



REAL ESTATE
COUNSELORS



Horseshoes, Hand Grenades & Construction: *Substantial Completion in Real Estate Transactions*



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IN CONSTRUCTION, CLOSE COUNTS. *“Substantial Completion”* is a phrase that is used in transactions involving construction to describe the stage when the construction or work is nearly complete, but not totally finished.

- **WHY IS IT IMPORTANT** – The concept of substantial completion is important because it is often used as a test or condition before certain obligations of one or more parties must be performed.
- **LEASING TRANSACTIONS** – When a landlord is building out the premises for the tenant or performing some refurbishment work, the tenant wants the landlord to complete such work before the tenant must move in and start paying rent. The landlord, however, does not want the tenant to find fault with a minor issue (like a light switch not working) and then refuse to take the space (further delaying when rent starts).

As a compromise, the landlord and tenant typically agree that the landlord’s work will be deemed *“substantially completed”* when all of the work is performed except for those items of unperformed work that do not prevent the tenant from using the premises for the permitted use. Such minor items of unperformed work are typically referred to as *“punchlist items.”*

When the tenant builds out its premises, substantial completion is often the test of when the landlord will fund all, or the final balance of, any improvement allowance it is providing to the tenant.



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- **LENDING TRANSACTIONS** – In construction loan transactions you will also see the test of substantial completion as a condition of funding, and perhaps also as a deadline to ensure a project is timely completed.
- **ADDITIONAL REQUIREMENTS** – Occasionally the test of substantial completion is broadened to include various requirements in addition to nearly completing the work. Those requirements may include issuance of governmental certificates (such as a certificate of occupancy), inspection and approval of the work by a representative of a landlord or lender, or a certification from the architect that the improvements have been substantially completed in accordance with the relevant plans.
- **EXCLUSIONS** – Sometimes the party performing the work will exclude specific items (*e.g.*, improvements to an elevator lobby area) from the test of substantial completion. Related to this are exclusions for work that could not be performed because of temperature issues or other external factors. For example, construction of a new home may be deemed substantially completed if work on the home is finished during the winter months, even though the builder may not be able to perform exterior landscaping work until spring.
- **DELAYS** – If there is a deadline or target date for substantial completion, the party performing the work will often negotiate for the right to extend the deadline to take into account delays caused by third parties, unavoidable delays, or other *force majeure* events.
- **YOUR TRANSACTION** – The issues discussed in this article may not necessarily apply to your transaction, and your transaction may raise issues not addressed in this article. In all cases, we advised you to consult an experienced commercial broker and experienced commercial real estate attorney to make sure the issues for your transaction are properly addressed.

