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Managing Construction Risks: *Strategies to avoid the Unexpected*



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CONSTRUCTION OF TENANT IMPROVEMENTS AND ALTERATIONS CARRY AN INHERENT RISK.

There are several key issues a tenant may want to consider, including the following:

- **Permitting** –Leases typically put two (2) construction related obligations on the tenant. Tenants are often charged with confirming that the leased premises are constructed in a manner consistent with zoning and building requirements (e.g., ramps, fire code exits). Likewise, leases assume the tenant will have obtained all necessary operating permits before rent commences. If there is a chance that the tenant could not receive a necessary permit (like a liquor license), or use variance, the tenant may want to negotiate an express permit contingency.
- **Delivery** –The majority of office leases have landlords providing some level of build out or refurbishment to the premises before tenant takes possession. To minimize any problems, an astute tenant will make sure the lease does not commence before landlord delivers possession of the premises with landlord's work substantially completed. In addition, consider requiring the landlord to confirm that on delivery the premises will comply with all applicable laws and have all building systems in good working order and repair.
- **Tenant Construction** –When the tenant constructs its own build out, more issues arise. Tenant will bear the risk of construction delays so, make sure the time periods in the work letter are reasonable. The tenant may also want the landlord to preapprove any architect and contractors the tenant plans to work with.



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- **Removal Obligations** – When considering the initial build out or alterations done later during the term, the tenant should review its obligations regarding surrendering the Premises when the term ends. Ideally the tenant should make sure the lease requires landlord to notify tenant whether any alterations will need to be removed at the time the landlord approves the alteration (or plans for the initial build-out).
- **Improvement Allowances** – A tenant improvement allowance is a negotiated sum of money that a landlord agrees to pay to subsidize the cost of building out a space for the tenant. Before the tenant moves ahead with the construction, particularly if large sums are to be expended, the tenant would be wise to confirm that the landlord has the funds to pay the allowance. Another concern about allowances not being paid arises if a lender takes over a project because the landlord defaulted on its mortgage. In cases where the tenant has significant leverage, the tenant should also make sure that the lender will agree to honor the improvement allowance (or provide a remedy like setoff) should the lender take over the project before the landlord has disbursed the allowance.

Final Thoughts – Early on in the leasing process, tenants should work with a team of experienced brokers and attorneys specializing in commercial real estate. Tenants who are pragmatic and have an understanding of the issues will successfully address many of their concerns and materially improve the terms of their lease. These tenants will avoid disputes and unexpected problems that may arise during construction.



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