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# Tenant Improvement Financing

*A Discussion*



# INTRODUCTION

Transforming raw commercial space into a functional, attractive, and competitive work or gathering environment requires significant financial investment, often placing a strain on the resources of landlords and tenants alike. In fact, it is estimated that landlords and tenants together spend nearly \$30 billion a year in building improvements.

The objective of this “white paper” is to have a candid discussion regarding the traditional manner tenant improvements (“TI”) have been financed, and the inherent inefficiencies and possible conflicts of interest encountered by many tenants and landlords in connection with determining the financial responsibility for funding leasehold improvements. We also hope to bring to the attention of the CRE market Dolfín’s ambition to become the most cost-efficient, dependable and flexible TI financing alternative for landlords, tenants and occupiers of commercial real estate through its fintech platform approach.

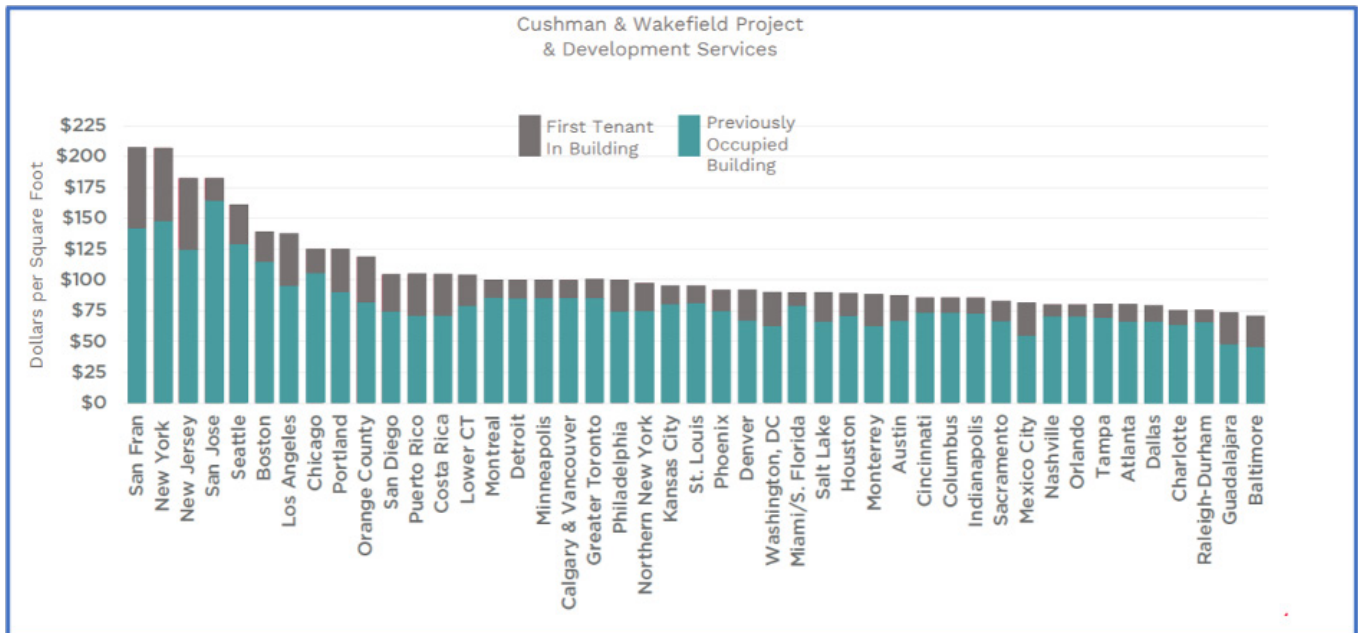
## What are Tenant Improvements?

Tenant improvements represent the scope of construction required to adapt raw core & shell space to the specific needs of a tenant. For example, in the case of an office it would include the cost of drywall construction, electrical

distribution, network cabling, lighting, wall coverings, reception areas, employee break rooms, etc. Such building improvements may be incurred at the inception of a lease at a newly constructed building, retrofitting an existing space for a new/existing tenant, or even at an owner-occupied building as workforce needs change.



The PSF costs of tenant improvements run the gamut based upon the nature of the tenant’s business, their financial resources, lease length, and whether the location is client/customer facing or simply a behind the scenes back office or assembly operation. It is not uncommon for landlords to offer \$50-\$75 PSF in the form of a build-out allowance to a new tenant, the actual level of such allowances being most often influenced by local market conditions. That is not to forget that some spaces are already built out which a prospective tenant



might view as “great” or feel they are in a take it or leave it situation.

It is unusual for the landlord allowance to cover the total cost of a tenant’s fit out needs; any excess costs being referred to as “above market” tenant improvements. Law firms and medical offices are frequent examples where tenant improvement costs easily exceed the allowances that landlords are willing to provide. In markets like San Francisco and New York City, tenant improvement costs easily reach \$200 psf. Many Fortune 1000 companies also create custom and highly identifiable properties as part of their branding and image initiatives. Tech offices of major companies fashion amenity rich work areas to attract talent. As further discussed below, there is only a limited set of current options to finance tenant improvements especially that which are considered “above market” or highly

specialized.

### How are Tenant Improvements Financed Now?

The most conventional manner in which leasehold improvements are currently financed is through the combination of a landlord allowance and the tenant contributing towards any excess costs. The landlord’s allowance can be “behind the curtain” funded by senior mortgage debt, short-term loans, and equity. When interest rates are low, landlords have historically been able to use tenant improvement allowances as profit centers charging incremental rent greater than their underlying financing costs.

The challenge for tenants is to make transparent the true cost of capital they are being charged for tenant improvements and compare such to their own cost of capital, liquidity, and other fi-

financing alternatives. Many first-time tenants, start-ups and small companies are under the misconception that tenant improvement allowances provided by the landlord are somehow “free” money and they heavily negotiate for



such without decompiling their scheduled monthly rent payment between the base rent with or without a tenant improvement allowance. Also, tenant improvement financing provided by the landlord is based upon the landlord’s cost of capital, not the credit-worthiness of the tenant. So an investment grade tenant might very well be paying the same incremental rent as a below investment grade tenant.

With that said, there have been recent, albeit limited, instances of third-party financings of tenant improvements principally for investment grade tenants. Borrowing and adapting a facsimile of

the credit tenant loan (“CTL”) structure, large ticket tenant improvement financings have occurred in the market from time to time. These \$15 million and upwards financings were an integral part of a new lease negotiation and required the alignment of the landlord, tenant, senior lender to the property and the investor funding the TI lease backed loan. One can easily imagine the challenges and costs associated with getting each party on the same page to execute a TI lease, a TI loan, an intercreditor agreement, establishing a special purpose entity, designating a TI rent lockbox, etc.

The takeaway at this point is that Dolfin believes that traditional landlord TI financing may not be cost effective in all applications and that alternatives to financing leasehold improvements are limited and burdensome. It is time to introduce a transparent, streamlined and cost-efficient TI financing platform.

## Benefits of TI Financing

Tenant improvement financing offers several benefits to tenants, including the ability to free up capital for higher ROI opportunities within their business and the flexibility to amortize tenant improvement payments over time for cash flow purposes. Additionally, tenants can access the necessary capital

to achieve corporate facilities goals in terms of workplace productivity, expansion space, safety, and image.

Tenant improvement financing also offers several benefits to landlords, including preserving liquidity for more strategic investments and offering turn-key packages to both incoming and renewal tenants for a competitive advantage. Additionally, certain landlords can obtain non-recourse TI financing with little out-of-pocket cost, which can help them minimize their risk and maximize their return on investment. There is a tangential benefit to landlords because as tenants efficiently access capital to invest in their leased space, overall property values and tenant commitment to their space should increase as well.

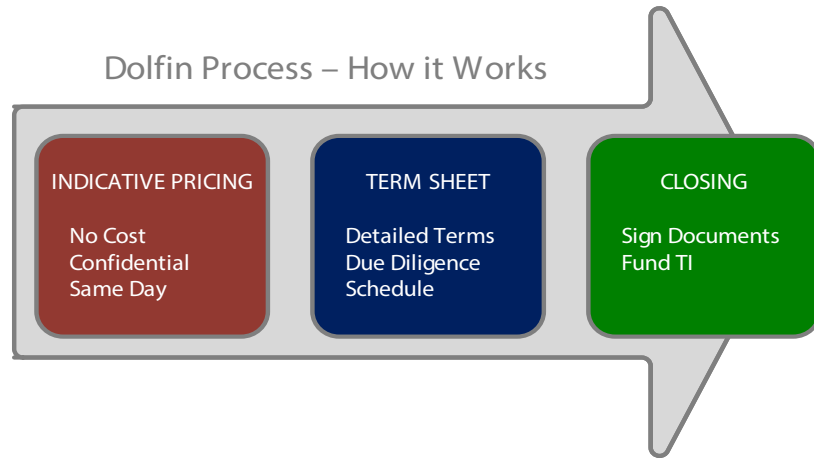
### **Dolfin – the Way Forward**

Dolfin is purpose built to take the friction out of tenant improvement financing, making such available to a broader array of credit-worthy tenants, while efficiently offering to fund smaller TI projects. This will be accomplished through our web-enabled platform which invites both tenants and landlords to quickly obtain indicative pricing for their projects in a secure and confidential system environment.

Dolfin's TI financing options are exclusively credit-based and priced at the equivalent of a senior unsecured fully amortizing term loan. Indicative pricing is based upon a preliminary electronic underwriting process using publicly available financial information, uploaded audited financial statements and third-party credit scoring databases. A senior Dolfin client representative is assigned to assist with any questions.

Once a Dolfin client has decided to move forward beyond the indicative quote stage, the client is requested to complete an online application detailing project specifics such as funding amount being requested, term, property location, closing date, etc. Once all is in order, Dolfin will electronically produce a commitment letter, subject to customary due diligence, for the tenant or landlord to execute.

Upon execution of the commitment letter, a closing checklist is produced and posted to the Dolfin web portal secure data room providing access to all parties to the TI financing transaction. Dolfin generates and provides to client legal counsel a set of pre-filled standard transactional agreements and a secure document workflow process indicating progress. Once all documentation is finalized and executed, the closing date



is established, and the TI financing is funded.

While Dolphin leverages technology to streamline the TI Loan process, the client is always assigned an experienced Dolphin finance expert to assure transaction success.

### The Future of Tenant Improvements

The commercial real estate industry is constantly evolving and the new hybrid work styles will reshape the future of office buildings. New remote and hybrid workplace strategies will likely make offices the destination for on-site collaboration and “touchdown” spots where sales staff and visiting employees can log in and work. Interior architecture giant Gensler looks to address the need to increase employee engagement by going beyond the reflexive responses to the pandemic and rethinking offices to make them less corporate feeling and more welcoming to employees.

Employees who have worked from the comforts of home, can expect of-

fice redo’s that have areas that look more residential with sofas, pillows, area rugs, and coffee tables. The office of tomorrow will have more open and flexible multi-purpose environments that will include a mix of areas for individual focused work, private meetings and videoconferencing rooms equipped with immersive technologies for hybrid gatherings. Another emerging priority for the return to the workplace is the need for people to concentrate on their work that will drive the creation of quiet zones within the office.

So while the overall demand for US office space may have significantly softened post pandemic, there should still be a robust demand for cost-efficient tenant improvements as the existing building stock renovates and retrofits to meet the new trends in office design.

## Summary

Tenant improvements are crucial for tenants and landlords who want to create attractive, market competitive, and functional commercial spaces. Dolfin provides occupants with the capital they need to make the necessary improvements while enabling landlords to offer turnkey packages for lease up and minimize their risk.

Whether you are a tenant or a landlord, it is essential to understand the benefits and options available for tenant improvement financing. By working with Dolfin, you can be ensured of easy access to the funding you need. We are always open to brainstorming about solutions for TI financing, so please reach out to us.



### *About The Author*

Winston G. van Buitenen is Dolfin's "Head of Works" overseeing the internal deal management, operations and finance functions of the firm. He has held Chief Financial Officer and Chief Operating Officer Positions at several companies and began his career at Price Waterhouse in their New York Practice Office.

Winston had a 15yr+ career at Sony with his last assignment leading the programming of Sony's 1,000,000 sq. ft. European Headquarters project in Berlin Germany. For the

past decade, Winston has spent his professional time becoming an expert in lease-back and credit based financing solutions for commercial property owners and tenants. He passed the CPA exam and has held various FINRA Securities licenses.

Winston is a graduate of Fairfield University where he majored in accounting. He also devotes a significant amount of time helping to educate the disadvantaged young men of the South Bronx by advising Cardinal Hayes High School.