

DRAFTING AND NEGOTIATING TENANT ALLOWANCE CLAUSES

In negotiating a commercial lease, the landlord may agree to provide the tenant with funds or credit known as a *Tenant Allowance* or *Tenant Inducement*, which may be compensation for all or a portion of the funds required to improve the leased premises or may simply be an inducement for the tenant to enter into the lease.

The term “Tenant Allowance” typically refers to funds that are recoupable by the landlord over the term of the lease and are tied to the tenant’s leasehold improvement obligations, whereas a “Tenant Inducement” typically refers to a non-recoupable amount paid by the landlord in order to entice the tenant to enter into the lease and may not be tied to leasehold improvements.

The following are some important issues which tenants and landlords should consider in drafting and negotiating a Tenant Allowance provision:

Issue	Tenant Perspective	Landlord Perspective
Turnkey or Tenant Allowance	<ul style="list-style-type: none"> • Does tenant want to control the improvement process, subject to landlord oversight, or does tenant want landlord to complete the work, subject to tenant oversight? • Tenant control comes with ability to quality control, select materials and contractors (subject to landlord oversight), but also attracts obligations to complete improvements in a certain manner and timeline. 	<ul style="list-style-type: none"> • Does landlord want to control the improvement process, subject to tenant oversight? • The allowance is typically recouped by landlord, amortized and built into basic rent over the term of the lease.
Calculation of Tenant Allowance	<ul style="list-style-type: none"> • Typically tenant allowances are calculated based on a fixed dollar amount per square foot of rentable area. • Tenant wants to ensure that HST is accounted for. 	<ul style="list-style-type: none"> • If there is a cap on GLA or Rentable Area for the purposes of calculating rent, then landlord should ensure the same cap also applies in calculating the allowance.
Timing of Payment – in advance, on progress, after completion.	<ul style="list-style-type: none"> • Tenant prefers a cash allowance be paid by landlord in advance as opposed to having to seek reimbursement; may be paid up-front or in instalments upon reaching progress benchmarks, on completion of work, with balance paid when open for business. • Cash flow and financing considerations. 	<ul style="list-style-type: none"> • Landlord prefers that tenant utilize its own funds to complete improvements and reimbursement is only provided once improvements are completed to landlord’s satisfaction, following expiry of construction lien periods, and tenant is open for business, fully fixtured, stocked and staffed.
Security for Obligations	<ul style="list-style-type: none"> • Tenant wants to provide for right of set-off in the event landlord does not pay 	<ul style="list-style-type: none"> • Landlord wants obligation to pay allowance to be deferred as long as possible and

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	allowance when due or obtain letter of credit from landlord as security for obligation to deliver allowance funds.	subject to certain conditions, so that tenant work is complete and tenant is open for business before any portion of the allowance is paid.
Construction Liens	<ul style="list-style-type: none"> • Tenant would prefer that only 10% of the allowance be held back by the landlord until expiry of the lien period. 	<ul style="list-style-type: none"> • Landlord does not want to pay the allowance before the lien period expires and the landlord is certain there will be no liens. • At a minimum, landlord retains 10% construction holdback. • Landlord may or may not be “Owner” for the purposes of the <i>Construction Lien Act</i> (soon to be <i>Construction Act</i>). • Account for new amendments to the legislation.
Termination Considerations	<ul style="list-style-type: none"> • Tenant will attempt to avoid obligation to repay allowance on termination. 	<ul style="list-style-type: none"> • Landlord will want tenant to repay unamortized portion of allowance in the event that lease is terminated early by tenant or in the event of default by tenant.
Unused Portion of Tenant Allowance	<ul style="list-style-type: none"> • Tenant will want any unused portion of the allowance to be credited against future rent. 	<ul style="list-style-type: none"> • Landlord may want to limit the allowance to actual, verifiable cost of the leasehold improvements only.
Landlord fails to pay Tenant Allowance when Due	<ul style="list-style-type: none"> • Tenant will want the right to set-off amount of allowance against future rent. • If the allowance is substantial, Tenant could ask for a letter of credit to secure the landlord’s obligation. • Tenant may wish to argue lack of payment results in fundamental breach of agreement permitting tenant to terminate the lease. Fundamental breach is not typically or easily established, nor is the termination of the lease realistic after the tenant has spent all the funds to fixture the premises. • Alternatively, tenant may sue for damages. 	<ul style="list-style-type: none"> • Landlord will attempt to limit tenant’s right to set-off and contract out of Section 35(1) of the <i>Commercial Tenancies Act</i>. • Mortgagees do not like tenant set-off rights.