

A photograph of a commercial building under renovation. Two construction workers are visible. One worker, wearing a yellow safety vest and a red ladder, is standing on a red A-frame ladder, working on the ceiling. Another worker, wearing a blue uniform and a white hard hat, is standing on the floor, looking towards the ladder. The room has large windows, some with blinds, and various construction materials and tools are scattered around. The text "Demystifying Construction and Tenant Improvement Allowances in Commercial Leases" is overlaid in white, bold font across the center of the image.

Demystifying Construction and Tenant Improvement Allowances in Commercial Leases

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When entering into a commercial lease, both landlords and tenants may find it advantageous to include provisions for construction or tenant improvement allowances. These allowances help facilitate the customization of the leased space to meet the specific needs of the tenant.



Most commercial building areas require some level of construction to suit a tenant's specific needs.

In this article, we will explore how these allowances are incorporated into leases, administered by landlords, applied toward the total costs of building the lease space, and how the funds are monitored. We will also delve into the crucial role of the Work Letter, which outlines the terms and conditions related to construction or tenant improvements within the lease agreement.

Incorporating Construction or Tenant Improvement Allowances into Leases

Construction or tenant improvement allowances are typically negotiated and included as specific items and documented within the lease agreement. The allowances are predetermined amounts of money that the landlord agrees to contribute toward the cost of construction or improvements needed to prepare the space for the tenant's intended use. The terms of the allowance, such as

the amount, purpose, and timeframe for usage, are clearly stipulated in the lease document, often in an exhibit called a "Work Letter".

Administration of Allowances by the Landlord

The responsibility for administering construction or tenant improvement allowances falls on the landlord. Once the lease is signed, the tenant usually submits their proposed plans or specifications for the space to the landlord for approval. The landlord will review the plans to ensure they comply with any legal requirements and building regulations. If the plans are approved, the landlord and tenant will then proceed with the construction or improvement process.

Application Toward Total Building Costs

The construction or tenant improvement allowance is applied toward the total costs incurred in renovating or customizing the leased space. This includes expenses related to materials, labor, permits, and other relevant construction costs. The tenant may also contribute additional funds if the

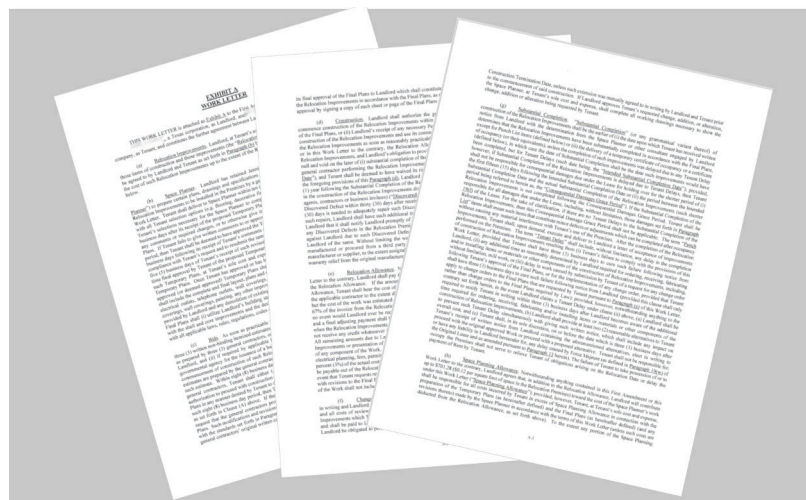
allowance is insufficient to cover the entire project cost.

Handling Excess Allowance Funds

In cases where the actual construction or improvement costs come in lower than the allocated allowance, the tenant is not typically entitled to keep the excess funds. Most lease agreements stipulate that any remaining allowance amount will not be refunded to the tenant, remaining the property of the landlord. In some cases, this can be a negotiated so that credits from unused funds are applied towards rent coming due or to other expenses related to occupying the space.

Payment Schedule

The payment schedule for the construction or tenant improvement allowance is specified in the lease agreement. It can vary depending on the agreed-upon terms and the size and complexity of the project. Generally, the payments are disbursed in installments, with the initial payment often made at the start of the project. Subsequent payments may be made upon the completion of specific milestones or



The Work Letter is part of a lease agreement that details all construction related issues.

phases of the construction.

Payments to Tenant or Contractor

The funds for the construction or tenant improvement allowance are usually paid directly to the contractor or vendors involved in the project. This ensures that the money is used exclusively for the intended purpose and prevents misuse or diversion of funds.

Application for Payment

To receive reimbursement for construction expenses, the tenant typically submits an application for payment to the landlord. This application includes detailed documentation of the expenses incurred, such as invoices, receipts, and other relevant records. The landlord reviews the application to verify that the expenses are in

line with the agreed-upon terms and then proceeds with making the appropriate payment.

Monitoring Fund Utilization

Throughout the construction or improvement process, the landlord may monitor the use of the allowance funds to ensure compliance with the lease agreement. Regular progress reports from the tenant or the contractor can help the landlord stay informed about the project's status and the funds' utilization.

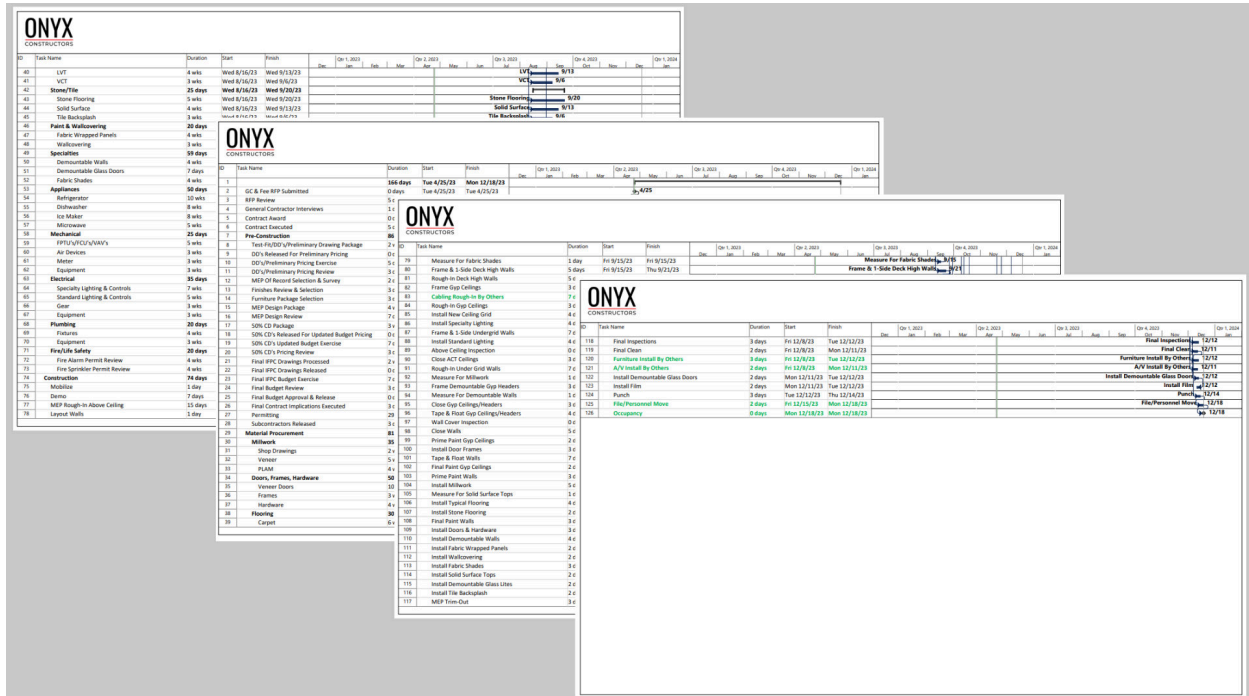
The Role of the Work Letter

A Work Letter is an essential component of a commercial lease that outlines the terms and conditions related to construction or tenant improvements to be made on the leased premises. Also known as a

The image displays a complex set of documents related to a construction payment application. On the left is the 'APPLICATION AND CERTIFICATE FOR PAYMENT' form, which includes fields for owner, project, application number, and contractor details. Below this is the 'CONTRACTOR'S APPLICATION FOR PAYMENT' table, which lists costs, taxes, and totals for various items. To the right of this table is a 'CHANGE ORDER SUMMARY' table with columns for additions and deductions. Further right is a 'NOTARY PUBLIC' stamp for KIRI GRIZZARD, Notary Public, State of Texas, with a commission expiration date of 04-11-2027. Below the notary stamp is the 'ARCHITECT'S CERTIFICATE FOR PAYMENT' section, which includes a signature and a date. On the far right is a 'JOB WORK' progress tracking table with columns for previous applications, total applications, total completed, and balance in hand.

A Pay Application details costs incurred to date and job progress is required to draw funds from the allowance.

"Construction Exhibit," "Tenant Improvement Exhibit," or "Build-Out Schedule," the Work Letter serves as a legally binding agreement between the landlord and the tenant, detailing the scope, budget, and responsibility for the construction or improvement work required to prepare the leased space for the tenant's specific needs.



The Work Letter requires a detailed schedule that will meet deadlines for completion and occupancy of the space.

Key Components of a Work Letter

- 1. Scope of Work:** The Work Letter clearly defines the scope of the construction or tenant improvement work to be performed. This includes specific details about the changes, modifications, or additions to the leased premises required to meet the tenant's requirements. The scope may encompass structural modifications, electrical and mechanical installations, flooring, walls, ceilings, and any other customization needed.
- 2. Budget and Allowance:** The Work Letter outlines the total budget

allocated for the construction or tenant improvements. This budget may be a fixed sum or a per-square-foot amount, depending on the lease agreement. Additionally, it will specify any construction or tenant improvement allowance provided by the landlord to cover a portion of the project's costs.

- 3. Responsibility and Roles:** The Work Letter clearly delineates the responsibilities of both the landlord and the tenant regarding the construction or improvement work. It establishes who will be responsible for coordinating and overseeing the project and who will engage and pay

the contractors and vendors involved.

4. Permits and Approvals: The Work Letter may address the requirements for obtaining necessary permits and approvals from local authorities. It may specify whether the landlord or tenant is responsible for securing these permits and how any related costs will be handled.

5. Construction Timelines: The Work Letter typically includes a schedule or timeline for completing the construction or improvement work. It may outline milestone dates for specific phases of the project or indicate the overall time-frame for completion.

6. Standards and Specifications: The Work Letter may define any standards or specifications that must be met during the construction or tenant improvement process. This ensures that the work meets quality and safety standards while aligning with the

overall design and aesthetics of the building.

7. Change Orders: The Work Letter may address how any changes or modifications to the original scope of work will be handled. Change orders can arise during the construction process due to unforeseen circumstances or changes requested by the tenant. The Work Letter may stipulate how these changes will be approved and accounted for in the budget.

8. Payment and Reimbursement: The Work Letter specifies the payment procedures, including when and how the tenant will receive reimbursements for construction expenses covered by the allowance. It may outline the documentation required for reimbursement, such as invoices and receipts.

Construction or tenant improvement allowances are valuable tools that can make a commercial lease more appealing to prospective tenants and enable them to create a space that suits their specific needs. By clearly outlining the terms of the allowance in the lease agreement and administering the funds responsibly, both landlords and tenants can benefit from a successful and satisfactory leasing experience.

The Work Letter plays a crucial role in this process by defining the scope, budget, and responsibilities for construction or tenant improvements, ensuring a structured and efficient process from start to finish. With the right approach to allowances and a well-drafted Work Letter, landlords and tenants can foster a collaborative relationship that results in a tailored and functional leased space.



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