

Rent Commencement and Construction

By Jen Mosscrop

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The relationship between the date rent first becomes due and the date construction of tenant improvements is complete is critical because it directly affects the tenant's rental cost and the landlord's income stream. In the current economic climate, landlords are seeking ways to start collecting rent earlier, and tenants are trying to ensure that they are not paying rent before they are able to use their space. These competing needs make it more important than ever that the parties involved understand the definition of the rent commencement date and that it is clearly described in the lease.

Who controls construction?

A preliminary issue is whether the landlord or the tenant is responsible for the tenant improvements. For the tenant, construction can be a time consuming and frustrating experience. Since the tenant is operating a business at the same time, and doesn't necessarily know how to efficiently bid, contract and supervise the work, unless it's a small job or the tenant has a good project manager, it's generally best to have the landlord manage the process. However, when the landlord handles the construction, there will be a landlord supervision fee (the tenant can try to negotiate the amount) and the landlord may not competitively bid the project, so the cost may be higher. These issues should be taken into account when setting the amount of the tenant improvement allowance.

The parties should agree what work must be completed during non-business hours, because requiring off-hours work adds to the cost and may delay completion. The risk of delay that is not the fault of either party ("force majeure" events, such as earthquakes, floods, strikes, and delay in obtaining permits) should be negotiated during the rent commencement date discussion.

Control of construction and rent commencement date

It's standard that the party who controls the construction is the party who assumes the risk of a delay in completion. If the tenant

controls the construction, the rent commencement date will be a date certain (the date construction should reasonably be completed), regardless of whether the project is completed on that date. If the landlord is responsible for the construction, the rent commencement date should be the date of substantial completion of construction, not a date certain.

Tenant construction

Since rent commences on a date certain, regardless of whether construction is complete by that date, a realistic time period for completion of construction will have to be agreed to by the parties. It's important for the tenant to consult with a qualified project manager familiar with the building and the local permitting agencies to determine how long it will take to complete construction — and then add as much of a cushion as possible! There should be defined time frames for landlord's approval of various stages of the project. Normally, the landlord has approval rights over the architect and general contractor, the plans and change orders. It's best if the tenant can identify the architect and general contractor and provide space plans during the lease negotiation, so the landlord can pre-approve them. However, that is not always possible, and there will be other items that will require landlord approval (final construction drawings and change orders). Since landlord delay in consenting will affect the time for completion of construction, it's important to make sure that consent will not be unreasonably withheld and that there is a definite and reasonable period for the landlord to respond. If the landlord does not respond within the required time period, the tenant should be entitled to an equivalent number of days of delay in rent commencement. Alternatively, the tenant may argue that it is entitled to "deemed consent" if the landlord does not respond within the required number of days.

If the tenant completes the construction more quickly than anticipated, the tenant should have the right to use the space for business purposes rent free until the "rent commencement date."

Landlord construction

When the landlord manages the construction, rent is not due until the project has been "substantially completed." Substantial completion means that the space is usable for the tenant's business purposes, except for minor issues of décor or completion that don't materially interfere with use. Substantial completion should be defined in the lease, and the definition should include a certificate of occupancy. The lease should state that the parties will create a list of items not completed by the date of substantial completion (punch list items), along with a schedule for completion.

The tenant should be given early access to the space without charge (generally two weeks prior to substantial completion) to install telephone and data and computer lines, and built-in fixtures and furniture.

Since rent doesn't start until the landlord has completed construction, the landlord will demand that the rent commencement date be advanced on a day-for-day basis for every day that substantial completion is delayed due to tenant delay. Tenants should carefully review the list of "tenant delays" and make sure the definition of tenant delay is reasonable. For example, instead of "lack of timely response," a tenant delay should be failure to respond within a specified number of days from request. A "lack of availability of tenant requested materials" shouldn't be considered a tenant delay unless the landlord has advised the

tenant that its selected material will cause a delay.

Linkage

Although the relationship between rent commencement date and completion of construction translates to dollars in a very real and immediate way, the lease may not make the relationship clear. The rent commencement date is at the beginning of the document, the force majeure clause (which permits delay for “beyond a party’s control” events) is at the end of the lease, and the work letter is attached to the lease as an exhibit. Although these sections are separated in the document, and often in the negotiation, they should be analyzed and negotiated together.

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