

## Build-Outs In Office Leases: Road Map For Possible Risks

*Law360, New York (June 15, 2016, 11:05 AM ET) --*

A critical consideration in a tenant's office leasing decision is the aesthetic and functionality of its potential new space. For the landlord, getting from a signed lease to a tenant-in-possession paying rent is a critical transition. The signed lease should provide both parties with a clear road map to achieving a mutually acceptable result: a rent-paying tenant in possession of space built to its full expectation in an expeditious manner and at a cost to both landlord and tenant contemplated at the lease signing.



Anthony Casareale

### Tenant Performs Build-Out

With this scenario, the tenant is hiring a general contractor to construct its space according to plans prepared by the tenant's architect. The plans and the contractor are subject to the approval of the landlord. There may be improvements in the space that will be utilized by the tenant or the landlord may have accepted the obligation to demolish all existing improvements before the tenant commences its work. The tenant typically gets a cash allowance from the landlord to pay for the build-out and a period of free rent to complete the work and move in.

This scenario puts the onus on the tenant to complete the build-out before its obligation to pay rent starts. As a result, the tenant will want to have strict time limits on the landlord's approval rights. The general contractors and major subcontractors that the tenant intends to bid the work should be preapproved by the landlord in the lease.

The tenant will try to obtain an extension of the free rent period in the event its construction is delayed for force majeure events and certainly for landlord delays. If the cash allowance is large enough, the tenant will request that it be used not only for the "hard costs" of construction, but also "soft costs" (permit fees, architect/space planner fees, etc.), furniture, fixtures and equipment (such as IT cabling, etc.), with any unused allowance credited against rent. The lease will typically provide for the disbursement of the cash allowance similar to disbursements of a construction loan.

### Landlord Performs Base Building Work and Tenant Performs Build-Out

In many instances, the space may not be in the condition to commence the tenant's work. Often, the existing improvements need to be demolished or other work, often referred to as "base building work," needs to be done. This work is typically done by the landlord's contractors, at landlord's cost.

For instance, a term sheet may simply say, "the premises shall be delivered with all improvements fully demolished and removed." Well represented tenants will want the lease to contain much more detail, including assurances that the premises will be asbestos free with perhaps improvements such as sprinkler systems and HVAC ductwork left in place.

### **Landlord Performs Build-Out**

When the landlord agrees to perform the build-out it is sometimes referred to as a "turnkey" lease. Typically, but not always, the "turnkey" lease is for smaller spaces. The "turnkey" lease is often used as a marketing tool to lure smaller office tenants who do not have the internal resources, experience or inclination to plan and supervise a build-out. Typically, the building has a "building standard workletter" that the landlord has developed with its architect and can show potential tenants other tenant space built to that specification.

For the landlord, the lease should simply state that the landlord agrees to complete the work shown on an exhibit. This exhibit should contain as much detail as possible, but the execution of the lease cannot wait for full construction drawings to be attached. As a result, what is attached is a preliminary space plan layout (showing partitions, furniture layout, etc.) and specifications describing the improvements and finishes in some detail.

In my experience, if not managed properly, this arrangement can lead to delays in signing the lease. A typical formulation in a term sheet is: "The landlord agrees to build out the premises in accordance with the building standard workletter." However, as the space-planning process begins with the tenant working with the landlord's architect, requests are often made by the tenant that are beyond the so-called building standard workletter.

A landlord will protect itself by providing that the tenant agrees to pay for all costs associated with change orders in work requested and approved. The tenant will generally have to agree to this protection in some form, but it should consider requesting dollar credits for work that is dropped or costs saved as part of such change order request. The easiest example to think of is carpeting. If the tenant wants to select a more expensive carpet after the lease is signed, it should be given a dollar credit for the initial carpet selected that was part of the budget.

As for timing, the tenant will certainly want the lease to have a time deadline for completion of the landlord's work, and subject the landlord to monetary penalties for missing the deadline. The size of these penalties is often linked to holdover rent the tenant may face in under its existing lease. The tenant may also want a termination right if the build-out is not done by a later outside date.

Most landlords will agree to these provisions with certain caveats. First, the dates selected will have some period of time that serves as a "cushion" typically, 60 days or more for monetary penalties and longer before a termination right is triggered. Second, the dates agreed to will be subject to extension for "tenant delays." This typically covers delays caused by a tenants' failure to respond to a request for approval in the time period required by the lease, or by delays caused by a change order in the work requested by the tenant. Third, the dates agreed to will be subject to extension in the event of a force majeure event, which should include labor strife and other causes beyond landlord's reasonable control.

### **Conclusion**

In the end, the objective is to get a lease signed expeditiously that clearly reflects the objectives of the

parties. The work for leasing counsel is to recognize the risks inherent in the build-out approach decided upon at an early stage for BOTH parties, and then negotiate and draft a lease that creates a road map for dealing with the risks over the three-to-nine-month build-out period after the lease is signed.

—By Anthony Casareale, Casareale & Partners PA

*Anthony Casareale is a partner with Casareale & Partners in Miami.*

*The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

---

All Content © 2003-2016, Portfolio Media, Inc.