



NEGOTIATING THE TENANT IMPROVEMENT ALLOWANCE

A KEY COMPONENT OF ANY LEASE NEGOTIATION

is the **Tenant Improvement Allowance** provided by the Landlord to buildout or retrofit an office space for the Tenant's specific use.

The amount of the Tenant Improvement Allowance and the length of the lease term have a significant impact on the negotiated rental rate. In addition to negotiating a favorable amount for Tenant Improvements provided by the Landlord, the ability to maintain control of the process is also important.

Tenant Improvement Allowances, provided by the building owner, to buildout or retrofit office spaces are typically structured in one of two ways:

1. TURNKEY BUILDOUT

The Landlord covers the entire cost of the Tenant Buildout as a part of the agreed upon rent and provides a space plan that generally outlines the scope of construction.

2. STATED DOLLAR AMOUNT

The Landlord provides a Stated Dollar Amount for the Tenant to use toward building out the space, which often includes architectural and engineering fees.

When negotiating a lease, Tenants prefer not to use their own capital for expenses related to their office space Buildout. Tenant Brokers often state that their client wants a Turnkey Buildout, but technically Tenant Brokers should strive to eliminate or minimize out of pocket costs for the Tenant, as well as maximize the value of the Tenant Improvement Allowance based on the negotiated rental rate.



THE PROBLEM WITH THE TURNKEY BUILDOUT

The inherent issue with the Turnkey Buildout approach is that the Landlord incorporates a significant amount of contingency cost into the construction cost estimates to prevent actual costs from exceeding the estimate.

This could be a contingency as much as 25 - 30 percent, effectively creating another profit center for the Landlord if the Buildout is managed efficiently. In some cases, “efficiently managed” could be construed as “cut corners.”

For example, if the Landlord estimates the cost of the buildout at \$35.00 per square foot, the allowance that the negotiated rental rate is based upon, and then ultimately buildout the space for \$29.00 per square foot, the Tenant gives up \$6.00 per square foot that could have gone towards improvements to Tenant’s premises.

Another issue with the Turnkey Buildout approach is that the Tenant relinquishes control of the Tenant Improvement Dollars being spent on their office space. Unless the Tenant negotiates an extensively detailed work letter based on a detailed set of full construction plans, it is not uncommon to have surprises in the buildout that do not favor the Tenant.



CONTROL THE PROCESS WITH STATED DOLLAR AMOUNT

In most cases, negotiating a Stated Dollar Amount for the Tenant Improvement Allowance and maintaining as much control as possible over the Tenant Buildout process yields the most favorable result for the Tenant.

In addition, it's good practice to request that the Landlord either waive or reduce the construction management fee and to allow the Tenant to retain a project manager of their choice to oversee the design and construction process.

The objective is to shift control of the Buildout from the Landlord to the Tenant that provides the ability to:

- Maintain quality control of the process and insure construction is completed on time to prevent any holdover rent fees in the case of relocation
- "Value engineer" as well as let the Tenant reap the benefit of competitively bidding the construction contract to insure Tenant gets the most value out of Tenant Improvement Allowance.

If possible, it is also prudent to negotiate the right to amortize additional Tenant Improvement Dollars into the rent if the Tenant decides to add additional improvements, upgrades or incur unexpected cost overruns before the office space is completed. Tenant may elect to simply pay any costs over the allowance themselves, but it's good to have that option.

Choosing the Tenant Improvement Allowance approach requires more upfront work by the Tenant's Real Estate team to insure allowance negotiated properly, but maintaining control of the construction process allows the Tenant to realize the benefits of potential cost savings and maximize the value of the Tenant Improvement Allowance.





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