

## **Real Estate Guidance - (7/2014)**

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## **2.3 Post Award Real Estate Process**

### **2.3.1 Inspection and Acceptance** Revised 10/2013

The RECO should arrange to inspect the space sufficiently in advance of the required occupancy date to ensure that it is ready for the customer. The lessor must provide evidence of a valid occupancy permit at this time unless the local jurisdiction does not issue occupancy permits, in which case the RECO can accept a certified copy of the FAA Safety and Environmental Checklist in lieu of an occupancy permit.

Acceptance may be provided in writing or verbally with any discrepancies or unfinished items noted in the lease file. In most cases the FAA and the lessor will agree to discrepancies in writing. However when large deficiencies remain it is often advantageous to delay acceptance until they are completed. The lease should be amended to reflect the actual commencement date.

Minor deficiencies are often referred to as "punch list items". These items need not prevent acceptance of space and commencement of rent. A follow-up inspection should be scheduled to ensure that the deficiencies are corrected. The results of the follow-up inspection should be documented in the file.

### **2.3.2 Alterations and Improvements** Revised 10/2013

Alterations or improvements done by the lessor may be amortized over the term of the lease, made by lump-sum payment, or other method determined appropriate by the RECO. Alterations and Improvement under an existing lease generally are considered single source and do not require competition.

#### *1.) Alterations*

It is normally in the FAA's best interest to have the lessor perform alterations in his/her own building, thereby eliminating any question of liability on the part of the FAA.

Alterations performed under an existing FAA lease by the lessor should be at a fair and reasonable cost. Determination of fair and reasonable may be made by 1.) formal appraisal, 2.) construction data, 3.) cost to build publications, and 4.) independent government cost estimate.

#### *2.) Improvements*

The FAA can make permanent improvements to private facilities under the provisions of the lease agreement. The ability to make permanent improvements using a third party is governed by 1.) 49 USC Section 44502 (a)(5) and the decision by the Comptroller General B-239520 (8/16/90).

The lessor should be considered first in providing improvements. Improvements should be evaluated for their value using FAA accounting practices. Determination of fair and reasonable may be made by 1.) formal appraisal, 2.) construction data, 3.) cost to build publications, and independent government estimate.

If the lessor is unwilling or unable to provide the means to complete the improvements, then the FAA can exercise the authority under 49 USC Section 44502(a)(5).

For all alterations and improvements dealing with large construction of leased space, the RECO may use the engineers/architects from Design and Construction, ALO-100C, to verify the cost estimates.

### **2.3.3 Tenant Improvements / Tenant Improvement Allowances for Space Acquisition**

Added 10/2012

It should be noted that the key component of any lease is negotiating the tenant improvement (TI) and the tenant improvement allowance. Commercial building owners often offer a TI allowance as an inducement to signing a long term lease. The longer the firm term of the lease, the larger the TI allowance. The TI allowance is often tied to the firm term, as the Lessor wants assurance that his investment in fronting the TI allowance is “paid back” by the stream of rent over the firm term of the lease. The TI allowance is for the tenant to maximize the savings in construction cost and rental consideration. The TI allowance is often quoted as \$X dollars per square foot leased. When conducting a space acquisition, the Real Estate Contracting Officer (RECO) must negotiate a TI allowance for either the build-out of space from a cold dark shell or retrofitting existing space from a warm lit shell (see glossary below for definition). As mentioned in Attachment B, it should be noted that no costs associated with the building shell (either dark cold shell or warm lit shell) whichever is negotiated by the RECO, shall be included in the TI pricing.

It is important for the RECO to maintain control of the process when the TI being used by the Lessor. The RECO should be in contact with the Lessor to ensure that progress of the TI build-out is being conducted in accordance with the lease and receiving information on the use of the TI Allowance from the Lessor.

#### **2.3.3.1 Questions and Answers** Revised 1/2013

**Q1:** What is a Tenant Improvement (TI)?

**A1:** Tenant improvements are the finishes and fixtures that typically take space from the “shell” condition to a finished, usable condition. The Government, at its sole discretion, will make all decisions as to the usage of the TI. In addition to construction costs, tenant improvements include associated costs such as preparation of construction plans, construction management fees, city fees and permit costs or penalties, certificate of occupancy, applicable taxes, and engineering fees.

The following represent some examples of tenant improvements:

- Keyed switches to elevators to restrict after-hours access; special location indicators and controllers
- All initial wall finishes on TI partitions
- Floor finishes beyond defined standard requirements in tenant areas
- All fittings and fixtures within designated rentable areas, e.g., millwork and tenant signage counters
- Work for heating, ventilation, air conditioning, and rebalancing systems to suit tenant floor layouts and usage, including re-arrangement of existing zones and adding new zones and controls (including diffusers; branch duct reallocations/alterations)
- Upgrade to fire protection systems (e.g., specialized applications such as systems or laboratory protection) to comply with specialized tenant requirements
- Plumbing for additional refreshment areas and washrooms, showers to support job functions, and plumbing for laboratory or special areas
- All electrical power distribution in tenant’s partitions and within tenant areas, such as service poles, power and controls for all TI equipment
- Additional lighting and controls to suit tenant space layout and usage
- Upgrade of light fixtures and diffusers in excess of those provided in base building, as well as specialty lighting such as pot lights and track lighting
- Adjustment to the location of “EXIT” and emergency lights to suit tenant layouts and exit routes
- Office tenant security, communication, public address and wiring systems, excluding removal and replacement and new mandatory operating equipment which are intrinsic to the building

**Q2:** What is a TI Allowance?

**A2:** Leases allow the Lessor to give the Lessee a TI Allowance for improvements to the leased premises:

- The Government uses the TI to build-out its area
- The Government’s TI will be performed by the successful Offeror as part of the rental consideration and/or lump-sum payment
- Improvements must meet the quality standards and requirements of the lease and attachments
- The Government, at its sole discretion, shall make all decisions as to the usage of the TI Allowance. The Government may use all or part of the TI Allowance.

**Q3:** What if we do not spend the full TI Allowance provided by the Lessor?

**A3:** The Government may return to the Lessor any unused portion of the TI Allowance in exchange for a decrease in rent according to the amortization rate over the firm term.

**Q4:** What if we spend in excess of the allowance provided by the Lessor?

**A4:** If it is anticipated that the Government will spend more than the allowance, the Government reserves the right to:

- Reduce the TI requirements;
- Pay a lump sum for the overage upon completion and acceptance of the improvements; and
- Increase the rent according to the negotiated amortization rate over the term of the lease.

**Q5:** What is the purpose of Attachment B?

**A5:** The purpose of Attachment B is to define and describe the processes which both the Lessor and the Government shall complete in order to design and build-out the TI. This process is based on generally accepted commercial building practices. This allows the RECO to maintain control of the process when the allowance is being used. Furthermore, if you look at Attachment B as being flexible (in a continual state of flux and not static) to fit the goals of the design and build-out for each project - then it will be easier to work with and will become a useful document/tool.

**Q6:** Can I make changes to the clauses? Who needs to approve the changes?

**A6:** The clauses in Attachment B are considered “recommended” which allows the RECO the flexibility to make changes based on the type of space requirement that is being built out, however, all changes to the attachment should be approved from the appropriate channels (i.e., legal council).

**Q7:** How does the RECO ensure that the FAA selects the general contractor?

**A7:** The RECO shall follow the following process:

- A minimum of three qualified contractors shall be invited to participate in the competitive proposal process. Each participant shall compete independently in the process.
- Each proposal shall be reviewed by the Government. The Government reserves the right to determine if bids meet with the scope of work, that the price is reasonable, and that the Offeror is qualified to perform the work. The Government reserves the right to reject all bids, at its sole discretion.
- The Lessor shall demonstrate to the Government that best efforts have been made to obtain the most competitive prices possible, and the Lessor shall accept responsibility for all prices through direct contracts with all contractors.

- Because the Lessor provided documentation that a minimum of 3 qualified contractors were invited to participate, detailed cost and pricing data are not required using the adequate price competition exception.

### 2.3.3.2 Examples of Attachment B in Practice Added 10/2012

The RECO can refer to these examples to see the flexibility of Attachment B in meeting requirements.

**1. Flight Standards District Offices Relocation (FSDO) Build-to-suit.** The purpose of Attachment B for this project was to provide for an Architect to represent the FAA and provide a viable method for both parties to complete the design and construction processes for a build to suit project. We looked at the page and half document General Services Administration (GSA) used at the time, we talked to Architects, and we drew from experience - to prepare this document for Legal approval. Legal checked for clarity and to make sure the process was legal but since it was a Real Estate document - they mostly left the structure up to Real Estate.

The most unique thing about this project was that the Shell (and the Tenant Improvements in that shell) had to be constructed from vacant land - and Attachment B was structured accordingly.

**2. FSDO Relocation for 20,000 sq. ft.** Attachment B was revised to fit the goals of this project of approximately 20,000 sq. ft. of TIs in a new empty shell building. It became a more complete document but many concepts were different than the FSDO project - and at eleven pages - it became longer.

**3. System Support Center (SSC) Relocation for 3,000 sq. ft.** Attachment B was reduced to just a few pages because this was smaller space (which also included warehouse space) and the design and construction process was not nearly as involved as the projects named above – and was almost entirely handled by the Lessor.

**4. Certificate Management Office (CMO) and ATO relocation for co-location.** Attachment B was revised to fit these two very different and unique projects. Louisville had incremental space challenges - and the FAA used an FAA Contractor as its Architect to interact with the Lessor's Architect and Contractor. The ATO project had timing challenges, Heating, Ventilation, and Air-Conditioning (HVAC) challenges, and at almost 79,000 sq. ft. was simply a large project to deal with overall. Attachment B for the ATO lease had significant revisions for the Regional Office Facilities Manager and the FAA Architect to deal with the design and build-out.

### 2.3.3.3 Glossary Added 10/2012

**1. American National Standards Institute (ANSI) / Building Owners and Managers Association (BOMA).** Industry standards offered by the building owners and managers association for measuring floor area in office buildings (Current ANSI/BOMA Z65.1).

Example: Corridors and restrooms on a multi-tenant floor are generally prorated and added to each tenant's rental space. Shafts such as elevator shafts and vertical ducts are generally not allocated to any tenant.

**2. Build-to-Suit.** Built to suit means building a property to the specifications of the tenant/line of business requirements.

**3. Change Order(s).** Requirements not captured in the original price proposal are documented and agreed to by formal submission of change order request. This request must be detailed in writing and include the cost. It is required these change orders are approved by the RECO and the line of business prior to the work execution.

**4. Construction/Working Drawings.** The document that explains all phases of the construction for the Lessors contractors. The drawings will include: Demolition plan, Mechanical plan, HVAC, Door Schedule, Reflected Ceiling Plan, Power and Communication Plan, Furniture Plan, Interior finishes, and any other information required to complete the Tenant Improvements (TIs).

**5. Design Intent Drawing (DID) (also known as “Preliminary Drawings” or “Prelims”).** Describe the architectural design and technical requirements. DID’s establish an early understanding between the FAA and the project architect on the desired design approach and detailed design assumptions to help work through design decisions early in the process before the development of construction documents (CDs). The DID’s increase the chance of project coming in on time and within budget.

**6. Heating Ventilation and Cooling System (HVAC).** Buildings heating, ventilation and cooling system designed to regulate the building atmospheric conditions.

**7. HVAC Air Balance Report.** Is a certified report provided by the HVAC technician to insure the HVAC system is functioning in harmony, at their optimum performance, providing total occupant comfort (Be sure to request the report prior to space acceptance).

**8. Price Proposal.** Is the proposed cost by the Lessor to complete the tenant improvements needed to fulfill the requirements for the FAA.

**9. Shell costs vs. Tenant Improvement Costs.** Are items that are required of the Lessor to have in place to meet the minimum “Warm lit Space” condition before any TI (Agency) cost are expended. TI costs are the amount paid by the agency over and above the Allowance offered by the Lessor to complete the requirements.

**10. Shell Space (Cold Dark Shell).** Is a commercial or residential building with an unfinished interior and lacking heating, ventilating, and air conditioning (HVAC), and usually without lighting, plumbing, ceilings, elevators, or interior walls. (It is important to make sure the Lessors TI Allowance is sufficient to bring the Shell Space to a “Warm Lit Space” condition prior to expending any tenant improvement funds).

**11. Shell Space with some improvements (Warm Lit Shell).** Is a commercial or residential building with a minimally finished interior, usually with ceilings, lighting, plumbing, heating and cooling (HVAC), interior walls (painted or unpainted), electrical outlets, elevators, rest rooms, and a concrete floor. A warm lit shell is considered ready to lease and ready for TIs.

**12. Tenant Improvement Allowance.** Is the amount of money offered by the Lessor to refresh or bring prospective space up to a finished useable condition which may be included in the proposed rental rate. Allowance does not get paid back to the Lessor. The amount depends on many factors including the creditworthiness of the tenant, the terms in the lease, and the total square footage of the space. Note, TI Allowances do not only come in the form of a dollar per square foot, they can also be in a one lump sum amount or with mixed/flex space each different type could get a different amount.

For space with walls, doors, ceiling tiles, lighting, and electrical already in place because of a prior tenant, the offered TI allowance will typically be enough to replace worn carpets and wallpaper, paint walls, freshen up some cabinetry, and move a minor number of walls and doors. For brand new space the TI should cover all or most of the cost of all new TI designs and components (except that of tenant specific or special requirements). Construction expenses in excess of the TI Allowance must be paid by the tenant.

**13. Reconciliation.** Final reconciliation of the total project cost from the original price proposal to the final invoice which should contain the paid receipts for all contractors and sub-contractors and release of lien notice from all contractors.

**14. Unamortized Tenant Improvement Allowance.** Provision in Attachment B for dealing with early termination by the government when agreeing to a TI allowance based on the full term of the lease. The RECO creates an amortization schedule based on a negotiated rate on which the TI allowance is treated like a “loan” payment schedule. The unamortized TI allowance declines as the FAA pays the agreed upon rent and should the FAA exercise a right to terminate prior to the full term then the Lessor is compensated for the TI allowance.