

*MAKING THE WORK LETTER WORK: ADDRESSING INCONSISTENCIES BETWEEN THE LEASE AND
CONSTRUCTION CONTRACT*

Intro

- Most often contractors want to use the basic form of AIA (American Institute of Architects) construction contracts and/or simply attach their proposal.
- AIA documents are designed to be flexible to be used for a multitude of projects, but as a result are fairly bare bones and too general to address buildouts driven by leases/work letters
- Many people assume that simply attaching a Work Letter and filling in the blanks to the form AIA document is sufficient – but numerous potential inconsistencies can arise
- Parties need to understand the interplay between the documents and make sure that expectations of the tenant, landlord and contractor/architect are all considered and papered
- There are a number of areas where issues arise, whether it be the scope of work, scheduling, deliverables, payments or insurance requirements.

Defining the Scope of Work

1. Paramount importance. Contractor proposals are often insufficient.
2. Be specific when addressing needs – “building standard” finishes may not be what you think they are.
3. Items like electrical/HVAC capacity, number of sinks, location of AV/IT are often overlooked.

Addressing Scheduling Issues

1. One of the most important issues in the Lease is the RCD; defining the RCD properly in the Lease and aligning the construction contract schedule with the Lease is of paramount importance.
2. Even when a schedule for the construction contract is diligently prepared, both the contract and the lease need to be specific and consistent with one another as to what happens when that schedule breaks down.
3. The construction contract should include comprehensive provisions regarding delays, time extensions, and remedies for delay, damages recoverable by the contractor for certain delays under various circumstances, and the Landlord’s/Tenant’s remedies for the contractor’s failure to maintain the schedule. Industry forms allow the contractor to seek BOTH schedule adjustments and increased costs. Schedule changes should take into account (1) concurrent delays and (2) Landlord’s/Tenant’s rights to accelerate work.
4. Landlords will typically be held accountable for four types of delay: (i) failure to approve plans in accordance with the time frames set out in the work letter or the lease, (ii) changes directed by the landlord to the approved plans that necessitate a delay; (iii) failure to complete landlord’s work within the time allotted for delivery, and (iv) conditions in the premises or building which vary from those represented by landlord and cause a delay to the work affected by such conditions.

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5. Tenants will most often be held accountable for delays arising from: (i) failure to timely submit or resubmit plans, (ii) requested changes in scope, (iii) long lead time items, and (iv) interference with landlord's work. Landlords will want to provide that the RCD will be on the date when substantial completion would have occurred but for the delays by tenant which must be carefully defined as this will protect landlord's rental stream from delays caused by tenant.
6. Most industry forms waive consequential and other indirect damages. Can be mitigated by including liquidated damages provisions, but there are drawbacks to this approach. At the end of the day, the parties want the construction completed on time, and not a check for an amount that does not cover the potential loss and additional effort required to fight the delay claim war with the contractor.

These are just some of the considerations when it comes to properly scheduling the work under the construction contract with expectations under the Lease. As a general matter, proper completion and timely delivery of the buildout is an essential starting point for negotiations of the lease and the construction contract as it will be the starting point for the beginning of a potentially long term relationship.

Addressing Timing and Conditions for Payment of TI Allowance

1. The lease should always include detailed provisions regarding payment of the Tenant Improvement Allowance by the landlord to the tenant. When Tenant's work is involved, the tenant's obligation to pay the contractor for construction work under the construction contract runs a parallel course, and many of the requirements in the lease regarding timing of payment, invoice submittals and lien waivers are the same as the requirements in the construction contract.
2. However, it's important to recognize and address any inconsistencies between the lease and the construction contract to avoid or minimize problems; as an example from the Tenant's perspective – the need to pay the contractor without receipt of the payment from the landlord.
3. When negotiating a Tenant Improvement Allowance, the parties often overlook the critical issue of ensuring the consistency between the timing of payment of the Tenant Improvement Allowance under the Lease and the timing for payments to the contractor under the construction contract.
4. If project funding is being provided by a lender, the disbursement provisions in the loan documents will also include very similar, but sometimes different, requirements regarding payments for work, and these requirements should also be checked for potential disconnects.

Deliverables for Completion of Tenant's Work

1. Construction contract must incorporate specific deliverables required under the Lease. Different Landlords want different things. (AIA forms do NOT always provide for state-specific items like sworn statements.)
2. Improvement Allowances will usually be conditioned at a minimum upon delivery to Landlord of:
(a) landlord's receipt of the Bills and Invoices, information, and lien releases and waivers for the

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work, (b) upon completion of the Tenant Improvements, the determination that the Tenant Improvements are Substantially Complete and a clear understanding by both parties as to when this has actually occurred, and (c) the determination that no substandard work exists which adversely affects the building's or center's systems or the structural or exterior appearance of the building or center or any other tenant's use of its leased premises in the building or center.

3. Ask for Landlord's forms of lien waivers, etc. in advance and provide them to the contractor to ensure no surprises.
4. There must be a clear understanding between all parties as to what constitutes each party's entitlement to payment.

Insurance Maintenance Inconsistencies

1. Insurance and indemnification provisions in leases can often be a trap when it comes to aligning such requirements with construction contracts. Always ensure that your contractor has agreed to maintain the insurance required by your Lease.
2. The potential for contradictory language in the lease and the construction contract with regard to insurance and indemnification is a very real concern. Large landlords and tenants can have very complex portfolio wide insurance policies which include many types of coverages with varying limits and exclusions and these are NOT addressed in industry construction contracts.
3. ALWAYS have your insurance consultant advise prior to execution. Having to adjust insurance policies after a Lease is signed can be costly.
4. If this is not addressed early in negotiations of both the Lease and the construction contract, it may lead to delays in commencing construction if the landlord rejects the contractor's insurance and the tenant/contractor find themselves blind-sided at the last minute when they expected work to commence.

Conclusion

Defining the scope of work, scheduling, deliverables, payment conditions and insurance maintenance are areas where the lease and construction contract often do not align. These are just a few of the issues to consider when planning for a buildout. The contractor must recognize that its duties affect the obligations of both the landlord and tenant under the Lease, but it is also the parties' obligation to make sure this is clearly communicated and documented in writing. Early and consistent communication of the Lease requirements to the contractor is essential, especially when the contractor is engaged early and is not kept informed of changes in the Lease requirements during protracted negotiations.