



**The York Group LLC**  
Strategic Lease Audit & Rent Due Diligence

## **THE YORK GROUP, LLC PRESENTS**

**“How to Deal With your Firm’s Office Rent Liability As Coronavirus Threatens Your Firm, Its Revenues and Work Culture”.**

**Presented: Commercial Leasing Program On Zoom Sponsored by Association of Legal Administrators NYC Chapter.**

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# INTRODUCTION

This presentation is broken down into two parts:

- I. What are the basic commercial lease concepts involving the billing of additional rents such as operating expenses, real estate taxes and other occupancy costs; & how do those concepts translate into the Landlord's rent and additional rent billings.
- II. How the Covid19 Pandemic has impacted the office landlord tenant relationship and how a tenant may deal with the business aspects of paying rent and complying with the terms of the Lease.

For the landlord, rent is the source of the income that it collects from its property so that it can:

**Pay Debt Service;**  
**Pay Operating Expenses;**  
**Pay Real Estate Taxes; and**  
**MAKE A PROFIT.**

To protect the landlord's net operating income or profit, rent escalation clauses came into being. Today, along with utility and sundry charges, rent escalations are the means by which the landlord seeks minimally to recoup all of its operating expenses and optimally to increase profits significantly. A prudent tenant needs to resist giving the landlord additional profits at its expense.

**Tenant's Goal:** To get the benefit of its bargain.  
Avoid unexpected and/or improper rental charges.

**Our Experience:** Most office leases are long, detailed and difficult to apply.  
Rent calculations are complex and mistakes are common.  
Rent overcharges are more common than undercharges.

Many buildings have changed ownership and management in recent years, making the task of applying complex leases properly and consistently even more difficult. Since the tenant is usually more adversely affected than its landlord by the misapplication of rent terms, the tenant needs to try to monitor the landlord's application of rental terms, as best it can.

## **ADVICE TO TENANT:**

Before lease execution:

- Gather and investigate information regarding the lease and the lease premises using experts such as attorneys, brokers, architects, engineers, and other consultants;
- Understand the business deal from the lease clauses; and
- Negotiate the lease so that the landlord only recoups its expenses and does not burden tenant with exorbitant, unbudgeted billings.

During lease term:

- Actively monitor the administration of the lease. Scrutinize rent billings and periodically audit landlord's compliance with the terms of the lease.
- Confront and resolve mistakes in the application of the lease using your experts.

## **WHAT RENT ESCALATIONS SHOULD ACCOMPLISH AND HOW**

### **I. CONSUMER PRICE INDEX ("CPI") ADJUSTMENT**

- Precise definition and method.
- Geographical location and type of CPI index.
- Frequency of adjustments- semi-annually, annually or once every five years.
- Application of CPI to years subsequent to Base Year.
- Percentage of fixed rent to which CPI is applied- 100% or less.
- Downward adjustment as well as upward but not to go below fixed rent.

### **II. OPERATING EXPENSES**

- Reimburse L for costs or increase in costs of operating and maintaining the building and/or common area premises.
- Expenses should be net of reimbursements.
- Not to reimburse costs of ownership i.e. proprietary costs.
- Not supposed to be profit center or landlord subsidy.
- Proportionate share of entire operating expense sum or escalation over base figure.
- Precise, clear definitions of operating expense inclusions and exclusions are critical.
- Apply consistent accounting standards and methods from year to year.

\*Right to examine and question landlord's books and records and supporting information that relates to the computations and the information.

\*Tenant may engage its agent or representative to conduct audit.

\*Tenant uncovers rent overcharges and delivers notice of dispute after completion of audit.

\*Try to resolve dispute amicably.

#### IV. REAL ESTATE TAXES

- Reimburse landlord for real estate taxes or increase in taxes over base figure.
- Require precise, consistent definition of taxes.
- Base year vs. comparison (escalation) year.
- Define reasonable base year figure.
- Ascertain base year tax figure when lease executed, if possible.
- Will pending certiorari proceedings impact the base year taxes?
- Assess impact of ICIP, ICAP or PILOT payments.
- Proportionate share may change if building size changes.
- Consider assessments attributable to capital improvements, tenant improvements, sale or refinancing.
- Net refund of tax reduction.
- Requires constant monitoring.
- How long is the tax abatement/incentive program? When does it burn off and impact on tenants.

**QUESTION:**

**After the lease is signed, how does a tenant avoid getting “ripped off?”**

**ANSWER:**

**Have a lease audit performed on a periodic basis.**

**LEASE AUDIT PROGRAM:**

Periodic DUE DILIGENCE to ensure lease compliance by detecting and recouping rent overcharges in operating expenses, real estate tax, utility and other tenant charges. A lease audit is not a CPA-type audit. It is an examination of the propriety of rent payments.

**Lease Audit Premise:**

Overpayments of rent are involuntary payments. They are made under compulsion of forfeiture. Non- payment of additional rent is a serious default. It can result in termination of the lease. If a billing mistake results in an overpayment, tenant is entitled to recover the amount of the mistake.

**Tenant’s Recourse:**

- Tenant typically has no right of offset.
- Negotiate settlement.
- Possible Causes of Action against landlord:

- ◆ Lease Default ( landlord's breach of lease/contract)
- ◆ Equitable grounds for recovery
- ◆ Restitution
- ◆ Fraud
- ◆ RICO
- ◆ Negligent Misrepresentation
- ◆ Violation of State Deceptive Trade Practices Act

**CONSIDER:** Usually, operating expense and utility overcharge claims can be settled to the reasonable satisfaction of landlord and tenant. Notably, in certain instances where litigation ensued and the tenant was able to substantiate significant rent overcharges and paint a picture of gross unfairness/bad faith by the landlord, the Courts took notice of the equities and made decisions favorable to the tenant. Audit time limits and other procedural barriers may not be enforced where the landlord doesn't demonstrate good faith. Especially in today's market, Courts look for ways to recognize the merits of the tenant's claim to recoup substantive rent overcharges.

## **PART II- Covid 19**

How the Covid19 Pandemic has impacted the office landlord tenant relationship and how a tenant may deal with the business aspects of paying rent and complying with the terms of the Lease.

### **Background**

Since the offices of most legal and professional firms have been closed as a result of governmental orders in the Greater NY Metro area, the inability of those firms to use and occupy their offices has almost uniformly hurt the business revenues of the firms and caused them to incur new expenses. It is expected that in the near term businesses will not occupy their offices and function normally at least until a vaccine is developed and productive therapies for the coronavirus are developed as well. In the context of leasing office space, both landlord and tenant share the concern that until the building and the leased premises are safe and perceived as safe by the employees of the building, the building will be underutilized, the businesses of the tenant will suffer and some health risks will continue to exist.

### **Office Lease Example for Illustration Purposes**

The Johnson& Johnson Law firm leases, as tenant (“Tenant”) from a typical NY landlord (“Landlord”) an exquisitely built out 50,000 square foot space ( with a loss factor of 28%) in a 750,000 square foot midtown Manhattan 1990’s office building. The cost conscious prudent Tenant had it premises designed and constructed by UniSpace, a design build firm. Landlord did the usual “Landlord Work” to prepare the premises and Tenant received a \$1.5 million tenant improvement allowance. Tenant is currently paying \$4 million per year in base rent and \$9 per square foot in operating and real estate taxes. Tenant is sub-metered and pays roughly \$120,000 in electricity and \$35,000 for condenser water for its supplemental HVAC units. It pays another \$100,000 in miscellaneous charges to the Landlord and \$100,000 to the janitorial company ABC Co. for additional cleaning services. On March 21, 2020 when offices were officially closed by decree in NYC, the Lease was in the 5<sup>th</sup> year of a 10 year term with two five year renewal options at fair market rent. As security for the Lease, the firm deposited a \$2 million letter of credit that burns off to \$1 million in year six. In addition, the 10 equity partners have executed a Good Guy Guaranty for the term of the Lease. This Good Guy Guaranty allows the Tenant to terminate the Lease upon 60 days’ notice and the payment of all rents owing through the date of termination plus a one month base rent “damages” payment.

In the past 3 months, Tenant's revenues have suffered significantly because the firm's daily court litigation work has come to a halt, attorneys are less efficient working remotely and some attorneys and staff have been furloughed. The law firm has received some PPP monies.

What should Tenant do in relation to its rent obligations?

**Insurance:** Tenant should review its casualty insurance policy to see if it can make a claim for damages caused by the Pandemic. Most if not all policies exclude pandemics from coverage.

**Lease:** Tenant should review the terms of its lease to determine if there are any clauses that may give rise to a claim by tenant to stop paying rent arising from the pandemic situation.

**Force Majeure Event:** Is there a clause that if a Force Majeure event happens, Tenant is excused from paying rent during the time of the event? If a lease contains a Force Majeure clause and the clause may cover pandemics, Tenant has a shot in court. BUT- Almost every lease specifically excludes Force Majeure as a defense to the payment of rents and in such case the Tenant will lose its case.

#### **Material Casualty, Condemnation or Failure to Provide Services-**

**Material Casualty-** The Lease may provide for Lease termination or abatement of rent for a period of time, if all or a material portion of the demised premises is damaged in a casualty. It would be a very difficult argument to win that Covid-19 in or possibly in the demised premises constitutes damage from a casualty because a casualty is always a physical event.

**Untenantability-** However, a clause that refers to "untenantability" of the premises rather than physical "damage" to the premises can be a winning case. The firm Jenner & Block ("J&B") has such language in its Chicago lease that states that if the premises become untenable. Simply the tenant is unable to occupy the premises with no reason specified and since it is not getting use of its space is entitled to a rent abatement for so long as the space is untenable. J& B is currently in Court with its landlord on this issue. Untenantability language will entitle a tenant to a rent abatement as we saw first-hand when our client had such language in its Manhattan office headquarters lease and for three months was unable to use or occupy its space because of the damage caused to the building by "Super Storm Sandy" in NY. None of the tenants could use their space in the building because of the damage however very few tenants had the untenantability language in their lease.

**Condemnation** is being argued by some as tenants as well across the country in order to obtain a rent abatement or even a termination. Condemnation would definitely apply if the government took over the Building to use for government use. However, it is a much harder argument if the forced closure of the building by a governmental authority constitutes a temporary taking of the demised premises for purposes of a condemnation provision.

**Failure to Provide Services:** The Lease provides that Landlord will provide certain services to the tenant (some office leases are weak from the tenant's position and don't even obligate landlord to provide services). Most leases provide however, that Tenant has waived any right to terminate or any claim of rent abatement or deferral of rent if the landlords' failure results from causes beyond its control. Some leases specifically provide for abatements, regardless of the cause of the landlords' failures but those are usually not office leases. Even those leases that provide that the lease will terminate if services are provided require the suspension to be a very long time and are always covered by insurance. When a certain risk of loss is covered by insurance, Landlords will more often agree to give tenant an abatement of rent because the insurance makes the Landlord whole. Also, if Landlord collected rent such that there was no loss of rental, it would not be able to collect on an insurance claim for lost rentals. In this pandemic, most Landlords do not have the special insurance endorsement to cover them for the financial or physical losses suffered from the Covid19 pandemic.

**Other More Difficult Arguments vis. a vis. rental obligations:**

**Constructive Eviction**

**Frustration of Purpose**

**Breach of Covenant of Quiet Enjoyment**

**WHAT CAN THE JOHNSON LAW FIRM DO TO GET RENT RELIEF FROM ITS LANDLORD?**

1. Ask for a rent abatement of the rent and additional rent.
2. Ask for a rent abatement of the base rent but pay the op ex and re taxes.
3. Ask for a deferral of all the rents or just a deferral of the base rent.  
Pay back the deferral beginning Jan 2021 or 2022 on a amortized basis for a one year payback without interest.
4. If law firm revenues suffer significantly demonstrate to the Landlord with financials this business reversal and ask for a rent reduction. Landlord may modify the Lease with an extension of the term and the rents during that extension period term are negotiable.
5. Exercise or threaten to exercise the Good Guy and terminate the Lease. When the firm needs to reoccupy it can surely negotiate with the Landlord to reinstate the contract on the same or better terms.
6. Review new NY City Laws and NY State Executive Orders.



## **WHAT ELSE SHOULD TENANT DO?**

\*Terminate its extra cleaning services contract with ABC Co. Most contracts terminate upon 30 days' notice. If and when Tenant resumes occupancy it can renegotiate the scope of the services and the cost.

\*Revisit its office-related contracts and see if it can negotiate better terms based on change of conditions.

\*Tenant should have serious discussions with its landlord first and then the building cleaning contractor (who happens to have a business relationship with the Landlord) about Landlord's plan of action for readying the office building and Tenant's premises, if and when Tenant resumes occupancy in whole or in part. Tenant may consider engaging a consultants independent of the Landlord ( architects, engineers, cleaning experts etc. ) to advise it on the extra services it should procure, the protocols for social distancing, office space utilization (spacing and occupancy standards) and the purchase of PPE and other sanitizing equipment/supplies.

\*Tenant should be mindful that the Pandemic has impacted the financial well- being of its landlord and as a result Landlord will be looking to bring in as much additional to standard rental revenues as possible from its existing tenants. That could mean the the tenants will be potentially significantly overcharged on Landlord's billing of operating expenses and the other additional rents. Assuredly, the costs of the new measures that Landlord takes to ready the building for occupancy such as Merv and Hepa filtration upgrades to the HVAC system, new equipment such as UV-C lighting, new janitorial services to the common areas, additional building personnel etc. will be shifted to the tenants as much as possible. However, the lease may not permit the landlord to include all such expenses in operating expenses and charge the Tenant for it. Only real scrutiny such as a lease audit by an expert will unravel these costs and enable a tenant to effectively succeed in challenging improper charges billed to Tenant.

\*Take a hard look at its office leasing obligations including, rent, square footage, term, and options; office usage/space utilization, operational; and other business revenue issues, and employee safety and labor requirements.

\*Understand and possibly use New NY City Legislation on Moratorium on Commercial Evictions & the tolling of the Statute of Limitations in any negotiation with the Landlord. Tenant should be mindful that Landlord may draw down on its security deposit and the lease usually contains an evergreen clause that requires the tenant to replenish a security deposit.

\*Note: NYC Statute Staying Enforceability of the Personal Guaranty of a lease is only for retail and NOT Applicable to office leases.

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Joel I. Binstok is the Managing Principal of The York Group and York Consulting, lease audit and consulting firms respectively that he co-founded. Over more than 20 years, York has helped commercial tenants in the U.S. and Canada save significant sums of money, reduce occupancy costs and better administer their commercial leases. York's group of experts critically examines whether the landlord is properly billing the tenant for operating expenses, real estate taxes, utilities & janitorial services. Some of York's notable clients have included, **Voya, Chubb Insurance, Bank of America, JPMorgan Chase, Thomson Reuters, CBS, Emblem Health, Pitney Bowes, United Nations, The Comptroller of the Currency, DuPont, News Corporation, Interpublic Group, Montefiore Medical Center, Hughes Hubbard, Latham & Watkins, Pillsbury, Bryan Cave, Greenberg Traurig, Marubeni, VF Corp., GAP, VF Nautica, Vivendi Universal, Anchin Block Anchin, LLP and Friedman LLP.**

Prior to forming York, Joel practiced transactional real estate and workouts with the national law firm, Gaston and Snow, and as an associate counsel with the NY City Economic Development Corporation.

Joel is on the Executive Committee of the Real Property Law Section of the NY State Bar . He is a former Secretary of the NY City Chapter of CoreNet Global.

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