



COMPASS COMMERCIAL, ITRA GLOBAL

Providing commercial real estate services by advocating for our corporate clients' interests and increasing their profits.

How to Improve Your Improvements Clause

Commercial real estate interior improvements can be favorable or disastrous, depending on how your lease "Improvements" clause or "Work Letter" reads. In terms of office space interiors, the extent of the landlord's contribution to a tenant's build-out is influenced by many factors, such as a landlord's motivation and vacancy rate in the property, available capital, market conditions, duration of the lease term, lease rental rate, credit and financial wherewithal of the prospective tenant, security measures (i.e. cash, guarantees, letters of credit), upcoming vacancy in the property, adverse economic conditions, lender requirements and many additional factors.

The best position that a tenant can have with respect to improvements is a "turn-key" build-out where the tenant improvements are specified, and the landlord simply does the work and pays for it all. This occurs more frequently in weak office markets than in robust ones. In 2014, after many years of landlord heartburn from high vacancy and low lease rates, landlords witnessed increased activity and began to slightly increase lease rental rates and reduce improvement contributions. This trend continues in many office markets today.

Many tenants are astonished to see what commercial real estate improvements actually cost. It is often a multiple of what they anticipate. When landlords don't provide a turn-key build-out, they will either cite certain improvements, or cap their contribution at a certain dollar amount per square foot. An important point here is whether the cap is based on the rentable or useable square footage. If based on the rentable square footage, then the tenant will secure an extra 16% or so of allowance, (as that 16% is attributed to the common area factor of the building). If the agreement is based on the useable square footage, then the allowance is based on the actual space between the walls of the premises.

The Compass Commercial Difference:

Your Advocate:

We represent only tenants and users of commercial real estate—never landlords or developers.

Your Expert:

Our team of seasoned professionals negotiate on your behalf, lowering your cost. We use our years of experience to leverage your negotiating power.

Your Local & Global Representative:

We provide broad geographic coverage and seamless representation in multiple markets through offices around the world.

Your Trusted Advisor:

You will always receive objective, unbiased advice. Our team will save your hours of time researching, conducting negotiations and other services or your behalf.



Need some help? Just call us at 248.817.5400

Info@compass-commercial.com

www.compass-commercial.com



The scope of work may include basic refurbishment, such as re-painting the walls and doors (perhaps staining wood), replacing flooring and base, replacing or upgrading HVAC systems and/or electric, replacing the ceiling grid and/or lighting, demolishing or installing walls, built-in workstations or reception desks and more. Some soft costs include architectural/engineering, project management and permitting fees.

The lease should specify how the allowance is disbursed. It may be paid directly to vendors, or returned to the tenant after the tenant pays and the receipts are submitted to the landlord. The lease may also stipulate what the allowance may cover, and the quality of materials that must be used. In some cases, allowances may be used toward voice and data or furniture installations. In other cases, a portion of the allowance (if unused) may be used by the tenant at a later point in the lease term. Be mindful that there may be a time limit for using this credit.

Timing for build-outs can be tricky. In major markets, it often takes three weeks for architects to generate the full-scale drawings (not sketches), possibly several months for the municipality to approve the plans, and then another couple months for the contractor to complete the work. In other cases, basic refurbishment may only take a few weeks. Also, some landlords may do extensive build-outs without obtaining the permits for the work, but that can be risky. It is always important to carefully schedule the timing for commencement of rental payments with completion of the build-out. Make sure that whenever possible, the rent commences after Substantial Completion of the work and receipt of the Certificate of Occupancy (and of course after any applicable rent abatement period).

If the landlord is managing the work with a build-out allowance cap, make certain that you minimize any landlord project management oversight fees, and that the landlord seeks bids from several contractors to stretch the coverage of your allowance dollars. It may also be prudent to make arrangements for any cost overage beyond the allowance cap. Some landlords will agree to amortize this sum over the rent and across the lease term, so the tenant does not have to pay for the cost overages due in cash. Note that an interest rate on this money may be applied in some cases. Many tenants prefer this option.

This is an overview of a very important process. Your best bet for making the most of this component of your office lease is working with both an expert tenant representative and also an in-state commercial real estate attorney. It is also critical to work with a well-reputed, professional landlord and to avoid notorious ones.

Article submitted by Jason Stagman, CCIM / ITRA Global Fort Lauderdale, Florida, USA

