# Port Authority of New York and New Jersey

## Selected Aspects of Leasing Practices for Real Estate Services Department and Port Commerce

Report 2017-S-58 | May 2019

OFFICE OF THE NEW YORK STATE COMPTROLLER
**Thomas P. DiNapoli, State Comptroller**
Division of State Government Accountability

# Audit Highlights

## Objective

To determine whether the Port Authority of New York and New Jersey has a tracking system that accurately accounts for all its properties, including all leases; whether it has identified revenue enhancement opportunities; and whether it has followed required procedures in the leasing of its properties. This audit covered the period January 1, 2014 through August 9, 2018.

## About the Program

The Port Authority of New York and New Jersey (PANYNJ) was established in 1921 and was the first bi-state agency ever created under a clause of the Constitution permitting compacts between states with Congressional consent. Its area of jurisdiction is called the Port District, a region within a radius of approximately 25 miles of the Statue of Liberty. The PANYNJ was created to promote and protect the commerce of the Port District and to undertake port and regional improvements not likely to be financed by private enterprise or would not be attempted by either state alone. These include the development of major infrastructure, a modern port for the harbor shared by the two states, tunnel and bridge connections between the states, and, in general, trade and transportation projects that secure the region's economic well-being.

The PANYNJ conceives, builds, operates, and maintains infrastructure critical to the New York/New Jersey region's trade and transportation network. These facilities include America's busiest airport system, marine terminals and ports, the Port Authority Trans-Hudson (PATH) rail transit system, six tunnels and bridges between New York and New Jersey, the Port Authority Bus Terminal in Manhattan, the George Washington Bridge Bus Station, and the World Trade Center (WTC).

The PANYNJ has five departments that reflect its major business segments, including:

- Port Commerce – operates the Port of New York and New Jersey, the third-largest container port facility by volume in the United States.
- Aviation – manages five airport facilities within the region that serve as vital gateways to the world. These facilities provide a global connection for passengers and cargo.
- WTC – whose core functions encompass the design and construction of the various capital projects at the WTC site (including coordination with private developers and governmental entities).
- PATH – operates and maintains a rapid transit railroad serving Newark, Harrison, Hoboken, and Jersey City in metropolitan northern New Jersey and Manhattan in New York City. The PATH operates 24 hours daily.
- Tunnels, Bridges, and Terminals – manages and maintains six interstate vehicular crossings and two interstate bus terminals that are the foundation of the transportation network that supports the economic engine of the New York and New Jersey region.

The PANYNJ uses two systems to track the status of its properties and to track rent and revenues – SAP and YARDI. SAP is an enterprise resource program that is used by the PANYNJ as the system of record; YARDI is a real estate investment and property management software used primarily for reporting occupancies and vacancies. The information contained in YARDI is downloaded from the SAP system and, thus, the two systems' data should match.

## Key Findings

We determined that certain weaknesses existed in the PANYNJ's internal controls over leases:

- The PANYNJ did not always accurately account for its leases. Discrepancies existed in the lease information contained in its two primary systems. Moreover, neither system accounted for all PANYNJ leases. For instance, multiple leases at Stewart Airport were not reflected in either system.
- In one case in 2015, the PANYNJ executed a permit for a property that it did not own. The PANYNJ response, dated October 24, 2018, stated "While efforts were ongoing for renewing MNS371, staff discovered that the area in question was not covered under the lease between PANYNJ and the City of Newark (not under the control of PANYNJ)." The new lease was not executed. Such an error should not have occurred.
- We found two properties that were previously leased and were vacant for a combined 45 months as of November 29, 2018, resulting in forgone revenue in the approximate amount of $828,290. On January 8, 2019, PANYNJ officials provided a preliminary document attesting to current negotiations to lease these assets.
- The PANYNJ could not document that it attempted to lease the properties we examined at market rate. We found that, for Port Commerce, seven out of nine leases had various segments of the property leased for well below the market rate. The PANYNJ does not have written procedures describing the leasing process. Moreover, based on the lease files we reviewed, the PANYNJ did not always follow its own "best" practices.

## Key Recommendations

- Ensure SAP and YARDI accurately reflect the agreed-upon terms and conditions and specifications in the contracts entered into by the PANYNJ (including Stewart Airport).
- Create a formal marketing strategy to proactively seek out tenants to rent vacancies. Take proactive, documented steps to minimize idle time for vacant properties.
- Conduct market research to ensure rents charged are consistent with market prices and rental properties generate optimal rental income.
- Implement formal policies and procedures to ensure that leases for similar types of properties follow a standard format and that files include complete documentation of the leasing process.

**Office of the New York State Comptroller**
**Division of State Government Accountability**

May 16, 2019

Mr. Kevin J. O'Toole
Chairman
Port Authority of New York and New Jersey
4 World Trade Center
New York, NY 10004

Dear Mr. O'Toole:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage their resources efficiently and effectively. By so doing, it provides accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit entitled *Selected Aspects of Leasing Practices for Real Estate Services Department and Port Commerce.* This audit was performed pursuant to the State Comptroller's authority as set forth in Section 7071 of McKinney's Unconsolidated Laws of New York.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Division of State Government Accountability*

# Contents

# Glossary of Terms

| Abbreviation | Description | Identifier |
|---|---|---|
| FBOs | Fixed Based Operators | *Key Term* |
| Firm | International advertising firm | *Key Term* |
| GWBBS | George Washington Bridge Bus Station | *Key Term* |
| PANYNJ | Port Authority of New York and New Jersey | *Auditee* |
| PATH | Port Authority Trans-Hudson | *Department* |
| RESD | Real Estate Services Department | *Department* |
| SAP | Enterprise software to manage business operations and customer relations | *Key Term* |
| Terminal | Red Hook Terminal | *Key Term* |
| WTC | World Trade Center | *Department* |
| YARDI | Real estate investment and property management software | *Key Term* |

# Background

The Port Authority of New York and New Jersey (PANYNJ) was established in 1921 with a wide-ranging mission that includes the administration and coordination of terminals and other transportation and shipping facilities located within the Port District of New York and New Jersey. The PANYNJ's real estate portfolio consists of over 12,000 acres of land and 45 million square feet of office, industrial, retail, and technical space.

The PANYNJ has five departments that reflect its major business segments. Within these, the PANYNJ's real estate assets include airport terminals, buildings, warehouses, parking lots, marine terminals, billboards, and advertising spaces, as follows:

- Port Commerce – operates the Port of New York and New Jersey, the third-largest container port facility by volume in the United States.
- Aviation – manages five airport facilities within the region that serve as vital gateways to the world. These facilities provide a global connection for passengers and cargo.
- The World Trade Center (WTC) – whose core functions encompass the design and construction of the various capital projects at the WTC site (including coordination with private developers and governmental entities).
- The Port Authority Trans-Hudson (PATH) – operates and maintains a rapid transit railroad serving Newark, Harrison, Hoboken, and Jersey City in metropolitan northern New Jersey and Manhattan in New York City. The PATH operates 24 hours daily.
- Tunnels, Bridges, and Terminals – manages and maintains six interstate vehicular crossings and three interstate bus terminals including the Port Authority Bus Terminal, and the George Washington Bridge Bus Station (GWBBS).

The PANYNJ uses two systems to track the status of its properties and to track rent revenues – SAP and YARDI. SAP is an enterprise resource program that is used by the PANYNJ as the system of record; YARDI is a real estate investment and property management software used primarily for reporting occupancies and vacancies. The information contained in YARDI is downloaded from the SAP system; therefore, the two systems' data should match.

According to PANYNJ officials, the leasing process is generally initiated through the Unit Directory and Occupancy Report generated by YARDI, which includes information about leases that are expiring within six months.

Subsequent steps include activities carried out by property representatives to lease the property, such as: meeting with potential lessees; preparing "term sheets" (documents drafted to summarize the basic business terms negotiated at the start of the leasing process); ensuring the transaction is subject to a review by legal, credit, and insurance; and facilitating the execution of the lease.

In addition to rental income from its facilities, the PANYNJ has the opportunity to collect advertising revenues from any location that might be used to accommodate ads. For its advertising needs and to rent ad spaces, the PANYNJ employs an international advertising firm (Firm) "that designs, installs and maintains a range of free or low-cost services for the benefit of cities, residents and travelers, including bus shelters, self-service bicycle schemes, passenger information panels and mobile charging terminals. These services are financed by advertisements that are located in busy thoroughfares, offering brands maximum visibility." For Teterboro Airport, the oldest operating airport in the New York and New Jersey metropolitan area, many of the properties are leased by Fixed Based Operators (FBOs). Under their agreement with the PANYNJ, the FBOs have full control of the space they lease from the PANYNJ, including all advertising rights.

# Audit Findings and Recommendations

The PANYNJ has weaknesses in its internal controls of leases. It has two systems for tracking its properties, including leases. The two systems should contain the same information; however, we found differences in the information contained within each. Additionally, neither system accounts for all of the PANYNJ's leases. For instance, several leases at Stewart Airport were not included in either system. The PANYNJ also does not have any written policies and procedures describing the leasing process, nor does it follow the practices that its staff describe as their "best" practices. In one case, the PANYNJ permitted and charged rent for a property it did not own.

We also found that the PANYNJ, in certain cases, did not lease its property in a timely manner or in a way that maximizes revenue opportunities. For example, we identified two previously leased properties in SoHo that were vacant for a combined 45 months as of November 29, 2018. Further, when we compared the leased values to market rates for our sample of 23 leases, we found that many of the leases (9) included provisions for leasing parts of the properties at well below market rates. We estimate, using the methodology the PANYNJ states it uses, the market rate for these properties was $6.5 million per month, while the properties were leased for $2.2 million monthly.

## Accounting for Leases

We found that information in the PANYNJ's primary information systems that track real property was inconsistently recorded for 3 of the 23 leases we examined: 2 leases were only recorded in the SAP system, and for the third lease, the dates in the systems differed. Additionally, there were leased spaces such as newsstands, restaurants, and car rental services at Stewart Airport that were not accounted for in either of the two systems.

Moreover, the PANYNJ does not have any written policies and procedures describing the leasing process; however, officials provided a work flow chart for SAP, including preparing a "term sheet" (a non-binding document to summarize the basic business terms negotiated at the start of the leasing process) and an authorization chart (approval required based on contract/agreement amount). According to PANYNJ officials, the leasing process in the flow chart has been in effect since October 2015. Prior to October 2015, they did not have any documentation for the process used to lease property.

According to the flow chart's steps, before a lease is executed, it should be listed in the Unit Directory and Occupancy Report and sent to the Credit, Collection and Accounts Receivables department for a review of the tenant's creditworthiness (ability to meet financial obligations) and coverage. Documentation was missing for 8 of the 23 leases reviewed. This is important because of the risk that the lessee could default if it does not have the financial resources to pay the rent or make the improvements agreed to as part of the lease negotiations.

For one permit, the PANYNJ was not the owner of the property; nevertheless, the PANYNJ permitted it from August 2015 to January 2016. In replying to the preliminary finding, the PANYNJ agreed with the finding and stated that it will explore ways to resolve the situation.

## Recommendations

1. Ensure SAP and YARDI accurately reflect the agreed-upon terms and specifications in the contracts entered into by the PANYNJ (including Stewart Airport).

2. Implement formal policies and procedures to ensure that leases for similar types of properties follow a standard format and that files include complete documentation of the leasing process.

## Revenue Enhancement

### Vacant/Unoccupied Property

The PANYNJ owns two parking lots in SoHo that, despite their location in a prime area, remained vacant for an extended period of time. As of May 31, 2018, both parking lots were vacant for a combined total of 33 months, with lost revenue estimated at $609,384. During our discussions with PANYNJ officials, they stated that they do not have a formal marketing plan for the two lots, and instead rely on the managing agent to find tenants for these properties. In response to our preliminary findings, the PANYNJ stated that the parking lots' proximity to one of its tunnels presents "unique security and design requirements," and that "it required time for PANYNJ staff to diligence [sic] such requirement." It further stated that "staff continue to actively market the lots." At the closing conference on November 29, 2018, the PANYNJ stated that the parking lots were under negotiations for leasing. As of November 29, 2018, the parking lots had been vacant for a combined total of 45 months and had forgone revenue in the approximate amount of $828,290 – an additional $218,906 after our May 31, 2018 observation. At the closing conference, we requested documents to support that the Real Estate Services Department (RESD) was in negotiations with a prospective tenant, but did not receive any information until January 8, 2019.

## Recommendation

3. Create a formal marketing strategy to proactively seek out tenants to rent vacancies. Take proactive, documented steps to minimize idle time for vacant properties.

## Market Value

Nine of the leases we examined were part of Port Commerce's portfolio. For seven of these leases, Port Commerce did not have any documentation regarding a market analysis. For the portions of the seven leases that we could analyze, it appears that the fixed market rent rates, when compared to rates charged for similar use properties within close proximity of the leased property, were significantly lower.

The properties for these leases were divided into 20 segments. One segment did not have any square footage assigned. The remaining 19 segments had approximately 35.1 million square feet.

- Six segments, totaling 8.2 million square feet, did not have any fixed rent assigned.
- One segment, 15.1 acres of land, had a comparable for 5 acres where rent was charged, and no comparable for the remaining 10.1 acres where no rent was charged.
- For two segments where rent was assigned, we did not find a comparable property because of the unique characteristics of the property. However, the lease amount per square foot for these two segments appeared low, given the features of the property.
- For ten segments, we identified similar properties.

In some cases, the properties that the PANYNJ leases contain unique features not shared by the comparable properties, making them more desirable. These include features such as water access, an internal rail distribution system, and access to the northeast coast of the United States. Based on our analysis of 11 segments where a comparable existed, we estimate the PANYNJ did not realize revenues of approximately $4.3 million. At the closing conference, PANYNJ officials stated that the comparables we used were not reflective of the particular features and conditions of their properties and, therefore, the values we used did not provide an accurate basis for comparison. The PANYNJ stated that, in some instances, tenants are making upgrades to leased properties and these upgrades are offset or taken into account when rents are determined. However, the lease files reviewed did not outline how any such terms were factored into rent determination.

For an additional lease, the PANYNJ had an operating agreement with a container company. Under this agreement, the PANYNJ paid the container company to manage the cargo flow through Red Hook Terminal (Terminal). During a meeting, we were told that the Terminal did not generate enough flow (less than 2 percent of the PANYNJ's ports) to produce revenues, and that the container company is subsidized by the PANYNJ to continue operating at the Terminal. A PANYNJ official stated that this is not a business decision because the property's "best uses" would generate significant revenues instead of being subsidized. However, the container company continues to operate, and the PANYNJ paid the container company $937,500 in the final year of the five-year agreement. In response to our preliminary findings, the PANYNJ responded that, in 2006, there was a Memorandum of Understanding with New York City to "develop a cruise terminal and a plan for mixed-use development." The cruise terminal was developed; however, the mixed-use development was not. Twelve years later, in 2018, the State issued a directive to the PANYNJ to explore the possibilities of relocating the operator of the Terminal.

## Recommendations

4. Conduct market research and issue requests for proposals to ensure optimal rental income.
5. Establish formal policies and procedures and retain supporting documentation to enable the PANYNJ to rent its facilities at market rates or at premium rates for specialty features (i.e., water access, internal rail operations for movement of containers, and any other unique features).
6. Monetize prime assets under the property's best uses, including unique waterfront and harbor properties and the Terminal.

## Advertising

One source of revenue for the PANYNJ is advertising at its facilities, such as in bus stations, walkways/common areas, billboards, and any place that might be used to accommodate ads. For its advertising needs and to rent ad spaces, the PANYNJ employs a Firm that has advertising rights to all of the PANYNJ's facilities, with the exception of the GWBBS, where it has shared rights with the developer. With regards to advertising, we reviewed the following three sites: the GWBBS, Teterboro Airport, and PATH.

The GWBBS re-opened on May 16, 2017 after closing for a redevelopment project that started in 2013. According to information received from the PANYNJ, the GWBBS has 30 advertising “spaces” available to the Firm for advertising, including 3 floor graphics, 21 bus gate column wraps, 4 round column wraps, and 2 glass wraps. One of the income-generating aspects at the GWBBS is advertising both on the interior and exterior of the station. We visited the site on June 28, 2018, and found no advertising on the interior or exterior of the GWBBS. Based on a monthly rent of $35,000, we calculated the revenue loss from October 2017 to June 2018 was $280,000; based on the practice used for a prior advertising campaign, the PANYNJ would have realized $182,000. We were advised that the Firm only conducts advertising campaigns when it has advertising rights to the entire structure. However, since the first two floors were assigned to the developer of the GWBBS, the Firm stated that it will not pursue advertising revenues at the GWBBS. Advertisement spaces were thus not leased or monetized to maximize revenue.

Between May 16, 2017 and June 18, 2018, the only revenue from advertising at the GWBBS was a department store’s opening campaign. We were advised by PANYNJ officials that all the parties within the GWBBS came together and facilitated the rental of space to advertise. The total rent received for the period of one month was $35,000, of which the PANYNJ received $22,750, with the remainder shared between the other two parties.

The Firm currently has the rights for advertising at Teterboro Airport on PANYNJ property. The advertising at Teterboro Airport is limited to two exterior banners at the Custom House. The Firm stated that the only other form of profitable advertising is the use of billboards; however, the cost of constructing billboards would outweigh the income generated due to airport restrictions on the height of billboards. Moreover, the PANYNJ stated in its response that federal regulations prohibit billboards in other locations on the property. In regard to other advertising, the Firm stated it is not profitable to explore other forms of advertising. However, no analysis or outreach was performed by the PANYNJ to determine if other companies would have interest in investing in additional forms of advertising at the airport or the viability of other forms of advertising. Similarly, the PANYNJ has no documentation to support that it is maximizing revenue from advertising at PATH. Advertising at PATH includes trains as well as stations. We found that the PANYNJ reduces or increases the projected income for future fiscal periods when there is a shortfall or increase realized in the previous period, without any support (see table below), and there is little analysis of ways to further maximize revenue.

| Projected and Actual Advertising Revenue to the PANYNJ from 2014 to Q1 2018, PATH* | | | | | |
|---|---|---|---|---|---|
| | FY 2014 | FY 2015 | FY 2016 | FY 2017 | 1Q 2018 |
| PATH (Projected) | $3,000 | $3,000 | $1,700 | $4,900 | $540 |
| PATH (Actual Rev) | $2,841 | $2,223 | $5,000 | $4,145 | $1,301 |

*Data received from PANYNJ RESD on July 20, 2018.

## Recommendations

7. Resolve the issues that impact the revenues from advertising at the GWBBS and document the results.

8. Assess the viability and interest of additional forms of advertising at Teterboro Airport as well as the PANYNJ's other facilities.

9. Establish and document policies and/or procedures to be used that show how advertising revenue projections are developed and will be compared to the revenues from advertising firms under contract.

# Audit Scope, Objectives, and Methodology

The audit objectives were to determine whether the PANYNJ has a tracking system that accurately accounts for all its properties, including all leases; whether it has identified revenue enhancement opportunities; and whether it has followed required procedures in the leasing of its properties. The audit covered the period January 1, 2014 through August 9, 2018.

To accomplish our objectives, we selected a sample of leases from the following PANYNJ departments: RESD (including advertising) and Port Commerce. For RESD, we selected 14 contracts valued at $150 million from a population of 114 contracts valued at $1.861 billion. Within these 14 leases, we selected 2 leases for two parking lots because we noted they were vacant in a high-demand location in Manhattan. Additionally, we selected 1 lease because we could not locate the space during a site visit. The other 11 leases sampled include a varied assortment of businesses leased out by RESD. For Port Commerce, we selected 9 leases valued at $853.5 million from a population of 93 leases with an approximate total value of $1.45 billion over the lease terms. These leases were judgmentally selected based on factors such as location, types of businesses, and observed usage. The results of our review were not intended to be projected to the population.

We reviewed advertising procedures and leases for RESD at Teterboro Airport, the GWBBS, and PATH.

We did not select leases that commenced before January 1, 2004 and did not have any extensions or renewals. We judgmentally selected RESD leases that were from locations such as Teterboro Airport, PATH, and the GWBBS.

We reviewed the PANYNJ's work flow chart for SAP and authorization chart. We interviewed PANYNJ officials to obtain an understanding of the leasing process. We also used data retrieved from the PANYNJ's two systems: SAP and YARDI, which, for the contracts outlined above, did not contain the same specs. Additionally, we reviewed data in electronic format and hard copy documentation. We also evaluated the internal controls over the leasing process.

# Statutory Requirements

## Authority

We conducted our 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.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds and other payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

The audit was performed pursuant to the State Comptroller's authority as set forth in Section 7071 of McKinney's Unconsolidated Laws of New York.

## Reporting Requirements

We provided a draft copy of this report to PANYNJ officials for their review and formal comment. Their comments were considered in preparing this report and are included in their entirety at the end of it.

In their response, PANYNJ officials generally disagreed with the audit findings, claiming that the auditors did not consider the documents or the explanations provided at numerous occasions. While they agreed with the recommendations to establish policies and procedures for the leasing of property, for the other recommendations, such as conducting and documenting actions (e.g., market research analysis), they claimed these practices are already in place and have resulted in the PANYNJ receiving the best value for its leased properties. We agree that PANYNJ officials provided explanations on the occasions when they were willing to meet with the auditors. However, only limited documentation was provided, and it did not support that they had met the intent of the recommendations. Our rejoinders to certain PANYNJ comments are embedded within the PANYNJ's response.

Within 90 days after the final release of this report, we request that the Chairman of the Port Authority of New York and New Jersey report to the State Comptroller advising what steps were taken to implement the recommendations contained herein, and where the recommendations were not implemented, the reasons why.

# Agency Comments and State Comptroller's Comments

THE PORT AUTHORITY OF NY & NJ

April 5, 2019

Mr. Daniel Bortas
Examiner in Charge
NYS Office of the Comptroller
Division of State Government Accountability
59 Maiden Lane, 21st Floor
New York, New York 10038

Re: Selected Aspects of Leasing Practices for Real Estate Services Department and the Port Department, Report 2017-S-58

Dear Mr. Bortas,

The Port Authority of New York and New Jersey (the "PA") is in receipt of your draft report as of February 2019 addressed to Mr. Kevin O'Toole, Chairman of the PA, regarding the above-referenced audit. Thank you for this opportunity to respond to your draft report.

This letter addresses the practices of the Real Estate Department ("Real Estate"), formerly known as the Real Estate Services Department and the Port Department ("Port"), formerly known as Port Commerce.

We strongly disagree with the conclusions reached in your audit report and believe that the audit did not consider the documentation and explanations that were provided to the audit team on numerous occasions throughout the audit process. In summary, we offer the following:

**State Comptroller's Comment** – Auditors reviewed all of the documentation that the PANYNJ provided in great detail. Moreover, due to the lack of documentation provided, we had several meetings with PANYNJ officials to attempt to obtain additional information about the practices followed in leasing PANYNJ property.

**Summary of Key Points**

With regards to the issue of leasing of property not owned by the Port Authority, the Port Authority did not lease property it did not own. The property in question was part of a short term space permit right of entry with PSE&G. When the lease was renegotiated and executed, the lot line boundary, consistent with the Master Lease with the City of Newark, was updated. The reconciliation of the land in question was self-corrected by the Port Department prior to the audit and is correctly reflected in the current leasehold with PSE&G. We disagree with the conclusions reached in the audit report.

1

**State Comptroller's Comment** – In a letter dated October 24, 2018, the PANYNJ offered an alternative explanation – that the "staff discovered that the area in question was likely not covered under the Lease between the PANYNJ and the City of Newark (not under the control of PANYNJ), and thus the [new lease] was not executed by the PANYNJ. Leasing staff are currently in the process of reviewing and crediting the rent received back to the [tenant]." As there was no new lease, we revised the report.

Regarding the assertion that Port Department has 8.2 million square feet with no rent revenue assigned, this is false. The audit team was looking at archived data related to a lease that was restated in 2011 at Port Newark. All acreage is accounted for in the restated lease, LPN-264, which consists of 7 objects comprising approximately 270 acres with a total land rent annual revenue of $15 million.

**State Comptroller's Comment** – PANYNJ officials provided information to auditors in piecemeal fashion. Nonetheless, auditors reviewed all the information provided and considered it in its totality. After looking at the initially provided archived data as well as all the restated information, auditors determined there were multiple segments that still did not have a fixed rent. This review included consideration of the rents assigned to lease LPN-264.

Regarding the assertion that the Port Department is under-valuing its land assets based on market comparisons with non-Port properties, we find this assertion to be inaccurate for a number of reasons. First, the Audit team seems to have plucked at random from industrial property listing sites "asking" or "advertised" rents as opposed to final negotiated rents and made no effort whatsoever to identify their comparability with the Port's property. Second, the audit team failed to incorporate other non-land revenue sources, such as wharfage and dockage fees, which are a component part of the total revenue stream. As such, the Port Authority has maximized its revenue streams and the contention that the PA did not realize revenues has no merit.

**State Comptroller's Comment** – In order to refute auditors' analysis that shows the undervaluation of PANYNJ properties, PANYNJ officials state that they disagree with the auditors' methodology and point out that auditors did not consider fees such as wharfage and dockage fees. However, they seem to miss the bigger point: auditors had to perform such an analysis because the agency provided no evidence that it had conducted its own analysis. At no time did the agency offer any evidence how it determined that these leases were appropriately valued, including in response to the auditors' market analysis.

The draft audit also includes a number of significant inaccuracies regarding advertising. It mistakenly suggests a loss of advertising revenue at George Washington Bridge Bus Station ("GWBBS"). First, the calculation of $280,000 is based on a monthly revenue of $35,000, but this amount was generated based on the one-time opening of Marshalls at the GWBBS. Second, advertising revenue at the GWBBS represents a tiny fraction of total gross advertising revenue generated across all Port Authority facilities ($75M in 2018). Third, the PA is insulated from any loss of advertising revenue at the GWBBS, and all other facilities. The PA has entered into a contract with one entity to perform these services. The PA receives a minimum annual guarantee ("MAG") payment from its advertising contractor, and the MAG places all financial risk on the contractor and mitigates the risk the PA loses advertising revenue below the MAG amount.

**State Comptroller's Comment** – As shown in the report, the PANYNJ collected $35,000 for a one-month advertising campaign; the nature of the campaign is not relevant. Therefore, $280,000 is the correct annualized figure ($35,000 × 12). In addition, the fact that the GWBBS is a fraction of the PANYNJ's advertising revenue is not a justification for the PANYNJ failing to ensure that revenue was maximized under this agreement, nor does it reflect any inaccuracy in the report. Rather, it appears to be a rationalization of why the PANYNJ did not maximize revenue under this agreement. Furthermore, striving for the minimum is not what the PANYNJ should set as a performance goal; rather, it should aim to maximize revenue for taxpayers.

We have further organized our responses below according to the individual audit findings.

**Recommendations**

The PA's response to each recommendation in the draft report is outlined below:

**State Comptroller's Comment** – The PANYNJ's pledge "to continue" certain activities, in response to several of our recommendations, is not reassuring since the PANYNJ did not demonstrate it had been performing any of these activities during the audit.

Response to Audit Recommendation #1
The PA will continue to monitor the data integrity of SAP and Yardi and continue to ensure both databases reflect the agreed-upon terms and specifications in the contracts entered into by the PA (excluding Stewart Airport).

Response to Audit Recommendation #2
The PA agrees to continue to enhance its formal policies and procedures for leasing, as is good practice, and to provide corresponding documentation of the leasing process.

Response to Audit Recommendation #3
The PA disagrees and has a formal marketing strategy to proactively seek out tenants to rent vacant spaces.

Response to Audit Recommendation #4
The PA will continue to conduct market research and issue requests for proposals. The PA has a robust procurement policy.

THE PORT AUTHORITY OF NY & NJ

**State Comptroller's Comment** – While the PANYNJ states it has a formal marketing strategy, officials did not provide any documentation of such to the auditors.

Response to Audit Recommendation #5
The PA agrees to enhance formal policies and procedures and retain supporting documentation showing the leasing of facilities at market rates for specialty features.

**State Comptroller's Comment** – Despite our requests, the PANYNJ did not provide any documents to support that it conducted market research.

Response to Audit Recommendation #6
The PA will continue to monetize prime assets. The PA is achieving maximum revenue under its current practices. The PA will continue to focus on using its real estate assets for their highest and best use in support of its public mission "to keep the region moving".

Response to Audit Recommendation #7 and #8
The PA disagrees with these recommendations. As noted in our response, the Port Authority receives a MAG payment from its advertising contractor. The advertising contractor is incentivized to maximize revenue under its contract because it does not receive revenue until the MAG is paid to the Port Authority. No further action is needed from the Port authority

**State Comptroller's Comment** – As shown in the report, the PANYNJ collected $35,000 for a one-month advertising campaign; the nature of the campaign is not relevant. Therefore, $280,000 is the correct annualized figure ($35,000 × 12). In addition, the fact that the GWBBS is a fraction of the PANYNJ's advertising revenue is not a justification for the PANYNJ failing to ensure that revenue was maximized under this agreement, nor does it reflect any inaccuracy in the report. Rather, it appears to be a rationalization of why the PANYNJ did not maximize revenue under this agreement. Furthermore, striving for the minimum is not what the PANYNJ should set as a performance goal; rather, it should aim to maximize revenue for taxpayers.

Response to Audit Recommendation #9
The PA will enhance its policies and/or procedures that show how advertising revenue projections are developed.

**Accounting for Leasing**

The PA uses two systems for lease and property management – SAP and Yardi. To expand on the information contained in the draft report, SAP and Yardi serve different reporting functions for the PA. SAP is the PA's system of record for all lease transactions and financial reporting. Additionally, SAP manages the workflow to approve tenant creditworthiness and execute agreements. YARDI is a real estate investment and property management software used primarily for reporting

4

occupancies and vacancies. The information contained in YARDI is downloaded from the SAP system. SAP data will always supersede YARDI because SAP is the system of record.

The draft report states the audit found differences between the information stored in SAP and Yardi for three of the 23 leases examined. The draft report suggests there are two leases with differing dates and one lease is not in the Yardi database. In response to our inquiries, you indicated that lease MNS 371 shows the discrepancy in dates, while two leases, MNS 376 and MNS 371, are not in Yardi. In fact, all three leases are in Yardi. The Port Department has corrected the discrepancy with dates in MNS 371. Further, this one noted discrepancy has no effect whatsoever.

**State Comptroller's Comment** – In a letter dated October 24, 2018, the PANYNJ offered an alternative explanation – that the "staff discovered that the area in question was likely not covered under the Lease between the PANYNJ and the City of Newark (not under the control of PANYNJ), and thus the [new lease] was not executed by the PANYNJ. Leasing staff are currently in the process of reviewing and crediting the rent received back to the [tenant]." As there was no new lease, we revised the report.

We respectfully disagree with the finding that the PA did not properly account for all New York Stewart Airport ("SWF") leases in either Yardi or SAP. The exclusion of certain SWF leases from Yardi and SAP is not the result of a lack of proper accountability by the PA, but reflects the SWF business model. More specifically, the PA acquired SWF in November 2007 and set up the operation as the economic and efficient gateway for passengers and cargo to access the New York metropolitan and Hudson Valley markets. Since the acquisition, SWF's business model includes having the daily operations and maintenance contracted out, while continuously providing oversight, guidance and direction by PA staff. Part of the services contracted out includes the administration of all the accounts payable and accounts receivables incurred at the airport. These functions also include day-to-day lease administration and storage of records as required by the New York State Department of Transportation. This process was fully authorized by the PA Board of Commissioners and continues to help keep SWF's cost of operations low.

**State Comptroller's Comment** – The leases should be fully accounted for in SAP – the PANYNJ system of record – regardless of the business model.

The report incorrectly asserts the PA does not have written policies and procedures regarding the leasing process. Real Estate provided two flow charts to the auditors reflecting the two central processes in Real Estate's leasing transactions. First, a flow chart was provided for the lease negotiation process, which explained the oversight and internal coordination with Law, the Office of Financial Planning, Treasury, Risk, and the line departments involved in reaching an agreement with a prospective tenant. Second, a flow chart was provided for the authorization process, which is ultimately governed by PA by-laws. As this clearly shows, established procedures for leasing are in-place.

**State Comptroller's Comment** – The PANYNJ points to the two flow charts as reflecting the two central processes in RESD's leasing transactions. However, the PANYNJ fails to mention that, in responding to our preliminary findings, it stated "If the audit team is referencing the lease process flow chart provided by RESD staff as the basis for concluding that [documentation is] missing from six transactions, it is important to clarify that the flowchart was only *illustrative*" [emphasis added]. Yet now, the PANYNJ chooses to refer to the flow charts instead as "established procedures for leasing."

The report incorrectly concludes the Unit Occupancy Report should indicate whether the PA Credit, Collections, and Accounts Receivables (CCAR) department has reviewed the creditworthiness of a potential tenant. The Unit Occupancy Report does not address interim steps during tenant negotiations and drafting the agreement. Instead, as we explained in our July 17, 2018 letter, the request for a credit check by CCAR is processed and documented through SAP.

**State Comptroller's Comment** – The PANYNJ states that the documents in question were either in the files, subsequently located, or not required by policy; however, officials still did not provide auditors with the documents that they claim they had.

In addition, your response identifies the following as leases without CCAR checks. The following addresses each individually.

- The lease at the GWBBS (LBF500) did not include a credit verification by CCAR because, at the time of lease execution, the developer pre-paid rent for the first ten years, negating the immediate credit risk and need for credit verification by CCAR. After this ten-year period, the PA can request a letter of credit from the developer at its discretion.

- As stated in the July 17, 2018 letter, LGB00l was for a small installation of telecommunication conduit, comprising 95 feet, at Goethals bridge from 1992. The license fee was $800 at the time of execution, and due to the small size of the transaction, a credit for security was not required.

- For agreement HWD002B, the PA has reviewed its records and has not found record of a credit review in its paper files.

In addition, the report incorrectly states leases were missing from the Unit Occupancy Report. As shown below, the leases did not appear in the report because many are not leases.

- Two transactions are fiber optic cable agreements (LB818 and LTL214)

- One transaction is a space permit (PRR316)

- Two transactions are advertising agreements (RO7920 and TA451)

- The one transaction that is a lease is to develop and operate retail at the GWBBS. However, the GWBBS is 100% leased to the developer, whose is responsible for all sub-leasing and bears all sub-leasing risk. As such, it is not our practice to report on sub-leasing occupancy. In this case, the GWBBS sub-leased retail space is 91% occupied. (LB500)

With respect to the Port transaction cited the draft report as a lease under which the PA was not the owner of the property but leased it to a tenant from August 2015 to January 2016: this was actually a short-term Space Permit let to PSE&G from July 15, 2015 through January 31, 2016. The Space Permit was applicable to a 3,854 square foot eastward expansion from the existing base lease to support metering and gas regulation work. It was subsequently determined, after the short-term Permit expired, that a portion of the 3,854 square foot expansion was not within the Port Authority's master lease contours with the City of Newark. As such, the attempt to renew the Permit ceased, and the Port Department is currently working on a lease extension with PSE&G which excludes the property not covered within the City of Newark Master Lease.

**State Comptroller's Comment** – In a letter dated October 24, 2018, the PANYNJ offered an alternative explanation – that the "staff discovered that the area in question was likely not covered under the Lease between the PANYNJ and the City of Newark (not under the control of PANYNJ), and thus the [new lease] was not executed by the PANYNJ. Leasing staff are currently in the process of reviewing and crediting the rent received back to the [tenant]." As there was no new lease, we revised the report.

**Revenue Enhancement - Vacant/Unoccupied Property**

The draft report inaccurately states that two PA-owned parking lots in SoHo have remained vacant for 33 months as of May 2018. In fact, the lots were vacant for 15 and 20 months respectively as of May 2018. As stated in the July 17, 2018 letter, the two lots are situated above the Lincoln Tunnel. As a result, the properties have unique security requirements, which took time to fully diligence with technical staff. The PA team has indicated that we are in advanced negotiations to lease the lots to a parking operator, and provided documentation to this effect, and are working to reach a closing as expeditiously as possible.

**State Comptroller's Comment** – The two PANYNJ-owned parking garages were vacant for at least 33 months as of May 2018 – as PANYNJ officials previously acknowledged to auditors in multiple conversations and written communications. Moreover, at the closing conference on November 29, 2018, PANYNJ officials informed us they were in negotiations with a tenant for the two vacant parking lots near the Holland Tunnel – not the Lincoln Tunnel, as they state in their response – and on January 8, 2019, provided us with a document supporting this. We note that this supporting document is dated June 1, 2018, which begs the question of why the PANYNJ did not provide it to the auditors at an earlier date.

**Market Value**

The Port Department strongly asserts that the audit team's sole reliance on online commercial property listings to support comparable market rental rates is flawed and concerning, especially since the audit team did not perform or take into consideration certain fundamental steps such as performing site visits to assess the condition of the buildings/site, take into consideration the Port Department's business model, including the unique longshore labor jurisdiction overlay, or perform other necessary analysis. Detailed below are the specific concerns noted with the audit team's market rate assessment.

**State Comptroller's Comment** – PANYNJ officials provided information to auditors in piecemeal fashion. Nonetheless, auditors reviewed all the information provided and considered it in its totality. After looking at the initially provided archived data as well as all the restated information, auditors determined there were multiple segments that still did not have a fixed rent. This review included consideration of the rents assigned to lease LPN-264.

- The online listings only provide "asking" rates, which are often materially higher than the final negotiated rates associated with successfully concluded lease transactions. As such, "asking" rates provided in online listings offer a limited and often inaccurate representations of "market" comparables.

- The online listings do not provide sufficient information on the physical characteristics of the properties. As such, they do not sufficiently inform comparability to the Port Department leases which are negotiated based on factors including condition of structures and open area, transportation ingress/egress, ceiling and loading dock door height, HVAC, structural integrity of flooring, adjacent/neighboring properties, as well as environmental conditions. Further, the audit team did not perform any site visits to the noted properties to assess their physical condition.

- Most of the online property listings selected by the audit team are completely different in terms of type/use, size and rental structure when compared to Port Department leased properties. As such, the online listings do not provide a basis for making specific conclusions about the market range associated with the Port leases:

  - Example 1: Lease HHT-004 is comprised of an approximately 153-acre leasehold for a major marine terminal operator handling international shipping containers. This is being compared to online listings for vacant lots between 0.23 to 1.68 acres, which are completely different property types and use and thus have no basis for market rental comparison.

  - Example 2: Lease LPN-264 is comprised of an approximately 270-acre (approximately 11.8 million square feet) leasehold for a major marine

8

terminal operator handling international shipping containers. This lease is being compared to the online listing for a 39,000 square foot warehouse building, which is a completely different property type, use, and size. As such, it has a limited basis for market rent comparability.

Note that Port Authority marine terminal operator leases, such as that in LPN-264, have multiple revenue streams in addition to the per-acre fixed rental, including a container volume throughput and guarantee components as well as a per unit cargo facility charge, which are vastly different from the rental structure associated with a warehouse building.

Note that Port Authority marine terminal operator leases, such as that in LPN-264, require substantial capital investments that the tenant/lessee is contractually required to make in the respective leasehold (in this case, over $300 million). This is in stark contrast to capital commitments, if any, for a 39,000 square foot warehouse building lease used as a market comparison.

We respectfully disagree with the assertion that the Audit Analysis "Estimates the PANYNJ Did Not Realize Revenues of Approximately $4.3 Million" for the following reasons:

- The Port Department believes it is achieving market rents on the leases reviewed, particularly with respect to the two container terminals discussed in the above Example 1 (HHT-004) and Example 2 (LPN-264), which collectively accounts for approximately $4.2 million of the $4.3 million shown on Appendix A of the Preliminary Finding report. Port Department's container terminal leases incorporate common rental structures and thresholds, providing historic and current internal market benchmarking for Port's specialized container terminal lease portfolio with its unique arrangements for landlord-tenant responsibilities, capital investments, and property profile/condition.
- To base the New York State Office of the Comptroller's assertion on internet comparable listings without performing site visits, understanding the Port Department's business model or performing other necessary analysis is concerning.

In addition, on Page 10 of the Draft Report, it was cited that "six segments, totaling 8.2 million square feet, did not have any fixed rent assigned." This was addressed by the Port Department in its response (dated October 24, 2018) to the Preliminary Findings report. Charging a tenant per the draft audit findings would result in overbilling and an inaccurate application of the lease. To Port Department again puts forward its response to this specific audit finding as follows:

- Objects Without Fixed Rent Assigned: the 6 of 18 objects cited as not having a fixed rent assigned were part of the pre-2011 version of LPN-264. In June

9

2011, a restructuring of LPN-264 was negotiated, authorized and executed under the Amended & Restated Lease for LPN-264, which superseded the pre-2011 rental objects. Thus, the 6 objects reflect archived information for background/historical purposes and do not reflect current objects for active billing under the lease. All acreage is accounted for and is being billed accordingly

**Advertising**

The PA's advertising program is managed by an advertising concessionaire ("Firm") for which it has concession agreement ("Agreement") through August 2020.[1] Pursuant to the terms of the Agreement, which was awarded as a result of a Request for Proposals issued by the PA, the Firm is authorized to sell and display advertising at PA facilities, including at the GWBBS, Teterboro Airport and PATH. The Agreement requires the Firm to pay, and the PA to receive the greater of a MAG or a percentage fee of gross revenues. The MAG places all financial risk on the Firm and mitigates the risk the PA loses advertising revenue below the MAG amount. It is in the Firm's interest to maximize sales of PA assets and surpass the MAG payment because the Firm collects its share of revenue above the MAG.

**State Comptroller's Comment** – As shown in the report, the PANYNJ collected $35,000 for a one-month advertising campaign; the nature of the campaign is not relevant. Therefore, $280,000 is the correct annualized figure ($35,000 × 12). In addition, the fact that the GWBBS is a fraction of the PANYNJ's advertising revenue is not a justification for the PANYNJ failing to ensure that revenue was maximized under this agreement, nor does it reflect any inaccuracy in the report. Rather, it appears to be a rationalization of why the PANYNJ did not maximize revenue under this agreement. Furthermore, striving for the minimum is not what the PANYNJ should set as a performance goal; rather, it should aim to maximize revenue for taxpayers.

The draft audit also presents a number of inaccuracies regarding advertising. First, the calculation of $280,000 is based on a monthly revenue of $35,000, but this amount was generated based on the one-time opening of Marshalls at the GWBBS. The revenue is not indicative of a typical advertising campaign at this location. Second, advertising revenue at the GWBBS represents a tiny fraction of total gross advertising revenue generated across all Port Authority facilities ($75M in 2018). Third, the PA is insulated from any loss of advertising revenue at the GWBBS, and all other facilities. The PA has entered into a contract with one entity to perform these services. The PA receives a MAG payment from its advertising contractor, and the MAG places all financial risk on the contractor and mitigates the risk the PA loses advertising revenue below the MAG amount. Fourth, the draft report suggests the Firm does not pursue advertising revenues because the first two floors of the GWBBS were assigned to the developer. This is not correct. The Firm does in fact seek to generate advertising revenue at GWBBS in the areas outside of the developer-controlled areas, but has found

[1] The Port Authority issued a Request for Proposals for the future advertising concession on March 29, 2019.

it difficult to identify demand for and generate sales from advertising at GWBBS. In addition, the predominate advertising asset type at the GWBBS, column wraps, are costly, and cost-prohibitive in light of the minimal demand from advertisers.

The draft audit also proposes the PA should seek to determine if other companies would be interested in investing in additional forms of advertising at Teterboro Airport. However, advertising is limited to the two exterior billboards on the façade and grounds around the Custom House building because the other advertising rights are retained by the individual terminal operators. Furthermore, there are federal restrictions that prevent the erection of exterior billboards elsewhere on the property, which would be more desirable assets to sell. The PA is working with the Firm to explore other forms of advertising at Teterboro Airport in light of these restrictions. Additionally, other advertising contractors will have opportunity to propose new advertising assets at Teterboro under a future concession agreement request for proposals.

**State Comptroller's Comment** – The PANYNJ's response does not add any new information. It simply reiterates what is stated in the draft report.

The PA respectfully disagrees that we are not maximizing revenue at PATH. To the contrary, PATH experienced its highest advertising revenues in 2017 and 2018, respectively. PATH advertising assets generated $4. lM and $5.4M in sales revenue in 2017 and 2018 respectively. The success was due in part, to additional inventory of advertising space identified by the PA and the Firm.

Furthermore, the report incorrectly states that the PA reduces or increases the projected income without any support and minimal analysis. The PA's budgeting process for advertising revenue fully adheres to the agency's financial policies published in the annual Budget Book. The budgeting process is a unified, multilateral and collaborative endeavor.

**State Comptroller's Comment** – The PANYNJ refers to an analysis for PATH, but this information was not provided to the auditors.

We would also like to point out that the description of Tunnels, Bridges and Terminals division in the background section incorrectly includes Journal Square Transportation Center, which is a facility managed by PATH.

THE PORT AUTHORITY OF NY & NJ

We appreciate the effort of you and your staff. Please let us know if you have any questions regarding the above.

Sincerely,

Mark Spector
Director, Real Estate

Sam Ruda
Director, Ports

12

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