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WHO PAYS FOR COST OVERRUNS IN LANDLORD'S FINISH-OUT OF TENANT'S SPACE?

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When a potential tenant negotiates with a landlord to lease space in the landlord's development, both parties focus on the extent to which the interior of the proposed tenant space will be completed by the landlord. In some cases the landlord will agree to provide the tenant with a "vanilla box" (generally, a space with electrical, lighting, plumbing, HVAC, concrete floor and bare sheetrock walls). Alternatively, the landlord may agree to provide "turn-key" finish-out of the tenant's proposed space, installing all equipment, wall and floor coverings, etc.

Final plans and specifications for the finish-out of the tenant's space are rarely available at the time the landlord and tenant sign the lease. The plans are not always available because of the hurried timeline associated with lease negotiation, and because the tenant usually does not want to spend the time and money on architectural and engineering fees associated with the final plans and specifications for the specific space in a shopping center before it knows that it has an agreed lease for that space. However, the landlord needs final plans and specifications to determine the cost to complete the finish-out of the tenant's space, because such costs will be a key factor in the rental rate charged to the tenant. Often the tenant delivers the final plans and specifications to the landlord well after lease execution. Generally, the tenant will provide the landlord with plans and specifications from another of the tenant's locations, similar in size to the proposed space, as pro forma plans and specifications for the proposed space, to allow the landlord to have a base line from which to calculate the tenant's rental rate.

Problems can arise when the tenant makes subtle changes between the final plans and specifications and the pro forma plans and specifications on which the land-

lord relied in setting the rental rate. Sometimes a subtle change such as a different brand of lighting or movement of a bathroom a few feet can materially increase the cost of construction, which can quickly provide a losing proposition for the landlord. Therefore, a well-drafted lease should take into account a possible adjustment in the event that the final plans and specifications provided by the tenant result in a cost increase to the landlord in construction of the tenant's space. The landlord will prefer this adjustment to be automatic, and to be determined after construction is complete, to allow the landlord maximum flexibility in completion of the tenant's space. A sample of such provision in favor of the landlord may read as follows:

Landlord agrees to construct leasehold improvements in accordance with the plans and budget (the "Final Plans") which shall be delivered by Tenant within thirty (30) days of execution of this Lease by Tenant and which shall be attached hereto and made a part hereof. Tenant agrees to reimburse Landlord for the cost of construction of the improvements to the Premises to the extent that the cost of construction of such improvements in accordance with the Final Plans or otherwise due to a change in Landlord's work requested by Tenant exceeds the cost of construction of the improvements described in any pro forma plans and specification delivered by Tenant to Landlord prior to execution of this Lease, within fifteen (15) days after written request by Landlord accompanied by paid receipts or other reasonable proof of Landlord's payment for such leasehold improvements to the Premises.

The tenant will want notice of any increase in costs of construction by the landlord, prior to the landlord incurring such costs, and an opportunity either to alter his plans and specifications to reduce the cost of construction, or to approve the increase in cost and agree to pay such cost. A tenant

might desire a provision such as the following:

Landlord agrees to construct leasehold improvements in accordance with the plans and budget (the "Final Plans") which shall be delivered by Tenant within thirty (30) days of execution of this Lease by Tenant and which shall be attached hereto and made a part hereof. If the Final Plans, or, if Tenant requests any changes to Landlord's work that would exceed the cost of construction of the improvements described in any pro forma plans and specification ("Proforma Plans") delivered by Tenant to Landlord prior to execution of this Lease, prior to Landlord's implementing such changes, Landlord agrees to give Tenant written notice that such changes would increase the cost of Landlord's work, including the amount of the increase. If Tenant does not give Tenant's written approval for such increased costs within fifteen (15) days of such notice, then Landlord shall not implement the change requested by Tenant and shall construct the Premises in accordance with the Pro Forma Plans.

Regardless of the approach actually taken, ultimately, the landlord gets to rely on the construction costs that were provided when it set the tenant's rental rate. Likewise, the tenant will have the flexibility to have its space completed as desired. .

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