Port Authority of New York and New Jersey

Selected Aspects of Leasing Practices for Real Estate Department, Aviation, World Trade Center, and Leasing of Properties

Report 2019-S-9 | May 2021

OFFICE OF THE NEW YORK STATE COMPTROLLER

Thomas P. DiNapoli, State Comptroller

Division of State Government Accountability

Audit Highlights

Objectives

To determine whether the Port Authority of New York and New Jersey (PANYNJ) collected all revenues due and identified revenue enhancement opportunities and whether PANYNJ followed its procedures in the leasing of properties. This audit covered the period January 1, 2014 through November 21, 2019.

About the Program

PANYNJ was created to promote and protect the commerce of the Port District – a region within approximately a 25-mile radius of the Statue of Liberty – and to undertake port and regional improvements not likely to be financed by private enterprise or attempted by either New York or New Jersey alone. 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, the Port Authority Trans-Hudson 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.

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, and includes airport and marine terminals, buildings, warehouses, parking lots, billboards, and advertising spaces.

Key Findings

- PANYNJ did not realize revenue of $8.3 million from four leases at the World Trade Center (WTC) during the period June 2014 through November 2019. This amount included money due to PANYNJ for utilities, amounts due when tenants terminated their leases early, and other percentages of revenues specified in leases.
- During our audit scope, PANYNJ's Real Estate Department leased seven external spaces for its use within a half mile of 1WTC at a cost of $15.9 million, despite the fact that 1WTC was not fully occupied at the time. Despite repeated requests, PANYNJ did not provide any documentation that it had evaluated its own available space before renting external space.
- Due to inadequate monitoring of its vendor and no independent tracking or verification of advertising revenue – lacking even a list of the estimated 1,000 spaces where advertisements were placed – PANYNJ does not have assurance that it is maximizing revenue from advertising at its airports.
- During our review of two sampled airport system leases, we found that a property leased from a municipality for future development of Newark Airport was later sub-leased to a private business for a for-profit purpose. PANYNJ should have notified the municipality of this sub-lease and paid real property taxes. The other lease was for a garage as part of the ongoing redevelopment of LaGuardia Airport. PANYNJ paid $1,040,755 in real property taxes for the period September 1, 2016 to December 12, 2019 instead of applying for an exemption based on the property's use and PANYNJ's status as a government entity.
- PANYNJ did not have formal policies and procedures for the leasing of properties. In addition, we found that PANYNJ did not always follow the process that PANYNJ officials described as routine.

Key Recommendations

- Collect all revenue due in a timely manner.
- Formalize policies and procedures for leasing external property, including requiring documentation of the decision to rent external property for PANYNJ use, such as the initial request for the space, an evaluation of the availability and usability of internal space, and the basis for determining that the leasing of external space was more beneficial for PANYNJ.
- Actively monitor the contract with the advertising vendor regarding inventory of advertising locations available for sale and advertisement pricing, and consider obtaining direct access to the vendor's system to support monitoring of contracts.
- Ensure that the taxing authorities where the leased properties are located are properly notified of the property uses and of PANYNJ's tax-exempt status.

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

May 4, 2021

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 Department, Aviation, World Trade Center, and Leasing of Properties.* 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

Term	Description	Identifier
1WTC	One World Trade Center	*Key Term*
PANYNJ	Port Authority of New York and New Jersey	*Auditee*
PATH	Port Authority Trans-Hudson	*Key Term*
RED	Real Estate Department	*Department*
WTC	World Trade Center	*Key Term*

Background

The Port Authority of New York and New Jersey (PANYNJ) was established in 1921. Its area of jurisdiction is the Port District, a region within about a 25-mile radius of the Statue of Liberty. 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 attempted by either New York or New Jersey alone.

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, 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).

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. Its real estate assets include airport and marine terminals, buildings, warehouses, parking lots, billboards, and advertising spaces. PANYNJ's five departments reflect its major business sectors:

- 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: Core functions encompass the design and construction of the various capital projects at the WTC site (including coordination with private developers and government entities) and property management of the WTC campus.
- PATH: Operates and maintains a rapid transit railroad serving as the primary transit link between Manhattan and neighboring New Jersey urban communities as well as suburban commuter railroads.
- 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.

In addition to rental income from its facilities, PANYNJ has the opportunity to collect advertising revenues under a contract with its advertising vendor. PANYNJ officials stated that the advertising vendor handles most aspects of renting advertising space. PANYNJ receives a minimum annual guarantee portion of the revenues, which is distributed to stakeholders according to PANYNJ instructions.

For One World Trade Center (1WTC), PANYNJ entered into a joint venture with a real estate firm to function as managing agent. Per the agreement, the managing agent solicits tenants and leases the 1WTC spaces, collects the rents, and manages the property.

Audit Findings and Recommendations

PANYNJ does not always collect all revenues due. For our judgmental sample of 10 leases and one license agreement, we found a total of $8.3 million that was not collected for various reasons.

Due to inadequate monitoring of its advertising vendor, PANYNJ does not have assurance that it is maximizing revenue from advertising at its airports. PANYNJ failed to maintain independent records and did not even have a complete listing of the locations where advertising was occurring.

PANYNJ does not have formal policies and procedures for leasing properties for its use. In addition, it does not always follow its own unwritten processes. Our review of seven leases for office space in the vicinity of 1WTC showed PANYNJ spent $15.9 million for rent through June 2019. In addition, we were provided documentation authorizing approximately $3.2 million for build-out costs for two of the properties. In total, PANYNJ paid approximately $19.1 million to lease space near 1WTC, where PANYNJ already owned space that was available for use. No documentation was provided to show that PANYNJ evaluated the use of available internal (PANYNJ-owned) space prior to leasing.

Revenue – World Trade Center

We reviewed files for 10 judgmentally selected leases and one license agreement at the WTC. Leasing files should include the signed leases, letters of credit (guarantees), and an insurance policy. PANYNJ did not provide approval for three of the 10 leases. We found that PANYNJ's records were incomplete and that PANYNJ did not always collect all revenue due. In total, we identified $8.3 million at risk, as discussed next.

For the sampled license agreement, we requested and reviewed the billing statements and found that the tenant, as specified in the agreement, was charged $6.6 million for utilities over a more than three-year period. However, the tenant did not remit any payments to PANYNJ. A PANYNJ official advised us that the tenant believes the amounts billed were incorrect and that there is an ongoing negotiation to settle the balance. PANYNJ stated it was willing to write off a substantial portion of that debt to settle the dispute.

Lease holders are required to provide PANYNJ with a letter of credit. If the tenant terminates the lease prior to its expiration, PANYNJ is entitled to a full drawdown of the amount listed in the letter of credit. For one lease, the tenant was required to provide a letter of credit for $1,771,553.93, but when the tenant terminated the lease prior to its expiration, PANYNJ drew down the amount of $1,705,677.75, which was $65,876.18 less than the amount due.

For the second lease, the tenant provided a letter of credit in the amount of $1,084,272 but terminated the lease prior to its end date. PANYNJ did not provide any documentation that it drew down the full amount listed in the letter of credit.

For another lease, the tenant was required to pay PANYNJ percentages of revenues that the property generated above specified threshold amounts (breakpoints). The lease also required that these amounts be adjusted annually by the percentage specified in the lease. In response to our preliminary findings showing underpayments, PANYNJ stated that the annual rent statements were correct and no payment was outstanding. At the closing conference, PANYNJ restated its concerns about the calculation, and we re-evaluated, determining PANYNJ was underpaid by $611,896 for three years ended May 2018.

Recommendations

1. Collect all revenue due in a timely manner, ensuring the amount in the letters of credit are correct and drawing down the total amount when warranted, starting with the two tenants noted in this report.
2. Verify and document that the amounts due from lessees are correct, and recover any underpayments.

Revenue – Aviation Advertising

PANYNJ contracts with a vendor to provide advertising at the airports it manages. PANYNJ receives a percentage of the revenue for advertising sold. PANYNJ Advertising Guidelines state that the agency seeks to “maximize revenue generated by advertising fees.”

Revenue for advertising at PANYNJ airports is directly affected by the number of advertising locations (points) at each airport. When we requested information regarding advertising points, PANYNJ officials provided only a total number per airport (by building and type), not a detailed listing of where each advertising point was physically located in the airport. The vendor was able to provide those details from its records.

We found significant discrepancies between the PANYNJ and vendor information. PANYNJ’s lists had about 1,200 points at its four airports, while its vendor listed about 1,000 points. The failure by PANYNJ to verify that its advertising points inventory reconciles with its vendor’s inhibits PANYNJ from effectively monitoring the vendor’s performance and maximizing its advertising revenue in accordance with its own Advertising Guidelines.

We conducted site visits at the four airports in November 2019 to determine whether the vendor list was accurate and whether each point was used for advertising or had some indication that it was available for advertising. We selected all the advertising points at Newark and Stewart Airports and a judgmental sample of advertising points at JFK and LaGuardia. However, with the exception of Stewart Airport, when we arrived on site at the airports, we were informed that certain points we had selected were inaccessible to us due to safety and/or security concerns. Even the PANYNJ official who accompanied us on our site visits was not able to access those points. Therefore, we were only able to physically observe a portion of the total locations in our sample. Of those, about 15 percent of the locations shown on the vendor’s map were not clearly marked as available for advertising. Further, without access to all advertising points, PANYNJ officials cannot verify whether the vendor has obtained advertising and owes PANYNJ revenue for those locations. Instead, PANYNJ must rely on the vendor to self-report the amount it owes to PANYNJ for revenue from those advertising points.

PANYNJ officials state that they monitor the duties carried out by the advertisers through the following actions:

- Approval of all images and advertising proofs. Proofs show how advertisements will appear in print and are sent to PANYNJ for review and approval before they are posted.

- Weekly meetings addressing issues such as possible upcoming contracts and potential new advertising points.

- Quarterly, unannounced walk-throughs of facilities to monitor advertising points within airports.

For the period January 1, 2014 to October 1, 2019, PANYNJ was able to provide us with only 800 undated proofs. A PANYNJ official stated he started receiving proofs in November 2017. Conservatively, we calculate that, from November 2017 through October 1, 2019, there should have been at least 14,400 proofs based on the number of points and the typical advertising cycle. An estimate was used because PANYNJ did not provide documentation on the number of advertisements at the airport facilities for the period or for how many different proofs were used at each facility. Similarly, we requested notes from the meetings held by PANYNJ and the vendor from January 1, 2014 (the beginning of our audit period) to October 1, 2019 (the date of our meeting with PANYNJ) – a total of 299 weeks. PANYNJ provided notes for only 16 of the 200 weeks from January 1, 2014 to November 1, 2017 and for 86 weeks from the rest of the period. We reviewed all the notes for the 16 weekly meetings from the earlier period and a sample of 42 weeks from the rest of the period. Our review of these 58 weekly meetings concluded the meetings were held.

For the five years ended December 31, 2018, PANYNJ officials provided documentation of one walk-through at three airports. The walk-throughs occurred on May 18, 2018 at JFK; May 24, 2018 at LaGuardia Airport; and June 1, 2018 at Newark Airport. PANYNJ provided photos of these walk-throughs, but no dates to show when they were taken. PANYNJ did not provide documentation of any walk-through at Stewart Airport until June 1, 2020, as part of its response to our preliminary findings. As with the other three airports, PANYNJ provided photos of this walk-through, but they were not dated and there was no other information to show when the walk-through occurred.

Furthermore, PANYNJ officials did not check the revenues the advertising firm reported for completeness and accuracy. They indicated that PANYNJ Internal Audit conducts audits of the contract to verify the numbers reported; however, when we contacted Internal Audit, the representative replied that the last audit conducted on this contract covered the period 2007–2012. In the absence of monitoring and oversight of the firm, PANYNJ has less assurance that the revenues reported are complete and accurate.

In response to our preliminary findings, PANYNJ stated that it has not audited this contract since 2012 based on the prior audit results and the limited resources available to Internal Audit to engage other audits based on risk. We noted that the prior audit identified areas of risk related to the collection of revenues, but PANYNJ has not followed up.

Recommendations

3. Actively monitor the contract with the advertising vendor including, but not limited to, inventory of points available for sale, advertisement pricing, and advertisements located in restricted areas.
4. Allow for direct access to the vendor's system for enhanced monitoring of contracts and to ensure that payment amounts remitted to PANYNJ are correct.
5. Periodically review and document the results of the lease payments made by the advertising vendor from sales of advertising points at PANYNJ airports to ensure that the self-reported advertising revenues are accurate and that payments are in accordance with the terms of the leases.
6. Ensure the advertising vendor calculates revenues and makes payments to PANYNJ as specified by contract.

Procedures – Leasing of Property for PANYNJ Use

PANYNJ's Real Estate Department (RED) did not have any documented policies and procedures for entering into new leases, exercising an option, or renewing a current lease. In response to our request for written documentation of such processes, a RED official prepared a brief document titled "Summary of Process for Sourcing and Filling Select PA Department Needs for Office Space" outlining the steps to be taken when RED acquires space for its use.

RED officials stated that, before leasing external property, the department that needs the space must submit a request, which is analyzed to ensure that PANYNJ does not already have suitable space available. Once an agreement is reached by the department requesting the space, RED, and the landlord, a lease is drafted. The lease is then approved by the Legal department and other PANYNJ officials, and eventually documentation of approval is memorialized by a Memorandum of Authorization or Memorandum of Justification, depending on lease terms.

In addition, if PANYNJ rents space in a building that is not tax exempt, PANYNJ may ask the owner to convert the units in the building to condominiums to be exempt from paying real estate tax for the portion it rents.

PANYNJ provided no documentation supporting that it evaluates the properties it owns before seeking external property for rental to fulfill requests. It also provided no documentation to demonstrate it inquired – as part of the leasing process – as to whether the landlords would explore converting property into condominiums to exempt a space from real property tax. Based on the lack of conformance to its own process, it appears that PANYNJ did not optimally manage the leasing of properties.

Our review of seven leases for office space in the vicinity of 1WTC showed that PANYNJ spent $15.9 million for rent through June 2019. In addition, we were provided documentation authorizing approximately $3.2 million for build-out costs for two of the properties. In total, PANYNJ paid approximately $19.1 million to lease space near 1WTC when it already had available space within its own properties.

In response to our preliminary findings, PANYNJ provided a formal standard operating procedure titled “Summary of Process for Sourcing and Filling Select PA Department Needs for Office Space” effective December 2019. All seven properties had the appropriate Memorandum of Authorization or Memorandum of Justification stating that the properties’ rental rates were within the prevailing market rates. However, for six of the seven leases sampled, RED did not provide a request for space, documentation that it had reviewed its own already available space, or support for the prevailing market rates.

Another concern PANYNJ must consider when leasing external properties is compliance with real property tax requirements. We sampled two leases from PANYNJ’s Aviation Department for space close to Newark and LaGuardia airports, respectively.

One property was leased from a municipality with the intention of future development of Newark Airport. Subsequently, PANYNJ sub-leased the property to a private company. Based on its use, the municipality should have been notified of the change, resulting in real property taxes of approximately $1.8 million.

The second property was leased as part of the continuing redevelopment of LaGuardia Airport. The property is near the airport/air bridges and was used by PANYNJ and federal employees and other necessary personnel for parking. These individuals previously parked at allocated spaces in an on-site garage, which was repurposed for public parking. PANYNJ paid $1,040,755 in real estate taxes during the period September 1, 2016 to December 12, 2019 for this property and provided no documentation it applied for an exemption, even though it was eligible for one based on its status as a government entity.

Recommendations

7. Formalize policies and procedures for leasing external property, including but not limited to requiring documentation of the decision to rent external property such as the initial request for the space, an evaluation of the availability and the usability of available internal space, and the basis for determining that the leasing of external space was more beneficial for PANYNJ.

8. Determine the feasibility and document the results of requesting owners of external property to convert their properties to condominiums so, when rented for long periods, PANYNJ would not have to pay real estate tax.

Audit Scope, Objectives, and Methodology

The objectives of our audit were to determine whether PANYNJ collected all revenues due and identified revenue enhancement opportunities and whether PANYNJ followed its procedures in the leasing of properties. This audit covered the period January 1, 2014 through November 21, 2019.

To achieve our audit objectives and assess relevant internal controls, we met with key PANYNJ officials, WTC managing agents, advertising firm officials, and officials from other government agencies. We also performed site visits and reviewed the files for the leasing of properties, leasing procedures, and documentation related to the collection of revenues.

During the audit, we experienced inordinate delays in obtaining records from PANYNJ. Documents that should have been on hand were not provided for months. Due to PANYNJ's lack of other records, we requested information kept by its leasing agent, after being advised the leasing agent had the required information. The leasing agent initially claimed the records were confidential and could not be shared unless we signed a non-disclosure agreement (NDA) with them. In February 2019, PANYNJ instructed the leasing agent to make the records available. After initially agreeing in July 2019 to provide the documents, the leasing agent again requested a separate NDA, even though an NDA existed with PANYNJ. The leasing agent did not provide the documents.

For the review of advertising at the airports, we addressed Teterboro Airport in our previous report 2017-S-58. Therefore, this report focused on four of the five airports operated by PANYNJ: JFK, LaGuardia, Newark, and Stewart. We visited these four airports, interviewed PANYNJ officials, reviewed the contracts and collection of revenue, and reviewed PANYNJ's monitoring of the contract. We also interviewed the advertising vendor representatives.

To determine whether PANYNJ collected all revenue due and was following procedures, we selected a judgmental sample of 10 leases and one license from a population of 54 leases and licenses at 1WTC. The 10 leases and license were valued at approximately $2.9 billion over the life of the leases and license based on the leased terms for fixed rent. These leases ranged from five to 26 years, covering the period from January 2, 2014 through December 31, 2039. The amounts billed from December 1, 2017 to July 2019 totaled $227 million.

To determine whether PANYNJ followed its process for leasing properties, we selected a judgmental sample of seven of 28 properties that RED leased, based on the square footage of the leased space and the expiration dates of the leases themselves. In addition, we reviewed two leases for Aviation properties that began during our audit period (of the five leases that were active) and one lease for Port Commerce that began during our audit period (of the two leases that were active).

PANYNJ provided a summary format list of advertising points for its facilities dated June 6, 2019. The advertising vendor provided maps of advertising points as of December 31, 2018.

PANYNJ reported in its summary that the eight facilities it operates had a total of 10,630 advertising points. We focused on the PANYNJ Aviation facilities. In the vendor’s summary, these facilities had a count of 1,717 advertising points, excluding Teterboro Airport.

The audit team, accompanied each time by a PANYNJ official, visited Stewart Airport on October 16, 2019; JFK Airport on November, 6, 2019; LaGuardia Airport on November 13, 2019; and Newark Airport on November 21, 2019. Our previously issued report (2017-S-58: PANYNJ – *Selected Aspects of Leasing Practices for Real Estate Services Department and Port Commerce*) covers leasing for non-airport facilities.

The samples were not intended to be projected to the entire population.

Statutory Requirements

Authority

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.

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.

As is our practice, we notified PANYNJ officials at the outset of the audit that we would be requesting a representation letter in which PANYNJ management provides assurances, to the best of their knowledge, concerning the relevance, accuracy, and competence of the evidence provided to the auditors during the course of the audit. The representation letter is intended to confirm oral representations made to the auditors and to reduce the likelihood of misunderstandings. Agency officials normally use the representation letter to assert that, to the best of their knowledge, all relevant financial and programmatic records and related data have been provided to the auditors. They further affirm that either the agency has complied with all laws, rules, and regulations applicable to its operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors. However, PANYNJ officials have not provided a representation letter in connection with this audit. As a result, we lack assurance from PANYNJ's officials that all relevant information was provided to us during the audit.

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.

Reporting Requirements

We provided draft copies of this report to PANYNJ officials for their review and formal comment. Their comments were considered in preparing the final report and are attached in their entirety at the end of the report.

We question how PANYNJ officials managed to rationalize a response stating that their operating practices during the audit field work were already in line with the recommendations. As an example, PANYNJ claims that it had written procedures for the leasing of property for its use, when, in fact, it did not until a document dated May 20, 2019 was prepared and provided to the auditors in response to the auditors' January 9, 2019 request. Moreover, PANYNJ had support for only one visit to its three major airports in May and June 2018 for the five years ended December 2018 to show it monitored the advertising. An accurate response would have reflected that PANYNJ's operating practices were not sufficient to ensure it received all the revenues from leasing space at its facilities or that it had to incur costs to lease offices for its use.

Within 180 days after the final release of this report, we request that the Chairman of PANYNJ 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.

PORT AUTHORITY NY NJ
AIR LAND RAIL SEA

November 23, 2020

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

Re: Port Authority Response to Key Findings and Recommendations: Draft Report 2019-S-9

Dear Mr. Bortas:

The Port Authority of New York and New Jersey (the "Port Authority") is in receipt of Draft Report 2019-S-9 ("Draft Report"), prepared by the New York State Office of the Controller ("NYSOSC"), dated October 2020, and titled "Selected Aspects of Leasing Practices for Real Estate Department, Aviation, World Trade Center, and Leasing of Properties." We would like to provide the following comments for consideration.

As you know, the Port Authority and NYSOSC have exchanged correspondence on this matter over the course of your work and we have provided written responses to your questions and preliminary findings in five letters - dated September 20th, 2019, April 23rd, 2020, June 1st, 2020, June 8th, 2020 and June 23rd, 2020. As we had previously indicated, we dispute many of the conclusions in the Draft Report and believe it continues to reflect a number of misunderstandings and inaccuracies and its conclusions are therefore misplaced; however, we find many of your recommendations to be appropriate and already reflected in our processes and procedures. We undertake to continue to follow them as described below.

Comment 1

The Draft Report focuses on several matters, finding that the Port Authority:

- has not collected certain amounts that NYSOSC believes are due at the World Trade Center complex ("WTC Site");
- rents office space from private parties when it has space available at its own facilities;
- is deficient in managing its airport advertising program;
- ought to have required its tenants pay certain municipal property taxes and should not itself have paid other property taxes on rented property; and
- does not have sufficient internal processes for its leasing operations.

The Port Authority disputes each of these findings as further discussed below.

The Port Authority's Leasing Operations

The Port Authority conducts significant leasing activities across its facilities, leasing millions of square feet

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under both ground leases (which may be subleased to others) and space leases for purveyors of goods and services to the traveling public. For example, the Port Authority holds the fee interest in the property comprising the 16-acre WTC Site, which it has ground-leased to a number of for-profit and not-for-profit enterprises. The Port Authority enters into leases with its tenants which permit them to conduct business as anticipated for a term of years. Some of our leases which require significant capital investment by our tenants extend up to 99 years.

From time to time, the Port Authority itself, leases space from other landlords for a variety of reasons including (i) unwillingness of the landlord to sell a fee interest to the Port Authority; (ii) preference of the Port Authority to maintain the space for a temporary period, not justifying acquisition of a fee interest in the property; or (iii) desire to leave existing space for more profitable rental to third parties.

The Port Authority's leasing operations are led by a team of real estate professionals in the Real Estate and Operation Services Departments, supplemented by third party experts and appraisers, as required and supervised by senior management and the Port Authority Board of Commissioners.

Comment 2

Draft Report Findings

1. WTC Site

The Draft Report states that the Port Authority did not realize revenues of $8.4 million ("Uncollected Revenues") from several leases at the WTC Site. The Port Authority disputes this claim.

Although the Port Authority owns fee title to the WTC Site and operates the below grade transportation Hub on the site, most of the above grade parcels are long-term leases for multiple uses. The office towers are intended to be subleased to office space tenants under detailed leasing plans, including market rental expectations, agreed to between the Port Authority and the primary lessees. Parcels have also been ground-leased to certain not-for-profit entities for development as cultural and memorial facilities. The 1 World Trade Center building ("Tower 1") has been leased by the Port Authority to the WTC Tower 1 LLC ("LLC"), for a 99-year term. Although the Port Authority continues to retain a significant economic interest in the building, its day-to-day management is conducted by a private real estate developer which also has an economic interest in the building. Operations are conducted in accordance with specified standards, including office leasing parameters. The Port Authority has no unilateral right to sublease space or set rents in the building.

As described in the Draft Report, the Port Authority understands that approximately 75% of the Uncollected Revenues ($6.6 million) relate to utility costs billed to a cultural institution, which has disputed the charges and has claimed other amounts arising from the build-out of the parcel. The Port Authority and the institution are engaged in discussions regarding settlement of these claims and anticipates that they will be satisfactorily resolved in due course and in accordance with Port Authority settlement processes.

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With regard to the remaining $1.8 million of Uncollected Revenues:

- NYSOSC claims that a tenant provided a letter of credit in the amount of $1.084 million and that the Port Authority did not provide any evidence that it drew down on the full amount when the tenant broke its lease in Tower 1. As explained above, the sublease was with the LLC, not directly with the Port Authority and was managed by the other member of LLC and LLC's agents. The managing member reported that the tenant never provided its letter of credit at lease signing. Consequently, after requesting the letter of credit to no avail, the sublease was terminated and the tenant never took possession of the property.

Comment 3

- NYSOSC claims that the Port Authority did not fully draw on a $1.772 million letter of credit under another Tower 1 sublease breach, leaving $65,000 undrawn. As above, the sublease was with LLC, not directly with the Port Authority and was managed by the other member of the LLC and LLC's agents. In this case, the managing member reported that the tenant experienced financial difficulties, ceased operations and the sublease was terminated. The LLC retained a letter of credit for approximately $1.706 million and drew on it in full. In lieu of pursuing the additional $65,000, the tenant agreed to vacate the premises and agreed to leave premises improvements with a value in excess of $65,000. The space was subsequently re-subleased at increased rental rates. Further information on this matter was provided in our June 8th, 2020 letter.

Comment 3

Comment 4

- NYSOSC claims that rentals based on a percentage of sales under a concession lease in Tower 1 were understated by approximately $612,000. The sublease is with LLC, not directly with the Port Authority and is managed by the other member of the LLC and LLC's agents. LLC has assured the Port Authority that the percentage rents were correctly calculated, and the subtenant's independent auditors have certified its financial statements on this basis. The Port Authority has also reviewed the sublease. We believe the difference as presented by NYSOSC relates to the sublease provision regarding the rate of escalation to be used in calculating percentage rents. In our judgment, the rents were correctly calculated.

Comment 5

- NYSOSC also noted in the Draft Report that it was unable to receive certain copies of leasing documentation. We recall the problem and regret the ensuing delay. However, as the issue was continuing, we made arrangements to obtain all of the documents from the agent and, as we indicated on April 23rd, 2020, they are available for your review at any time at our offices.

Comment 6

2. Advertising

The Draft Report states that the Port Authority was not fully aware of the scope of advertising operations at its five airports and was unable to access certain advertising spaces during a NYSOSC inspection. The Draft Report also states that the Port Authority does not maintain a list of the available spaces and therefore cannot possibly be certain it is maximizing revenues from this contract. The Port Authority disputes this characterization.

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Since 2005, the Port Authority has contracted with a third party to manage all advertising across all of its facilities, which agreement terminates this year (the "Subject Contract"). In 2019, the Port Authority solicited proposals for one or more new vendors, splitting the advertising management among several categories of assets – airports, billboards, bus terminals and PATH (rail transit). All such management awards have been made and the parties have entered into contracts. The new advertising agreements anticipate strong oversight of the program by the Port Authority, permitting real time analysis of inventory and revenues.

With regard to the Subject Contract, the Port Authority has always maintained close contact with the contractor, with both weekly meetings between the contractor and the Real Estate Department and monthly meetings with the contractor and both the Real Estate Department and the departments which manage the relevant Port Authority facilities. The Port Authority has maintained a list of available assets, but as these change frequently, the Port Authority relied on its periodic meetings as a practical update to the written schedule. These meetings included an analysis and discussion of the following reports: (i) the top ten advertisers generating revenue, (ii) the top three revenue generating locations, (iii) revenue generated by display type (i.e., banner, diorama, spectacular, etc.), (iv) year-over-year revenue for the month, (v) advertising revenue disaggregated between static and digital assets, (vi) out-of-home advertising trends, (vii) and the best performing sales categories. The Port Authority also receives monthly reporting of unsold locations that could be utilized for its own initiatives. Port Authority and contractor senior management also conducted regular meetings on strategies to optimize revenues and advertising scope. The Port Authority conducted quarterly visits to facilities to review assets and confirm advertising asset locations; however, the program had been most closely managed through review of contractor reporting given the wide scope of assets and the alignment of interests between the contractor and the Port Authority. Importantly, the contractor receives payments based on percentage of sale revenues and is therefore incentivized to maximize revenue. In addition, the Revenue Accounting Division of the Port Authority's Office of the Comptroller received monthly reports from the contractor stating the sales activity and gross revenues received. Revenue Accounting's procedures also include a month-to-month and year-over-year variance analysis, providing an independent view on the accuracy of contractor reports to the Real Estate Department.

Comment 7

Comment 8

The new advertising contracts incorporate all of the supervisory requirements in the Subject Contract and go further to provide additional information to the Port Authority as it is generated by the new contractors. As required under the new contracts, the relevant contractor will initially prepare plans for advertising, sponsorship, reporting, and management and develop sales and marketing strategies to enhance the Port Authority's advertising program. Reporting is required to include the ability for the Port Authority to (i) track advertising display locations and unsold inventory; (ii) review monthly and annual revenue reports and projections from each contractor; (iii) have real time access to rate cards for every advertising asset; (iv) review periodic forecasts of revenue projections by asset type, and (v) ensure that the contractors optimize advertising sales in innovative ways with investments in new technology to capitalize on market demand.

Comment 9

Many of the advertising displays are located in airport areas which are limited to passengers under security

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aspects of federal law. However, the Port Authority has implemented a change in procedures to ensure the Real Estate Department representatives also have credentials allowing access for inspection purposes as mentioned in the Draft Report.

Comment 10

3. Port Authority-leased Property

Since the Port Authority returned to the WTC Site in 2014, most of its corporate functions have been housed at its facilities at 2 Montgomery Place, Jersey City, New Jersey and 4 World Trade Center, New York. However, the Port Authority has a need, from time to time, for limited space for particular purposes which cannot be satisfied at its existing properties. This might occur (i) if the Port Authority needed a field office for development or construction; (ii) if the Port Authority would temporarily overflow its facilities due to temporary unavailability of office premises; (iii) for very large construction projects, where there is a need for close collaboration with third party firms; (iv) when temporary space is available at less expensive rates; or (v) for security or other operational reasons. As explained above, Tower 1 is nearly fully leased by tenants paying Class A market rents and the Port Authority may not unilaterally reduce such rents to provide a subsidy for its own use.

The Port Authority's Department of Operation Services ("OSD") is responsible for the allocation of Port Authority space among competing internal uses. It has been OSD's longstanding practice to consider the rental costs of existing space relative to the costs of renting new space over a variety of factors, including (i) term of the need for additional space; (ii) projected use of existing space; (iii) cost of existing space on a square foot basis relative to swing space elsewhere; (v) travel costs to any proposed new space; and (vi) special requirements for the space (i.e., security; large conference facilities). In particular, the Port Authority rented space in a lower Manhattan office building in 2016 at 80 Pine Street for staff engaged in the planning, design and construction of the WTC Site, essentially a construction site field office for a massive construction project in lower Manhattan which could not have been accommodated in its executive offices, given the number of third party contractors and others who needed access to the office space.

Comment 11

OSD's analysis is conducted each time when Port Authority staff requests space and has now been embodied in written protocols as of December 2019, which were provided to you in our June 1st, 2020 letter. Leasing of private space by the Port Authority proceeds only if it is both operationally and financially beneficial relative to the space options available at owned facilities.

4. Municipal Property Tax Exemptions

The Draft Report notes that the Port Authority has leased certain property (which is part of Newark Airport) in Elizabeth, New Jersey (the "Elizabeth Lot") to a private air shipping business for its airport operations. NYSOSC appears to conclude that the property is no longer entitled to a tax exemption because it is used by a private party. The Port Authority disputes this conclusion. The City of Elizabeth is the underlying lessor of the site and is itself exempt as a municipality from property taxes. The lease permits the Port Authority to sublease the site for airport purposes. The sublease was entered into with a private party

Comment 12

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conducting an airport use.

5. Port Authority Should Not Pay Property Taxes on Property it Leases.

The Draft Report states that the Port Authority should apply for exemptions from property taxes for spaces it leases and uses for public purposes. It is not practicable for the Port Authority to receive a discounted rent reflecting exemption from property taxes when the property taxes are incorporated into a total rental cost and the premises are a small portion of the entire property on which taxes are assessed. The Port Authority's landlords would have to apply for a partial reduction in property taxes and pass that reduction to the Port Authority through its lease. Practically, landlords are not willing to lease small spaces to the Port Authority on a relatively short-term basis on this condition.

Comment 13

NYSOSC's suggestion that a landlord be required to "condominium-ize" an office building in order to apply for a unitary tax exemption for the Port Authority is not realistic, given the significant time and cost required by a landlord to accomplish this conversion and other tax and business consequences arising from the conversion, relative to the limited benefits the landlord would achieve.

Comment 14

6. Deficiencies in the Overall Leasing Program.

NYSOSC alleges that PANYNJ did not have formal policies and procedures for the leasing of properties and did not always follow the process that PANYNJ officials described as routine. PANYNJ disputes this claim. In September 2019, Real Estate provided NYSOSC with a document to reflect the practice followed entitled, "The Summary of Process for Sourcing and Filling Select PA Department Needs for Office Space". As indicated in PANYNJ's June 1st, 2020 letter, Real Estate formalized the process regarding leasing procedures as of December 2019. It is now memorialized as part of the "Port Authority Real Estate Department Standard Operating Procedures (SOPs)," of which NYSOSC has received a copy.

Comment 15

NYSOSC's Recommendations

Below are NYSOSC's recommendations in the Draft Report. In most cases, as indicated below, the Port Authority agrees with the recommendations, is currently in compliance with them, and will continue to do so in the future.

1. World Trade Center

A. *"Collect all revenue due in a timely manner, ensuring the amount in the letters of credit are correct and drawing down the total amount when warranted, starting with the two tenants noted in this report."*

The Port Authority already complies with this recommendation and agrees to continue to conduct its operations so as to collect all leasing revenue due in a timely manner, subject to its customary write-off and settlement policies and procedures. We note that as to Tower 1, the day-to-day management, including rent collection is under the control of the other LLC member and the LLC's agents. We have discussed above why the factual predicates for NYSOSC's findings with respect to the three tenants are inaccurate.

B. *"Verify and document that the amounts due from lessees are correct and recover any underpayments."*

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The Port Authority already complies with this recommendation and agrees to continue to verify and document that all lessee payments are correct and to recover any underpayments. We will continue to ensure that the LLC member that controls day-to-day management of the LLC provides the Port Authority with timely documentation sufficient to determine that amounts due from lessees are correct and that sublease contractual terms are enforced in all reasonable respects.

2. Aviation Advertising

A. *"Actively monitor the contract with the advertising vendor including, but not limited to, inventory of points available for sale, advertisement pricing, and advertisements located in restricted areas."*

The Port Authority already complies with this recommendation and will continue to actively monitor its new advertising contractors under agreements which provide additional reporting granularity including direct monthly revenue reporting by asset, display characteristics by asset, occupancy by asset, expenses by asset, and real-time performance online portals. The Port Authority will continue its quarterly visits to facilities in order to review advertising assets. The contract administrators are arranging for security access to all areas where advertising assets are located.

B. *"Allow for direct access to the vendor's system for enhanced monitoring of contracts and to ensure that payment amounts remitted to PANYNJ are correct."*

The new advertising contracts awarded by the Port Authority now explicitly include the features suggested in the Draft Report, including direct access to the vendor platform for tracking revenue performance.

C. *"Periodically review and document the results of the lease payments made by the advertising vendor from sales of advertising points at PANYNJ airports to ensure that the self-reported advertising revenues are accurate and that payments are in accordance with the terms of the leases."*

The Port Authority will continue to actively monitor its vendors through real-time revenue and pricing reporting by vendor to the PA and quarterly visits to facilities in order to review assets. As stated above, Port Authority oversight will be enhanced by review of direct vendor reporting of monthly revenues by asset, display characteristics by asset, occupancy by asset, and expenses by asset, among other metrics. The Port Authority will receive access to each vendor's platform for tracking revenue performance, for further verification. These new tools will enhance the PANYNJ's currently strong oversight of the advertising program with access at all times to advertising revenue, ongoing performance and current approved advertisement on display.

D. *"Ensure the advertising vendor calculates revenues and makes payments to the PANYNJ as specified by contract."*

The Port Authority already complies with this recommendation and will continue to confirm that its advertising vendors are paying amounts owed to the Port Authority and to others who share in this revenue.

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As is currently the case, the Port Authority Comptroller's office will oversee this leasing activity by recalculating the monthly amounts reported by advertising vendor. This recalculation worksheet will then be used to allocate the Port Authority's net share of revenues among the respective departments and facilities (now rendered less complex under the new contracts, which generally are department-specific). The procedures also include a month-to-month and year-over-year variance analysis.

3. Leasing of Properties for Port Authority Use

A. "*Formalize policies and procedures for leasing external property, including but not limited to requiring documentation of the decision to rent external property such as the initial request for the space, an evaluation of the availability and the usability of available internal space, and the basis for determining that the leasing of external space was more beneficial for PANYNJ.*"

The Real Estate Department has established detailed policies regarding its longstanding leasing standards and procedures that were formalized in December 2019 and have been provided to you.

B. "*Determine the feasibility and document the results of requesting owners of external property to convert their properties to condominiums so, when rented for long periods, PANYNJ would not have to pay real estate tax.*"

Alone among NYSOSC's recommendations, the Port Authority respectfully believes this recommendation rests on the incorrect assumption that the Port Authority's rented properties are of a sufficient term and size to incentivize a landlord to convert its property to a condominium, in order to consummate the transaction. However, to the extent that the Port Authority leases extensive space for a lengthy term, we agree to raise this structure with our counterparty landlord or otherwise discuss how the Port Authority can retain the benefit of tax-exempt status.

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Thank you for your audit recommendations in support of Draft Report 2019-S-9.

Sincerely,

X DocuSigned by: Derek Utter
77A2A9891B97406...

Derek Utter
Chief Development Officer

X DocuSigned by: Huntley A. Lawrence
1AD650239FA84F8...

Huntley Lawrence
Director, Aviation Department

X DocuSigned by: Alan Reiss
176026CFD21B4DA...

Alan Reiss
Director, WTC Department

State Comptroller's Comments

1. There is no misunderstanding by the auditors. We based our conclusions on a thorough review of the records provided by PANYNJ officials. PANYNJ's comment that "we find many of your recommendations to be appropriate" is an accurate statement. However, PANYNJ goes on to state "… and already reflected in our processes and procedures," which will be accurate when PANYNJ implements the recommendations.
2. The use of real estate professionals employed by or under contract with PANYNJ does not excuse the lack of formal procedures and well-documented actions taken by these individuals.
3. PANYNJ, as a member of the joint venture and as a beneficiary of the revenues received, has an interest in assuring that all amounts due are realized.
4. PANYNJ did not provide documentation that the tenant left improvements valued in excess of $65,000. The re-subleasing of the space has no impact on the amount due from the prior tenant. In addition, the space would have been vacant from January 2019 to June 2019.
5. We maintain that the escalation factor was not calculated in accordance with the lease terms, resulting in the underpayment we calculated.
6. We requested on April 24, 2020 to review the documents on site at the managing agent's offices because we needed to verify the original documents. PANYNJ was not responsive to this request. We requested these documents in January 2019, and PANYNJ should have obtained them faster than 15 months.
7. The response paints a picture that included several meetings with the advertising firm and PANYNJ officials, which is very different from the information provided to the auditors during field work. The report reflects the documents provided, and there was a clear lack of support for actions by PANYNJ.
8. PANYNJ does not verify that the amounts reported are accurate. While a variance analysis is a useful tool in monitoring expected revenues, it does not confirm the accuracy of the reports.
9. Our observations, as stated in the report, confirmed that PANYNJ's monitoring of the advertising activities was deficient. We are pleased to learn that PANYNJ hopes to improve its monitoring with the implementation of the new advertising contracts.
10. We are pleased that PANYNJ has taken action to correct the condition.
11. Despite repeated requests, PANYNJ did not provide documentation that these factors were considered for the leases we reviewed.
12. PANYNJ did not provide information about the use of the space. Simply stating that it was for "airport use" without further documentation is insufficient. Moreover, if the property was for private and not public use, it presents a question as to whether the tax exemption should be allowed. We also note that the City of Elizabeth was not notified of the change in use.
13. While PANYNJ is willing to use exempt property for a private company use, which it claims is for airport use, PANYNJ disagrees that it should request an exemption for the parking lot that was clearly for its use. The parking lot was used for three years. We note that tax exemptions can be granted and removed by the City's real estate processes.

14. We did not recommend that the landlord be "required to condominium-ize." We recommended that PANYNJ request that the owners determine the feasibility of converting the properties to condominiums.

15. It is a fact that PANYNJ's RED did not have formal procedures for the leasing of properties. We requested procedures in January 2019, and there weren't any in writing. At our request, the RED prepared and provided a document in May 2019 of the process it claimed to follow.

Contributors to Report

Executive Team

Tina Kim - *Deputy Comptroller*

Ken Shulman - *Assistant Comptroller*

Audit Team

Carmen Maldonado - *Audit Director*

Abe Fish - *Audit Manager*

Daniel Raczynski - *Audit Supervisor*

Daniel Bortas - *Examiner-in-Charge*

Monique Clarke-Taiwo - *Senior Examiner*

Peter Teelucksingh - *Senior Examiner*

Contact Information
(518) 474-3271
StateGovernmentAccountability@osc.ny.gov
Office of the New York State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236