



## Leasehold Improvements—Who Has Responsibility?

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*Commercial leases are complex and contentious documents to draw up. One of the least understood aspects is the work letter that deals with improvements to a property that are done by a landlord or tenant.*

A work letter outlines what already exists in the property, as well as what needs to be done, how much it will cost and who's going to pay. If a letter isn't carefully drafted, you can wind up spending more time and money than you expect and possibly run into added costs and delays.

Let's begin with the basics. Usually there are two sections in a work letter:

1. An outline of what the tenant has to do to provide plans for approval from the landlord. This includes language on how to deal with the job and any unusual work, penalties, delays, and cooperation needed.
2. A description of what already exists at the property, usually stated in dimensions, numbers, measurements, and quality schedules.

Work letters can be 20 pages or longer and spell out such details as the amount of money each party will spend on improvements, the type of ceilings, the number of light fixtures, the power supply and air conditioning.

It also gives one of the parties control over the improvements.

For those reasons, a work letter deserves considerable attention and negotiation and requires an attorney. There are three types of work letters:

### **Tenant builds**

The landlord provides basic systems and may provide the tenant with an allowance for improvements, but the tenant pays for any work that exceeds the allowance. The tenant hires and controls both architects and contractors. Rent begins on an agreed-upon date. In this situation, the tenant controls costs, materials and time.

### **Landlord builds**

The tenant hires an architect and the landlord hires the contractor. The landlord provides basic systems and pays for improvements within a set allowance. Rent starts when a substantial amount of work is finished. The tenant loses control over quality and time and pays all costs that exceed the allowance. The tenant can address some of these concerns by insisting on the right to clear any changes to the plans and reviewing specifications for materials and other items to be installed.

### **Turn-key**

The landlord hires both an architect and contractor and pays for all work, regardless of cost. Rent usually begins when a substantial amount of improvements are completed. If the tenant asks for any changes to the original plans, he must pay for the additional costs. Early completion is critical to the landlord, so a tenant may be concerned about the quality of the work and materials.

### Improvement Allowances

Tenant improvement allowances are usually set as a dollar amount per square foot. The work letter should say whether the amount is based on rentable or usable space.

A work letter should also state what happens when costs exceed the allowance. The tenant is responsible for paying, but how and when?

Landlords prefer to have the money deposited before work begins. Smart tenants try to delay payment until the allowance is depleted. Another option is to add money to the rent and have it amortized over the life of the lease.

A work letter should also list what the allowance pays for. Landlords often prefer using it only for hard costs such as construction and permanent improvements. It's generally better for tenants to negotiate some soft costs, such as fees for architects or moving costs. There are tax consequences too, so consult with your tax adviser.

The language dealing with materials is particularly significant to avoid future disputes. Be careful that the letter accurately addresses the labor required and that the description of materials includes everything. For example, a door requires door knobs, and that detail must be spelled

out. Checking, pricing, and evaluating the work letter should be done at the beginning of the lease negotiation. Careful analysis of any deficiencies and negotiation by your attorney and the construction team, can save hundreds of thousands of dollars. ■

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