

How to outline landlord, tenant responsibilities

Prior to their move-in dates, commercial tenants usually require some construction modifications to the properties they've leased to meet business operational needs. One of the major issues in lease negotiations — and one that should be resolved in the primary phase — is who is responsible for the tenant improvements: the tenant or the landlord?



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Normally, when extensive tenant improvements aren't necessary, the landlord provides full construction services and funds the costs, which then are absorbed into the lease rate.

If extensive improvements are necessary, however, the landlord may require that the tenant take the construction responsibility and pay for the improvements. The landlord then would reimburse the tenant for the expenses incurred after all the work is completed and the release of all construction liens are received.

There are disadvantages to the tenant being responsible for construction improvements. The tenant must be responsible for the risks associated with construction, funding, credentialing, insurance and liability issues.

Moreover, when a tenant is responsible for hiring a contractor and that contractor damages the landlord's property or interferes with business activity because of construction delays, the tenant can be entangled in costly legal proceedings.

Many times, tenants are not experienced in construction and must expend an extraordinary amount of time managing the construction, which impedes their ability to operate their businesses.

Furthermore, in the event that construction is delayed, the tenant's rent will begin before the company can occupy the space.

In cases in which tenants pay out-of-pocket funds in advance and then are reimbursed

30 days after they receive all releases of construction liens, significant risk of peril to the tenant is a possibility. During the construction phase, subcontractors may not honor monetary bids or labor commitments. Labor disputes can hamper work performance and hinder job completion.

Furthermore, construction responsibility adversely can affect the tenant's working capital. Cash flow imbalances can interfere with business plans and operations during the construction and initial occupancy phases.

Particularly if tenants act as their own general contractors, daily business operations and anticipated growth can suffer.

The single advantage

However, there is one major advantage to tenants handling construction improvements. In cases that require complex security systems or other sensitive systems, tenants have better control over the construction costs, privacy, quality and cadence of the work. Every step of the construction process must be monitored to ensure adherence to work schedules. Periodic inspections and quality checks must be performed.

Perhaps a good compromise, then, is to shift the responsibility of construction to the landlord and allow the tenant to play a major role in the construction decision-making process. Ideally, the landlord should shoulder the risk of the construction responsibility and hire the workforce to perform the improvements. The landlord should oversee and ensure the project's timely completion, quality of work, and payments to subcontractors and vendors.

However, the lease negotiation should include the following conditions:

- The tenant should be granted the right to approve the subcontractors as to price, capacity and reputation.
- The tenant should be able to approve the terms of the construction contract relating to change orders, delay claims, and additions or deductions to the scope of the work.

- All warranties and guarantees must be provided directly to the tenant.

- All construction costs above the landlord's allowance will be paid by the tenant.

- The lease should commence when the tenant's facility receives a certificate of occupancy and is able to use the space to conduct business operations.

The tenant should only take an oversight position and not provide daily directions, so as not to confuse the issue of legal construction responsibility.

The compromise

Under this arrangement, the advantage to the landlord is that a positive rapport is established at the beginning of the tenant/landlord relationship.

The tenant is involved in the construction process and is informed of how allocated dollars are being spent on his or her behalf.

Good communication minimizes tenant and landlord disputes, because the tenant is protected — through prior negotiation and agreement — of price increases from change orders and other claims.

Because the landlord/owner is responsible for timely construction, the work most likely will progress swiftly, which is a benefit to both the landlord and the tenant.

In the event of a dispute, all parties can refer to the contract to assign responsibility.

Proper contract negotiation sets forth the operative rules of the tenant/landlord relationship. Don't leave any issue to chance; the lease contract must cover all eventualities. There is no such thing as a "standard" commercial lease.

Always remember: In commercial real estate, you don't get what you deserve, you get what you negotiate.

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