross leasable square footage as reported in a property survey commissioned by Seaport Associates. For the period July 1, 2010, through June 30, 2011, we calculated percentage payments based on audited gross income. For the period January 1, 2005, through June 30, 2010, we calculated percentage payments based on Seaport Associates' certified quarterly and annual statements. We then determined whether minimum or alternative base rents were applicable. We compared applicable payments to Seaport Associates' payments reported and made to EDC and quantified underpayments.

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

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

We reviewed the Department of Finance's ACRIS database to identify potential leasehold mortgages. We then requested from EDC and Seaport Associates approved capital budgets and capital expense documentation.

To determine whether EDC adequately monitored Seaport Associates' performance and enforced lease terms in a timely manner, we interviewed EDC officials, reviewed lease files, and requested prior audits and other financial or compliance reviews.

CADWALADER

Cadwalader, Wickersham & Taft LLP
One World Financial Center, New York, NY 10281
Tel +1 212 504 6000 Fax +1 212 504 6666
www.cadwalader.com

New York London Charlotte Washington
Houston Beijing Hong Kong Brussels

April 5, 2013

VIA HAND DELIVERY AND ELECTRONIC MAIL

City of New York
Office of the Comptroller
Bureau of Audit
Municipal Building
One Centre Street, Room 1100
New York, New York 10007-2341
Attn: Ms. H. Tina Kim, Deputy Comptroller

**Re: Audit Report of the Compliance of the South Street Seaport Associates
With Its City Lease Agreement (FK12-069A)**

Dear Ms. Kim:

We represent Seaport Associates L.P. ("Seaport Associates"), the Tenant under the lease, dated March 15, 1988, with the City of New York (the "City"), and the New York City Economic Development Corporation ("EDC") as the lease administrator on behalf of the City (as amended, the "1988 Lease").¹ On behalf of Seaport Associates, we respectfully submit this written response to the draft Audit Report on the Compliance of South Street Seaport Associates with Its City Lease Agreement (the "Draft Audit Report"), prepared by the New York City Office of the Comptroller (the "Comptroller's Office"), and dated March 22,

¹ The City's entire analysis in the Draft Audit Report is flawed. Seaport Associates is the tenant under two lease agreements with the City, a lease agreement, dated October 27, 1983 (as supplemented on December 29, 1983 and amended on March 15, 1988 and November 23, 1998, the "1983 Lease"), and the 1988 Lease. The Draft Audit Report mentions only the 1988 Lease, which was entered by South Street Seaport Corporation (the "SSSC"), as landlord, and Seaport Associates, as tenant (as amended on November 23, 1998), pertaining to approximately 15,000 square feet of office space located within the South Street Seaport Historical District. The 1983 Lease concerns approximately 33,000 square feet of additional office space within the South Street Seaport Historical District. The Draft Audit Report ignores the 1983 Lease. Yet, the analysis and calculations in the Draft Audit Report do not match the specifications of the 1988 Lease. Indeed, they could not possibly relate to the 1988 Lease alone. This, we submit, speaks volumes about the lack of care and attention to detail that the City put into the analysis underlying the Draft Audit Report. For purposes of this Response, we assume the City intended for the Draft Audit Report to be applicable to the 1983 Lease as well. The 1983 Lease and the 1988 Lease are referred to herein together as the "Lease Agreements."

C A D W A L A D E R

2013. The Draft Audit Report contains several material errors, which should be addressed if the Draft Audit Report is finalized and published. Moreover, any publication of the Draft Audit Report should include this response.

PRELIMINARY STATEMENT AND BACKGROUND

The Draft Audit Report reflects a misguided and improper attempt by the City to re-write the Lease Agreements and disregards the long-course of dealing and course of performance among the parties, all so the Comptroller's Office can score short-term political points for its leader, 2013 mayoral candidate John C. Liu. In the Draft Audit Report, the Comptroller's Office erroneously contends that Seaport Associates, which has generated and paid to the City nearly \$4 million-pursuant to the Lease Agreements, improperly calculated rent payments, did not report all Subtenant² rental income and, therefore owes the City unpaid rent in the amount of \$787,664, and accrued interest in the amount of \$507,172.

The Draft Audit Report is predicated on a flawed reading of the Lease Agreements. The Lease Agreements expressly provide that Seaport Associates can exclude reimbursements from subtenants for operating expenses and maintenance costs before calculating the Gross Income to be shared with the City. There is no dispute that this is exactly what Seaport Associates did when it paid the City Alternative Base Rent under the Lease Agreements between January 1, 2005 and June 30, 2011. Seaport Associates uses gross subleases, which require subtenants to pay a single rental amount that reflects (a) the cost of leasing the space, plus (b) reimbursements for various operating expenses and maintenance costs that are paid directly by Seaport Associates. In calculating "Gross Income" to be shared with the City, Seaport Associates properly, and with full knowledge and agreement from the City's designated agent under the Lease Agreements, the Economic Development Corporation ("EDC"), has excluded the portion of its subtenants' rental payments that reflects reimbursements for expenses and costs. As a result, the City shares only in Seaport Associates' profits, which is what the parties' intended when they entered the Lease Agreements. Given the plain language of the Lease Agreements, the Draft Audit Report's conclusion that Seaport Associates did not satisfy all of its rental obligations to the City are without basis under the law

In addition, this conclusion is inconsistent with Seaport Associates' extensive and uncontroverted course of dealing with the City (and its agent the EDC) as well as the facts known to the City and the EDC. Indeed, the Draft Audit Report simply disregards the practical and legal effect of the shared-understanding concerning the calculation of Alternative Base Rent reached in or around 2007 between Seaport Associates and the City's designated agent under the Lease Agreements, the EDC. At the March 20, 2013 exit conference, the Comptroller's Office admitted that, at all times since the Alternative Base Rent has been paid, the EDC was fully aware of how Seaport Associates calculated its rental payments. The

² Capitalized Terms not defined herein shall have the definition provided for them in the Lease Agreement.

C A D W A L A D E R

Comptroller's Office also admitted that EDC had agreed to the methodology that Seaport Associates has consistently used since 2007. The Comptroller's Office further admitted that the City issued estoppel certificates in 2010 and 2011 in which the City expressly represented that Seaport Associates had paid all rent and charges arising and due and payable under the Lease Agreements. In light of these admissions, the Comptroller's Office has no legal basis to claim that Seaport Associates owes it additional rent, much less additional rent plus a 15 percent penalty for not paying it on time. This is especially true with respect to the Comptroller's Office's assertions with respect to rent for 2005. The Statute of Limitations for collecting past rent for this period has passed.

For these reasons and those discussed below, the Draft Audit Report should be withdrawn entirely.

Seaport Associates Has Paid The City Everything It Is Owed

The Draft Audit Report, including the recommendations and conclusions set forth therein, cannot be reconciled with the plain language of the Lease Agreements or the parties' long-standing prior course of dealing. The Draft Audit Report also is entirely inconsistent with the estoppel certificates that the City executed in 2010 and 2011, in which the City expressly represented without qualification that Seaport Associates had satisfied all of its rent obligations. The Draft Audit Report is also premised on an interpretation of the Lease Agreements that is contrary to the long standing shared-understanding reached between Seaport Associates and the EDC, the City's designated agent under the Lease Agreements. Finally, the City has no legal claim to any unpaid rent from 2005 because the relevant statute of limitations has expired.

A. Seaport Associates Properly Calculated And Paid All "Adjusted Base Rent," Due To The City, Including Twenty Percent Of "Gross Income" As Defined By The Lease Agreements

The Draft Audit Report is based on a flawed reading of the relevant provisions of the Lease Agreements. Pursuant to Section 3.01(b) of the Lease Agreements, Seaport Associates is to pay the City twenty percent of its "Gross Income" from subleases when Seaport Associates' aggregate net income from such subleases exceeds certain thresholds.² Section 3.02 of the Lease Agreements, in turn, defines "Gross Income" to *exclude* amounts

² Section 3.01(b) of the Lease Agreements provides that Seaport Associates will pay to the City, "Base Rent," which shall consist of the greater of the following amounts:

(i) "Minimum Base Rent", which term shall mean the product of \$2.60 and the total number of square feet of Gross Leasable Area included in the Premises . . . ; and

(ii) "Alternative Base Rent", which term shall mean twenty percent (20%) of all Gross Income for such Fiscal Year.

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reimbursed to Seaport Associates by its subtenants for Seaport Associates' "actual costs of maintenance and operation" of the leased premises.³ Thus, the term "Gross Income as defined by the Lease Agreements has a meaning which varies substantially from a more conventional reading of that term when used in other contexts. As a result, if Seaport Associates generates profits from the Lease Agreements, it only shares its profits with the City. Put another way, the parties did not intend for the City to profit from Seaport Associates' expenses.

Together, Section 3.01(b) and 3.02(a) ensure that in any Fiscal Year, the City will receive at least the Minimum Base Rent, with the potential for greater profitability if the Alternative Base Rent is higher. The Alternative Base Rent depends upon, and is generated by, the economic success of the leased premises based on the management expertise of Seaport Associates and its ability to increase revenues.

To maximize the profitability of the leased premises, Seaport Associates uses "gross leases" when subletting the premises to commercial tenants. Under a gross lease, the landlord typically pays for all of the building's insurance, property taxes, maintenance, repairs or utilities, directly. When a landlord elects to use a gross lease, it passes costs that it incurs on to the tenants or subtenants in the amount of rent that is charged. Thus, operating expenses and maintenance costs are built into each subtenant's monthly rent. When the subtenants pay rent each month, they pay Seaport Associates a single rental amount that reflects (a) the cost of leasing the space, plus (b) reimbursements for various operating expenses and maintenance costs that are paid by Seaport Associates. When Seaport Associates calculates "Gross Income" as defined by the Lease Agreements, it excludes the portion of rental payments that reflects amounts which would otherwise be reimbursements for expenses and costs.

During the March 20, 2013 exit conference, the Comptroller's Office acknowledged that Seaport Associates used "gross leases" with its subtenants that required the subtenants to pay a single rent amount, a portion of which reflected a "reimbursement" to Seaport Associates for its expenses and costs. The Comptroller's Office acknowledged that Seaport Associates was excluding actual expenses and costs from its calculation of "Gross Income," expenses and costs that were bona fide reimbursements from subtenants. Accordingly, the amount of expenses reimbursed is undisputed and there is no suggestion that these amounts do not reflect actually incurred expenses. In fact, the Comptroller's Office instead argued that only "direct reimbursements" could be deducted from the "Gross Income" calculation even though the Lease Agreements do not distinguish between "direct" or

³ Section 3.02(a) of the Lease Agreements provides that Gross Income includes the following:

all sums paid to Tenant for such Fiscal Year by Subtenants, including, without limitation, annual basic rental or minimum rental pursuant to Subleases, all other rental paid to Tenant by Subtenants, pursuant to Subleases, *other than amounts reimbursed to Tenant by Subtenants for actual costs of maintenance and operation of the Premises . . .* (emphasis added)

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“indirect” reimbursements, and only mention “reimbursements.” Under the Comptroller’s Offices’ flawed reading of the Lease Agreements, there are no “amounts reimbursed to Tenant by Subtenants for actual costs of maintenance and operation of the Premises or for Impositions” when Seaport Associates’ subtenants pay a single gross rent amount rather than base rent plus a separate payment reflecting reimbursements to Seaport Associates for its expenses and costs. In other words, it is the Comptroller’s Office’s position that Seaport Associates effectively forfeited the right to deduct operating expenses and maintenance costs from the “profits” shared with the City by using “gross leases.” That is not what the Lease Agreements provide. It also exalts form over substance and creates an absurd result in the process.

The Draft Audit Report does not articulate the “direct reimbursement” argument, for good reason. The Draft Audit Report simply ignores the fact that Seaport Associates incurred expenses which it is permitted to deduct to arrive at “Gross Income,” and seeks to increase the rent due by extracting a portion of the expense reimbursement amounts for the City in contravention of the Lease Agreements. Section 3.02(a) provides that “Gross Income” includes “all sums paid to Tenant . . . other than amounts reimbursed to Tenant by Subtenants for actual costs of maintenance and operation of the Premises.” The word “direct” does not appear anywhere in this provision. Nor is there any language which supports the Comptroller’s Office’s novel construction. The Comptroller’s Office’s attempt to impose additional terms that would fundamentally modify the terms of the Lease Agreements is not permissible under New York law. Salvano v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 85 N.Y.2d 173, 182, 647 N.E.2d 1298, 1303, (N.Y. 1995).⁴ If the parties wished to limit Seaport Associates’ deductible reimbursements to “direct” reimbursements, they surely would have said so in this provision.

Instead, the Draft Audit Report offers an equally flawed and internally inconsistent interpretation of the Lease Agreements. The Comptroller’s Office starts by observing that Seaport Associates “was permitted to exclude from Gross Income only Subtenant reimbursements for maintenance, operations or impositions.” Draft Audit Report at 7. In the very next sentence, the Comptroller’s Office criticizes Seaport Associates for doing just that, *i.e.*, deducting operating expenses from the Gross Income calculation. In particular, the Draft Audit Report states that “Seaport Associates improperly calculated Alternative Base Rent as 20 percent of *net income*, *i.e. Gross Income after deduction therefrom of all Operating Expenses*, which include maintenance, operations, or Imposition expenses.” Draft Audit Report at 6 (emphasis in original). This reasoning and conclusion make no sense. To be sure, ordinarily, taking revenues and adjusting for the cost of doing business, taxes and other expenses is referred to as “net income,” not “gross income.” But this does not mean that Seaport Associates is not permitted to deduct operating expenses when it calculates “Gross

⁴ A lease is subject to the rules of construction applicable to any other agreement. George Backer Management Corp. v. Acme Quilting Co., Inc., 46 N.Y.2d 211, 217, 385 N.E.2d 1062, 1065 (N.Y. 1978).

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Income” pursuant to Section 3.02(a) given how the parties defined the term in the Lease Agreements.

The term “Gross Income” is a defined term which has a specific meaning in the Lease Agreements. The parties defined the term in a manner that renders the label “Gross Income” a misnomer as they expressly excluded operating expenses and maintenance costs from the “Gross Income” calculation. The Draft Audit Report ignores the substantive definition chosen by the parties, which is expressly contrary to the short-hand label that the City used when it drafted the Lease Agreements.⁵ Limiting “Gross Income” to rental payment amounts that Seaport Associates actually keeps as profit after subtracting property-related expenses is not only commonsense, but the only fair and equitable reading of the Lease Agreements.⁶

B. The Draft Audit Report Ignores The Legal Effect Of EDC, As Agent For The City, Agreeing To And Approving Seaport Associates’ Methodology For Calculating Gross Income

Not only is Seaport Associates’ “Gross Income” calculation methodology explicitly supported by the Lease Agreements, it is derived from an interpretation that was discussed with, and agreed upon by, the City’s designated agent under the Lease Agreement, the EDC. The parties’ course of dealing, as reflected by the accord reached in 2007 concerning how to calculate Alternative Base Rent and “Gross Income” is further evidence that the Comptroller’s Offices’ current interpretation of the Lease Agreements, which is the premise of the Draft Audit Report, is fatally flawed. See Murray Hill Mews Owners Corp. v. Rio Rest. Assocs. L.P., 92 A.D.3d 453, 454(1st Dep’t 2012) (“Further, when viewing the parties’ course of conduct-including respondent’s consistent payment for over eight years, without protest, of rent increases based on a compounded fixed rent figure, and its renegotiation of the renewal lease on the same terms as the original lease-it is clear that petitioner’s construction of the escalation clause comports with the parties’ intent”); See Bridget Burgos v. Metro North, 40 A.D.3d 377 (1st Dep’t 2007) (court finds parties’ course of conduct sheds light on ambiguity and demonstrates intent of agreement); Milt Holdings LLC v. 181 PM LLC, No. 570014/10,

⁵ The City drafted the Lease Agreements. Consequently, to the extent the Lease Agreements contain any genuine ambiguities – which Seaport Associates does not concede – such ambiguities must be construed against the City as drafter. See Guardian Life Insurance Company v. Schaefer, 70 N.Y.2d 888, 524 N.Y.S.2d 377 (1987) (where a contract provision is susceptible to differing interpretations, the rule of construction that any ambiguity be construed against the drafter is applicable); see also Watling v Hiawatha Plaza, 59 N.Y.2d 964, 466 N.Y.S.2d 311 (1983); State v. Home Indemnity Co., 66 N.Y.2d 669, 495 N.Y.S.2d 969 (1985).

⁶ Seaport Associates retained the law firm Cadwalader Wickersham & Taft LLP (“Cadwalader”) to provide an explanation of the proper application of the relevant provisions of the Lease Agreements to share with EDC. On or about February 19, 2013, Cadwalader provided Seaport Associates with a memorandum explaining that the plain terms of the Lease Agreements limit “Gross Income” to rental payment amounts that Seaport Associates actually keeps as profit after subtracting property-related expenses. This memorandum was shared with the EDC by email, dated February 20, 2013.

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2010 WL 1949057, at *1 (N.Y. Sup. Ct. App. T. May 14, 2010) (provision of commercial lease governing circumstances under which tenant was obligated to pay additional rent conclusively resolved in favor of tenant's interpretation of the lease because of the "the extensive (approximately decade-long) course of dealings between the landlord, tenant and their respective predecessors in interest").

In or around 2006, the EDC conducted an audit of Seaport Associates. The EDC and Seaport Associates engaged in cordial and productive discussions regarding whether Seaport Associates had properly calculated the Alternative Base Rent due for the period starting with the year 2000 and ending with the year 2006 (the "2006 Alternative Rent Dispute"). In connection with the 2006 Alternative Rent Dispute, Seaport Associates conducted an analysis of the income and expenses of Seaport Associates during the period starting with the year 2000 and ending with the year 2006.

Without having to resort to threats, rent demands or other intimidating notices, the EDC reached an accord and shared understanding with Seaport Associates, which resolved the dispute.⁷ Seaport Associates and the EDC agreed that the Alternative Base Rent owed by Seaport Associates to the City for that entire seven year period was only \$177,136.00 (or approximately \$25,000 per year). The EDC and Seaport Associates agreed that Seaport Associates would make payments against this total at a rate of \$5,000.00 per month until the \$177,136.00 balance was satisfied. The \$177,136.00 that the EDC agreed was the amount owed by Seaport Associates was calculated using the very same Alternative Base Rent calculation methodology that the Comptroller is now challenging.⁸ As the Draft Audit Report correctly notes: "Seaport Associates did not dispute these charges and paid them – Alternative Base Rent arrears were paid in installments and satisfied on April 22, 2010." Draft Audit Report at 9 (emphasis added).

The methodology Seaport Associates and the EDC agreed to use was fully transparent to the City. Pursuant to the Lease Agreements, Seaport Associates consistently provided the City detailed certified statements setting forth all rents and other income received by Seaport Associates for each Fiscal Quarter.⁹ The template for the quarterly Alternative

⁷ In sharp contrast to the tactics employed by the EDC with respect to the parties' current dispute over Seaport Associates' rent calculations (discussed in more detail below), in 2006, the EDC communicated with Seaport Associates regarding their concerns about Seaport Associates' rent calculation methodology.

⁸ In connection with reaching their shared understanding about how to calculate rent going forward, the EDC provided Seaport Associates with an abstract of the Lease Agreements and a marked-up excerpt of the Lease Agreements. This written document further reflects that the EDC accepted and adopted the rent calculation methodology used by Seaport Associates to calculate rent payments from 2007 to 2012.

⁹ Section 3.04(a) provides that Alternative Base Rent shall be payable in quarterly installments, in arrears. This section also requires that, within forty-five (45) days after the end of each Fiscal Quarter, Seaport Associates furnish to the City a detailed written statement certified to be true setting forth all

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Base Rent statements has been used by Seaport Associates for many years without objection from the City, clear evidence that the City has accepted Seaport Associates' methodology with respect to the treatment of the costs of operation and maintenance of the leased premises. Notably, *Seaport Associates has always paid the Alternative Base Rent that was due to the City* for each Fiscal Quarter when due. In addition, Seaport Associates has consistently cooperated with the City and the EDC's requests for information and records pursuant to the Lease Agreement.

The Comptroller's Office begrudgingly acknowledges that Seaport Associates and EDC reached an accord in 2007 concerning how to calculate "Alternative Base Rent" and "Gross Income." See Draft Audit Report at 8.¹⁰ In fact, at the March 20, 2013 exit conference, the Comptroller's Office admitted that EDC knew exactly how Seaport Associates calculated "Gross Income," and that the EDC approved the calculation methodology. Yet, the Comptroller's Office disavowed the EDC's interpretation of the Lease Agreements and repudiated its approval of the agreed-upon methodology for calculating Alternative Base Rent. There is no basis in the law for the City to do so.

Under the Lease Agreements, the EDC is the City's designated agent for administering the Lease Agreements. As such, the EDC had actual authority to negotiate and resolve disputes arising under the Lease Agreements. The City is therefore bound by the EDC's interpretation of the Lease Agreements. See *Farr v. Newman*, 14 N.Y.2d 183, 189, 199 N.E.2d 369, 372, 250 N.Y.S.2d 272, 276-77 (N.Y. 1964); *Graham Court Owners Corp. v. Taylor*, 34 Misc.3d 153(A), 950 N.Y.S.2d 491 (Table), at *1 (App. Term 1st Dep't 2012) (landlord estopped from enforcing no alterations provision of lease agreement where landlord's agents expressly consented to the work complained of); see also *Assoc. v. CW*, 24 Misc.3d 1225(A), 897 N.Y.S.2d 668 (Table), at *5-6 (N.Y. City Civ.Ct.) (N.Y. City Civ.Ct. 2009). It is hypocritical, to say the least, for the Comptroller's Office to criticize the EDC for purportedly "not adequately monitor[ing] Seaport Associates," on the one hand, while claiming the City is not responsible for any of the decisions that the EDC made as the City's agent with respect to how to calculate "Gross Income" and Alternative Base Rent.

rents and other income received by Seaport Associates for such period and all other factors, including without limitation permitted deductions and exclusions, relevant to the computation of Base Rent for such period, and such statement shall be accompanied by payment of Alternative Base Rent, if any, owing for such period.

¹⁰ The Draft Audit Report opaquely acknowledges the accord and shared-understanding reached between Seaport Associates and EDC. Amazingly, the Draft Audit Report uses the resolution of the 2006 Alternative Rent Dispute to criticize EDC. See Draft Audit Report at 8-9 (EDC "improperly back-billed Seaport Associates for unpaid and unreported CY2000 to CY 2006 Alternative Base Rent.").

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C. The Draft Audit Report Cannot Be Reconciled With The Two Estoppel Certificates That The City Executed In 2010 And 2011 Confirming That Seaport Associates Paid All Of Its Rent

The City is estopped from claiming that Seaport Associates did not pay rent through at least September 8, 2011 when the City executed the second of two estoppel certificates (the “Estoppel Certificates”) in connection with Seaport Associates obtaining financing. In the Estoppel Certificates, the City itself made unqualified representations that Seaport Associates had paid all of the rent due under the Lease Agreements. The Estoppel Certificates cannot be reconciled with the conclusions in the Draft Audit Report concerning rent underpayments. See 210 W. 70 Owner LLC v. Cosmic Grp., LLC, 36 Misc. 3d 72, 73-74 (N.Y. Sup. Ct. App. T. 2012) (“... we find no basis to deny effect to the clear terms of the August 2008 estoppel certificate”); Orchard Hotel, LLC v. D.A.B. Grp., LLC, No. 850044/2011, 2012 WL 1109389, at *5 (Sup. Ct. N.Y. Co. Mar. 28, 2011) (holding that borrower’s allegations, which were contrary to its representations in estoppel certificate that “to the best of [borrower’s] knowledge, ‘[l]ender has performed and satisfied all of its obligations under the Note, the Mortgage and the Loan Documents through the date hereof,’” did not have to be considered); see also Health-Loom Corp. v. Soho Plaza Corp., 272 A.D.2d 179, 181 (1st Dep’t 2000).

On or about September 29, 2010, in connection with a refinancing, Seaport Associates secured a mortgage loan from TD Bank (the “2010 Refinancing”). In connection with the 2010 Refinancing, the City provided a written Estoppel, Consent and Agreement for the benefit of TD Bank (the “2010 Estoppel Certificate”). The 2010 Estoppel Certificate expressly provided that “Seaport [Associates] has paid all rent and charges arising and due and payable under the [Lease Agreements] through September 30, 2010.”¹¹

On September 9, 2011, Seaport Associates refinanced a then-existing loan with TD Bank by securing a mortgage loan from Signature Bank (the “2011 Refinancing”). In connection with the 2011 Refinancing, the City provided another written Estoppel, Consent and Agreement for the benefit of Signature Bank (the “2011 Estoppel Certificate” and with the 2010 Estoppel Certificate, the “Estoppel Certificates”). The 2011 Estoppel Certificate provided that “Seaport [Associates] has paid all rent and charges arising and due and payable under the [Lease Agreements] through September 8, 2011.”¹²

¹¹ The 2010 Estoppel Certificate further provided that “neither [City] nor [Seaport Associates] is in default of their respective obligations thereunder and no event, act or condition exists which with the giving of notice or the lapse of time or both would constitute a default thereunder or would allow Fee Owner to terminate either or both of the [1983] Lease or the [1988] Lease.”

¹² The 2011 Estoppel Certificate further provided that “neither [City] nor [Seaport Associates] is in default of their respective obligations thereunder and no event, act or condition exists which with the giving of notice or the lapse of time or both would constitute a default thereunder or would allow [the City] to terminate either or both of the [1983] Lease or the [1988] Lease.”

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Under both the 2010 Refinancing, and the 2011 Refinancing, the Seaport Associates' leasehold interests under the Lease Agreements were encumbered. Seaport Associates would not have (nor could it have) entered into either the 2010 Refinancing, or the 2011 Refinancing without having received the assurances provided by the City in the 2010 Estoppel Certificate and the 2011 Estoppel Certificate.

At the March 20, 2013 exit conference, the Comptroller's Office acknowledged that the City's Law Department prepared the 2010 and 2011 Estoppel Certificates, and that the City executed the Estoppel Certificates. The Comptroller's Office nevertheless argued that the Estoppel Certificates were meaningless because they contained a knowledge qualifier. In particular, the Comptroller's Office argued that the statements in the Estoppel Certificates were made to the "best of the City's knowledge." The Comptroller's Office reasoned that the City did not have knowledge of the rent underpayments at the time of 2011 Estoppel Certificate because the Comptroller's Office had not yet conducted its audit. These arguments are belied by the express terms of the 2010 and 2011 Estoppel Certificates.

The City's representation concerning Seaport Associates having fulfilled its rent obligations in both the 2010 and 2011 Estoppel Certificates does not contain any knowledge qualification whatsoever. To the contrary, the representation is express, unqualified and unequivocal: "Seaport [Associates] **has paid all rent** and charges arising and due and payable under the [Lease Agreements]."

To be sure, there is a representation in the 2010 and 2011 Estoppel Certificates that is qualified, in part, based on the City's knowledge: "Each of Fee Owner and Tenant represents and warrants: (i) that the [Lease Agreement is] in full force and effect; (ii) to best of its knowledge after due investigation and inquiry, neither Fee Owner nor Tenant is in default of their respective obligations thereunder and no event, act or condition exists which with the giving of notice or the lapse of time or both would constitute a default thereunder or would allow Fee Owner to terminate [the Lease Agreement] together with all amendments and modifications with respect thereto have been delivered to [Lender]." (emphasis added).

Importantly, the separate representation in the Estoppel Certificates concerning payment of rent contains no such qualification whatsoever. After all, whether a party has paid its rent is not something that should require a "knowledge qualification." This is in contrast to other potential defaults, such as those of which the City could not possibly be aware. But making rent payments is not one of them. In any event, while the broader default provision contains a knowledge qualifier, it states that the City made the representation "after due investigation and inquiry." Given this "clarification to the qualification," there is no justification for the Comptroller's Office's complete disregard of the Estoppel Certificates.

Finally, the Comptroller's Office's entire argument concerning the "best of its knowledge" language is a red herring. It ignores the fact that the EDC, its agent for purposes of the Lease Agreements, knew exactly how Seaport Associates had calculated its rental payments. The City expressly chose EDC to be its agent in connection with the Lease

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Agreements. The EDC's knowledge concerning how Seaport Associates calculated its rental payments – which the Comptroller's Office does not dispute – is therefore imputed to the City as a matter of law. Schwartz v. Certified Management Corp., 117 A.D.2d 521, 522-23 (1st Dep't 1986). For this additional reason, the City cannot escape the binding and dispositive nature of the Estoppel Certificates on the rent underpayment issues raised in the Draft Audit Report.

At the March 20, 2013 exit conference, the Comptroller's Office also argued that the EDC abdicated its obligation to monitor Seaport Associates' compliance with the Lease Agreements by approving what might have been a change in control of Seaport Associates when the City executed the 2010 Estoppel Certificates. In this vein, the Draft Audit Report criticizes the EDC for approving a reorganization of Seaport Associates by allowing for the withdrawal of Fulton Street General Corporation as co-general partner, and the merging of Fulton Street Holdings LP into Seaport Associates. In the Comptroller's Office's view, the EDC failed to determine whether these changes resulted in the transfer of a controlling interest in any general partner or the admission of new general partners.

Initially, it is absurd for the Comptroller's Office to criticize the EDC for approvals effectuated by a document that the City itself signed. More fundamentally, however, the assertion that the changes approved might have resulted in a change in controlling interest are baseless. As Seaport Associates explained at the March 20, 2013 exit conference – and consistent with what was acknowledged by the City in the 2010 Estoppel Certificate¹³ – there has been ***no change in control*** with respect to Seaport Associates since 1988. On October 8, 1998, following Seaport Associates' bankruptcy, Fulton Street General Corp. was substituted for Seaport General Corporation, and Beacon General Partners, Inc. ("Beacon") was substituted for Interfunding South Street Group Inc., as the general partners of Seaport Associates L.P.. This (post-bankruptcy) control structure was approved by the City at that time. Beacon General Partners, Inc. continues to control Seaport Associates L.P. Alan B. Wolpert is the President and sole-owner of Beacon General Partners, Inc.

D. The Draft Audit Report Ignores That The Relevant Statute Of Limitations Precludes The City From Recovering For Any Purported Rent Underpayments In 2005-2007

Even if the Comptroller's Office's legal interpretation of the Lease Agreements was not completely flawed, the City has no legal right to recover all of the rent the Comptroller's Office is recommending Seaport Associates remit to the City. At this juncture, the City has no basis to seek rent underpayments to the extent such additional rent payments

¹³ "Fee Owner and Tenant acknowledge and Fee Owner consents that consistent with the [1983 Lease] and [1988 Lease]: (a) Fulton Street General Corporation has withdrawn as co-general partner and Beacon General Partners, Inc. is now the sole general partner of Tenant. and (b) Fulton Street Holdings LP has merged into Tenant, ***which did not result in any change of control with respect to Tenant.***" 2010 Estoppel Certificate at 4 (emphasis added).

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were purportedly due more than six years ago. The Statute of Limitations in New York for breach of contract is six years. McKinney's CPLR § 213(2). The statute of limitations begins to run from the date of the breach of the contract, not from discovery. Ely-Cruikshank Co., Inc. v. Bank of Montreal, 81 N.Y.2d 399, 402 (N.Y. 1993); De Hernandez v. Bank of Nova Scotia, 76 A.D.3d 929, 930 (1st Dep't 2010). As a result, the City is not entitled to recover any additional rent for 2005, which the Comptroller's Office claims is \$87,515 plus approximately \$91,889 in interest at 15% per annum.

The Draft Audit Report's Conclusory Assertions Concerning Affiliate Income Are Based On A Flawed Reading Of The Lease Agreements

The City is not entitled to any rental income derived from the profits of any entity which bears any relation to Seaport Associates that is engaged in business that is completely unrelated to the South Street Seaport. Likewise, the City is not entitled to any rental income derived from the profits of a current entity that has any relation to Seaport Associates entity that did not exist at the time the Lease Agreements were entered. Nevertheless, the Comptroller's Office now suggests otherwise. See Draft Audit Report at 7. It is wrong.

When the parties entered the Lease Agreements, they intended for Seaport Associates to include in its calculation of "Gross Income" "any and all revenues received by Tenant or any Affiliate of Tenant. . . from the conduct of other businesses and/or transactions in, on, or from the City Lease Premises (including without limitation but by way of illustration, revenues from the sale, lease or licensing of the name trademarks, trade name, logo, copyrights and other similar interests in connection with the Project), after deduction therefrom of the direct costs and expenses payable by Tenant or such Affiliate. . . in connection with such other businesses and/or transactions. . ." (emphasis added). Under the Lease Agreements, "Affiliate" is defined as "any entity which owns and controls, is owned and controlled by, or is under common ownership and control with, another entity." (emphasis added). Individuals cannot be an "Affiliate" as defined in the Lease Agreements.

At the March 20, 2013 exit conference, the Comptroller's Office asserted a sweeping construction of the scope of the affiliate-revenue provision. The Comptroller's Office argued that any revenue generated by any individual or entity affiliated with Seaport Associates in the broadest possible sense, had to share that revenue with the City, regardless of the nature of the business that generated that revenue. The Comptroller's Office went so far as to claim that the City was entitled to a share of any profits made by the individuals who owned Seaport Associates' general partner if they happened to place calls to their stock brokers to execute trades from a mobile phone, provided that the calls were made in the management office that Seaport Associates maintains at the leased premises. Clearly, this is not what the parties intended when they entered the Lease Agreements.

The Comptroller's Office's interpretation amounts to a gross overreach. The parties only intended to capture revenue derived indirectly by Seaport Associates or its

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corporate principals by reason of Seaport Associates being a tenant in the South Street Seaport Historic District, and receiving the benefits that might be derived by reason of that particular tenancy as opposed to some other tenancy. For example, the parties intended for the City to profit from any South Street Seaport-related business that Seaport Associates conducted from the leased premises. If, for example, a Seaport Associates Corporate affiliate sold t-shirts or coffee mugs from the leased premises bearing a South Street Seaport logo, Seaport Associates' Affiliates had to share that revenue with the City.

Moreover, Seaport Associates does not have any corporate affiliates that existed in 1988, which currently do business at, on, or in the leased premises. When the parties entered into the Lease Agreements in the 1980's, they only intended for Seaport Associates' then-existing corporate affiliates to share their revenue with the City. "Absent explicit language demonstrating the parties' intent to bind future affiliates of the contracting parties, the term 'affiliate' includes only those affiliates in existence at the time that the contract was executed." Ellington v. EMI Mills Music, Inc., 36 Misc.3d 1228(A) (Table), 2011 WL 8622750 (Sup. Ct. N.Y. Co. 2011), citing VKK Corp. v National Football League, 244 F3d 114, 130-31 (2d Cir 2001). Here, there is nothing in the Lease Agreements that suggests that the parties intended for future affiliates to be impacted by the Lease Agreements' terms.

Finally, the City is not entitled to any additional rent based on any "Affiliate" theory. The Draft Audit Report erroneously provides that Seaport Associates should have reported income derived from Seaport Associates' "related entities, including Wolpert Associates and Belle Harbour Capital, LLC that conducted their real estate and management consulting businesses, in whole or in part, from the lease premises." Draft Audit Report at 7. By definition, however, the "Affiliate" from whom the City may capture revenue under Section 3.02(a) is limited to entities that are owned and controlled by Seaport Associates. Seaport Associates does not own or control Wolpert Associates, Belle Harbour Capital, LLC, or any other entities for that matter. Alternatively, under Section 3.02(a), the City could capture revenue from any entity that owns and controls, or is under common ownership and control with Seaport Associates. Seaport Associates is not owned or controlled by Wolpert Associates or Belle Harbour Capital, LLC. Seaport Associates is owned and controlled by its general partner, Beacon, and its sole limited partner, Seaport Associates General Inc. ("SAG"). Neither Beacon nor SAG conducts any revenue-generating business from the leased premises other than that which is directly related to the Lease Agreements. Beacon and SAG do not own or control any other entity together, except Seaport Associates. Moreover, Beacon does not own or control Belle Harbour Capital, LLC, and SAG does not own or control Wolpert Associates. Thus, contrary to what the Comptroller's Office asserts, any income derived by Wolpert Associates and Belle Harbour Capital, LLC does not constitute income derived by an "Affiliate of Tenant," for the purposes of this prong of the definition of "Gross Income," and any implication that Seaport Associates failed to report income relevant to Section 3.02(a) is simply false. Moreover, despite the Draft Audit Report's suggestion to the contrary, neither Wolpert Associates' nor Belle Harbour Capital, LLC's principal business addresses are located on the leased premises.

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The Audit And The Conclusions Therein Are Politically Motivated

The Comptroller's Office's attempt to erase more than six years of history concerning the parties' agreements regarding how to calculate the rent due the City can be explained by the fact that 2013 is an election year in New York City. The Comptroller John C. Liu has announced he is running for Mayor. Political infighting between the Comptroller's Office and the EDC seem to be driving the sudden interest in disregarding the previously agreed-upon Alternative Base Rent calculation methodology. The timeline of the EDC's and Comptroller's sudden interest in Seaport Associates bears this out.

Through the Office of the Comptroller, the City began its audit of Seaport Associates in January of 2012 when the City exercised its right under Section 37.02(a) of the Lease Agreement to conduct a routine examination of Seaport Associates' books and records. During the course of the audit, Seaport Associates provided the City with a substantial amount of information as well as a legal memorandum from its outside counsel regarding the proper interpretation of the Lease Agreements.

The City's audit involved numerous burdensome requests for information and records. For example, last fall, the South Street Seaport was damaged by super storm Sandy. Seaport Associates had to address the disruption to the leased facilities. Nevertheless, the City and its audit team continued to press Seaport Associates for documents and records while it was dealing with the aftermath of the storm. In connection with its audit, the City asserted that it did not agree with the rent calculation methodology, which the EDC agreed to in 2006, and which was the basis for the rent payments it said were fully made when the City issued the Estoppel Certificates in 2010 and 2011. This position was in sharp contrast to the course of dealing between EDC and Seaport Associates.

The EDC's course of dealing with Seaport Associates is based on the only reasonable interpretation of the provisions in the Lease Agreements pertaining to "Gross Income." The City's sudden attempt to rewrite the terms of the Lease Agreements (and to rewrite the parties' history of interpreting such terms) is a transparent reaction to the New York City politics of the day. Indeed, given the recent attention that politicians and the media have placed on the City's commercial real estate dealings, it is not surprising that the Comptroller's Office would be eager to audit and evaluate the Lease Agreements. After all, 2013 is a mayoral election year. The City's Mr. Liu is waging an intense media battle to appear tough on business and brutal with regard to the EDC and others concerning commercial real estate deals.

On or about February 14, 2013, just days after Mr. Liu publicly criticized the EDC administration and its management of the City's commercial real estate holdings in connection with its dealings with the Marriott Marquis, the EDC served Seaport Associates with a Notice To Tenant And Demand For Payment Of Rent, dated February 14, 2013 (the "Rent Demand"). The Rent Demand threatened a summary proceeding to dispossess Seaport Associates from the leased premises if, on or before March 15, 2013, Seaport Associates did

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not pay EDC rent in the amount of \$770,478.00, such rent purportedly being owed for the time period March 31, 2007 to September 30, 2012.¹⁴ It is readily apparent that the EDC made the Rent Demand without conducting any meaningful analysis of the Lease Agreements or Seaport Associates' subleasing practices. Instead, it is obvious that the EDC hastily made the Rent Demand to stave off further criticism by attempting to appear one step ahead of the City's Office of the Comptroller, which the EDC knew would soon issue the results of its own audit of Seaport Associates. The Rent Demand forced Seaport Associates to commence a civil action against EDC and the City concerning the Lease Agreement.¹⁵

On February 24, 2013, the *New York Post* reported that the City was losing millions of dollars on the proposed South Street Seaport development by Dallas-based Howard Hughes Corp. ("Howard Hughes"). Similar to Mr. Liu's criticism of the Marriott lease, the Post called the proposed deal between Howard Hughes and the EDC "a sweetheart deal for publicly owned land at the Seaport."¹⁶

Just two days later, on or about February 26, 2013, acting through its counsel Leon I. Behar, P.C., just as the City had done in 2012, the EDC suddenly demanded access to the books and records of Seaport Associates pursuant to Section 37.02(a) of the Lease Agreements (the "February 2013 EDC Audit"). Inexplicably, the February 2013 EDC Audit demand was issued *over two weeks after* the EDC had served its Rent Demand on Seaport Associates. As it has always done with past requests for information, whether from the City or EDC, Seaport Associates cooperated with the February EDC 2013 Audit.

Not to be outdone, on or about March 8, 2013, the Office of the Comptroller sent Seaport Associates a preliminary draft of an audit report concerning Seaport Associates' compliance with the Lease Agreement (the "Preliminary Draft Audit Report"). In its myopic haste to criticize the EDC at any cost, the Comptroller's Office demonstrated its lack of attention to the terms of the Lease Agreements. Indeed, in the Preliminary Draft Audit Report, the Comptroller's Office included several criticisms of the EDC that were belied by, not only

¹⁴ The \$770,478.00 figure purportedly owed for Alternative Base Rent, for the time period March 31, 2007 to September 30, 2012 under the 1988 Lease is based the same erroneous construction of Sections 3.01(b)(ii) and 3.02(a) of the Lease Agreements as the City's Draft Audit.

¹⁵ Seaport Associates vigorously disputes the assertion that it owes \$770,478.00 for rent purportedly due for the time period March 31, 2007 to September 30, 2012. To that end, on March 13, 2013, Seaport Associates commenced an action in the New York County Supreme Court, captioned Seaport Associates L.P. v. The City of New York and the Economic Development Corporation, Index. No. 650908/2013. In this action, Seaport Associates seeks a declaration that that it does not owe the EDC or the City the \$770,478.00 demanded in the Rent Demand or the \$1,294,836.00 referenced in the Comptroller's Draft Audit Report. Pursuant to a stipulation, the City's and the EDC's time to respond to the complaint is currently set to expire on April 30, 2013.

¹⁶ Kate Briquet, South '\$weet' lease deal, *New York Post*, February 24, 2013, available at: http://www.nypost.com/p/news/local/south_weet_lease_deal_6eRnNfhL1cwFy8SH6xjUQK (last viewed April 5, 2013).

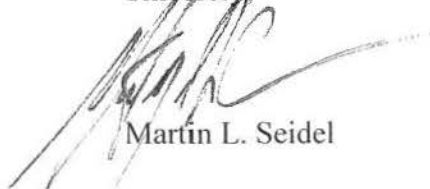
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the facts, but by the express terms of the Lease Agreements. Once these errors were pointed out, the Comptroller's Office should have withdrawn the entire report and reconsidered its strategy. However, it was too late. The Comptroller's Office needed to justify its decision to expend taxpayer dollars auditing the Lease Agreements as a predicate for advancing its political agenda of painting the EDC in a poor light. At the March 20, 2013 exit conference, we raised our concern that Seaport Associates was being caught in political cross-fire. The Comptroller's Office audit team could barely keep a straight-face when it denied that politics was involved.

Following the exit interview held on March 20, 2013, the Comptroller's Office delivered the Draft Audit Report that is the subject of this response. The Draft Audit Report continues to heavily criticize the EDC's actions in connection with administering the Lease Agreements. Indeed, the Comptroller's Office asserts that "the EDC did not adequately monitor Seaport Associates to ensure its compliance with significant lease terms." As discussed in the letter by Alan B. Wolpert, President of Seaport Associates' general partner, Beacon, dated April 5, 2013, and attached hereto as Exhibit 1, the Comptroller's Office's shortsighted findings and conclusions are not in the best interests of the City.

The timing of: (i) the EDC's hastily issued Rent Demand; (ii) the EDC's post-Rent Demand audit request, and (iii) the Comptroller's Preliminary Draft Audit Report was no coincidence. It confirms that the political infighting highlighted by the recent press discussed above is motivating the Comptroller's Office, and that the Comptroller's Office's targeting of Seaport Associates is improper and misguided. Seaport Associates did not receive a "sweetheart deal." After all, the Lease Agreements that Seaport Associates entered into proved to be unprofitable for at least its first decade. They only became profitable because of the financial and managerial investments made by Seaport Associates that went above and beyond what the City had originally expected.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Seidel', with a long horizontal flourish extending to the right.

Martin L. Seidel

MLS

Exhibit 1

SEAPORT ASSOCIATES



3000 Marcus Avenue Lake Success, New York 11042
Phone (212) 513-0030 Fax (212) 513-0550

April 5, 2013

VIA HAND DELIVERY AND ELECTRONIC MAIL

City of New York
Office of the Comptroller
Bureau of Audit
Municipal Building
One Centre Street, Room 1100
New York, New York 10007-2341
Attn: Ms. H. Tina Kim, Deputy Comptroller

**Re: Audit Report of the Compliance of the South Street Seaport Associates with
Its City Lease Agreement (FK12-069A)**

Dear Ms. Kim:

I am the President of Beacon General Partner, Inc. the general partner of Seaport Associates L.P. ("Seaport Associates"), the Tenant under the lease, dated March 15, 1988, with the City of New York (the "City"), and the New York City Economic Development Corporation ("EDC") as the lease administrator on behalf of the City (as amended, the "1988 Lease"). I write in response to the draft Audit Report on the Compliance of South Street Seaport Associates with Its City Lease Agreement (the "Draft Audit Report"), prepared by the New York City Office of the Comptroller (the "Comptroller's Office"), and dated March 22, 2013. As discussed in the formal response to the Draft Audit Report, being submitted concurrently herewith by Seaport Associates' counsel, Cadwalader, Wickersham & Taft LLP ("Cadwalader"), the Draft Audit Report is hopelessly flawed and contains several material errors. Most significantly, as the Cadwalader response explains, Seaport Associates has paid the City everything that it is owed. I write, however, for the additional reason of explaining how the Comptroller's Office's shortsighted findings and conclusions are not in the best interests of the City.

We have been involved with this property for nearly 30 years. We directed the acquisition of this asset because we saw value in retaining the historic structures in the Seaport District. No one thought the property would make money because that was the history of office space in historic buildings, such as Faneuil Hall in Boston, which like Seaport was developed by The Rouse Company. The benefit of the investment was for the historic tax credits that were permitted in the early 1980's. The Rouse Company did not want the office space so we were approached and asked if we would be interested. The money paid to the South Street Seaport Corporation (SSSC) by our investors was supposed to be used for the benefit of the South Street Seaport Museum and to build out the office space.

SSSC was to manage the entire venture, perform the build out and do the lease-up. The build out was terrible. In fact SSSC nearly voided the historic tax benefits because of the poor workmanship they displayed. We had to engage the services of an expert to undo what SSSC did and meet with the Department of Interior in Washington D.C. to resolve the issues to which they objected. We were the one who retained many of the old lifts and grain doors and other historic artifacts that adorn the building today.

The original leaseup was also a disaster. SSSC solicited the fish merchants and restaurateurs in the area to tenant the building. The stench when you walked into the building was atrocious so no professional companies would consider leasing space in the building. Also, as is the case with many restaurants, many of these tenants filed for bankruptcy but nevertheless continued to occupy their space in the premises without paying rent.

Meanwhile, we had the obligation to watch the property and leave SSSC and or the Museum in charge of the asset because that is what EDC wanted. After investing additional funds in the property, and refinancing it so we could obtain funds to renovate the building, we were forced to place the asset into bankruptcy in the late 1990's. After the property emerged from bankruptcy we took over the management, repaired the property, rebuilt many of the suites and started an active leasing program. We made the property a success, and for the first time, occupied it with substantial tenants who paid rent regularly. Then came 9-11. There was no electricity to the building and no communications. Tenants were having difficulty operating and we had to let a number of them out of their leases. It was most difficult. Also during this period, we had to replace many of the HVAC systems because of the debris that was in the air, which compromised the operation of those HVAC units. We persevered and re-occupied the building. Then came Super Storm Sandy, and again we were faced with problems but we managed to hold it together. This whole time living up to the spirit and the letter of the Lease Agreements, as we and the EDC together had interpreted those documents over the past 30 years of operations.

We never asked for any commendation or thanks for turning this building into a vibrant workplace for small business owners, in spite of all the hurdles that we needed to cross to make it a reality. But, now, to be faced with these harassing and outlandish claims by the Comptroller's Office is disheartening and disgusting. Hard working business people who take risk and invest meaningful dollars that generate cash flow to the City should not be treated this way.

As I, along with counsel from Cadwalader, explained to the Comptroller's Office at the March 20, 2013 exit conference, the Draft Audit Report's findings and recommendations would force Seaport Associates to do two things: (1) amend the subleases with existing subtenants effective as of some date in the past; and (2) discontinue our "gross leasing" strategy in favor of some form of "net leasing" strategy that would enable Seaport Associates to deduct all of its operating expenses and maintenance costs from "Gross Income" going forward. This would place form over substance to the economic detriment of the City.

The first prong of Seaport Associates' response would formalize the expense and cost reimbursement mechanism that is inherent in the gross leases that Seaport Associates previously entered with its Subtenants. Once implemented, it would moot the Comptroller's

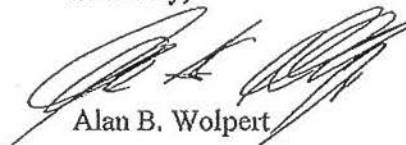
Office's entire conclusion concerning rent underpayments as there would no longer be a question about whether the reimbursements were sufficiently "direct" to be properly excluded from the calculation of "Gross Income." Seaport Associates would incur expenses to do this, which would further reduce future "Gross Income" because the expenses would be legitimate operating expenses that would be excluded from Seaport Associates' future "Gross Income" calculations.

The second prong of Seaport Associates' response also would have the effect of reducing the City's revenue from the Lease Agreements. The Comptroller's Office's interpretation of the Lease Agreements makes it economically irrational for Seaport Associates to continue to enter gross leases. Going forward, Seaport Associates would only offer net leases to future subtenants. This would adversely impact the profitability of the Lease Agreements to the City over the long run.

The Alternative Base Rent that Seaport Associates pays to the City depends upon, and is generated by, the economic success of the leased premises. The success of the leased premises is a result of the management expertise of Seaport Associates and its ability to increase revenues. By offering gross leases, Seaport Associates was able to increase occupancy rates and create profits and favorably compete with other Landlords in the area. That is because Seaport Associates had found that tenants seeking office space, like the leased premises demised pursuant to the Lease Agreements, prefer gross leases to avoid variable costs and expenses that fluctuate based on the seasons and commodity prices, among other things. The use of gross leases has resulted in maximum occupancy at the leased premises. Clearly, this has benefitted not only Seaport Associates, but the City as well.

Seaport Associates will lease fewer offices if it is forced to use net leases as the Comptroller's Office is requiring so that it can be properly credited for the cost and expense of operating and maintaining the leased premises. This, in turn, will inevitably reduce the Alternative Base Rent received by the City. The Lease Agreements run through at least 2039, with the potential to be extended through 2052.¹ While Mr. Liu and the Comptroller's Office may prefer short-term political gains, there is no doubt that the City and its citizens have an overriding interest in maintaining maximum subtenant occupancy at the leased premises for the duration of the Lease Agreements. This interest is undermined by the recommendations and conclusions in the Draft Audit Report. Indeed, it is ironic that the purported champion of fiscal responsibility, and a claimed crusader against the politicization of the City's commercial real estate holdings, would pursue such a fiscally irresponsible course, much less one premised on such an incredibly strained and unsound reading of the Lease Agreements.

Sincerely,



Alan B. Wolpert

¹ See Section 2.02 of the Lease Agreements.



New York City Economic Development Corporation

April 8, 2013

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

Re: Response to Audit Report of the Compliance of the South Street Seaport Associates with its City Lease Agreement (FK12-069A)

Dear Ms. Kim:

New York City Economic Development Corporation ("EDC") has reviewed the draft of the above-referenced audit report, dated March 22, 2013, and responds to the recommendations directed in the audit as follows:

Seaport Associates should:

1. Immediately remit to EDC unpaid rent and interest charges totaling \$1,294,836 related to Subtenant rental income.

Response: EDC agrees with this recommendation. Seaport Associates to respond.

2. Immediately pay EDC reinstated interest and rent charges totaling \$27,032.

Response: EDC view is discussed in 6 below. Seaport Associates to respond.

3. Report all Subtenant rental income or other income from all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises and pay additional rent and unpaid interest due the City.

Response: EDC believes Seaport Associates should report all Subtenant Rent and income and all revenues received from all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on, or from the City Lease Premises and pay any and all additional rent and unpaid interest due. Seaport Associates to respond.

With regard to Seaport Associates, EDC should:

4. Send written notice to Seaport Associates advising it that unpaid rent and interest charges totaling \$1,294,836 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 is grateful that the Comptroller's audit has corroborated EDC's internal findings and has lent the Comptroller's office support as EDC seeks payment for unpaid rent and interest. As stated in the audit report, EDC issued a rent demand to Seaport Associates on February 14, 2013 for \$770,478 for the period of March 31, 2007 to September 30, 2012. At this time, EDC and the City of New York are currently in litigation to collect unpaid rent and interest from Seaport Associates and we will continue to pursue this matter aggressively. EDC would appreciate any additional support the Comptroller's office can provide in this effort.

5. Identify all Tenant or Affiliate of Tenant businesses and/or transactions conducted in, on or from the City Lease Premises; quantify any and all revenues received by Tenant or any Affiliate from such businesses and/or transactions net of related direct costs and expenses payable; and calculate additional rent and unpaid interest due the City.

Response: EDC has engaged Marks Paneth & Shron LLP to conduct an independent and thorough audit of the books and records of Seaport Associates to determine all outstanding rent and additional rent owed by the Tenant. A notice of demand for access of books and records for the past six years was sent to Seaport Associates on February 26, 2013.

6. Reinstate interest and rent charges totaling \$27,032.

Response: With respect to the interest charges, EDC disagrees with the recommendation to re-institute the charges since these amounts are likely to be uncollectible. As the audit report notes, EDC was able to successfully collect \$84,714 in water charges instead of pursuing other charges of \$17,364. With respect to the \$9,668 in recommended adjustments for alternative rent, EDC will make this adjustment pending the outcome of the aforementioned audit EDC has commissioned.

7. Send written notice to Seaport Associates advising it that interest and rent charges totaling \$27, 032 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: See response to Recommendation 6.

8. Determine whether changes in Seaport Associates' ownership throughout the lease term resulted in the transfer of a controlling interest in any general partner or the admission of new general partners.

Response: EDC is pursuing this matter.

9. Take appropriate enforcement action as needed.

Response: In addition to the aggressive measures outlined above, EDC, together with the City of New York, will take whatever enforcement action is necessary.

With regard to its Board Member, EDC should:

10. Immediately direct its Board Member to cease using space in EDC-leased premises regardless of whether the Board Member pays rent in consideration for such space.

Response: EDC directed the Board Member to cease any connection with the leased premises and the Board Member immediately complied.

11. Direct its Board Member to make all facts known to EDC's General Counsel regarding its relationship with Seaport Associates.

Response: EDC's General Counsel and Board Member have had several conversations regarding the relationship of the Board Member and Seaport Associates. As a result of these conversations, EDC believes it has learned all material facts relating to such relationship.

12. Direct its Board Member to detail any and all activities that would be considered to be in violation of the Code of Ethics for Directors of EDC on his certified Disclosure Statement for Directors.

Response: The most recent Disclosure Statement the Board Member submitted in accordance with EDC's Code of Ethics for Directors states that the Board member's company did not occupy any space in the leased premises but as an extended courtesy from management, the company did have a mail drop at the premises where the company's name was listed on the building directory. Because it did not occupy space at the premises, the company did not make any lease payments to Seaport Associates during this time; however, the company paid the costs of forwarding its mail.

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

13. 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 an extensive audit program in place for participation leases and will continue this program of conducting routine audits and other reviews of leases it administers.

With regard to its lessees that request that the City executed estoppel agreements in connection with leasehold mortgages, EDC should:

14. Conduct substantive reviews of mortgage agreements, including but not limited to, reviewing mortgage amounts and the intended use of funds, and assessing lessees risk of default and thus, the rise of lease assignment.

Response: EDC agrees to conduct ongoing reviews in the future.

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