

**Thursday, November 4, 2021
9:30 AM – 10:45 AM**

Workshop 10

Work Letters: The Construction Contract Hiding in Your Lease

Presented to

**2021 U.S. Law Conference
San Francisco Marriott Marquis
San Francisco, CA
November 3-5, 2021**

by:

Laura Lee Garrett
Partner
Hirschler
2100 East Cary Street
Richmond, VA 23223-7078
lgarrett@hirschlerlaw.com

Marcus A. Mollison
Partner
Dorsey & Whitney LLP
Suite 1500, 50 South Sixth Street
Minneapolis, Minnesota 55402
mollison.marcus@dorsey.com

Work Letters: The Construction Contract Hiding in Your Lease

Discussion Hypothetical:

Pumps Plus (or “PP”) is a growing company with a popular, recently developed concept, which borrows from numerous other successful ventures, including coffee shops, fast casual restaurants, convenience stores, electric vehicle charging stations and fueling stations, to create a comprehensive shopping experience for people on the go, marketing to a customer base including all ages and socio-economic levels. The idea is to move beyond the traditional boundaries of a gas station and create a pleasant one-stop destination for all of these products and more. PP has expanded rapidly based on the success it has enjoyed and now has over 900 stores on the East Coast of the United States. The standalone facilities on average consist of two acre sites improved with a 4,000 square foot building, curbing, pavement, driveways, machinery, underground storage tanks, a canopy, and motor fuel dispensing equipment.

With the current trends big box shopping centers are experiencing, particularly post-COVID, the PP executive team believes a brief window of opportunity exists to capitalize on the availability of certain prime suburban locations and to redevelop some existing sites in certain high traffic locations to expand its concept. Not surprisingly, many power center landlords have expressed great interest in PP, particularly given the promise of the strong rental rates PP pays coupled with the volume of traffic customers will bring to the center.

From its inception, Pumps Plus has employed a highly leveraged strategic plan. PP leases its entire portfolio of convenience stores and aggressively negotiates for extensive base landlord improvements and eye-popping TI allowances. PP, in turn, generally has been willing to pay above-market base rent to effectively finance its unique build-outs, which it views as indispensable to its brand.

As part of its East Coast expansion plan, PP has identified a seemingly ideal site in the Staples Mill retail corridor (“SMC”), a venerable 60-year-old big box and small shop shopping center located in an affluent suburb 8 miles west of Washington, DC. SMC has been an iconic destination since its opening, but in recent years has lost two of its four anchor tenants and experienced never-before-seen levels of vacancy. SMC sees the PP opportunity as a chance to positively alter the trajectory of its flagging property in a single transaction and hopes

to replicate this model with PP at several other sites it owns up and down the East Coast. PP has a successful, but undersized store located only four miles from SMC and believes that relocating to SMC would immediately result in a net increase in annual revenue of 35%.

PP has proposed taking just over two acres of the shopping center requiring demolition of one of the vacated anchor buildings and several shop spaces located in between the two anchors, some of which are still in operation. This will require SMC to relocate several existing tenants and deliver to PP a pad-ready, re-zoned site subdivided from the remainder of the shopping center and consisting of a new separate tax parcel. SMC would be obligated to deliver the pad in accordance with detailed specifications on or before an outside date of 365 days to allow PP to commence and complete its TI construction in accordance with its expansion roll out schedule. PP's current lease for the location it will be relocating expires in 18 months, and it has no ability to extend its current lease beyond that date. The tenant improvements will include the convenience store building and all interior finishes, fuel pumps and other fueling station equipment, landscaping, lighting and other site work.

We will use the above hypothetical to illustrate and analyze the following issues related to construction in the landlord-tenant context.

I. Completion Delay Issues

A. Relocation Ramifications

1. Tenant Concerns

- a. **Coordination** – Only a six-month overlap exists between PP's projected TI completion and the expiration of its current lease. PP must vacate its current location and occupy the new site on schedule. PP must avoid the possibility that it could have no operations in the market due to a delayed Landlord delivery. PP may well want to insist upon a stringent liquidated damages provision for delay to further incentivize Landlord to maintain the delivery schedule (see §IIA below) and minimize any possibility for delays.
- b. **Contingency Plan** – Given the extreme tightness of the schedule and the severe consequences that would result from a gap in operations, PP will want to explore contingencies such as exercising any holdover opportunities under the existing lease, negotiating an extension with its current landlord, or, if feasible, obtaining an option for a short term tenancy at an alternate site.
- c. **Milestone Schedule** – PP may attempt to impose certain schedule milestones throughout SMC's work schedule, which, if breached, could trigger consequences such as schedule acceleration and/or PP takeover rights.

2. Landlord Concerns

- a. **Allocation of Business Risk** - Landlord wants to avoid liability for costs associated with PP's inability to relocate from its present operating location to the new site, believing that PP has control over this risk or knowingly is entering into a potentially risky business arrangement and, as such, should solely assume the risk. Accordingly, Landlord will want to negotiate as much extra time in its delivery schedule as possible as well as strong force majeure and excused delay provisions to account for unusual weather conditions, COVID-19/pandemics (see further below), unexpected events and delays beyond Landlord's control. An example of a Landlord-favorable (but somewhat balanced) excused delay provision follows:

- Excused Delay. Any delay in achieving substantial completion caused or contributed to by any of the following will be deemed an "Excused Delay":

- (i) Labor disputes, fire or other casualties, acts of God or the public enemy, floods, vandalism, sabotage, earthquakes, epidemics, adverse weather conditions not reasonably anticipated, governmental embargo restrictions, shortages of fuel, labor, building materials, or other causes beyond Landlord's reasonable control, including hazardous materials and concealed or latent physical conditions, or subsurface conditions that are of an unusual nature, differing materially from the conditions described in or reasonably inferable from any environmental, geotechnical, or other physical inspection report obtained by or delivered to Landlord prior to the date of this Agreement.

(ii) Action or non-action of governmental entities, public utilities, or of local, state or federal governments affecting the work; or

(iii) Any Tenant Delay.

Landlord will notify Tenant in writing as soon as reasonably practicable following the occurrence of an Excused Delay, but in any event within fifteen (15) days. In the case of continuing Excused Delays, only one such notice from Landlord will be necessary. Landlord's obligation to Substantially Complete the Work and any other deadline under this Lease will be extended equitably for the minimum number of days required as the result of the occurrence any Excused Delays properly noticed as set forth herein.

- b. Pandemic/COVID-19 Risks** – The COVID-19 pandemic highlighted the deficiencies inherent in many force majeure and excused delay construction provisions. Rather than rely on the general proposition that a pandemic should fall under the general language such as “caused beyond Landlord’s reasonable control,” it is prudent for both parties to unequivocally allocate risk for pandemic situations going forward. Specific risks to be considered include both additional costs and time extensions based on government shutdowns, unavailability of materials, unavailability of labor, personal protective equipment and cleaning.
- c. Further Limitation of Landlord’s Liability** – Landlord should attempt to obtain PP’s waiver of consequential damages and avoid or limit liquidated damages for delay.
- d. Schedule Exposure Deflection** – Landlord needs to pass its schedule-related risk to its general contractor and reflect the same or harsher consequences in its general contract. The general contractor, in turn, should take the same approach with its subcontractors and material suppliers down the line.

B. Damages and Losses

1. Tenant Concerns with Landlord Work Delay

- a. Lost Revenue/Operations** – Landlord’s late delivery of the premises could result in PP’s inability to timely complete its TIs and fixturing and possibly a late opening. At a minimum, this outcome would result in significant lost revenue for PP and quite possibly could suspend PP’s operations entirely for a period with significant negative financial and public relations consequences.
- b. Third Party Contract Defaults** – Numerous third party contracts would likely be impacted by material delays in the premises delivers, which may have a default domino effect for PP, including its various maintenance and management agreements.
- c. Additional Carry Costs** – A delay in delivery undoubtedly would result in additional carry costs for PP, including loan interest, holdover or replacement space, and attorney/broker/consultant fees.
- d. Increased Construction Costs** – Any meaningful Landlord delay in delivery likely will require PP to take measures to accelerate its TI work and further compress its construction schedule. The result will likely be additional construction costs, including labor costs for overtime and additional work forces.
- e. Seasonal Losses** – Depending on the nature of a tenant’s business, in addition to other damages, tenants may suffer tremendous harm if late delivery of the premises results in being precluded from operating during its critical sales season (e.g., holiday season).

2. Landlord Concerns with TI Completion Delay

- a. Adverse Effects on the Shopping Center** – The failure of PP to complete its TI work and open on schedule would exacerbate strain on the overall health of the shopping center.
- b. Co-Tenancy** – To the extent other shopping center tenants have any co-tenancy provisions in their leases, Tenant construction and opening delays could result in direct negative economic losses for Landlord or even loss of such co-tenants entirely.
- c. Loss of Percentage Rent** – To the extent PP’s lease with Landlord incorporates percentage rent, opening delays obviously would adversely impact Landlord’s rental stream.

- d. **Lender Issues** – PP’s construction-related delays also could trigger Landlord obligations and covenants in its loan documents, potentially leading to a Landlord default with its lender.

II. Remedy Considerations

A. Liquidated Damages

1. Tenant Concerns

- a. **Generally** – To address the concerns and potential losses noted above, tenants commonly will attempt to impose per diem liquidated damages for delays beyond a specified target date potentially with increases in the per diem rate depending on the length of the delay (e.g., after a thirty day delay the per diem rate doubles). In the authors’ view, the best conceptual use of liquidated damages is to serve as a tangible incentive for the Landlord to deliver the premises on time rather than as a windfall to Tenant. If delay liquidated damages actually become effective, all parties lose.
- b. **Amount** – PP will want to ensure that the amount imposed for the delay liquidated damages is sufficient to cover its actual losses. Parties enforcing liquidated damages often are surprised by latent costs and losses that were not anticipated when the lease originally was negotiated. It also proves to be helpful in negotiations with Landlord to be able to justify the liquidated damages sum in a meaningful way versus picking a random dollar amount.
- c. **Target Completion Date** – PP will want to carefully consider what date is most appropriate as the trigger for the liquidated damages. Tenants prefer the target date to be final completion in accordance with the scope of work set forth in the lease (vs. substantial completion).
- d. **Remedy Election Issues** – PP will want to carefully define the losses that the liquidated damages are intended to cover. Simply stating that the liquidated damages are intended to compensate for “delay in completion” may provide the breaching party an opportunity to characterize many types and categories of damages as “delay damages,” and use the liquidated damages for the unintended purposes of a Landlord liability shield.
- e. **Narrowly Tailored** – PP will want to tightly confine the circumstances under which Landlord can obtain schedule extensions due to excused delays. In the event Landlord insists on a Tenant Delay for an excused delay, consider the following tenant-friendly provision:
- **“Tenant Delay(s)”** means each day of delay in the performance of Landlord’s Work that occurs because of delay in completion of Landlord’s Work solely caused by Tenant’s failure to reasonably coordinate Tenant’s Work with Landlord’s Work prior to the Delivery Date as required pursuant to Section XX above. For any of the preceding to be deemed a Tenant Delay, Landlord must have delivered written notice to Tenant (which notice may contain notification by e-mail to Tenant’s construction project manager) indicating with specificity the (i) nature of the nature of the delay, (ii) how Tenant is responsible for it and (iii) notification that any further delay will be deemed a Tenant Delay. Landlord agrees to provide Tenant with a good faith estimate of the extent of the applicable Tenant Delay after Landlord has reasonably determined the same.
- f. **Other Requirements** – In addition to other requisite elements, for a liquidated damages provision to be enforceable, (i) actual damages must be difficult or impossible to ascertain and (ii) the amount of liquidated damages stated must be a fair approximation of the actual damages and not overtly punitive.

2. Landlord Concerns

- a. **Alternative Liquidated Damages Perspective** - Frequently landlords and their contractors summarily disfavor the concept of liquidated damages for delay as being onerous and singularly tenant/owner favorable. Rather than avoiding liquidated damages, however, landlords may want to consider intentionally employing a modest level of liquidated damages to effectively serve as a limitation of liability for delays in delivery.
- b. **Passing the Buck** – To the extent that the work letter subjects landlord to liquidated damages for delay, Landlord should attempt to mitigate its exposure by imposing the same or more stringent liquidated damages obligations on its general contractor.

- c. **Completion Date** – As noted above, to avoid liquidated damage disputes, Landlord and its general contractor should insist on an objective standard for the satisfaction of its duty to deliver the premises, such as upon issuance of the certificate of occupancy (temporary or final) or upon certification of the architect. Landlord also will want the trigger for the liquidated damages to be substantial completion rather than final completion.
 - d. **Grace Period** – Landlord will want to attempt to negotiate a grace period after the target completion date before liquidated damages commence.
 - e. **Excused Delay** – Landlord will want broad and generous concepts of excused delays for force majeure events, COVID-19/pandemics, tenant-caused delays, and delays with causes beyond Landlord's reasonable control (See §IIA2(a) above).
 - f. **Liquidated Damages Cap** – Landlords often will seek to impose an absolute cap on their liquidated damages liability to avoid the risk of catastrophic losses.
3. **Sample Liquidated Damages Provision – Tenant Favorable** (with bracketed Landlord alternate language)

• *[Subject to excused delay as provided herein,] If Substantial Completion of the Work does not occur on or before the Required Delivery Date, Landlord shall pay to Tenant as reimbursement for Tenant's additional carry costs an amount equal to \$_____ per day for each day that Substantial Completion of the Work is delayed beyond [fifteen (15) days after] the Required Delivery Date. Such damages (a) are a reasonable estimate of Tenant's additional carry costs, (b) shall not be considered a penalty, (c) [shall be payable by Landlord to Tenant as an offset credit against Tenant's rent obligations], (d) are intended to reimburse Tenant for additional carry costs only, and (e) shall not impair, waive, release or otherwise hinder any claim, action or suit by Tenant against Landlord for damages suffered by Tenant with the exception only of additional carry costs. [Notwithstanding the foregoing, in no event will Landlord's damages due to delay under this paragraph exceed and aggregate total of \$_____.] If Landlord does not pay such per day damages set forth in this section within ten (10) days after written demand by Tenant, Tenant may (x) sue to collect such amount, or (y) offset the such per day damages against any amounts owed Landlord by Tenant in accordance with this Lease. The obligations set forth in this paragraph shall survive the termination of this Lease.*

B. Takeover Rights

1. **Tenant Concerns** - To avoid the dire consequences associated with Landlord delays and failure to meet critical path milestones, PP may require the right to take over the Landlord's work in an effort to get the project back on schedule and complete it in a timely fashion.
2. **Landlord Concerns** - Landlord vehemently will resist allowing PP to take over its construction obligations for numerous reasons, including:
 - a. **Loss of Control over Work** - Landlord does not want to lose control over work being performed within the boundaries of its shopping center and may not even have the right to do so under the applicable REA, other leases, or its financing documents.
 - b. **Loss of Control of Completion; Potential Delay Implication** - The concept of liquidated damages for delay becomes quite problematic if Landlord no longer is in control of the schedule and construction of the project.
 - c. **Potential Cost Overruns** - A takeover of the Landlord's work undoubtedly would result in extreme cost overruns for the project, and again would be beyond landlord's control

C. Lease Termination Rights

1. **Tenant Concerns** – In addition to its other remedies, PP ultimately will want the right to terminate its obligations under the lease provided Landlord does not perform beyond what PP deems to be a reasonable cure period.
2. **Landlord Concerns** – Depending on the scope of Landlord's work, Landlord simply may not be in a position to allow PP a termination right once meaningful construction has commenced. In this hypothetical, for example, Landlord is making an enormous investment in the new premises in sole reliance on PP actually occupying the space. Further, Landlord's lender likely will not allow for the possibility of a tenant lease termination right.

D. Other Possibilities To Consider

1. Delayed Rent Commencement
2. Rent Offset

III. Tenant Improvement Allowance Issues

A. Securing the Tenant Improvement Allowance

1. Landlord Concerns

- a. **Cash Escrow vs. Letter of Credit** - In the event PP wants the TI allowance secured, if Landlord is willing to provide security for such TI allowance versus other mechanisms to give some “teeth” to Landlord’s obligation to fund the TI allowance (e.g., rent abatement), Landlord will want to find a way to secure payment of those funds in a manner that minimizes costs and other potential adverse impacts to Landlord. For example, Landlord may prefer a cash escrow to secure the TI allowance as it can be done at a low cost and will not adversely impact Landlord’s credit rating; however, Landlord will be funding the escrow up front in cash thereby reducing the Landlord’s available cash flow, which in the case of the hypothetical and the “eye popping” TI allowance, this could be a significant outlay of cash. Alternatively, a letter of credit can be a significantly more expensive option as bank fees are usually a percentage of the amount to be secured and may adversely impact Landlord’s credit and ability to borrow as it is viewed as a financing mechanism. The financial institution issuing the letter of credit may also require Landlord to collateralize other assets as a condition of its issuance of the letter of credit. If Landlord and PP determine a letter of credit is the mechanism that will be used to secure the letter of credit, Landlord will want to negotiate financial institution criteria that are broad enough to give Landlord flexibility to shop around for the most favorable terms for the letter of credit and provide for adequate notice and cure periods before PP is able to draw upon the letter of credit (the latter also would apply in the context of a cash escrow as well).

2. Tenant Concerns

- a. **Cash Escrow vs. Letter of Credit** - Given the considerable TI allowance, even if Landlord is a stable and creditworthy landlord and especially in the instance that Landlord is not, PP will want to have the TI allowance secured. In particular, PP will want to have easy access to the TI allowance in the event Landlord does not perform in accordance with the terms of the work letter and provide for clear direction as to when PP can access the security and for what purposes. In addition, a security mechanism that is bankruptcy proof is would also be ideal. For the foregoing reasons, the cash escrow would not be the preferable mechanism from PP’s perspective. First, the cash escrow is not bankruptcy remote, and even in the event the work letter and/or cash escrow agreement provides clear and unambiguous direction as to when PP can access the funds, if Landlord disputes the disbursement of any funds by the escrow agent to PP, most escrow companies will not want to take sides in the dispute and will interplead the matter causing potentially significant delays and costs to resolve the dispute. The letter of credit itself is more likely to be bankruptcy proof and so long as the conditions for PP to draw on the letter of credit have occurred, the issuer of the letter of credit will issue the funds requested by the draw. If Landlord and PP agree that Landlord will secure the TI allowance with a letter of credit, the work letter should contain provisions identifying the term of the letter of credit, the standards required for the financial institution issuing the letter of credit, the process and under what conditions the letter of credit may be drawn upon and when the letter of credit may be returned to Landlord.

B. Disbursing Complexities

1. Landlord Concerns

- a. **Tenant Improvement Payment Timing; Disbursement Conditions** - Ideally, Landlord would treat the TI allowance as a reimbursement and pay out the TI allowance in one lump sum upon PP’s final completion (including punch list items) of its work or in installments (e.g., monthly basis) based on progress for the preceding month but including a retainage – generally 5% to 10% - to ensure final completion of PP’s fit out and payment of any outstanding anticipated costs and any unforeseen costs and expenses. However, the foregoing may not always be the preferred structure especially where a tenant, such as PP, may be relying on the TI allowance to fund its improvements to and within its premises. One option would be to draft the work letter such that the TI allowance is paid out in larger chunks based on certain agreed upon conditions. For

example, at the time PP pulls its building permit to perform its work and commences construction, a portion of the TI allowance will be paid and the remainder of the TI allowance will be paid following PP's opening of its premises for business. Landlord will also want to ensure that its request for a portion of the TI allowance includes certification of the work done to date, the amounts expended, what contractors performed the work (or suppliers supplied the materials) and for what contracted and paid amounts and lien waivers from such contractors and suppliers for the work performed. At the final disbursement, evidence that the permanent certificate of occupancy for the premises has been issued should also be included. If the TI allowance is conditioned upon such funds only being expended on capital improvements, any requests for the TI allowance should also include a certification from PP's general contractor that such expenditures were for capital improvements. A sample provision illustrating the above concepts is as follows:

- In consideration for Tenant's agreement to enter into this Lease and perform its obligations hereunder in accordance with its terms, Landlord shall pay to Tenant the amount of Five Million Dollars \$5,000,000 (as such amount may be adjusted pursuant to this Section the "**TI Allowance**") as follows (i) Two Million Five Hundred Thousand Dollars (\$2,500,000) of the TI Allowance shall be paid on the date which is the later of (a) thirty (30) days following Tenant's commencement of Tenant's Work and (b) January 1, 2018, and (ii) the remainder of the TI Allowance, as adjusted herein (the "Second Installment"), shall be paid no later than ten (10) days following the date that Tenant opens for business to the public and Landlord receives the information required below in this Section:

(1) A final sworn statement from Tenant's general contractor listing all subcontractors with whom Tenant's general contractor contracted with directly, the dollar amounts which they were contractually to be paid and the amounts they were actually paid, for work performed in connection with Tenant's Work; and

(2) A notarized final lien waiver from Tenant's general contractor, Tenant's architect and each contractor providing labor and materials in excess of Fifty Thousand Dollars (\$50,000.00) with whom Tenant contracted directly or with whom Tenant's general contractor contracted directly, waiving all of such party's lien rights. If the general contractor or Tenant is unable to deliver a notarized final lien waiver from any required contractor, Landlord shall pay the TI Allowance to Tenant as required by this Section less an amount equal to one hundred fifty percent (150%) of the amount of services or materials provided by such contractor and/or subcontractor from which a lien waiver was not obtained (the "Lien Holdback Amount"). Landlord shall be required to pay the Lien Holdback Amount (or partial amount thereof) to Tenant on the earlier of such time as Tenant delivers to Landlord, or Landlord otherwise obtains, a notarized final lien waiver from such contractor, provided that a lien has not been filed prior thereto, the date which is sixty (60) days after the expiration date of the period within which a mechanic's lien would have to be filed in the State, less any amounts that may have been paid by Landlord in contesting or removing any lien that such party may have filed against the Property; and

(3) An unconditional certificate of occupancy from all applicable Governmental Authorities; and

(4) A statement, signed by Tenant's construction project manager (the "Tenant Cost Statement"), itemizing the direct construction costs in reasonable detail (with such supporting documentation as may be reasonably requested by Landlord) all actual fees and costs incurred by Tenant in connection with the design and construction of the Tenant's Work and otherwise incurred to prepare the Premises for its operations (including, without limitation, procurement, labor, materials, permit fees, the cost of legal, architectural and other professional services and the cost for Tenant's furniture, fixtures and equipment) (collectively, the "**Direct Construction Costs**").

- b. TI Amount and Additional Considerations** - Landlord should also consider whether the TI allowance is a fixed amount regardless of how much PP spends on its fit out or whether the TI allowance is in an amount up to a certain cap. In addition, Landlord may want to negotiate other

limits on the TI allowance or a claw back of the TI allowance (e.g., in the event of a default by PP under the work letter or under the lease between Landlord and PP). For example, the following could be added to the end of the sample provision above to address this concern:

- Provided, however, in no event shall Landlord be obligated to pay the Second Installment if there is in existence a default at the time such Second Installment is due. Within thirty (30) days following Tenant's cure of such default, Landlord shall pay the Second Installment.

or

- In the event Landlord elects to terminate this work letter [lease] in the event of a Tenant default, Tenant shall, on or before the date that is ten (10) business days following the date this Lease terminates, repay to Landlord all portions of the TI Allowance previously paid by Landlord to Tenant pursuant to Section XX below as of the date this Lease terminates. Such repayment obligation of Tenant arising under this Section shall survive termination of this Lease.

Before finalizing the terms of any TI Allowance, Landlord should also partner with an accountant and/or tax professional to determine the most advantageous way to structure the TI allowance. Finally, Landlord and PP should address if there is sunset on when PP can no longer make a request for disbursements of the TI allowance.

2. Tenant Concerns

- TI Allowance Timing and Preferably (Lack of) Conditions** - Given PP's desire to aggressively negotiate robust TI allowances, PP's preference may include a fixed TI allowance that is front loaded such that PP can finance its tenant improvements. If PP is unable to get the TI allowance in a lump sum up front, PP will want to ensure the work letter has clear objective criteria (e.g., lien waivers reasonably acceptable to the landlord vs. statutory lien waivers or AIA lien waiver forms) for PP to draw upon the TI allowance. In addition, to the extent Landlord insists on being able to withhold any portion of the TI allowance in the event of a PP default, such default should be beyond any applicable notice and cure periods and should not include any good faith disputes. The same can be said for any Landlord claw back but any agreed upon Landlord claw back should be amortized over an agreed upon period of time such as the following sample provision:

- If Landlord elects to terminate this agreement in accordance with this Section XX, (i) Tenant will surrender its possession of the Premises no later than the Termination Date to Landlord in the condition required by this Lease, and (ii) so long as Landlord has delivered to Tenant the amount of the TI Allowance Repayment Amount along with reasonable evidence thereof, within thirty (30) days after the earlier of (a) the Termination Date or (b) the date Tenant fully vacates the Premises, Tenant will pay to Landlord an amount equal to the unamortized portion (based on amortization over the Initial Term, such amortization commencing as of the Rent Commencement Date) of the TI Allowance previously paid by Landlord to Tenant (the "**TI Allowance Repayment Amount**").

Similar to Landlord, PP will want to partner with a tax and/or accountant professional to understand the tax treatment of any TI allowance and determine the preferential structure of such TI allowance from a tax and accounting standpoint.

C. Tenant Equity Contributions

1. Mutual Concerns of Landlord and PP- Depending on the advice from Landlord's tax and/or accountant professionals, Landlord and PP could structure PP's equity contribution in the form of above-market rent or a cash contribution structured similar to a TI allowance. The concerns here of Landlord and PP are the reverse of the TI allowance analysis set forth above. In addition, depending on the financial strength of PP, Landlord may wish to have Tenant's equity contribution secured similar to PP's concerns as it relates to the securing the TI allowance set forth above. In addition, if PP is paying above market rent, Landlord may want to negotiate an agreed upon liquidated damages sum if the lease between the PP and Landlord terminates prior to a certain point in time in the term of the lease (e.g., prior to the expiration of the initial lease term).

IV. Third Party Entanglements

A. Landlord Concerns

1. **Existing REAs and Leases** - In projects with multiple occupants, oftentimes one or more REAs or other similar governing documents will be in place to ensure that the intended use, development and maintenance of the project is developed and maintained. In a leasing context, it is common for a lease to contain similar provisions. Any construction work to be performed, whether by Landlord or PP, will need to be done in a manner as to not result in a violation of any applicable third party documents (e.g., REAs, leases with other occupants). Landlord will want to carefully review any third party documents prior to approving or finalizing any final scope of work or schedule. In particular, Landlord should consider the following:
 - a. Limitation on hours for construction;
 - b. Blackout periods when construction cannot occur (e.g., holiday);
 - c. Limit areas of the shopping center where buildings or other improvements cannot be built or construction staging/storage can be located ;
 - d. Prohibit closure or require third party consent to alter (e.g., access roads, parking areas);
 - e. Require deliverables to any third party in connection with any construction work (e.g., evidence of insurance, copies of permits, constructions plans);
 - f. Require certain construction standards (e.g., all construction shall utilize new materials and shall be performed in a good, safe, workman-like manner), insurance requirements to be met during construction, architectural theme or review or construction mitigation measures (e.g., construction area screening); and/or
 - g. Use limitations (e.g., no fitness facilities or gyms may be located above or adjacent to a particular tenant) or other development limitations (e.g., height or building area limits, no drive-thru).
2. **Quiet Enjoyment** - Landlord should also be mindful that PP's development at the shopping center does not result in a breach of the covenant of quiet enjoyment pursuant to any of Landlord's leases with other tenants at SMC. Landlord should ensure that its leases with third parties qualifies that any covenant of quiet enjoyment is subject to the terms and conditions of the lease and contain a provision whereby the tenant acknowledges that landlord may over the course of the lease term develop or redevelop portions of the shopping center similar to the following provision:
 - Tenant understands and expressly acknowledges that Landlord and its Affiliates intend to construct (or cause or allow to be constructed) additional phases and/or buildings and improvements in the Shopping Center and/or on lands nearby or adjacent thereto, and that Landlord and its Affiliates are therefore, reserving the right at any time and from time to time to increase, reduce or change the size, height, layout, or location of any of the various buildings, driveways, entrances and exits, automobile parking areas, mall truck concourse and other circulation areas now or at any time hereafter forming a part of the Shopping Center, the common areas, or any lands nearby or adjacent to the Shopping Center, to make alterations or additions to and build additional stories on any building or structures now located in the Shopping Center or the common areas, and on lands nearby or adjacent to the Shopping Center, to construct other buildings and improvements in the Shopping Center, the common areas, and/or on lands nearby or adjacent thereto, including double-decked, subterranean or elevated parking structures and which may include the construction of additional improvements in the Building above the Premises.

Even in the REA context, Landlord should be aware of the provisions similar to the following that may be implicated depending on the scope of PP's intended development at the shopping center:

- No construction activities performed or authorized may unreasonably interfere with the use, occupancy or enjoyment of any part of the remainder of the Shopping Center by any other party or its permittees.

3. **Lease Subject to Existing Restrictions and Encumbrances** - Landlord will want to ensure that its lease with PP acknowledges that it is subject to any REAs or similar agreements encumbering the property and include any limitations contained in existing, third party leases. With respect to the work letter, Landlord will want PP to provide detailed plans and specifications and work, particularly in those areas or categories that implicate any third party documents to ensure compliance with such third party documents and require any changes to be subject to Landlord's prior approval. In addition, if any third party consents are required, Landlord should disclose the need for such third party consent(s), and accordingly, provide that any penalties that could apply to Landlord for any delays in the schedule or changes in the scope are not applicable due to such third party consents. Ideally, any third party consents should be obtained prior to finalizing the work letter but, in some instances, due to timing or other considerations, this may not happen and Landlord should build in some protections for itself.

B. Tenant Concerns

1. **Compliance Assurances** - PP will want review all documents encumbering the shopping center or otherwise disclosed by Landlord to understand the impact, if any, on PP's intended development and plan its development, construction staging and construction schedule in compliance with such documents. Ideally, PP will attach the plans and specifications for PP's intended development at the shopping center and obtain Landlord's approval and consent to them. Further, PP will want the work letter and/or lease with Landlord to contain a representation and warranty that, except for those documents appearing on the title report or other documents otherwise previously disclosed by Landlord to PP and set forth in an exhibit to the work letter and/or lease, there are no other agreements encumbering PP's premises or its rights under the work letter and/or lease. Examples of this may include:
 - Excepting those permitted exceptions set forth on Exhibit attached hereto and incorporated herein (collectively, the "**Permitted Exceptions**"), Landlord is the owner of fee simple title to the Shopping Center free and clear of all restrictions, covenants, easements, liens, encumbrances and any other exceptions, and that the Premises and Exclusive Elements are free and clear of other tenancies, occupancies or other rights of possession.
 - The Shopping Center is zoned to permit the Permitted Use and, excepting the Permitted Exceptions, no recorded or unrecorded agreement exists that prohibits, restricts or would otherwise interfere with the construction and operation of a retail store at the Premises, including the Permitted Use.
2. **Landlord Reps and Warranties** - PP will also want the work letter with Landlord to include a representation and warranty that Landlord and PP are permitted to develop PP's premises in the shopping center in accordance with the approved plans and specifications set forth in the work letter and that no third party consents are required for Landlord or PP to develop the premises in accordance with the approved plans and specifications set forth in the work letter or, if any required third party consents are required for Landlord or Tenant to develop the premises in accordance with the approved plans and specifications, such third party consents have been obtained by Landlord. If third party consents are required and will not be obtained prior to execution of the work letter, an affirmative obligation should be added to require Landlord to obtain these third party consents. A sample provision addressing this concept is as follows:
 - On or before the delivery date, Landlord shall obtain all necessary non-governmental third party approvals required for the work contemplated in this work letter, including any and all necessary approvals of other occupants of the Shopping Center and any mortgagees of Landlord and pursuant to the Operating Agreements all free of any terms or conditions that affect the Premises or Tenant's rights under this work letter that Tenant has not otherwise agreed to in writing (collectively, the "Third Party Approvals"). Landlord shall indemnify, defend and save harmless Tenant from and against any claim, loss, cost, demand and legal or other expense, whether in respect of any litigation, judgment or otherwise, arising out of the failure of Landlord to obtain any of the Third Party Approvals by the delivery date, and this indemnity shall include (without limitation) reimbursement to Tenant of the costs of Tenant's Work if Tenant is unable to operate the Premises as contemplated by this Lease due to the failure to obtain any such consent, and increases in the cost of Tenant's Work due to interruptions or delays of work because of any such claim, but only to the extent the costs of Tenant's Work were not reimbursed by Landlord

as part of the TI Allowance. Landlord's obligations arising under this Section shall survive the expiration or termination of this Lease.

3. **Sunset Provisions** - To the extent Landlord wants to condition PP's intended development of its premises on any third party agreements, PP will want to ensure that such limitations are only in effect so long as such provisions in such third party agreements are in effect (i.e., if a third party lease at the shopping center contains provisions limiting construction activities with a holiday black out period and such third party lease is terminated or otherwise expires after the work letter is executed, PP will want such provisions to burn off and no longer be applicable) similar to the following:

- Tenant also agrees to comply with those certain provisions limiting or prohibiting certain construction activities arising under Existing Leases as more particularly set forth on Exhibit _____ (collectively, the "**Construction Limitation Provisions**"); provided, however, at such time as the Existing Lease containing one or more of the Construction Limitation Provisions expires or terminates, Tenant shall no longer be subject to the Construction Limitations Provisions of the expired or terminated Existing Lease.

4. **No New Agreements** - In addition, PP will want language in the work letter and/or the lease that Landlord will not enter into any new third party agreement or modification or amendment of any existing third party agreement that would impact PP's development and use of the its premises. Here are a few sample provisions that can be modified for specific transactions:

- Landlord represents and warrants to Tenant that there are no private use restrictions applicable to the Shopping Center and Landlord agrees not to impose any use restrictions on the Premises during the Term.

- Landlord may not enter into or consent to any REA amendment, modification, termination, consent, or waiver that may (i) adversely affect the exercise of the easements, covenants, conditions, rights, or restrictions granted for the benefit of Tenant or the Premises, or (ii) create additional covenants, conditions, restrictions, encumbrances, or other burdens on Tenant or the Premises.

- Landlord covenants and agrees that it will not permit any new agreement or other document on or after the Effective Date affecting the Premises or Tenant's rights under this Lease that would adversely affect any rights of Tenant under this Lease or create additional covenants, conditions, restrictions, encumbrances, or other burdens that adversely affect Tenant, the Premises, Tenant's rights under this Lease or Tenant's permitted business operations at the Premises.

V. Scope of Work Considerations

A. Qualified Expenditures for the Tenant Improvement Allowance

1. **Tenant Concerns** – Tenant wants maximum flexibility in how the TI dollars can be spent and does not want to deal with the logistical and practical issues involved with justifying the expenditures.
2. **Landlord Concerns** – Conversely, Landlord wants to carefully control where the allowance funds are being directed and wants them to be used to improve the value of Landlord's asset and enhance the shopping center generally.

B. Clarification and Coordination of Landlord's Work vs. Tenant's Work

1. **Mutual Concerns** – Clarity and specificity regarding Landlord's and Tenant's respective scopes of work benefits both parties. Ambiguity is everyone's enemy. An example of language for mutual cooperation and coordination is as follows:
 - Each of Landlord's Work and Tenant's Work shall be coordinated and done in a manner reasonably designed to minimize any interference with the construction of the balance of the other party's work and both parties will cooperate in the completion of Landlord's Work and Tenant's Work to the extent overlapping.
2. **Tenant Concerns** – To allow Tenant to properly design, bid and perform the TI and fixturing work, Tenant needs a precise understanding of the condition of the premises that Landlord will deliver.
3. **Landlord Concerns** – Landlord requires clarity and certainty as to its scope of work to avoid (a) having to provide "free" improvements beyond what was intended in the lease and (b) entanglements with respect to defining completion of the work and, if applicable, liquidated damages for delay.