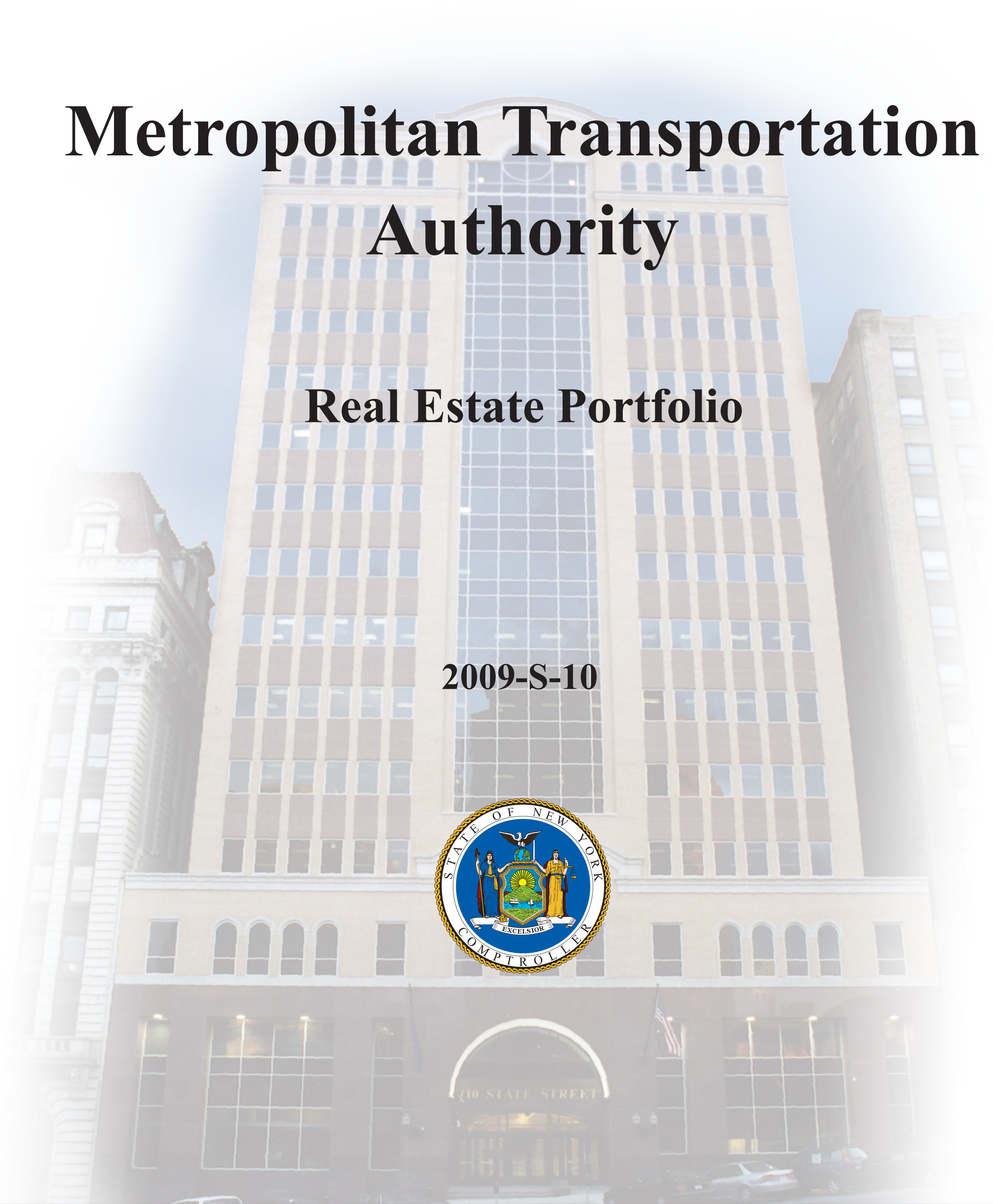
Office of the New York State Comptroller

Division of State Government Accountability



Metropolitan Transportation Authority

Real Estate Portfolio

2009-S-10

Thomas P. DiNapoli

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Office of the State Comptroller

Division of State Government Accountability

June 30, 2010

Mr. Jay Walder
Chairman and Chief Executive Officer
Metropolitan Transportation Authority
347 Madison Avenue
New York, NY 10017-3739

Dear Chairman Walder:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing 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 of the MTA's *Real Estate Portfolio.* This audit was performed pursuant to the State Comptroller's authority under Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law.

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,

Office of the State Comptroller
Division of State Government Accountability

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objectives

Our objectives were to determine whether the Metropolitan Transportation Authority (MTA) fully and accurately accounts for its real estate holdings, has established a value for those holdings, and manages the holdings in a manner that maximizes revenue opportunities.

Audit Results - Summary

The MTA, which provides public transportation in and around the New York City metropolitan area, has a vast portfolio of real estate and related property rights under its control. Like other public authorities in New York State, the MTA is required by law to publish, at least annually, a report listing all its real property. However, we found that the MTA does not publish such a report. As a result, the MTA's vast real estate holdings have not been subject to the intended level of public accountability and transparency.

The MTA's Real Estate Department attempted to provide us with a complete and accurate listing of the MTA's real estate holdings, but was unable to do so, as the listing contained numerous omissions and inaccuracies. For example, 148 rental units listed as vacant were in reality not presently owned by the MTA. Part of the reason for the omissions and inaccuracies is the fragmentation of the MTA's real estate records, as the MTA has no single system to account for its portfolio of real estate assets. We recommend the MTA improve its real estate records and publish the property listing required by law.

While the MTA estimates the current value of some of its real estate holdings, it makes no attempt to estimate the value of many holdings. We recommend the MTA establish a value for all its real estate holdings and record that value in its real estate records.

The MTA leases space in its buildings to retailers and other tenants, sells advertising space in its buildings and trains to businesses, and leases and licenses portions of its properties for various uses. According to the MTA, the rental revenue from these activities totals about $199 million annually. We identified a number of opportunities for the MTA to increase it revenues and reduce its costs, and thus increase its net income, from its real estate operations.

For example, many of the rental units that were vacant at the time of our audit had not been actively marketed by the MTA, even though some of the units had been vacant for years. For example, six large rental units in the 42nd Street/Sixth Avenue subway station at Bryant Park had been vacant since the property was renovated in 2004. We recommend that the MTA more actively market such units and develop a strategic marketing plan to guide its marketing efforts. We also found that the MTA does not always market its rental units competitively to ensure that the rents paid are in line with market values, and does not charge interest and late fees when rent payments are late. At the time of our audit, approximately 1,000 of the MTA's tenants had been in arrears on their rent for more than one month.

We further found that the MTA has not tried to sell the rights to the space above certain of its properties, even though a consultant hired to find revenue-generating real estate disposals valued the rights at more than $12 million; has spent more than $6 million to maintain one vacant and one nearly vacant building, because the renovation of one building and sale of the other have been delayed; pays more than $600,000 a year in real estate taxes on properties it leases from others, without trying to exercise its status as being exempt from such taxes; and routinely leases space from others at an annual cost of about $25 million without documenting whether its own vacant space would meet its needs.

Our report contains a total of 12 recommendations for improving the MTA's real estate operations.

MTA officials replied to our report that the new Chairman and CEO has mandated an overhaul of the way MTA does business, reducing costs and increasing efficiency in every part of our operation. This new way of doing business is equally important for their real estate operations. They indicated MTA Real Estate generates a significant amount of revenues, but they must do more to identify new opportunities to maximize revenue potential and be prepared as the economy improves. They stated that because they are in the midst of an overhaul, our draft audit report of Real Estate Department (RED) practices is a timely one. However, they do not agree with all of our recommendations.

This report, dated June 30, 2010, is available on our web site at: http://www.osc.state.ny.us.
Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
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Introduction

Background

The Metropolitan Transportation Authority (MTA) provides public transportation in and around the New York City metropolitan area. The MTA includes the following seven constituent agencies:

- New York City Transit (Transit), which operates the New York City bus and subway systems.
- The Long Island Rail Road (LIRR), which operates a commuter railroad between New York City and Long Island.
- Metro-North Railroad (Metro-North), which operates a commuter railroad between New York City and parts of upstate New York and Connecticut.
- The MTA Bus Company, which provides bus service in certain parts of New York City.
- Long Island Bus, which provides bus service on Long Island.
- MTA Bridges and Tunnels, which operates seven bridges and two traffic tunnels in New York City.
- MTA Capital Construction, which manages certain MTA capital projects.

The MTA is governed by a Board of Directors, whose 17 members are nominated by the Governor and confirmed by the Senate. The MTA also includes a Headquarters, which provides administrative support for the seven constituent agencies. MTA Headquarters and the constituent agencies account for an annual operating budget of about $12.9 billion, including salaries for about 71,700 employees.

The MTA and its constituent agencies have a vast portfolio of real estate and related property rights under their control. Included among these real estate holdings are buildings, commuter parking lots, retail establishments, billboards for advertisements, the right to make use of the space above certain properties (air rights), and others. The MTA's inventory of real estate holdings lists hundreds of units of property and property rights. The MTA has not estimated the total current value of these units.

MTA Headquarters includes the MTA Real Estate Department, which has overall responsibility for managing the MTA's real estate portfolio. This includes acquiring properties as well as licensing, leasing and selling properties. The Real Estate Department has a staff of 52 with an associated annual budget of about $12.4 million including $5.2 million in payroll costs. The Real Estate Department also contracts with six firms to perform certain marketing and tenant management duties at various locations, at an annual cost of about $6.9 million. For example, one firm provides management services at Grand Central Terminal, while another firm provides administrative, billing, accounting, site management and inspection services for various other properties.

Audit Scope and Methodology

Our audit objectives were to determine whether the MTA fully and accurately accounts for its real estate holdings, has established a value for those holdings, and manages the holdings in a manner that maximizes revenue opportunities. Our audit scope covered the period January 1, 2005 through August 31, 2009. To accomplish our audit objectives, we interviewed officials from the MTA Real Estate Department, as well as employees of the tenant management firms contracted by the Real Estate Department (RED). We also reviewed Real Estate Department Policies and Procedures for Licensing-Out, Leasing-Out and Sale of Real Property. In addition, we visited and observed selected MTA properties, and analyzed documentation and data provided to us by the Real Estate Department and the tenant management firms. Our sampling methodologies are described in the body of the report.

We conducted our 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.

Authority

We performed this audit pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Section 2803 of Public Authorities Law.

Reporting Requirements

A draft copy of this report was provided to MTA officials for their review and comment. Their comments were considered in the preparation of this final report and are included at the end of this report.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Metropolitan Transportation Authority shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Contributors to the Report

Major contributors to this report were Carmen Maldonado, Robert Mehrhoff, Erica Zawrotniak, Daniel Raczynski, Nancy Zgaljardic, Elizabeth Norniella, Lillian Fernandes, and Dana Newhouse.

Audit Findings and Recommendations

Accountability and Transparency for Real Estate Portfolio

According to Section 2896 of the New York State Public Authorities Law, each public authority is to publish, at least annually, a report listing (1) all its real property and (2) all the real property disposed of during the reporting period, with the sale price and name of the purchaser for each property.

We examined whether the MTA was complying with this requirement and found that it was not. While the MTA had published a report on property disposals for 2005, 2006, 2007 and 2008, it had not published a report listing the real property under its control for any of these four years. As a result, the MTA's vast real estate holdings have not been subject to the intended level of public accountability and transparency. MTA officials told us that they were not aware of this reporting requirement. We recommend the MTA comply with this requirement in the future.

During our audit field work, the Real Estate Department attempted to provide us with a complete and accurate listing of the MTA's real estate holdings, but was unable to do so. For example, the listing provided by the Real Estate Department contained the following omissions and inaccuracies:

Three properties, with a total of 23 tenants, were not included on the listing. The three properties are located at 2 Broadway (12 tenants), the Battery Park Garage (4 tenants), and 525 North Broadway in White Plains (7 tenants). Real Estate Department officials said that the three properties were not included on the listing because the listing was generated from the Real Estate Department's database of MTA real estate holdings (called YARDI), and the three properties are recorded on other databases maintained by the contracted tenant management firms.

When we compared the information on the listing to the New York City Department of Finance website that listed MTA-owned property, we identified one more property that was not included on the listing and five others for which data on the listing was incorrect (e.g., the lots were incorrectly identified).

Four units recorded as vacant on the listing were not, in fact, vacant, as they were being leased by the MTA from other entities.

A total of 148 other units listed as vacant were in reality either "dummy" records or units that were no longer owned by the MTA.

Many of the MTA's properties are actually owned by New York City, and are being used by the MTA in accordance with the terms of a Master Lease Agreement between the MTA and New York City. These properties were originally owned by Transit before it became a part of the MTA, when Transit was still controlled by New York City. However, the MTA's listing of real estate holdings does not indicate which properties are covered by the Master Lease Agreement. This is a significant omission, because the properties cannot be sold by the MTA, but instead revert to New York City when the MTA no longer needs them. The properties not covered by the Master Lease Agreement belong to the MTA and can be sold by the MTA where appropriate.

Part of the reason for these omissions and inaccuracies is the fragmentation of the MTA's real estate records. The MTA has no single system to account for its portfolio of real estate assets. Rather, there are five separate database systems: the YARDI database maintained by the Real Estate Department and four other databases maintained by the contracted tenant management firms. Since the five databases do not readily share information, there is no single, authoritative listing of the MTA's real estate holdings.

MTA officials stated that it would be duplicative to include information from the tenant management firms' databases on the YARDI database. However, we believe that to help fulfill the real estate reporting requirements of the Public Authorities Law and to facilitate various aspects of the management of MTA properties, it would be beneficial for the MTA to have a single, authoritative database.

We also note that the Real Estate Department (RED) does not record the value of the MTA's real estate holdings on the YARDI database. MTA officials stated they do not always attempt to estimate the value of their property, and do not attach much importance to any estimates that are developed, because the true value of the property is only what is actually offered by an interested party at the time it is put up for sale. Another method that could be used is an assessment of its property by the New York City Department of Finance. We acknowledge the uncertainty of property appraisals and other such estimates, but note that they are an accepted practice and, if done properly, provide a reasonable indication of a property's value.

Recommendations

1. Assign and train staff to ensure that the MTA is in compliance with the requirement in the Public Authorities Law to publish a listing of its real estate property holdings.

(MTA officials replied to our draft audit report that they submitted the list of real estate property holdings in March 2009 and again in March 2010. They added that additional training is not needed to enable the MTA to continue to satisfy the requirement.)

Auditor's Comments: We contacted MTA officials and the listing for March 2009 and March 2010 were posted to the website on June 8, 2010.

2. Correct the real estate database inaccuracies and omissions noted in this report, and monitor the database to ensure that it remains accurate and complete.

(MTA officials replied to our draft audit report that their database, YARDI, will continue to be updated and monitored for completeness and accuracy, as it has been in the past. They indicated that 2 Broadway, the Battery Parking Garage, and 525 North Broadway are not "missing" from YARDI and it is unreasonable to suggest that the RED has lost track of such properties. They added that the errors identified by the audit were corrected. They also indicated that instead of referring to certain units as "vacant" they will use the term "inactive" when units are not "presently owned by the MTA." Regarding the New York City/New York City Transit (NYC/NYCT) master lease, officials indicate they have a list of 62 NYCT properties which the MTA owns, all of which have been purchased since 1985.)

Auditor's Comments: We are pleased that MTA has taken some corrective actions regarding the YARDI listing. We did not say that the properties at 2 Broadway, the Battery Parking Garage, or 525 North Broadway are "missing" or that RED lost track of them. We said the properties were not included on the listing. The list of 62 properties referred to was not provided to the auditors.

3. Implement a single MTA real estate portfolio management system identifying all properties along with their value and other important identifying information to improve the MTA's control over these properties and its access to information about the properties.

(MTA officials replied to our draft report that they will consider creating linkages between YARDI and their contractors' databases, and/or require all future MTA tenant management contractors to use YARDI as Greystone does, only if they determine such changes to be cost-effective. Officials also commented that it is unfounded to suggest that the properties would not be successfully managed without one complete list. In addition, officials cited several reasons why it would not be productive to include valuation data for all properties.)

Auditor's Comments: We did not state that the properties would be unsuccessfully managed without one complete listing. We said that to help fulfill the real estate reporting requirements of the Public Authorities Law and to facilitate various aspects of the management of MTA properties, it would be beneficial for the MTA to have a single, authoritative database. We acknowledge the difficulties and limitations of providing valuation information for all MTA properties. We urge the MTA to consider obtaining appraisal and valuation where it is appropriate to do so in keeping with "its new way of doing business" and funding of Capital Programs through the sale of assets.

Maximizing Revenue Opportunities

We identified a number of opportunities for the MTA to increase its revenues and reduce its costs, and thus increase its net income from real estate operations.

Rental Revenue

The MTA leases space in its buildings to retailers and other tenants, sells advertising space in its buildings and trains to businesses, leases commercial parking lots to parking lot operators, leases parking spaces at stations to taxis, leases portions of its property to public utilities, and licenses other portions for particular uses. According to the MTA, the rental revenue from these activities totals about $199 million annually. We examined the actions taken by the Real Estate Department in marketing vacant rental units and establishing the amount of rent for those units, and found that there are opportunities for the MTA to increase its net rental income.

Vacant Units

We found that many of the rental units that were vacant at the time of our audit had not been actively marketed by the Real Estate Department, even though some of the units had been vacant for years. For example, according to information provided by the Real Estate Department, as of March 2009, 600 rental units were vacant, excluding newspaper boxes. We found only three of those units had been marketed on the MTA's website, although some may have been marketed by other means.

MTA officials stated that some of the units already have scheduled Request for Proposal (RFP) dates in the near future, but many others are not readily marketable because they can only be used by an adjacent owner, lack utilities, are needed by the MTA, or have other impediments. Officials also stated that there are only a few genuine marketing opportunities among the list of vacant rental units. For example, they noted that 50 of the units were taxi parking and retail/food units that would be low revenue generators and did not have sufficient income potential to warrant full marketing efforts absent other considerations. We note that the smaller units could be posted to a map on the Real Estate Department's web page, and linked to an offer sheet containing terms and information for that property. A good example of this type of marketing can be found on the website of the Chicago Transit Authority. The officials agreed that they would review the units to determine if any could be bundled to create marketing opportunities.

(In response to the draft audit report, MTA officials agreed that the MTA website should be used to market all properties that are publicly offered for lease or license.)

We also selected a judgmental sample of 21 of the vacant units of various types and reviewed the files to determine how long they had been vacant, and whether marketing efforts were underway. Most of these units have been vacant for an average of 6 years with the longest standing empty for 14 years. We found 11 of the 21 units had not been marketed by the Real Estate Department, while six units had been marketed on the internet or by other means. Due to a lack of supporting documentation, we could not determine whether the remaining four units had been marketed.

MTA officials explained that different priorities are put on vacant units, and that units that have the opportunity to generate the highest revenue are marketed first. They acknowledged that one of the eleven unmarketed units needed to be marketed and indicated that it was now slated to be marketed. They stated that the remaining ten units were not marketable for various reasons, such as because the unit was a "phantom" unit that did not really exist, had safety issues, needed environmental remediation, was a newspaper box (which is typically marketed by placing a flyer in the front glass of the box), or was a Master Lease Agreement property that was being surrendered to New York City. We agree that some units may not be marketable at this time. However, some of these units could have been marketable if the MTA had taken timely and appropriate corrective actions, such as addressing the safety issues and providing the needed environmental remediation.

When we visited selected vacant rental units, we identified six large units in the 42^{nd} Street/Sixth Avenue subway station at Bryant Park that had been vacant since the station was renovated in 2004. The Real Estate Department had not attempted to market these units because a heating, ventilation and air conditioning (HVAC) system had not been installed in the underground space containing the rental units. We acknowledge the difficulty of marketing such space, but question why the HVAC system, which was estimated to cost less than $1 million, was not installed when the station was renovated at a reported cost of $19.6 million. We also question why other alternative marketing efforts have not been actively pursued, such as negotiating a rent with an incentive for the vendor to install air conditioning in exchange for occupancy, marketing the units to vendors in nearby Bryant Park for use in the winter months when air conditioning would not be needed, or marketing the units' storefronts as advertising space (as was done for the 2009 New York Marathon, and which reportedly generated $50,000 in revenue for the MTA over a period of a month).

(In response to our draft audit report, MTA officials stated that potential for revenue generation at the station is marginal and would not justify the cost of the HVAC system. They added their belief that prospective tenants would not find it cost effective to install the system in exchange for rent abatement incentives. They further commented that other alternative marketing strategies have been pursued for these units through discussions with its advertising licensees, but without success to date.)

Auditor's Comments: We reiterate that the HVAC investment was estimated to cost less than $1 million while the overall station renovation cost a reported $19.6 million. We were not provided with any marketing analysis supporting the MTA's claims that installation of the HVAC system or a partial rent abatement plan to induce tenants to pay for the system were not cost justified alternatives. Similarly, we were provided with no documentation to support the pursuit of alternative marketing strategies.

A strategic marketing plan would help the Real Estate Department ensure that such actions were appropriately considered and any impediments to a rental unit's marketability were addressed. However, the MTA has not developed a strategic marketing plan for its real estate portfolio.We recommend the MTA develop such a plan, ensure that the plan contains provisions for removing impediments to rental units' marketability, and ensure that adequate efforts are made to market all vacant units. At the closing conference, MTA officials indicated that the current real estate market is proving a challenge to their mission. We believe a strategic marketing plan would help the MTA meet this challenge.

We also note that more could be done to market vacant newspaper boxes on LIRR and Metro North, which cost $1.3 million to install and maintain. We found 851 of the 1,385 modular boxes on train platforms (61 percent) were vacant at the time of our audit, and there were no marketing flyers in the front glass of any of the vacant boxes we observed during our site visits. MTA officials cited a declining interest in newspapers and noted that the boxes were installed primarily to clean up the stations.

(In response to the draft audit report, MTA officials did not agree that more could be done to market the vacant newspaper boxes. However, officials indicated that they will reach out to vendors again to determine if there is any additional interest.)

Competitive Rental Rates

We also found indications that the amount of rent charged by the MTA may not always be as high as it could be. For example, we selected a judgmental sample of 101 various types of occupied rental units and examined the files to determine whether the units had been marketed through one of the competitive processes required by the MTA's Policies and Procedures for Licensing-Out, Leasing-Out, and Sale of Real Property (Policies and Procedures). For 74 of the 101 units, we found either that one of the required competitive processes was used (57 units) or that there was a valid reason for not using one of these processes (17 units). However, for 26 of the remaining 27 units (the rental of one unit was still pending), no documentation exits to explain why one of the required competitive processes was not used. As a result, there is no assurance these units are being rented for a fair market price.

The Policies and Procedures also require that the market value of a rental unit be determined before the unit is offered for rent. However, we found that this had been done, either by an outside assessor or through an in-house analysis, for 20 of the 101 rental units in our sample. Real Estate Department officials stated that the rental amount is usually set by other means, and a fair market analysis is usually not performed because the actual market rent will be determined when an RFP is issued and offers for the unit are submitted. We note that a fair market analysis is required by the MTA's own Policies and Procedures. Such an analysis is useful, because it helps ensure that the MTA only accepts proposals that do, in fact, reflect the fair market value of the units being rented. In the absence of this analysis, there is an increased risk the MTA could be charging rents that are too low.

Late Rent Payments and Nonpayments

MTA arrears reports show that about 1,000 tenants are in arrears by a total of $52 million (as of various dates between March and May 2009). Of this amount, $43 million is owed by another government entity and the MTA is in the midst of a settlement for this amount. The remaining $9 million is owed by non government tenants. While MTA has a process to pursue arrearages, the MTA does not provide for the assessment of interest or late payment fees, even in cases where the terms of the lease so provide. As a result, there may be no cost to the tenant for the failure to pay rent owed to the MTA. We recommend that interest and late fees be assessed when rent payments are late.

We also determined that the Real Estate Department generally does not assess any monetary penalties when tenants are found to be in default of their lease agreements (e.g., tenants are not penalized if they occupy a rental unit before the lease takes effect; in fact, they may not even be charged rent for the early occupation, as the Real Estate Department made no effort to collect rent for 41 days, at least, of early occupation by a tenant that we found to be occupying its unit early). We recommend the Real Estate Department assess monetary penalties, when appropriate, on tenants that are in default of their lease agreements.

Other Revenue

We also determined that the MTA's rental revenue could be increased if the following improvements were made in its leasing practices and internal controls:

- If a tenant's lease expires, the tenant may remain on a month-to-month basis until an RFP is issued. Such tenants are considered holdovers and are supposed to be routinely charged a 5 percent rent increase until the RFP process is completed and there is a new lease. However, we found that some holdover tenants were charged less than 5 percent, because the standard holdover clause was not for this amount or was not applied to the tenants' new rent. This occurred for 6 of the 24 holdover tenants in our sample of 101 occupied units. In addition, because of delays in issuing RFPs for new leases, some tenants remain holdovers for years. The 24 holdover tenants in our sample had been holdovers for an average of 4 years, and as long as 14 years. We recommend that the standard 5 percent holdover clause be included in all leases, that this increase be applied and collected, and that the delays in RFPs be reduced.
- In one of the leases in our sample, a 20-year lease for restaurant space in Grand Central Terminal, the MTA reduced the tenant's future rent payments by $1,737,500 and paid the tenant an additional $625,000 because certain provisions in the lease were not met by the MTA. The MTA was required by these provisions to keep the tenant's space, which is an open balcony, within a certain temperature range. However, after the lease was in effect, the MTA determined through an engineering study, that it may not be possible to keep the space

within that temperature range. There was no evidence the MTA had conducted such a study before accepting the tenant's request for the lease provisions. We recommend the MTA ensure such special lease provisions are, in fact, practicable before it commits to them.

- The MTA receives more than $100 million annually from the sale of advertising space in its buildings and trains. The MTA receives this revenue from advertising firms, which represent the businesses being advertised. Generally, the MTA receives either the higher of an annual guaranteed amount from the advertising firms or a percentage of the firms' gross receipts from their clients. The firms are required to submit an annual CPA-certified gross receipts statement within 60 days of the end of the year, and the MTA is to review the statements to ensure that the rental payments for the year are appropriate. However, we found that the statements are not always reviewed by the MTA and are not always submitted on time (e.g., one of the three advertising firms in our sample did not submit its certified statements for calendar years 2007 and 2008 until September 2009). We recommend the MTA ensure that these certified statements are submitted on time and are reviewed to verify the appropriateness of the advertising firms' payments.

Sales Revenue

According to the MTA's Policies and Procedures, the Real Estate Department's marketing objective is to ensure the greatest level of revenue generation and other potential benefits to MTA. However, we found that 3 of the 12 properties sold by the Real Estate Department during the period covered by our audit were not sold in a manner that was consistent with this objective.

Two of the properties were "sold" for $0, as they were transferred, for free, to other government entities. One property (in East Williston) was transferred to the Village of East Williston for use as a public pavilion. The other property (in Amenia) was transferred to the State Department of Environmental Conservation to facilitate access to a public fishing area. The East Williston property was appraised at $90,000 and the Amenia property was purchased by the MTA for $220,000 in 2000 to extinguish a private grade crossing.

While the two properties are being used for public, and not private, purposes, we question whether they should have been transferred for free. Such transactions could give rise to an appearance of favoritism and are not in the financial interest of the MTA. We recommend the MTA charge a reasonable sale price for such properties.

We also recommend the MTA ensure that the sale contracts in such transactions include a clause requiring the reversion of the title to the

MTA should the purchaser use the property for a purpose other than that specified in the contract. MTA officials told us such clauses are not always included in these sale contracts, and even when they are, the MTA does not follow up to ensure that the properties are, in fact, being used for the public purposes originally specified. We recommend the MTA perform such follow-up.

The third property (a portion of the West Side Yard) was valued at $487 million in an appraisal. After negotiating with New York City, the MTA sold a 50 percent interest in this property to the City, for use in an economic development project. However, rather than selling this 50 percent interest for half the appraised value of the property ($243 million), the MTA accepted a price of $200 million, plus additional compensation if the City sells the development rights to a private developer for more than $200 million. While the MTA may eventually realize the additional $43 million, if the eventual sale price is high enough, it is also possible that it may not. We question whether the MTA "ensure[d] the greatest level of revenue generation" for itself in this transaction and recommend that properties that are to be sold to private interests not be sold for significantly less than their appraised value.

We also determined that the MTA has taken no action to realize potentially significant sale revenue from its air rights (the space above certain of its properties; e.g., platforms may be constructed over railroad tracks, and commercial buildings may be built on those platforms). A consultant hired by the MTA in 2006 to find potential revenue-generating real estate disposals identified 72 MTA-owned parcels in New York City with air rights valued at $12.2 million (Additional air rights were also identified outside New York City.) However, the MTA has made no attempt to sell these rights. Real Estate Department officials indicated that there would not be a market for the air rights in the current economy, but they have neither documented this determination nor set a date when they will revisit the opportunity to sell the air rights.

Avoidable Costs

We identified ways in which the MTA could reduce its real estate-related costs, and as a result, increase its net income from its real estate operations. First, because of delays in the MTA's efforts to renovate or sell its buildings, it sometimes incurs significant maintenance costs for buildings that are either entirely, or almost entirely, vacant.

For example, in July 2004, the MTA began moving employees out of its former Headquarters in Brooklyn so that it could renovate the building. All the employees were moved out by July 2007, leaving the building vacant, and since that time, the MTA has spent $2.88 million a year, and $5.76 million in total as of July 2009, to operate the building while it awaits renovation.

The renovations have been delayed because funding for the work has yet to be approved by the MTA Board (the funding was initially denied when it was part of the MTA's 2005-2009 Capital Plan, and is being reconsidered as part of the 2010-2014 Capital Plan). We note that the MTA also spent $1.4 million a year to lease temporary office space for the employees who were moved out of the building.

MTA officials stated that if they do not obtain approval to fund the renovations for this building, they will consider other options, including returning the building to New York City under the Master Lease Agreement. We recommend MTA officials act promptly to either make use of, or dispose of, this building.

Similarly, the MTA plans to sell a building it owns in Mineola. As of December 2008, only four tenants lease space in the building. However, the sale was delayed because of problems with the buyer's funding. Since the MTA's costs to operate the building ($493,655 a year) exceed the rent paid by the four tenants ($234,390 a year), the MTA is losing $259,265 a year to operate this building. MTA officials told us that they expect the building sale to be finalized in the near future. We recommend the officials set a deadline for the sale and remarket the property if the delays continue.

We also found that the MTA is paying real estate taxes on some of the properties it leases, even though it is, by law, exempt from paying such taxes. We selected a judgmental sample of 14 of the 126 properties leased by the MTA (judgmentally selecting some of the larger properties) and determined that the MTA has paid real estate taxes on 6 of these 14 properties. The taxes paid on the six properties totaled $3.9 million over the life of the leases (between 2003 and 2009 for four of the leases, between 2001 and 2009 for one lease and for 2009 for the sixth lease). We further determined from MTA records that the MTA is paying $619,000 annually in such real estate taxes (including $338,244 on one property).

In response to our preliminary audit findings, MTA officials stated that the Real Estate Department "vigorously seeks to implement its exemption from real estate taxes in every situation in which such exemption is applicable." The officials also provided letters sent to municipalities seeking a tax exempt status on three properties. However, these three properties were not included in our sample of 14 properties; also, the letters were sent in September and October 2009 for two leases that were entered into in 1996 and one that was entered into in 2006. The officials further stated that, in their opinion, the MTA cannot claim such tax exemptions when it rents only a portion of a landlord's property.

We note that the MTA does not have any written policies or procedures regarding such real estate taxes. We recommend the MTA develop such policies and procedures, request exemption from such taxes for every leased property, and maintain documentation of these requests.

We further found that the MTA may unnecessarily be leasing space from others when its own vacant space would meet its needs. The MTA spends about $25 million a year to lease space from others. According to MTA officials, prior to leasing such space, the MTA constituent agency should assess whether vacant MTA-owned property could meet its need for space. However, we found no indication such assessments were being performed.

We selected a judgmental sample of 15 such leases, selecting the leases with the highest rent payment amounts (the rent payments on these 15 leases totaled about $18.2 million annually), and reviewed the files relating to these leases. We found no documentation showing that MTA officials assessed MTA-owned property prior to entering into the leases. Real Estate Department officials stated that the constituent agency is responsible for making this assessment, but officials at the constituent agencies stated that they rely on the Real Estate Department to perform such assessments.

Since such assessments are not being performed, there is no assurance the MTA is minimizing its rental expenses and making the best use of its own vacant space. We recommend written procedures be developed requiring the Real Estate Department to perform such assessments, and the performance of the Real Estate Department be monitored to ensure that the assessments are being performed.

Recommendations

4. Develop a strategic marketing plan. Ensure that the plan contains provisions for removing impediments to rental units' marketability and that adequate efforts are made to market all vacant units. In addition, as part of the plan, consider marketing smaller rental units on the internet like the Chicago Transit Authority, and increase efforts to market vacant newspaper boxes.

   (In replying to our draft audit report, MTA officials replied they will consider developing a "strategic marketing plan" for their vacant retail units, but do not anticipate that doing so would fundamentally alter their understanding of the portfolio they are managing. They added that for the past ten years RED-administered revenues have increased. They question the use of "phantom" when referring to units as it creates the impression that a unit was lost or intentionally hidden from view, whereas there is a good reason why the units were not marketable. Furthermore, they state that they were able to locate all of the documents in the four files once they were returned by the auditors.)

Auditor's Comments: We continue to maintain that a strategic marketing plan would provide added assurances that the MTA is managing the real estate portfolio to obtain the best results. As MTA officials stated in the opening paragraph to their response to the draft audit report; "We must be creative and identify new opportunities to maximize this revenue potential so that we are prepared to move forward as the economy improves." We also point out that "phantom" is a label used by RED and did not originate with the auditors. Contrary to the response, we requested the information from the folders and on November 17, 2009, received an email stating: "There is no further information."

5. Monitor the actions of the staff in Real Estate Department to ensure that all rental units are marketed through one of the competitive processes required by the MTA's Policies and Procedures, and the market value of all rental units is determined before the units are offered for rent.

   (MTA officials replied to our draft report that staff actions will be subject to review and multiple approvals by supervisors, as well as, ultimately, MTA Board approval. RED recently substantially revised it leasing-out manual, in part to conform with recent amendments to the Public Authorities Law, and is fully committed to conducting all of its marketing efforts in accordance with applicable law and policies.)

6. Improve leasing practices by ensuring that:

   - the standard holdover clause of 5 percent is included and collected from all lease agreements and RFPs are issued for expired leases as soon as possible,
   - all special lease provisions requested by tenants are practicable for the MTA, and
   - advertising firms' certified statements of receipts are submitted on time and are reviewed to verify the appropriateness of the firms' payments for their advertising space.

   (MTA officials replied to our draft audit report that they apply the 5 percent holdover clause where applicable. Where it is not in lease they have been working to issue new RFPs for those properties and the resulting new agreements include the 5 percent holdover clause. They also provided explanations for the 10 holdover tenants that did not receive 5 percent increases. MTA officials agreed they should ensure all special lease provisions are practicable for the MTA and that advertising firms certified statements should be submitted on time.)

<u>Auditor's Comments</u>: We reviewed the explanations for the 10 properties and concluded that four of them are with constituent agencies, and, as such appear to be exempt from the 5 percent holdover clause. The rent for these properties was approved by the MTA Board on July 28, 1999. Our final report has been modified to reflect 6 exceptions rather than the 10 exceptions cited in our draft audit report. For the remaining six properties the 5 percent should have been applied. Although the response indicated that 2 of the 6 properties were considered to be exempt from the 5 percent, RED did not provide documentation to support the statements.

7. Improve rent collection practices by:

- establishing and enforcing a policy requiring interest and late fees to be assessed when rent payments are late by a certain number of days,
- collecting rent from tenants that occupy rental units before the lease takes effect, and
- routinely inspecting vacant units that are scheduled for future occupation to ensure that they are not being occupied before a new lease takes effect.

(MTA officials replied to our draft audit report that, excluding out-of-the-ordinary and broad-ranging disputes, in 2009 the RED collected approximately 96 percent of the aggregate amount owing under the agreements it administers, which they indicate compares favorably with other real estate operations. They added that most existing RED agreements already include a provision that allows the MTA to charge interest on unpaid rent. They agree that RED should more routinely enforce such provisions, and the RED also intends to consider providing for monetary penalties for specified non-monetary defaults. However, MTA officials point out that enforcement commonly results in litigation that can be disproportionately costly compared with amounts requiring collection. Therefore, MTA requires latitude to exercise discretion in connection with such efforts. The MTA is evaluating the cost-effectiveness of installing a "YARDI Portal," which would enable tenants to make payments by credit card or automatic bank transfers. MTA did not dispute the need to collect rent from tenants that occupy space before leases take effect or the need to routinely inspect vacant units to ensure they are not occupied before a new lease takes effect.)

8. Maximize the revenue from the disposal of property by:

   - charging a reasonable sale price for property that is transferred to another government entity for public use, ensuring that the sale contract includes a clause requiring the reversion of the title to the MTA should the purchaser use the property for a purpose other than that specified in the contract, and following up to ensure that the property is being used for the public purpose originally specified; and

   - ensuring that properties that are to be sold to private interests are not sold for significantly less than their appraised value.

(MTA officials replied to our draft audit report that from time to time, as contemplated by Section 2897 of the Public Authorities Law, the MTA disposes of property, not required for its corporate purposes, to municipalities or other public agencies for the benefit of the public. They restated their position that the transfer of two of the three properties at no cost to the municipalities was justified and that the $90,000 value ascribed to one property was theoretical. They agree that appropriate deed restrictions, should and under the Public Authorities Law, as amended, must be employed where sales to public entities are predicated on agreements that they will only be used for public purposes. However, they do not believe that they have to police such deed restrictions. Regarding the West Side Yards property they stand behind the decision because of the financial benefit to the City.)

<u>Auditor's Comments</u>: We reiterate that, according to the MTA's Policies and Procedures, the Real Estate Department's marketing objective is to ensure the greatest level of revenue generation and other potential benefits to the MTA. We question how the disposal of the two properties in question for no monetary consideration is consistent with this objective. Also, it is interesting to note that the MTA would refer to an appraisal that it paid for as "theoretical" simply because the property was deemed not developable unless combined with a parking lot which, as a matter of fact, was already owned by the acquiring municipality. Again, as stated in the audit report, we also question how the transaction for the sale of the West Side Yard property for less than the appraised value with contingencies for additional revenue based on the sale of the property by the City of New York to a private developer is fully consistent with the specified Policies and Procedures objective.

9. Formally evaluate the marketability of the MTA's air rights. If the air rights are found to be marketable, promptly act to market the rights. If the rights are found to be unmarketable at the present time, document the reasons for this determination and set a date to re-evaluate their marketability.

   (MTA officials replied to our draft audit report they have evaluated and will re-evaluate from time to time, the marketability of air rights associated with its properties and when market conditions are favorable the MTA will aggressively market air rights that it believes to be marketable. They noted several conditions and circumstances that impact on the marketability of air rights. Also, they commented that the $12 million of aggregate value that the consultant ascribed to development rights proved speculative, as the consultant was unable to generate any interest whatsoever.)

   <u>Auditor's Comments</u>: We note that no information regarding the evaluation of air rights was provided during our audit. Also, the consultant's "green light" to market the air rights expired in 2007. Particularly as the economy emerges, we urge the MTA to be expeditious in its efforts to re-evaluate the marketability of air rights.

10. Act promptly to either make use of, or dispose of, the Brooklyn building cited in our report. Set a deadline for the sale of the building in Mineola, and remarket the property if the delays in the sale continue.

    (MTA officials replied to our draft report that no action can be taken regarding 370 Jay Street in Brooklyn until the Proposed MTA 2010-2014 Capital Program is approved. The sale of the building in Mineola may be completed in July 2010 or not until January 2011. In the interim, the MTA continues to receive payments from the purchaser and if the sale is not completed, the purchaser forfeits all of the money paid and the property will be re-marketed.)

    <u>Auditor's Comments</u>: In June 2010, subsequent to MTA's response, the 2010-2014 Capital Program was approved by the State and includes funding for the 370 Jay Street building. However, without provision of capital funding three years ago, MTA has incurred millions of dollars of carrying costs for the Brooklyn property. Regarding the Mineola building, we are pleased to learn that the MTA has set a January 2011 deadline for the sale.

11. Develop written policies and procedures requiring the Real Estate Department to request an exemption from real estate taxes on all properties leased by the MTA and to maintain documentation of these requests.

(MTA officials replied to our draft audit report they seek to implement their exemption from real estate taxed in every situation where such exemption is applicable.)

Auditor's Comments: The response does not address the recommendation which calls for committing to writing the actions MTA officials claim they take "where such exemption is applicable" and retaining documentation of these requests. We reiterate the need to establish procedures and to document compliance.

12. Develop written procedures requiring that no lease for space be entered into until the Real Estate Department determines whether vacant MTA-owned property can meet the need for space. Require that this determination be documented, and monitor the performance of the Real Estate Department to ensure that such determinations are being made.

    (MTA officials replied to our draft report they routinely check the MTA's inventory before going out to procure new space. In addition, agency requests are heavily vetted within the requesting agency. However, in the future, RED staff will be instructed to more fully document their compliance with such requirements, and will be redoubling efforts to ensure that everything possible is done to use the existing facilities as efficiently as possible and to identify and dispose of any surplus property.)

347 Madison Avenue
New York, NY 10017-3739
212 878-7000 Tel

Metropolitan Transportation Authority
State of New York

May 17, 2010

Ms. Carmen Maldonado
Audit Director
The Office of the State Comptroller
123 William Street – 21st Floor
New York, New York 10038

Re: Report #2009-S-10 - MTA Real Estate Portfolio

Dear Ms. Maldonado:

This is in reply to your letter requesting a response to the above-referenced draft audit report.

I have attached for your information the comments of Mr. Jeffrey Rosen, Director, MTA Real Estate Department, which address this report.

Sincerely,

Michael J. Fucilli
MTA Auditor General

Attachment

347 Madison Avenue
New York, NY 10017-3739
212 878-7000 Tel

Metropolitan Transportation Authority
State of New York

May 17, 2010

Ms. Carmen Maldonado, Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

RE: Audit of the MTA's Real Estate Portfolio (Report 2009-S-10, covering the period January 1, 2005 through August 31, 2009)

Dear Ms. Maldonado:

Since coming to MTA, Jay Walder, the Chairman and CEO, has mandated an overhaul of the way the MTA does business, reducing costs and increasing efficiency in every part of our operation. This new way of doing business is equally important for our real estate operations. While MTA Real Estate currently generates significant revenue for the MTA -- more than $75 million from rents for newsstands, retail shops, ATMs and other commercial locations last year, more than $100 million from advertising activities and over $1 billion in pending contracts for the sale of assets to help fund the 2005-2009 and proposed 2010-2014 Capital Programs -- we must do more. We must be creative and identify new opportunities to maximize this revenue potential so that we are prepared to move forward as the economy improves. And we intend to do so.

On the advertising front, MTA is working with its agents to implement new media outlets, such as digital advertising in stations and tunnels and on trains and buses.

- If you ride the subways, you will have noted that we have introduced and are expanding our use of innovations like "station domination" campaigns and the "wrapping" of subway cars that generate buzz among advertisers and boost our ad revenues.
- On the exteriors of buses, new digital electronic signs are being piloted and we will soon be expanding wraps.
- We will seek both to increase revenues and enhance our customer experience by introducing digital advertising inside trains, buses and stations and displays that animate as trains move through tunnels.
- We are exploring a variety of corporate sponsorship and naming rights opportunities along the lines of our landmark deal with Barclays for the naming

The agencies of the MTA,

MTA New York City Transit	MTA Long Island Bus	MTA Bridges and Tunnels	MTA Bus Company
MTA Long Island Rail Road	MTA Metro-North Railroad	MTA Capital Construction	

rights to the subway station adjoining the site of the new Nets/Barclays Center arena in Brooklyn, which will generate $4 million in addition to the payment we received from the sale of the site itself.

Opportunities to maximize the sale or development of our real estate assets, are far more limited than commonly understood, given that the vast majority of our facilities are located on property that we lease and do not own. However, we do have opportunities to unlock value for the MTA.

- As we reduce headcount, we will consolidate functions and space across the MTA's various agencies -- irrespective of specific agency boundaries -- to free up facilities for sale.
- We will identify industrial properties in parts of the City that are changing and work to upzone those properties to unlock their full value, as we have successfully done with the Atlantic Yards and West Side Yards to allow us to capture over $1 billion for MTA's capital programs.
- We propose to partner with the owners of properties that MTA uses for transportation purposes (such as the City of New York with respect to NYC Transit master lease properties) to enable joint sale or development of properties that may no longer be needed for such purposes.
- MTA will aggressively advocate for regional policies, local regulations and state laws that facilitate more intensive use of land near transit facilities to encourage the creation of economic value for the MTA and other local and regional stakeholders, as well as the opportunity for in-kind improvements to benefit transit.

And we will continue to seek opportunities to reduce our occupancy costs.

- Following the very substantial reductions in administrative headcount that it has announced, the MTA will relocate employees currently in leased spaces to MTA properties so as to significantly reduce our rental costs.
- To the extent that MTA has space needs, those can be used to anchor economic development projects at lower rental cost to the MTA while furthering the economic development of the region.

At the same time that we have been pursuing these revenue-enhancement and cost-reduction initiatives, we have been implementing changes in the policies and procedures that govern the operations of the MTA's Real Estate Department ("RED"), both in response to requirements of the recent Public Authorities Accountability Act and otherwise, and the MTA Board has recently approved all new guidelines for the sale and leasing-out of MTA property in general and for tenant selection at Grand Central Terminal in particular.

Because we are in the midst of overhauling our operations, your draft audit report respecting the past practices of the RED (Report 2009-S-10) is a timely one. However, we do not agree with all of your recommendations. Our detailed response to your report is attached.

Sincerely,

Jeffrey B. Rosen
Director of Real Estate

Attachment

Detailed Response to Audit of the MTA's Real Estate Portfolio (Report 2009-S-10, covering the period January 1, 2005 through August 31, 2009).

The Report makes 12 "recommendations", based on various "findings" that are set forth in the Report, and we address such recommendations in the order in which they appear in the Report. We appreciate the fact that in various instances the Report paraphrases information and/or explanations that we have previously furnished in response to the preliminary version of the Report; and, to the extent that we believe the Report fairly summarizes such responses, those responses will not be repeated here. However, additional comments with respect to particular findings have been included as warranted.

Recommendation #1:

Assign and train staff to ensure that the MTA is in compliance with the requirement in the Public Authorities Law to publish a listing of its real estate property holdings.

Response: The MTA will continue to comply with the requirements of Public Authorities Law 2896, which requires it to publish annually a listing of its real estate property holdings. Although RED staff had been unaware of such requirement prior to 2009, such lists were submitted as required in March 2009 and again in March 2010, and neither any change of staff assignments nor any additional training is needed to enable the MTA to continue to satisfy such requirement.

Recommendation #2:

Correct the real estate database inaccuracies and omissions noted in this report, and monitor the database to ensure that it remains accurate and complete.

Response: Our database, Yardi, will continue to be updated and monitored for completeness and accuracy, as it has been in the past, by the RED and its property management contractors.

With reference to the particular "inaccuracies" and "omissions" noted by the Report:

- 2 Broadway, the Battery Parking Garage and 525 North Broadway are not in fact "missing" from Yardi, and it is unreasonable to suggest that the RED has lost track of such properties. Each is a major facility to which the RED devotes substantial time and energy. 2 Broadway, for example, contains approximately 1.6 million square feet of MTA office space, in addition to the retail units that Cassidy/Turley manages for the RED.
- Yardi contains entries for some 14,000 properties, yet the audit identified only a single MTA property that had been omitted from the database and only a handful of instances where tax lot information had been entered improperly. We strive for

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100% completeness and accuracy, but minor errors are, regrettably, inevitable. Of course, we have corrected the six errors that were referenced in the Report.

- While it is true that the148 "dummy" units to which the Report refers were not at the time in question available for leasing out, it is simply not the case, as the Report asserts, that such units were described as such or "in reality not presently owned by the MTA". As we have previously explained, the 148 "dummy" (as well as the 4 "leased-in" units) were listed as "vacant", rather than stricken from our database, so that we would not lose track of our records with respect to such units when units are eliminated due to station renovations or for other reasons. Our current software only allows us to retain records relating to past tenancies if they are linked to a "unit". Therefore, it has been the RED's practices to categorize such units as vacant so that the record remains. This has not in practice caused confusion within the RED, but we are nonetheless now taking steps to identify such units as "inactive" rather than vacant.
- It is not necessary for every list of NYCT facilities to specify which are covered by the NYC/NYCT master lease, given that RED personnel are well aware that such lease covers virtually all NYCT facilities. The RED does in fact maintain a list of 62 NYCT properties that the MTA owns in fee, all of which have been purchased since 1985 when the MTA began purchasing properties pursuant to its capital programs.

Recommendation #3:

Implement a single MTA real estate portfolio management system identifying all properties along with their value and other important identifying information to improve the MTA's control over these properties and its access to information about the properties.

Response: The MTA already has a single property database, Yardi, which contains data on all of the approximately 14,000 properties controlled by the MTA. It separately accounts for some 8,000 "units" (spaces occupied by "tenants") and 10,000 "tenants" (including past, present and future tenants and licensees). The Yardi database was built in 2000, and combined multiple databases that existed at the time.

The MTA currently contracts with Greystone Corporate Realty Services to manage the out-leases and licenses at all but five of its facilities (Grand Central Terminal, the Battery Parking Garage and 2 Broadway in Manhattan, 242/250 Old Country Road in Mineola and 525 North Broadway in North White Plains), and Greystone uses Yardi in connection with its management of such leases and licenses.

Three MTA contractors manage and are responsible for billing 175 tenants at the remaining five properties, which represent approximately 2% of our entire tenant database; and such contractors (Jones Lang LaSalle at Grand Central, Central Parking Systems at the Battery Parking Garage and Cassidy/Turley at 2 Broadway, 525 North Broadway and 242/250 Old Country Road) are not set up to use Yardi. The Report suggests that without one complete listing of current units and tenants the MTA runs the risk of not being able to successfully manage its properties. However, since these properties are well managed by the responsible contractors and RE staff, this concern is unfounded. Having data with respect to these 175 tenants input into Yardi as well as the systems of such contractors would entail considerable cost and duplication of effort. We will consider creating linkages between Yardi and our contractors' databases, and/or requiring all future MTA tenant management contractors to use Yardi as Greystone does, only if we determine such changes to be cost-justified.

The Report correctly notes that the RED does not have its properties appraised on an annual basis and does not regularly record the value of MTA's holdings in the Yardi database. However, the RED does obtain appraisals when and as appropriate to aid it in establishing appropriate benchmarks in connection with anticipated transactions. For good reason, the Public Authorities Law only requires determinations of value to be made when dispositions are undertaken. The cost and workload to obtain and review appraisals of all MTA property would be enormous and the resulting appraisals would be of little or no value to the MTA.

The following are just a few of the problems with the suggestion that we establish values for properties that are neither deemed to be surplus nor the subject of anticipated transactions:

- Even if one *were* to establish values for all of the MTA's properties, such values would have to be re-established regularly, in what would undoubtedly be a futile effort to reflect constantly changing market conditions, and then again just prior to disposition.
- Appraisals must be competitively procured, which absorbs significant staff time, and cost thousands of dollars apiece.
- Even when applied to typical commercial properties, the appraisal process requires subjective determinations as to how and to what extent the properties in question differ from "comparable" properties for which recent sales data happen to be publically available. Moreover, the MTA's properties tend to be physically unique, so that such comparable properties are commonly impossible to find. Most of the MTA's property does not have a market value in the sense that you could not offer it for sale at an auction and expect any number of interested buyers to show up to bid. Rather, it consists largely of isolated and oddly configured parcels that, if they have any value at all to anyone other than the MTA, are uniquely valuable to adjoining landowners who may or may not be ready, willing and able purchasers. In such instances, the value of the property for sale lies somewhere between its unique value to the MTA and its unique value to such adjoining landowner, both of which are inherently difficult, if not impossible, for an appraiser to determine.
- Then there is the question of what exactly would need to be appraised. The possibilities would range from the fee interest in the property, to the MTA's interest in the property as encumbered, to different portions of the property that might conceivably be separately valued for disposition. Such determinations are

necessary and appropriate where a transaction might be in the offing, but not merely for purposes of a theoretical exercise.

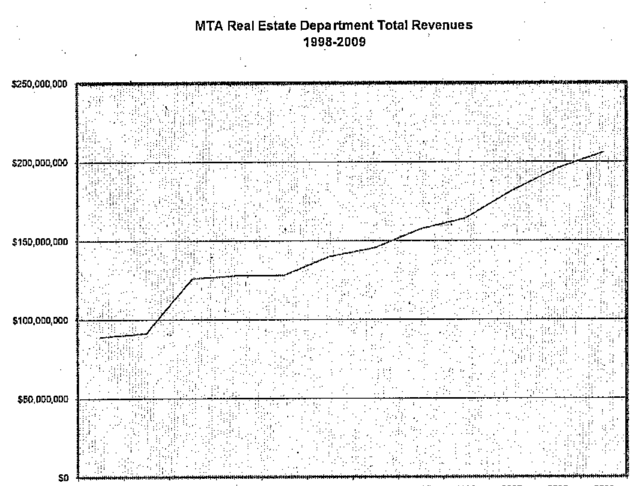
While, as the Report suggests, we can always check the assessments promulgated by the NYC Department of Finance, we have no reason to suppose that such assessments have been prepared using uniform and appropriate assumptions (given that such assessments are not used for any practical purpose, since the properties are exempt from taxes). Therefore uploading the data into Yardi would be a waste of staff time and effort, which can be better spent devoted to producing revenue.

Recommendation #4:

Develop a strategic marketing plan. Ensure that the plan contains provisions for removing impediments to rental units' marketability and that adequate efforts are made to market all vacant units. In addition, as part of the plan, consider marketing smaller rental units on the internet like the Chicago Transit Authority, and increase efforts to market vacant newspaper boxes.

Response: We will consider developing a "strategic marketing plan" for our vacant retail units, but do not anticipate that doing so would fundamentally alter our understanding of the portfolio we are managing.

For each of the past ten years, RED-administered revenues have increased annually, despite severe economic downturns and despite the closing of many facilities that were being rehabilitated, including Grand Central Terminal, the "Coliseum" office building and exhibition space at Columbus Circle, and the Battery Parking Garage. We believe this performance speaks for itself, and provides evidence that the RED has consistently sought out and found opportunities to increase its revenues.



4

With regard to the lists of properties (containing 600 and 21 units, respectively) that are referenced on pages 15 and 16 of the Report, we stand by our earlier responses, which are summarized in the Report. We would add here only that (a) labeling a unit as a "phantom" unit creates the impression that it was lost or intentionally hidden from view, whereas, as explained above, there is in fact a good reason why unmarketable units are not deleted from Yardi, and (b) the supporting documentation that the Report says was "lacking" from four of our files was located by RED staff in those files once they had been returned to the RED by the auditors.

The Report questions why $1 million was not spent to install an HVAC system to heat and cool retail stores at the 42nd Street/6th Ave. (Bryant Park) station, and implies that it clearly should have been, since that cost would have been relatively small compared to the $19.6 million total cost (in 2000 dollars) of the station rehabilitation. This expenditure, however, would have been wasteful. Passenger flows at the station in question are concentrated at the north and south ends of the station, with minimal foot traffic in the central paid zone where the vacant units are located. As a result, the potential for revenue generation at this location would be marginal even if there were HVAC systems in these units. The up-front cost to the MTA could not have been recouped for many years, if at all, and, in light of the MTA's limited resources, we felt it was the correct financial decision not to spend the money. The Report suggests that "negotiating a rent with an incentive for the tenant to install air conditioning in exchange for occupancy" should have been pursued, but we believe prospective tenants would conclude that even a full rent abatement would not justify such a large capital expenditure on their part (and even if it did then we wouldn't have any income to show for it).

The Report questions why other "alternative marketing" strategies have not been pursued for these units, but such strategies have in fact been pursued. The RED has had discussions with its advertising licensees in order to explore potential non-traditional uses of these storefronts, such as digital advertising displays and so-called "pop-up" stores, which might not require such extensive services as a standard retail location would require. However, to date, the RED has not received any interest in these locations for such purposes. In the meanwhile, as noted in the Report, the storefronts have been marketed and used for conventional advertising, a practice that we intend to continue in the future.

Regarding the use of the internet for marketing, the RED concurs that the MTA website should continue to be used to market all properties that are publicly offered for lease or license, including properties that were previously marketed for which no responses were received. The MTA is currently evaluating the cost-effectiveness of an add-on to Yardi ("Yardi Portal") that would enhance our ability to provide access to marketing materials on line, both with reference to on-line maps and otherwise.

However, we do not agree that more could usefully be done to market vacant newspaper boxes at MTA Metro-North and MTA Long Island Railroad stations. As we have previously explained, when the modular boxes were installed each vacant unit had a notice placed on the front of the unit, visible to all passersby, stating the modular unit was available for use and providing a number at the MTA for interested parties to call. Furthermore, upon implementation of the program, all news vendors with then existing agreements were contacted and offered the opportunity to enter into new agreements to place their publications in the new modular boxes. While such efforts reached all parties with potential interest in the boxes, the RED will reach out to these vendors again to determine if there is any additional interest. However, given the recent decline in hard copy periodical circulation in the face of competition from the internet, we expect little additional interest.

Recommendation #5:

Monitor the actions of the staff in Real Estate Department to ensure that all rental units are marketed through one of the competitive processes required by the MTA's Policies and Procedures, and the market value of all rental units is determined before the units are offered for rent.

Response: Staff actions taken with regard to marketing will continue to be subject to review and multiple approvals by supervisors, as well as, ultimately, MTA Board approval. The RED recently substantially revised its leasing-out manually, in part to conform with recent amendments to the Public Authorities Law, and is fully committed to conducting all of its marketing efforts in accordance with applicable laws and policies.

Recommendation #6:

Improve leasing practices by ensuring that:

> ***a. The standard holdover clause of 5 percent is included and collected from all lease agreements and RFPs are issued for expired leases as soon as possible,***

Response: The RED reviews each expiring lease or license, and if the agreement provides for an automatic increase, the rent or license fee charged is increased accordingly; if it does not, the RED has been working to issue new RFPs for these properties and the resulting new agreements include the 5% holdover clause.

The Report states that 10 of the 24 holdover tenants in the auditors' sample did not receive 5% rent increases, and notes that some of these holdovers have been allowed to remain in place for several years. However, the Report does not include the explanations we have furnished, which are as follows:

- **Mahabubar Rahman** (t0000259) - This newsstand licensee has been allowed to remain in place on a month-to-month since 1997 while station renovations were being considered and then implemented. The renovation was finally completed at the end of 2009 and the space is now scheduled to be offered by request for proposals later this year. In the meanwhile, the RED has in fact assessed and collected 5% annual increases from the licensee since 2000, even though the

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original license agreement was entered into before the RED started including 5% annual increases for holdovers in its boilerplate in 1992.

- **Mehta** (t0006924, t0006921) - These agreements relate to two separate locations at a single station at which NYCT has been intending to undertake major renovations. The RED delayed issuing a request for proposals pending NYCT's decision-making with respect to such renovation, while working with NYC Transit to ascertain whether it is feasible to offer two additional spaces at the station in question, which would entail significant new electrical work. In the meanwhile, the licensee has in fact been assessed 5% annual increases per the applicable month-to-month license agreement.
- **347 Madison Avenue** (t0004888, t0004894, t0004887) - These three agreements are year-to-year agreements between the MTA and its subsidiary Metro-North. The annual rents are within the parameters that have been approved by the MTA Board on July 28, 1999.
- **NY Team Federal Credit Union** (t0009695) – The LIRR considers the credit union an employee support service and has therefore elected to continue to accommodate its occupancy on a month-to-month basis and for nominal license fees.
- **Traveler's World** (t0006285) is a tenant at 250 Old Country Road in Mineola, which the LIRR purchased from Keyspan in order to construct its Mineola Intermodal Center. The Traveler's World lease was not negotiated by the RED and was assumed at the time of the purchase. The RED has contracted to sell the subject property, and in the meanwhile Traveler's World has been allowed to hold over to generate income for the MTA pending the closing of the sale.
- **LIRR** (t0006570) – This unit is also part of the Mineola property that was purchased from Keyspan. The premises were occupied by the LIRR's contractors in conjunction with the construction of the Mineola Intermodal Center, that work has been completed and the space is being held vacant pending the closing of the sale.
- **Matura Insulation, Inc.** (t0005280) - This site was acquired by settlement in lieu of condemnation for the East Side Access project. As part of such settlement, the owner was allowed to remain in the premises for a limited period of time.

b. All special lease provisions requested by tenants are practicable for the MTA, and

Response: Agreed.

c. Advertising firms' certified statements of receipts are submitted on time and are reviewed to verify the appropriateness of the firms' payments for their advertising space.

Response: We agree that all required reports from our advertising contractors should be required on a timely basis and that it is of great importance that such reports be thoroughly scrutinized. No harm resulted from Titan Outdoor's failure to make timely

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delivery of required CPA-certified statements, as it was clear that the compensation owed by Titan for the periods in question was equal to the minimum annual guaranteed amounts to which the Report refers. However, Titan's contract with the MTA has nonetheless been terminated for cause.

Recommendation #7:

Improve rent collection practices by:

a. ***Establishing and enforcing a policy requiring interest and late fees to be assessed when rent payments are late by a certain number of days,***

Response: Excluding claims associated with, out-of-the-ordinary and broad-ranging disputes with the Long Island Power Authority and Verizon (which involve various offsetting claims), in 2009 the RED collected approximately 96% of the aggregate amount owing under the agreements it administers, which we understand compares favorably with other comparable real estate operations. Moreover, since early 2007 our arrears have declined by approximately 19%, notwithstanding that we have been experiencing the worst economic downturn since the Great Depression.

Most existing RED agreements already contain (and all new RED agreements routinely contain) provisions that permit the MTA to charge interest on unpaid rent. We agree that we should more routinely seek to enforce such provisions, and the RED also intends to consider providing in its leases and licenses for specified monetary penalties (i.e. liquidated damages) for specified non-monetary defaults. However, it should be noted that enforcement efforts commonly result in litigation, which typically entails legal and administrative costs that are disproportionately large relative to amounts requiring collection, and we therefore need to have latitude to exercise discretion in connection with such efforts.

The MTA is currently evaluating the cost-effectiveness of installing the aforementioned "Yardi Portal", which would enable tenants to make payments by credit card or automatic bank transfers, thereby potentially reducing the extent of late payments.

b. ***Collecting rent from tenants that occupy rental units before the lease takes effect, and***

Response: The case on which this recommendation is based resulted from a mutual oversight. No tenant is authorized to open for business before its lease takes effect.

c. ***Routinely inspecting vacant units that are scheduled for future occupation to ensure that they are not being occupied before a new lease takes effect.***

Response: The occurrence in question, while regrettable, was to our knowledge unprecedented. The MTA does inspect tenant improvement work before move-ins are permitted, and we do not believe that additional inspection routines are required.

Attachment: Detailed Response to Audit

Recommendation #8:

Maximize the revenue from the disposal of property by:

a. ***Charging a reasonable sale price for property that is transferred to another government entity for public use, ensuring that the sale contract includes a clause requiring the reversion of the title to the MTA should the purchaser use the property for a purpose other than that specified in the contract, and following up to ensure that the property is being used for the public purpose originally specified; and***

Response: From time to time, as contemplated by Section 2897 of the Public Authorities Law, the MTA does dispose of property (not required for its corporate purposes) to municipalities or other public agencies for the benefit of the public. In these cases, the potential for revenue from the sale of the property to a private party is weighed against the public benefit of conveying the property to the applicable municipality or agency.

The Report cites three sales of properties in which the MTA allegedly disposed of properties in a manner not consistent with its policies and procedures in that revenue was not maximized.

In the case of the referenced disposition to the Town of East Williston, the 1,500 square foot lot in question had no value to LIRR and was not developable unless combined with a parking area that was already owned by the Town. Thus, the $90,000 value ascribed to it by the appraiser was entirely theoretical. Accordingly, the MTA Board authorized disposition of the property to the Town for use as community space.

The property we conveyed to the NYS Department of Environmental Conservation was originally acquired to eliminate a grade crossing over the Wassaic extension of Metro-North's Harlem Line. Had the property not been acquired, Metro-North would have been required to pay for and install signals, gates and other work at the crossing, the cost of which would have exceeded the purchase price. Once the property was acquired and the grade crossing eliminated, the property was landlocked and of limited use and negligible value. After the elimination of the grade crossing, its highest and best use, as appraised, was for fishing and hunting. For this reason, a disposal to the DEC was a logical choice, preserving the property for recreational purposes for residents of New York State while relieving Metro-North of any continuing maintenance obligation.

We agree that appropriate deed restrictions should (and under the Public Authorities Law, as amended, must) be employed where sales to public entities are predicated on agreements that they will only be used for public purposes, and the deeds by which the foregoing conveyances were effected did contain such restrictions. However, the MTA does not consider it to be an appropriate use of its limited resources to police such deed restrictions. We believe that responsibility for compliance with such deed restrictions lies with the public sector grantees, and understand the primary purpose of such deed restrictions to be the prevention of subsequent dispositions for private use.

The MTA stands behind its business decisions with respect to the West Side Yards air rights sale that is referenced in the Report. The sale of the air rights in question (to which the Report devotes just four sentences) represented only one part of a highly complex set of transactions, involving interconnected land use regulation and infrastructure development issues, that provided significant financial benefits to the MTA that included fair and more than adequate compensation from the City for the air rights in question.

b. ***Ensuring that properties that are to be sold to private interests are not sold for significantly less than their appraised value.***

Response: The MTA will continue to comply with the Public Authorities Law, as it has recently been amended, including without limitation the requirements of such law relating to the preparation of appraisals. However, it should be noted that the appraised value of a property to be disposed of merely represents the appraiser's estimate of, and is not tantamount to, such property's fair market value.

Recommendation #9:

Formally evaluate the marketability of the MTA's air rights. If the air rights are found to be marketable, promptly act to market the rights. If the rights are found to be unmarketable at the present time, document the reasons for this determination and set a date to re-evaluate their marketability

Response: The MTA has evaluated, and will re-evaluate from time to time, the marketability of air rights associated with its properties and, as noted above, when market conditions are favorable the MTA will aggressively market air rights that it believes to be marketable.

However:

- Overbuilds are costly and logistically difficult and therefore economically feasible only in limited circumstances.
- In most jurisdictions, there is no entitlement to purchase development rights from one's neighbors, and the concept of "transferrable development rights" has no applicability. Instead, if a developer proposes more bulk than is allowed under the applicable zoning ordinance, the developer seeks an upzoning or variance.
- In New York City, transfers of development rights are accomplished through so-called "zoning lot mergers", which are a function of the definitions of "block" and "lot" that appear in the Zoning Resolution; and the vast majority of the MTA's right-of-way carries no development rights transferrable or otherwise because railroad rights-of-way are generally treated as if they were "streets". The only exception is for rights-of-way that are below grade and even then the Zoning Resolution poses various significant procedural and substantive obstacles to the utilization of air rights associated with such parcels.

- The "consultant" to which the Report refers was engaged by the MTA on a commission basis, and was given a green light near the height of the recent development boom to identify and solicit interest from prospective purchasers of the development rights associated with the referenced parcels in Queens. The $12 million aggregate value that the consultant ascribed to such development rights proved to be entirely speculative, as the consultant was unable to generate any interest whatsoever.

Recommendation #10:

Act promptly to either make use of, or dispose of, the Brooklyn building cited in our report. Set a deadline for the sale of the building in Mineola, and remarket the property if the delays in the sale continue.

Response: Regarding the building at 370 Jay Street in Brooklyn, the capital funding for the proposed work is included in the Proposed MTA 2010-2014 Capital Program that was recently submitted for approval to the Capital Program Review Board, but until the program is approved no action can be taken.

The Mineola building remains under contract and the MTA has to date received $8,022,222 and is about to receive an additional $700,000.00 on account of the purchase price, which has been increased to $12,572,222. Moreover, $6,522,222 of such amount has been unconditionally released to the MTA and is no longer being held in escrow. The Report correctly states that the current rental revenues from the facility do not cover the facility's operating expenses, but fails to note that to extend the closing the purchaser has remitted option payments that are properly offset against such operating expenses for purposes of evaluating our cost to hold the building. The closing is currently scheduled for July 2010, subject to an option to extend, with an additional option payment, until January 2011. If the closing is delayed past July 2010, the option payments will total $450K. Furthermore, the contract price significantly exceeds the current market value of the building. That is why we decided to agree to postpone the sale and accept additional downpayment installments and option payments rather than remarketing the property. If the purchaser is unable to close by January 2011, all of the funds the purchaser has paid to date will be forfeited and the property will be re-marketed.

Recommendation #11:

Develop written policies and procedures requiring the Real Estate Department to request an exemption from real estate taxes on all properties leased by the MTA and to maintain documentation of these requests.

Response: RED seeks to implement its exemption from real estate taxes in every situation in which such exemption is applicable. However, in some instances, the MTA exemption has been deemed not to apply to newly acquired property until the tax year following the first tax year in which the MTA is in possession. And it has proved very difficult to implement the exemption where the MTA occupies only a portion of a tax lot (as where it occupies only part of a multi-tenanted office building).

In October 1989, the MTA and New York City Transit Authority commenced litigation against the City of New York challenging the City's failure to exempt certain properties that had been leased to them. Additional complaints were filed, and parallel administrative challenges were commenced, in 1990 and 1991. Ultimately, the MTA was unsuccessful in obtaining judicial relief. However, an informal understanding was reached with the City whereby the City exempts tax lots (whether constituting whole buildings or condominium units within buildings) that are leased in their entirety to the MTA. So, for example, when NYCT leases a whole warehouse or office building from a private landlord that building is fully exempt. But when the MTA leases less than a whole building the MTA has been unable to obtain an exemption unless the owner and its lenders are prepared to subject the building to a condominium regime of ownership.

The $338,244 amount referred to in the Report relates to a building that is leased in its entirety to the MTA Police. The City of Mount Vernon has improperly refused to grant the MTA's landlord the exemption from taxes to which the landlord is entitled by reason of the MTA's occupancy, and the MTA has accordingly commenced a legal action to compel the City to grant such exemption, but in the meanwhile the MTA has been obliged to pay additional rent to compensate the landlord for the taxes that the landlord has been forced to pay to the City.

Recommendation #12:

Develop written procedures requiring that no lease for space be entered into until the Real Estate Department determines whether vacant MTA-owned property can meet the need for space. Require that this determination be documented, and monitor the performance of the Real Estate Department to ensure that such determinations are being made.

Response: When the RED receives space requests, it routinely first checks the MTA's existing inventory before going out to procure new space. Moreover, agency requests are heavily vetted within the requesting agency. For reasons related to expense and time, agencies are strongly incentivized to make use of their own holdings prior to submitting a request to the RED to acquire new properties for them. Before it asks the RED for assistance, the user agency must promulgate its space requirement and then determine if there are any alternatives available within the space inventory it controls. Upon receiving a request for space, if the RED is aware of any MTA property that might be available to meet the agency's needs and reduce occupancy expense, it is brought to the agency's attention. These are the procedures that the RED has followed in practice, albeit perhaps not with the degree of formality that the Report envisions. However, in the future, RED staff will be instructed to more fully document their compliance with such requirements, and we will be re-doubling our efforts to ensure that we are doing everything possible to use our existing facilities as efficiently as possible and to identify and dispose of any surplus property.