



## Understanding and Negotiating Work Letters

### BASIC WORK LETTER ISSUES

1. Who is doing the work – Landlord v. Tenant?
2. Who selects the contractor and how?
3. Who pays for what?
4. How does the Rent Commencement Date relate to the construction of the improvements?
5. What happens if there are delays caused by Tenant? By Landlord?

### THREE BASIC TYPES OF WORK LETTERS

1. **TURN-KEY**<sup>1</sup>
  - (a) Landlord and Tenant approve the plans for Tenant's improvements prior to the execution of the Lease.
  - (b) Landlord agrees to pay the cost of such improvements in accordance with the approved plans, regardless of the cost (typically Landlord has determined the cost of the improvements prior to the execution of the Lease).
  - (c) If Tenant requests changes to the pre-approved plans, Tenant may be responsible for the cost of such changes.
  - (d) The approved plans are either specifically referenced the Work Letter or attached as an addendum to the Work Letter.

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<sup>1</sup> The term is derived from the concept that after Landlord completes construction of the improvements, Tenant only needs to "turn the key", open the door and begin operating its business in the Premises.

- (e) Landlord enters into a construction contract with a general contractor and architect, usually selected by Landlord.
- (f) Rent Commencement Date is typically tied to the substantial completion of the improvements (can be subject to Tenant's Delays).
- (g) Tenant may negotiate remedies for Landlord's failure to deliver within a fixed period.
- (h) Landlord may be responsible for punch-list items and/or latent defects

2. **LANDLORD WORK LETTER (TENANT RECEIVES AN ALLOWANCE**

- (a) Landlord agrees to pay a fixed amount per rentable or useable square foot in the Premises. If the cost of the improvements exceeds the amount of the allowance, Tenant is responsible for the excess.
  - (i) Timing of payment of excess amount by Tenant is negotiable (*options include*: up front, 50/50, after substantial completion).
  - (ii) What costs the tenant allowance can be applied to are negotiable (i.e., soft costs, cabling, moving costs, stationery, etc.) as is what happens to the excess allowance (*options include*: rent credit, balance on account with landlord for future improvements, "use it or lost it").
- (b) The plans for Tenant's improvements are typically finalized after the execution of the Lease.
  - (i) More sophisticated Work Letters may have a timeline for plan review and comment, final approval, etc. that ties into the "Tenant Delay" concept.
  - (ii) Negotiable as to which party selects the architect/space planner.
- (c) Landlord enters into a construction contract with the general contractor and architect.
  - (i) Landlords usually want control/approval rights over the general contractor and most major subcontractors (particularly MEP).
  - (ii) Tenant can usually get Landlord to agree to competitively bid for the job.
- (d) Rent Commencement Date is typically tied to substantial completion of the improvements (can be subject to acceleration based on "Tenant Delays").

- (i) Definitions of “substantial completion” and “Tenant Delays” are important in this context.
  - (ii) Need to incorporate concept of “punch list” and responsibility for “latent defects.”
  - (iii) On larger jobs, may want to address the assignment of warranties to Tenant.
- (e) Tenant may negotiate remedies for Landlord’s failure to deliver with a fixed period of time (e.g., free rent, cash payment, payment of holdover premium in Tenant’s current space).
  - (f) Landlord usually charges a “construction management fee” that comes out of the allowance.
    - (i) Amount of the construction management fee is negotiable (5% is Landlord standard).
    - (ii) What costs are counted in calculating fee are important (i.e., hard costs only v. total costs).

3. **TENANT PERFORMS WORK (WITH OR WITHOUT AN ALLOWANCE)**

- (a) Incorporates many of the same concepts as Landlord Work Letter, except that Tenant enters into a contract with the general contractor to perform the improvements.
- (b) Tenant controls construction and construction schedule, but Tenant usually takes timing risk.
- (c) Rent Commencement Date is typically a fixed date (should be subject to Landlord Delays and/or force majeure).
  - (i) What constitutes a “Landlord Delay” is negotiable – e.g., Work Letter may include specific time line for Landlord response to plan approvals, etc.
  - (ii) What constitutes a “force majeure” delay is negotiable – e.g., is unavailability of selected materials considered a “force majeure” event?
- (d) If Landlord provides an allowance, Tenant will be responsible for costs in excess of allowance.
  - (i) Timing of payment is typically very important.

- (ii) Tenant usually needs ability to draw down the allowance on the same schedule as draws must be paid to the general contractor (otherwise Tenant must come out of pocket).
  - (iii) Landlord may require Tenant to deposit excess costs with Landlord in advance as additional security that sufficient funds will be available to pay the contractor.
  - (iv) Landlord may elect to make payments jointly to Tenant and the general contractor.
  - (v) Typically, landlord will require interim lien waivers, certificates from the architect regarding percentage of completion, etc. as condition of payment of draws from allowance.
  - (vi) Retainage is negotiable – i.e., Landlord often holds back a portion of the allowance (10% is typical) until construction is completely finished (maybe including the punch-list) and the contractor has delivered the final lien waiver, certificate of occupancy, “as-built” survey, etc.
- (e) Landlord may still charge a supervisory fee.

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