

Tenant Improvements Can Sour Your Office Lease



After numerous tours, the requests for proposals, and lengthy negotiation, the Tenant can now concentrate on the few scheduling items to complete the successful move into a new productive office environment. If the leased space is perfect for their use, and leased “as is”, then their biggest concern is getting the data, telephone and movers coordinated with the lease commencement.

If however, the lease spells out tenant improvements, this is an area where the introduction of third parties can adversely affect the economics of the lease and even the relationship of the parties. In order to agree on the rental, both Landlord and Tenant will want to define their costs as precisely as possible. Both sides want to minimize the risk associated with any construction and the bigger the job, the more the parties will focus on this issue. For that reason, the Tenant may push for “turn-key” construction where the Landlord bears all the costs of construction, known and unknown. The Landlord, on the other hand, may propose a build-out allowance and suggest that the tenant be responsible for coordinating the construction. This usually involves the rent commencing upon a specific date, whether or not the work is completed. If the lease is contingent upon a limit on the investment from either the Landlord or Tenant, or a firm delivery date, exceeding that target amount, or going past that delivery date, can mean the termination of the lease and the process starts over for everyone involved.

If you have been the Landlord, Broker or Tenant involved in a lease where 1) the cost numbers came in too high, 2) there were numerous change orders or 3) the contractor was not committed to delivering the space at the date promised, you will agree that steps should be taken in advance to try to avoid these kinds of problems. There are three things that can be done during and just after the lease negotiation to improve the odds of having a positive experience when dealing with tenant improvements.

First. Details, details, details. If you care about the cost, then you should be passionate about generating enough detail in the drawings and specifications to insure that contractors will provide bids that are truly apples and apples. Detailed plans make the contractors confident that they can determine the actual cost with a minimum of contingency funds. The lack of detail does just the opposite, since the contractors are forced to interpret the scope of work and add more contingency costs to cover the unknowns. When providing detailed plans, request a detailed construction schedule in return that shows the space being delivered on time. Beware of custom construction items, since items like sound proof panels or glass entry doors may have a long lead time for delivery.

Secondly, who's in charge and can get the job done. If this is a remote branch office, the Tenant is not likely to be in a position to co-ordinate construction. Contractors are eager to please repeat customers and if you are doing minor improvements on a multi-year lease, you are not going to be viewed as a repeat customer. However, if the Landlord is local, he/she is likely to have construction jobs going on in the building throughout the year and has an ongoing relationship with local contractors. If the Landlord's selected contractor performs the work, the lease should require that the Landlord to be responsible to enforce a 12 month warrant.

Lastly, bring all third parties to the party. You need to do more than sign off on the drawings and hope for the best. Before construction begins, there should be a meeting of the Landlord, Tenant, architect or space planner, contractor, IT consultant, and any specialty contractors. It is best if everyone is there in person, since the various contractors will now be dealing with people they know if a future problem arises.

Make sure that all parties have detail plans for their work and begin by asking for questions, concerns or suggestions regarding the work at hand.

- Questions provide an opportunity to head off areas of confusion before they affect the job.
- Unforeseen problems can be presented that may cost additional money, time, or just not produce the desired product.
- Suggestions will, in many cases, improve the project, save money or solve problems mentioned during the meeting.

Also insure that timing is a part of the conversation and that everyone knows the date the Tenant is to move in. By the end of this meeting, the goal is that all the third parties are committed to the delivery date. The contractor needs to plan their schedule to allow the IT consultant and systems furniture installer access to the space without delaying delivery. Another benefit of this process is the chance to head off change orders so once the job starts, it can stay on schedule.

Even with all the planning and details, it is still important to determine who should be contacted if there is a problem during construction and who has authority to approve any changes. It may be the local manager, but many times, it is not. If the payment for improvements is to be made upon occupancy, or if there are to be partial payments for work as it progresses, it should be specified in the lease who is responsible for the payments and under what conditions. If the Tenant is coordinating the work, the Landlord normally requires a tour of the property to insure that the work was completed as approved. Once the Landlord has inspected the completed construction, the construction allowance is paid to the Tenant within a certain number of days.

Through communication, planning and team building, the Tenant can help generate the space that they envisioned when they originally approached the office lease. For everyone involved, avoiding that sour taste can result in a sweet deal.

*John A. Hayden, SIOR
Concourse Group, Inc.
May 10, 2012*