

BUILD-TO-SUIT AND CONSTRUCTION MATTERS

WORK LETTERS AND CONSTRUCTION EXHIBITS

While often left to the final stages of the lease negotiation process and usually physically placed at the back end of the lease, the “work letter” or construction exhibit is as vital to the success of the deal as the rent clause and other typical economic provisions of the lease. It is here that expectations are established, performance obligations are spelled out, and the budgetary predicate of the demised premises is detailed and controlled as much as possible.

Do not underestimate the complexity and pit-falls that await you in this part of the Lease. Each one will vary as much as retail buildings themselves vary. Just as each retail tenant which occupies any particular space is different from the guy next door, so do the provisions and parameters of customized construction exhibits. It is critical that the craftsman of this part of the lease understand the business needs of his or her client, and that the financial risks are appropriately allocated between the landlord and the tenant. The failure to properly identify and assign construction risks between the parties will certainly result in failed expectations by at least one of the parties to the lease.

The solution and correct approach to this potential mess is simple:

Details, details, details.

PART 1. TYPICAL BTS ISSUES AND LEASE PROVISIONS.

Landlord’s Construction Obligations; Performance Dates Specified; Section of Architect.

Landlord covenants and agrees that on or prior to the Construction Start Date set forth in Section C(iii) of the Fundamental Lease Provisions it will commence the construction of Tenant’s Building and will, at Landlord’s sole cost and expense, proceed diligently to complete Tenant’s Building on the Premises and any other Improvements to be built by Landlord in accordance with the provisions of this Lease. Tenant’s Building and any such other Improvements shall be constructed in accordance with Final Plans and Specifications and Change Orders approved by Tenant and prepared by the architect designated by Tenant.

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What is to be built? The use of prototypical plans and specifications reduces the risk of buildings that are functionally not acceptable to the tenant.

Landlord acknowledges and agrees that Tenant has, prior to the date hereof, provided to Landlord or Landlord's representative a copy of the following instructional plans and specifications for a building which is approximately the size and type as Tenant's Building: "PETSMART 20K December 2006 Instructional Set" including all applicable bulletins, and the Site Development Criteria dated January 2006 (collectively, the "Instructional Plans").

Use of a pre-design conference will minimize design conflicts after the architect has prepared the plans.

Both Landlord and Tenant must approve the final plans and specifications for the building.

Risks of governmental imposed changes or enhancements must be allocated.

Change orders must be contemplated and additional costs anticipated.

Exterior elevations should be agreed-upon. Interior ceiling heights should be specified.

Following the pre-design conference, Landlord shall promptly cause the Architect to prepare the architectural, structural, mechanical, plumbing and electrical plans and specifications for Tenant's Building

The exterior elevation and building materials for Tenant's Building shall be substantially similar to the design and specifications set forth on Exhibit D-1 attached hereto.

Tenant's Building may be as tall as any improvement or structure in the Shopping Center and as permitted under local governmental codes and regulations; provided, however, at a minimum, Tenant's Building may be thirty-five (35) feet in height above finished floor level.

If Tenant requires any changes to the preliminary plans and specifications, Landlord shall promptly cause the Architect to make such changes in accordance with any reasonable requirements of Tenant and shall promptly resubmit the same to Tenant for Tenant's review. If any of the changes to the preliminary plans and specifications requested by Tenant involve material deviations from the Instructional Plans provided by Tenant to Landlord ("Design Changes"), then the net verifiable change in the cost to Landlord of any such Design Changes which are requested by Tenant shall be included in the calculation of any adjustment of annual Base Rent pursuant to Section 1.5 of this Exhibit D.

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Any changes in the preliminary plans and specifications, or to the building elevation design or building materials specified in Exhibit D-1 which are initiated by Landlord or required by any governmental entity shall be subject to Tenant's reasonable approval, and all costs related to such changes, including any Architect's fees and expenses, shall be paid by Landlord.

Landlord shall be solely responsible to assure that the Final Plans and Specifications comply with all applicable building code or other legal requirements and private restrictions.

All fees and expenses of the Architect in preparing the Final Plans and Specifications or any Change Orders (other than Discretionary Change Orders) ... shall be paid solely by Landlord pursuant to the Architect's Agreement.

The Final Plans and Specifications are done and permitted. Now, what happens when somebody changes their mind? The Tenant must be able to adapt its building to its latest operational requirements. Specifying the change order process upfront will solve problems later.

Any changes to the Final Plans and Specifications ("Change Orders") shall require the prior written approval of Tenant; provided, however, Tenant shall have the right to make changes thereto (any such change initiated by Tenant after the Final Plans and Specifications are mutually and finally agreed upon and which require a material departure from the Final Plans and Specifications are herein referred to as "Discretionary Change Orders"). Any Discretionary Change Orders shall (a) be made in writing; (b) be signed by an officer of Tenant if the then aggregate total Discretionary Change Orders exceed Ten Thousand Dollars (\$10,000.00); (c) be generally consistent with the nature and scope of the work; and (d) comply with applicable governmental requirements. However, Landlord agrees that Tenant shall not be responsible for any increased costs due to Tenant's requested changes to the Final Plans and Specifications, unless Tenant has approved in writing such increases prior to Landlord commencing such work.

What to do about increased (or decreased) costs? Write a check or adjust the rent?

At Tenant's election, (a) the Annual Base Rent is subject to adjustment based on the net verifiable change in the cost to Landlord of constructing Tenant's Building resulting in the aggregate from any and all Design Changes and Discretionary Change Orders (including any Architectural fees and expenses related thereto, if required) (collectively, "DCO Costs"), as provided herein, or (b) Tenant may pay Landlord an amount equal to the DCO Costs.....

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The adjustment under option (a) of this Section shall be: Annual Base Rent for the Initial Term shall be adjusted at the rate of ten percent (10%) of such net cost increase or decrease in the cost of constructing Tenant's Building calculated on the basis of the cost per square foot of Gross Floor Area of Tenant's Building. If Tenant elects option (b) in this Section, then such amount shall be payable within thirty (30) days of Tenant's receipt of the Close-Out Documentation, all back up materials relating to any Discretionary Change Orders, the Certified GFA (as set forth in Section 1.8 of this Exhibit D) and any other documents or information required hereunder.

Building permits, tap fees, standard of work and legal compliance.

Promptly after approval of the Final Plans and Specifications and prior to the Construction Start Date, Landlord shall (i) obtain or cause to be obtained at its own expense all building permits and licenses; (ii) pay all utility fees (including so-called "tap" fees and "meter" fees) and any development and/or impact fees if required; and (iii) obtain any temporary permits for, without limitation, demolition, excavation or compaction, grading or other site work, and temporary power necessary to commence and to construct and complete Tenant's Building and any other Improvements to be built by Landlord hereunder in accordance with the Final Plans and Specifications and any Change Orders.

The construction work on Tenant's Building and any such other Improvements shall be done in a good and workmanlike manner in compliance with all requirements of this Lease and the construction contract.

Landlord shall comply, and all construction work shall be in compliance, with all applicable laws, orders and regulations of federal, state, county and municipal authorities having jurisdiction, with any direction pursuant to law of any public officer thereof and with all regulations of any board of fire underwriters having jurisdiction and with the requirements of any conditions, covenants and restrictions affecting the Land.

And just as importantly, Landlord must assure the Tenant that the completed Premises can be used for Tenant's intended purpose.

Landlord represents and warrants that it has obtained and agrees to maintain in full force and effect all necessary zoning, variances, permits or other public and private approvals or consents to allow the use of the Premises for any part of Tenant's Primary Business including, specifically but not in limitation, veterinary clinics and hospitals, boarding, pet day care, animal training and obedience classes, pet adoption and grooming services, as well as retail purposes generally.

Performance dates must be clear.

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If construction has not commenced on or before the Construction Start Date, or if the Delivery Date shall not have occurred on or before the Outside Delivery Date set forth in Section C(iv) of the Fundamental Lease Provisions, Tenant shall have the right, in addition to any other right or remedy, to: (1) extend such deadline to a date not more than three (3) months from the date provided herein or from any previously extended deadline, as the case may be; or (2) terminate this Lease by giving not less than thirty (30) days prior written notice to Landlord.

Tenant must be assured that a capable and qualified general contractor will be selected to perform the construction.

Landlord shall solicit bids from one or more general contractors, all of whom shall be duly licensed and bonded and adequately staffed and capitalized to complete the construction of Tenant's Building in a timely and efficient manner, upon terms no less favorable to Landlord than a standard AIA Owner/Contractor Agreement and consistent with the terms of this Lease, and shall warrant for a period of at least one (1) year following the Delivery Date that all work has been completed in accordance with the Final Plans and Specifications and Change Orders and applicable legal requirements; that all materials are new and of good quality; and that all work is of good quality and free from defects.

Punch lists must be completed as a condition of Delivery. Remedies should be specified if Landlord does not promptly complete punch list items.

Within ten (10) days after the Delivery Date, Tenant may deliver to Landlord a punch list setting forth defective work or additional work remaining to be done on the Premises or the Common Area in accordance with the requirements of this Lease, and Landlord shall promptly commence and with due diligence shall proceed to perform and complete the work set forth on said punch list. Subject to Section 25.2 of the Lease, if all such work has not been completed by Landlord within fifteen (15) days after receipt of such punch list, or if such work reasonably requires more than fifteen (15) days to complete and Landlord has not commenced work within said fifteen (15) day period and Landlord does not thereafter diligently prosecute such work to completion within a reasonable time, Tenant shall have in addition to any other right or remedy the right, but not the obligation, to complete said work and to deduct the cost and expense thereof plus twenty-five percent (25%) thereof for administration from all sums which become due and payable to Landlord hereunder. Such sums shall be due and payable by Landlord to Tenant upon demand and shall bear interest from the date expended or incurred by Tenant until repaid by Landlord at the Interest Rate.

Warranties and warranty work should be detailed.

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Landlord shall and does hereby assign to Tenant all assignable warranties and guarantees received in connection with the construction of Tenant's Building or any repair or reconstruction thereof relative to those elements or portions of the Premises which are Tenant's responsibility to maintain and/or repair. Landlord shall use its best efforts to enforce any non-assignable warranties and guarantees at Tenant's request on behalf of Tenant; provided, however, that nothing herein shall relieve Landlord from any warranty obligation or repair provided in this Lease.

In or around the eleventh (11th) month following substantial completion of Tenant's Building, Landlord, Tenant and the Architect shall jointly inspect Tenant's Building for the purpose of preparing and mutually approving a list setting forth defective work or additional work remaining to be done in accordance with the requirements of the construction warranties provided to or for the benefit of Tenant pursuant to this Lease. Landlord shall promptly commence and with due diligence shall proceed to perform and complete, or shall cause the general contractor to promptly commence and proceed with due diligence to perform and complete the work set forth on said warranty list.

A methodology for an accurate, post-delivery measurement of the gross floor area of the Building, and a corresponding adjustment in the rent must be specified.

The Base Rent is also subject to adjustment based on the actual Gross Floor Area of Tenant's Building, as defined in Section __, provided that in no event shall the Gross Floor Area of the Premises exceed the Gross Floor Area set forth in the Final Plans and Specifications or any Change Orders (as such terms are defined in Sections 1.3 and 1.4 of Exhibit D), but not including any increases in Gross Floor Area based on site specific issues or conditions.

PART 2. DELIVERY OF POSSESSION

Landlord shall be deemed to have delivered the Premises to Tenant only when all of the conditions set forth in Section 2.1 of Exhibit D have been fulfilled and Landlord has delivered written notice thereof to Tenant as provided in Section 2.1(f) of Exhibit D (all of which conditions are referred to herein as "Delivery Conditions"). The date on which all Delivery Conditions have been fulfilled is referred to herein as the "Delivery Date".

Typical Delivery Conditions - Construction of Tenant's Building as well as Common Areas and other improvements to be occupied by other tenants (in particular, any required Co-Tenants) should be addressed:

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- Actual and exclusive possession of the Premises shall have been delivered to Tenant broom clean and free of all construction tools, materials or debris of any kind.
- Construction of Tenant's Building, the connection of utilities to and in the Tenant's Building, the installation of all lighting, landscaping and storm and sanitary sewers in the Common Area and the construction of Landlord's pylon or monument structure and installation of Tenant's signage thereon shall have been completed in accordance with the Final Plans and Specifications and Change Orders and other requirements of this Lease;
- all utilities shall be separately metered and in adequate supply; the storm and sanitary sewer drainage shall be completed and connected in accordance with the Final Plans and Specifications and Change Orders; the HVAC system, lighting system, sprinkler system and electric and plumbing systems for the Premises and all meters and monitoring devices for such systems shall be fully connected and in good working order;
- the entire Common Area, including but not limited to the paving, striping and curbing of all roadways, driving and parking areas, shall be usable for the purposes intended;
- the number, location and configuration of parking spaces in the Common Area and the location and dimensions of all vehicular and pedestrian access ways shall be as shown on Exhibit A;
- access to the rear of Tenant's Building shall be sufficient and with at least a 145 foot unobstructed clear distance to the dock to accommodate the largest trucks and semi-trailers permitted by law;
- the slope of the parking area shall not exceed two percent (2%) within one hundred (100) feet of the front wall of Tenant's Building and in all areas that are handicap accessible; the maximum slope shall not exceed four percent (4%) in parking areas and drive aisles;
- any work remaining to be completed or corrected by Landlord on Tenant's Building, the Premises or the Common Area shall be of such a nature as not to interfere with or prevent Tenant's full use and enjoyment of the Premises and the Common Area and the operation of Tenant's business in the Premises and the making of preparations therefor;

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- Landlord, the Architect and the general contractor shall have signed and delivered to Tenant an A.I.A. Certificate of Substantial Completion confirming all of the foregoing; Landlord, Tenant and the Architect shall have completed the “walk-through” inspection of the Premises, and the Architect shall have prepared and certified an initial punch list of any work remaining to be completed or corrected;
- Landlord shall have obtained and delivered to Tenant a certificate of occupancy from the local governing authority which is legally sufficient to permit Tenant to enter the Premises and begin the fixturing process, and upon completion of the work to be performed by Tenant hereunder, to secure a permanent and unconditional certificate of occupancy.
- In addition, construction of all buildings which are shown in Exhibit A, with the exception of freestanding pad structures, shall have been completed. This condition shall be deemed to be satisfied (i) as to the Improvements to be occupied by the Initial Co-Tenants, if any are identified in Section 1 of Exhibit E, upon substantial completion thereof, and (ii) as to all other Improvements, upon the completion by Landlord of the foundations, exterior walls, roof and storefronts (excluding any tenant improvements) and exterior finishes.
- Landlord shall have recorded the Memorandum of Lease.
- All environmental obligations of the Landlord specified in the Lease be satisfied.

So, how does the Tenant know when Delivery is going to occur, or has occurred? Actual written notice must be given prior to the Delivery Date. Remedies for failure to satisfy all Delivery Conditions must be spelled out.

Landlord shall have given Tenant written notice (“Delivery Notice”) at least sixty (60) but in no event more than ninety (90) days prior to the date on which all of the Delivery Conditions are to be fulfilled. The Delivery Notice shall specify a particular Delivery Date which shall be subject to extension only if and to the extent of any delays excused pursuant to Section 25.2 occurring after the date of such notice, and, if all of Delivery Conditions have not been fulfilled on or before such Delivery Date, then, as liquidated damages (which the parties acknowledge will be substantially less than Tenant’s actual damages and do not constitute a penalty), Tenant shall be entitled to a rent credit equal to four (4) days of free rent for each day or part thereof which elapses between the Delivery Date specified in the Delivery Notice and the date when all of Delivery Conditions shall have been satisfied.

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Tenant should have the right to enter the Premises notwithstanding the failure of the Landlord to satisfy all Delivery Conditions without causing a waiver of those conditions.

Tenant's occupation of the Premises for fixturing and stocking or opening of the Premises to the public for business prior to the performance of all of Delivery Conditions shall not cause the Delivery Date to occur or constitute waiver or acceptance of or relieve Landlord from any of its obligations hereunder, including without limitation the obligations to complete construction of the Improvements and provide any certificates and approvals required for use or occupancy thereof by Tenant.

If the Tenant needs or wants to restrict Delivery to certain periods of time, such "black-out" or "excluded" periods must be noted.

If the Delivery Date would otherwise occur at any time on or during the dates set forth in the Fundamental Lease Provision, Tenant shall have the option, which may be exercised by giving written notice to Landlord at any time prior to or within ten (10) days following the date when the Delivery Notice is received by Tenant, to postpone the Delivery Date for such period as Tenant may specify in such notice.... Tenant may enter the Premises during any such blackout period for purposes of installing equipment and fixtures, stocking and preparing to open and shall not be deemed thereby to have waived its rights under this Section.

Certain Items should be provided by Landlord following Delivery.

Within thirty (30) days after the Delivery Date, Landlord shall provide to Tenant the following information and documentation ("Close-Out Documentation"): final construction and operating systems documentation, including but not limited to as-built drawings of Tenant's Building and the Premises, manuals for all equipment incorporated into Tenant's Building or the Premises, spare parts, maintenance materials, the warranties from general contractors, subcontractors and equipment manufacturers or suppliers which are to be assigned to Tenant, copies of all other warranties identified in the Final Plans and Specifications pertaining to any portion of Tenant's Building, and any other items required by the Final Plans and Specifications.

PART 3. VARIATIONS ON A THEME

BTS alternatives include Reverse Build-To-Suit ("RBTS") and BTS with a construction cost cap. Both present unique legal and drafting challenges.

In a RBTS situation, the Tenant builds the building, using an allowance paid by the Landlord.

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In a BTS with a construction cost cap (sometimes referred to as a “Hard Building Cost” maximum), the Landlord builds the Tenant’s building, but if the HBC exceeds a specified amount, the Tenant must pay the excess costs.