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How to Make Sure Your Work Letter Protects You

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Perhaps the most overlooked facet of leasing new corporate office space is the complicated world of work letters, which are attachments or exhibits to a lease identifying the landlord's responsibilities to fund all or a portion of the improvements to the tenant's premises.

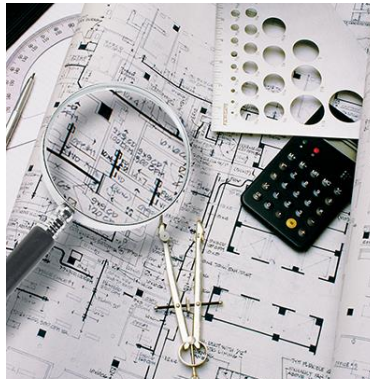
The work letter agreement between the landlord and tenant establishes the scope of work and the terms of how the tenant improvements ("TI") will be designed, constructed, and funded.

Look at the Big Picture

There are a multitude of factors to consider when negotiating and structuring a work letter. The most important are:

- The specific funding vehicle must be determined. The landlord may either provide a lump sum or a dollar amount per rentable square foot; fund 100 percent of the TI, or amortize the cost over the base rental rate. Additionally, the landlord may try to restrict use of funds to general improvements that benefit the overall space vs. tenant's specific needs. For example, a landlord will typically want to approve TI for conformance to building standards, signage guidelines, and quality of finishes.

- It is important to understand the type of space being improved. Will the funding be used for improving core and shell space or for second generation space previously occupied by a tenant? There are different



levels of core and shell space: totally unfinished (without HVAC equipment or main HVAC, plumbing, and power distribution), or "warm" core and shell space with some infrastructure in place.

- The project delivery method must be defined - design/bid/build; construction

manager design-assist, or design/build. Equally important, the work letter must clearly designate who will be responsible for the TI design and construction and whether the landlord or tenant will hold the TI contracts.

- The work letter agreement must also stipulate who holds professional design liability for the improvements. Will the landlord perform the work "turn-key" based on approved plans and specifications created by landlord or based on the tenant's architect and engineer's design? It also is important to determine if the landlord will negotiate the work with its preferred contractors or be competitively bid. On the other hand, if the tenant does the improvements, it should be clearly defined whether the tenant needs to use the landlord's authorized architects, engineers, and contractors, or has the right to select its own team. Concurrent work performed by landlord and

tenant also needs to be addressed.

No Detail is Too Small

A tenant should negotiate everything related to improvements in a work letter and should not assume anything. Therefore, the tenant must thoughtfully plan how the improvements will be executed and include the following points in the work letter:

- Describe the improvements with drawings and specifications, but understand that changes happen to even a well-defined scope of work. Change orders can be costly. Therefore, negotiate unit prices to apply to change orders (in dollars per square foot, or dollars per linear foot for example) and include them in the work order.
- Define payment terms, lien waivers, retention, and release of retention. Consider using the American Institute of Architects (AIA) G702™ payment application or similar form certified by the architect of record.
- Outline a space plan, room finish schedule, material quality, specifications, and approvals. Consider the need for computer server rooms, structured voice and data cabling, security and access control requirements, acoustic treatment, kitchen/café spaces, and any other special programs or requirements.

- Define Substantial Completion (SC) of the improvements and consider using the AIA G704™ form signed by the architect of record to establish the date when the work is “completed.” Tie the lease and rent commencement date to SC or a certificate of occupancy, either on a specific date or a set duration after SC. Specify the maximum duration from SC date for the landlord to complete 100 percent of the punch-list and deliver as-built record drawings. Equally important, consider what happens when delays to the improvements are caused by Force Majeure, by landlord, or by tenant. If delay is caused by the landlord, then consider free rent or other concessions. If the delay extends beyond a certain number of days, it could be cause for termination of the lease and consequential damages should be negotiated and included in the work letter.

Beneficial Occupancy should also be defined as well as tenant’s rights once achieved, including access for tenant constructed improvements and installation; e.g. voice and data wiring and office systems furniture and cubes. Tenant-furnished material and equipment installed by the landlord should be considered.

- Establish limits for landlord’s project management, technical review, administrative, and other overhead fees. If the TI allowance is underspent, how can it be used? What happens when additional improvement allowance is needed: Will it be a lump sum payment to the

landlord or an amortized increase to the base rental rate?

- Consider warrantees, “attic stock”; (e.g. carpet, ceiling tile, paint). Negotiate ownership of and responsibility for the server/data rooms, HVAC equipment, and uninterrupted power source equipment.
- Determine end-of-lease restoration of the space for conforming or non-conforming improvements so it is clearly understood structured voice and data cabling, for example, needs to be removed at the end of the tenancy.

Conclusion

Work letters vary and need to be crafted for each specific lease. Therefore, the duration of the lease term, economic conditions, and local and country norms are also considerations. Based on the anticipated budget, the complexity of the tenant improvements, and the project delivery method selected, the tenant should consider engaging the professional support of an architect, mechanical and electrical engineers, project manager, attorney and tax/accountant if not available in the tenant’s organization. The support could be one-time consulting or ongoing for the duration of the tenant improvements. In either situation, the time invested in a work letter is well worth it to prevent disputes with the landlord and avoid unforeseen costs.

This article appeared in the Fall 2014 Issue of ITRA Global’s Newsletter, Corporate Real Estate Strategies.