

July 14, 2008

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Re: Tax-exempt financing for sports facilities, Atlantic Yards Arena and new regulations.

Gentlemen:

We write with respect to the proposed regulation issued by the Internal Revenue Service on October 19, 2006 concerning the treatment of payments in lieu of tax (“PILOTS”) under the private activity bond test applicable to tax-exempt bonds (the “Proposed Regulations”). In particular we respond directly to assertions contained in the letter dated May 8, 2008, from the New York City Industrial Development Agency (IDA) and the Empire State Development Corporation (ESDC),<sup>1</sup> hereinafter referred to as the “Ratner Arena Letter.”

Assertions in the Ratner Arena Letter regarding the bonding for that arena leave out key pieces of information and make misleading and politically slanted arguments,<sup>2</sup> and as such compel the IRS to conduct a review with a heightened level of scrutiny and due diligence.

Moreover, it is significant to point out that whereas financing for the new Yankees Stadium was approved prior to the IRS's proposed regulatory change, the Atlantic Yards financing was approved in late December 2006—over two months after the IRS proposed its amended rule. That proposed regulation change was then effectively implemented because nobody could get any financing once it was on the table. The New York State Public Authorities Control Board (PACB) approved financing *after* the IRS proposal knowing that the proposed amended regulation would shut out tax-exempt financing for the Atlantic Yards Arena. As such, there is no plausible argument that could be made that the Atlantic Yards project sponsor, the ESDC, or the PACB had a rational basis to rely, to their detriment, upon an impending repealed IRS regulation, and therefore no basis for the IRS to permit tax-exempt bonds to be issued to finance the Atlantic Yards project.

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<sup>1</sup> That letter can be found here: [www.dddb.net/documents/IRS/IDA\\_ESDC\\_submission.pdf](http://www.dddb.net/documents/IRS/IDA_ESDC_submission.pdf)

<sup>2</sup> We note that financing of the arena for private benefit is a developer-driven transaction. Since the time the project was initiated by the developer, ESDC has frequently been a conduit for information about the project obtained from the developer, not in its own possession, and not subject to its own independent verification. We hope that the IRS will not be accepting of assurances from those who are not carefully verifying that which they assert to you.

The following substantive statements made in the Ratner letter regarding the Atlantic Yards project in Brooklyn and the project developer's effort to secure tax-exempt bonding for that project's professional basketball arena using a PILOT structure are factually incorrect.

1 The Ratner letter asserts that Forest City Ratner Companies (FCRC, the developer) will pay a semi-annual PILOT “*not to exceed the full real estate taxes which the City would assess were the Arena Building Site and the Arena not exempt from such taxes and the LDC shall have the right to pledge such PILOT payments to service the LDC's tax-exempt bonds.*”

However, the Ratner Arena Letter fails to explain that ESDC/LDC/FCRC will not peg the PILOT to any actual assessed foregone property tax, but rather will fabricate a number working backwards from their calculation of what is necessary to pay the debt service to pay towards the private arena facility. We note that the operative documents have provisions to manipulate the sizing of the tax-exempt bond issuance so as to maximize it for the developer's benefit. Further, these same payments, if not used by the developer for tax exempt bonds are being returned to the developer to run his private enterprise thus emphasizing that the theoretical tax payments are being discretionarily sized to benefit the developer as a tax-avoidance/evasion device. Conversely, the way in which New York real property taxes are set involves formulaic programs and the developer has independently represented to New York media that if bonds are not issued supported by these payments they would participate in various tax abatement, tax exemption programs, (this includes as-of-right programs) so that the amounts to support the bond would not otherwise ever be paid as taxes.

The artifice and device nature of these manipulations is quite transparent and we do not believe that current IRS regulations allow this and do not believe the Proposed Regulations permit nor should be interpreted to allow such artifice and device.

Plans for the FCRC arena and overall project of which it might be a part have been evolving and with substantial changes in, among other things, the financing numbers. According to information available, if the PILOTS cannot exceed the foregone property taxes—as stated in the Ratner Arena Letter—then the PILOTS will not come anywhere near paying off the \$800 million in tax-exempt bond financing FCRC has stated it will pursue for its currently price \$950 million arena. If the PILOT were really pegged to foregone taxes, the developer would be approximately \$40 million dollars short of the roughly estimated \$48 million annual bond payment. If those numbers are not precise, it is clear that FCRC would be substantially short of the roughly estimated annual bond payment if the PILOT were truly pegged to assessed property tax.<sup>3</sup>

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<sup>3</sup> The *Atlantic Yards Report* makes the effort to figure out these totals, something ESDC/IDA and FCRC have not publicly done, or attempted in their letter to you—for a reason. (See: [www.atlanticyardsreport.com/2008/06/another-potential-snap-for-ay-arena.html](http://www.atlanticyardsreport.com/2008/06/another-potential-snap-for-ay-arena.html)). From *AYR*: “Extrapolating from the amount of bonds and the PILOT payments for the Yankees, a similar 6% ratio suggests annual PILOT payments on \$800 million in tax-exempt Atlantic Yards arena bonds would be about \$48 million.

In 1/7/08 testimony to the City Council Finance Committee, Theresa Devine of the Independent Budget Office stated that owners of Madison Square Garden, who benefit from a full property tax exemption, were saving \$11 million in the current fiscal year.

That's a lot less than \$48 million.

In its September 2005 report on Atlantic Yards, the IBO estimated the value of the Atlantic Yards arena at \$100 a square foot, compared to Madison Square Garden at \$125/sf. Based on the \$100 figure, the IBO had calculated the foregone

Appendix D of the Ratner Arena Letter *only* lists the assessed property tax foregone for the nearly completed new stadia for the New York Yankees and Mets, while the assessment for the Nets arena is studiously missing. There is a tactical reason for this omission. We believe the assessed taxes for the Mets and Yankees are also made up numbers having nothing to do with foregone taxes. But the reason the Nets assessment is missing is not because the IDA and ESDC cannot estimate the assessed property taxes for the improved arena site (the arena is not under construction, has not broken ground, and currently *cannot* break ground), but rather because it is that only after FCRC calculates the arena construction cost and the tax-exempt bond financing it requires, will it be able to make up a PILOT value necessary to pay the debt service BUT call it “Annual Estimated Taxes” as in Exhibit D of their letter.

Were ESDC to provide for you today the estimated taxes, the developer would be boxed into a corner from which it would have trouble removing itself when the arena cost increases again as it is certain to do.<sup>4</sup> At that time the sought-after increased tax-exempt bond financing, with the increased PILOT payment needed, will of course lead to a higher, yet fabricated, estimated tax value.

2. The IDA/ESDC letter blatantly states that the Atlantic Yards development has already proceeded significantly as follows:

*“In order to illustrate the substantial progress that has been made with the Project prior to the issuance of the Proposed Regulations, we have provided the chronology of events set forth below.... **Substantial amounts have been spent on the Project:** approximately \$99 million prior to 2006 (of which \$15 million related to the Arena) and approximately \$219 million prior to 2007 (of which \$47 million related to the Arena).”* (Emphasis added)

But consider how misleading that statement is in reality:

Exhibit A of the Ratner Arena Letter seeks to justify an extension of the effective date of the Proposed Regulations to February 19, 2009 or even later, rather than retroactive to February 2007 and by doing so bestow a significant tax benefit to a private developer. Exhibit A offers a history of Atlantic Yards, which is not only inaccurate but is disingenuously fabricated to set forth a politically and factually slanted story.

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property tax at the Atlantic Yards arena at only \$3.85 million.

The value of Madison Square Garden, IBO’s George Sweeting told me in a recent email, is now calculated for tax purposes at \$250/sf. So even if doubled to \$200/sf, the foregone property tax for the AY arena would be less than \$8 million a year--a reasonable ratio if the figure for Madison Square Garden is \$11 million.

Sweeting noted that the agency’s 2005 analysis “was based loosely on the Department of Finance’s official market value for MSG at the time, discounting for differences in land value. It is probably true that neither the MSG value assigned by the city, nor the AY arena value estimated by IBO, reflect the actual cost somebody would pay to buy the land and build a new arena. We based our value on an assumption that whatever the Finance Department is doing when valuing MSG, they would do for AY.”

If so, there would have to be a lot more taxable bonds than currently contemplated. So what would be the regular property tax amount for the AY arena? That issue becomes ever more worthy of scrutiny as the question of PILOTs for Atlantic Yards emerges. How can the foregone property tax--which would seem to be less than \$10 million--match up with PILOTs that could well exceed \$40 million?

<sup>4</sup> The Barclay Center Nets Arena construction cost was \$637 million when approved in December 2006. On March 21, 2008—only 15 months later—FCRC’s CEO Bruce Ratner told the *NY Times* the arena cost has escalated to \$950 million.

In fact, a mere \$47 Million (a little less than 5% of the cost of the \$950 million arena) has been spent that would be allocable and relate to the arena should the arena ever be built. These expenditures<sup>5</sup> are for needed basic infrastructure in the area, independently necessary for public purposes without regard to the proposed development.

3. The IDA/ESDC states: *"(To) illustrate the substantial progress that has been made with the Project prior to the issuance of the Proposed Regulations, we have provided the chronology of events set forth below. The Project commenced in 2003; the Arena is anticipated to be completed in 2010, and the balance of the Project is expected to be built over the next decade."*

These claims are palpably, self-servingly and cynically false. This information is publicly available. This is one example of why the IRS should be reviewing all the assertions in the Ratner Arena Letter with rigorous skepticism and rejecting many of them. When the Project was announced the developer's press release stated: *"Arena development to begin at the end of 2004, with completion set for summer of 2006."*<sup>6</sup> What they fail to tell you is that now the ESDC has a state funding agreement<sup>7</sup> that allows 6-plus years to build the arena but ground has not been broken, 12-plus years to build the rest of the Project's smaller Phase 1 and *no timeline at all* to build Phase 2 where the bulk of the Project is proposed. The anticipated Arena completion date of 2010 is an impossibility based on FCRC's own public construction schedule.<sup>8</sup>

4. The "Summary of Litigation" on page 9 of the Ratner Arena Letter states, *"Early in the development of the Project, the Project's opponents pledged to sue early and sue often."* This is false and was never said or pledged. We should know, as we lead the grassroots community campaign in opposition to the Project.<sup>9</sup> Since the Project was announced in December 2003, we have been responsible for filing three lawsuits over that 4.5-year period. Only two of those lawsuits might have resulted in stopping the Project. Furthermore, none of the lawsuits have enjoined or currently enjoin FCRC from moving forward with its Project. The blame is misplaced. We don't argue with the fact that we have taken our government to court when it has misbehaved, as we firmly, and with principle, believe is not only our right but our duty.

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<sup>5</sup> As to who has actually incurred these expenses as a bottom line economic matter is a tactical tangle the IRS may want to investigate before reaching conclusions to support any special loopholes or exceptions. In point of fact, the way that Forest City Ratner is proceeding as a conduit of public funds for general improvements which in the end both the city and Ratner have an interest in seeing happen. It is possible Ratner will be economically subtracted out of the picture if the arena is never built.)

<sup>6</sup> FCRC December, 2003 Project announcement press release at, quote on page 5 of: [www.dddb.net/documents/ratner/FCRreleaseDec2003.pdf](http://www.dddb.net/documents/ratner/FCRreleaseDec2003.pdf)

<sup>7</sup> See *Atlantic Yards Report*: [www.atlanticyardsreport.com/2008/03/read-fine-print-esdc-gives-ratner-6.html](http://www.atlanticyardsreport.com/2008/03/read-fine-print-esdc-gives-ratner-6.html)

<sup>8</sup> See *Atlantic Yards Report*: [www.atlanticyardsreport.com/2008/05/barclays-center-to-open-december-31.html](http://www.atlanticyardsreport.com/2008/05/barclays-center-to-open-december-31.html)

<sup>9</sup> Our opposition to the Project, in large part, stems from our overriding belief, shared by a multitude of economic experts and the vast majority of taxpaying citizens, that professional sports facilities, frequently owned by billionaires, which basically never turn a profit for the public, should not be financed by the public and should certainly not receive tax-exempt financing from the federal government (which *never* benefits from sports facility financing), of all places. These entities simply do not need the tax-exempt financing to build their sports palaces laden with luxury skybox suites. The Atlantic Yards developer Bruce Ratner says as much, see NY1 comment in letter below.

As you are aware, Congress has acted with clear intent in the area of tax-exempt bonds to distinguish between public purpose and private activity bonds. Critical to whether the requested IRS loophole should be granted in this instance is whether the intent of Congress should be side-stepped so that a developer's private activity will be paid for by the taxpayers. From Congressman Kucinich's March 29, 2007 Domestic Policy Subcommittee hearings you know that the "incidence" of the subsidy benefit, if granted, will be to the developer and his private activity and not the taxpayers. The concepts of public vs. private activity purpose are related but differ in different areas of the law. The concepts are stricter in terms of the dictates of Congress with respect to private activity bonds. Not to re-litigate the issue we believe it is nevertheless pertinent to point out, for purposes here, that a chief concern in the lawsuits we brought were questions of public purpose.

The Atlantic Yards Arena is a for profit, privately owned arena, which the Independent Budget Office (IBO) of New York City has shown would be a net loss for the taxpayers of New York City<sup>10</sup>, and the State of New York has never shown any evidence through a cost benefit analysis that the Arena itself would be a net gain for the State.

The Arena is about luxury skyboxes and naming rights. The skyboxes are proposed to sell at costs ranging from \$300,000 to \$540,000, and Barclays Bank has purchased the naming rights for the Arena, not from the public but from the private developer at an estimated cost of \$400 million. This facility needs triple tax-free bonds?

FCRC CEO and President Bruce Ratner told *NYI News* on June 13, 2008, "You know if the [bond] regulations don't change, do change, whatever the regulations will do, we'll be able to finance this."<sup>11</sup> This comment should help you evaluate the earnestness of the IDA/ESDC letter when it comes to the Atlantic Yards Arena: even the developer says he doesn't need the tax-exempt bonds. A non-binding promise to FCRC made four years ago with respect to an inchoate and since much altered project should not be overlaid to bootstrap FCRC into tax loophole benefits on the backs of federal, state and local taxpayers (likely over \$1.3 billion total) through the issuance of artifice and device tax exempt bonds and special agreements which are not true "PILOTs."

5. Exhibit A of the letter represents that "*Forest City Ratner Companies ("FCRC"), the developer of the Project, has already acquired approximately 85% of the project site.*"

This is not true, 40% of the site is currently property of the New York Metropolitan Transportation Authority, which has not yet been acquired and there is much other additional property beyond that to be acquired. (Even the developer's website, [www.atlanticyards.com](http://www.atlanticyards.com), doesn't go so far as to say that FCRC has acquired 85% of the project site.) Also, though Exhibit A takes pains to recite that certain hearings were held it neglects to mention that those knowledgeable are anticipating that given the need for a variety of changes any project that may

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<sup>10</sup> The only IBO study to date, now three years old, showed an extremely modest net gain for New York City of *less than* \$1 million per year net present value over 30 years. But that study predated an additional \$105 million direct subsidy the City directed to Atlantic Yards on top of the already committed \$100 million each from the city and state. Additionally the IBO study did not include various project costs to the public, predated the increased cost of the arena (the cost has doubled since the IBO study), included a faulty assumption given to the IBO by FCRC that half of the Nets games attendees would be coming from New Jersey with their new revenue, and it predated the increased tax-exempt bonding FCRC is seeking. (September 2005, IBO Study available at: [www.ibo.nyc.ny.us/iboreports/atlyards\\_fbsept2005.pdf](http://www.ibo.nyc.ny.us/iboreports/atlyards_fbsept2005.pdf))

<sup>11</sup> Text and video at: [www.nyl.com/ny1/content/index.jsp?stid=1&aid=82668](http://www.nyl.com/ny1/content/index.jsp?stid=1&aid=82668)

one day proceed will be substantially different than the "project" as it was conceived at the time of those hearings so that new hearings and approvals will be needed.

The Atlantic Yards project presents a development in which private gain substantially exceeds any purported or imputed public benefit. As such, it will be held up and reviewed for future generations as a textbook example of the need for public vigilance, scrutiny and accountability.

Very truly yours,



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