

# How Tenants Can Guard Against Unpaid Build-Out Allowances

By **James Carlon and Janet Scognamiglio** (June 9, 2026)

Consider this: Your client's company has spent hundreds of hours assessing its office space needs in a postpandemic world where the C-suite's adamant drumbeat of "return to office" has collided with the mindsets and lifestyles of employees who have long since reorganized their lives around remote or hybrid work schedules.

The employee population has been canvassed; department heads have weighed in on how many people will occupy the office space, and at what frequency. After months of searching and countless broker pitches and site visits, the client has finally found the perfect location.

The new lease has been signed, and it includes a multimillion-dollar commitment from your client's new landlord to help subsidize the build-out. The general contractor has been selected, construction drawings have been finalized and permits have been pulled.

Now, the race is on to complete construction and to move into the new space before the term of your client's existing lease runs out.

The foregoing is a typical scenario that plays out every day in both urban and suburban office markets throughout the U.S. In certain markets, landlords face continued headwinds in the form of increased operating costs and stagnation in the office market. In Fairfield County, Connecticut, for example, the commercial market saw a vacancy rate that approached 26% in March, at the end of the first quarter of this year, only a modest decrease from the same time in 2025[1].

The abundance of available office space has created an environment in which building owners and their brokers are constantly competing to attract a seemingly shrinking pool of available, and desirable, tenants, which, themselves, are continually focused on maximizing efficiency by shrinking their office footprints.

Intensifying this pressure is the reality that rent-rolls have not kept pace with financing costs — cap rates are increasingly no match for interest rates.

Facing a still steep maturity wall, as well as pressure from their investors, landlords are increasingly pressured to offer large concessions to tenants, including construction allowances, sometimes requiring them to make such commitments to multiple tenants simultaneously.

This confluence of stressors on landlords raises the risk of a liquidity crunch and the untimely payment of allowances to tenants. What might this mean for you as either in-house or outside counsel?

Well, if your client is both well capitalized and has a hard move-out date from your existing space to avoid holdover penalties, then your client may well spend what is needed to get construction completed.



James Carlon



Janet Scognamiglio

When that's accomplished, they'll spend more time and resources chasing the landlord down for reimbursement. All the while, the new lease probably makes it clear that your client has no right to offset rent even though the construction allowance has not been paid in full, if at all. This is a lose-lose scenario.

Avoiding this requires a shift in mindset prior to negotiating the lease, as well as the implementation of commonsense strategies that should be advanced by both the legal and business teams on your transaction.

In the first instance, tenants and their advisers should reject the axiom that a lease is a collection of separate and independent covenants and obligations. It is well settled under Connecticut common law, for instance, that "the covenants of a commercial lease are deemed to be independent so that the breach of a landlord's [obligation] ... does not suspend the obligation of the tenant under the lease [to perform]."[2]

As a general matter, therefore, unless modified by a statute or an express provision in the lease to the contrary, a tenant's obligation to, for example, pay rent under a commercial lease is independent of any obligation of the landlord under the lease, including the payment of an allowance.[3]

Accordingly, in the event of a landlord breach, a tenant's remedy is generally limited to suing the landlord for breach of contract.[4] While the principle that the covenants of a lease are independent from each other is enshrined in case law and is generally well recognized in custom and practice, it has very little logical appeal when it comes to a tenant's rent payment obligations.

For example, a tenant is generally paying market rent for space with the understanding that a landlord will operate and maintain the rest of the building in a manner commensurate with other similar-class buildings within that particular market. Accordingly, if a building's common-area HVAC and passenger elevators are regularly out of service, then how is the tenant realizing the full value of its financial commitment?

In the case of an allowance, it is axiom that a landlord will consider the cost of the allowance in the determination of the base rent being charged to the tenant.

Accordingly, when the tenant is paying base rent, it is paying a rate that, in part, reflects the landlord's financial commitment to the tenant's construction, which begs the question: If that financial commitment is not fulfilled in whole, or in part, (or if payment is late), then how can it be deemed equitable to insist that the tenant timely fulfill its financial obligations to the landlord?

Accordingly, the first tip for the tenant and its advisers is to adopt a change in mindset: a paradigm shift away from the notion of a lease being a collection of multiple separate minicontracts and toward the more pragmatic and realistic concept of the lease as a singular, cohesive agreement, replete with certain dependent obligations.

In addition to this shift of mindset, tenants should also consider implementing one or more of the following strategies.

### **Verify the Landlord's Liquidity**

As Sir Francis Bacon famously wrote, "knowledge is power." [5] Accordingly, early on in lease negotiations and before a letter of intent is even signed, tenants should insist that

landlords furnish evidence of adequate capital to fund the allowance obligation.[6] Tenants and brokers should consider this request to be part and parcel of their site selection process.

Furnishing evidence of adequate capital can take many forms, including the landlord providing copies of its financial statements or comfort letters from the landlord's financial institution. Moreover, a simple title search can be run on the target building to determine whether the landlord has secured construction financing on the property.

If the landlord has secured construction financing, then details can be solicited regarding the availability of proceeds to fund the tenant improvements.

Tenants should also advocate for language to be included in a nondisturbance agreement with the landlord's lender, requiring the payment of the allowance following any lender takeover of the building in the event of a foreclosure or receivership.

### **Escrow and Letters of Credit**

Tenants should consider insisting that landlords escrow the allowance funds, and provide transparency into the account balance on a going-forward basis during the pendency of construction.

Funds from the account can be disbursed when the tenant meets the disbursement criteria negotiated in the lease, and the lease, or separate escrow agreement, should require that the funds be segregated and used solely in connection with the tenant build-out.

Alternatively, a tenant should consider requiring that a letter of credit be issued by the landlord's lender in the total amount of the allowance. A letter of credit from a well-capitalized commercial bank provides substantive protections and security to the tenant with the added benefit of mitigating the inherent risk to the tenant of a landlord bankruptcy, which would subject the tenant to potential preference claims under the Bankruptcy Code.

With a letter of credit, the payment obligation exists with the landlord's lender and not with the landlord itself. As a result, generally speaking, a landlord letter of credit will not be considered part of the landlord's estate in the context of a bankruptcy proceeding and will not be subject to the automatic stays or value caps that affect creditor claims.[7]

### **Offset Rights and Extended Abatement Periods**

A landlord's initial lease draft will often contain express language that rent is payable by a tenant "without counterclaim or offset except as otherwise set forth in the lease."

This carveout covers limited provisions, such as a prenegotiated, free rent periods, or abatements occasioned by casualty, condemnation, etc.

In an effort to expand the carveout language, tenants should seek to extend the offset right to cover any unfunded disbursements.

Tenants might also consider arguing for an interest factor to apply since the tenant's funding of the landlord's portion of an allowance is, arguably, tantamount to the tenant giving an interest-free loan to the landlord.

Lastly, conditioning the start of the rent commencement date on the tenant first receiving

all or a portion of tenant improvement allowance may also incentivize the landlord to pay the allowance sooner rather than later.

### **Landlord Guaranty**

Tenants should consider requiring that the landlord's parent company, or a well-capitalized affiliate, guarantee the payment of the allowance. Without a guaranty, a tenant's recourse against a landlord for breach of the lease may be limited by a variety of factors.

For example, most landlord entities are special purpose entities created to own and operate the building and to serve as the contract party under leases, construction contracts and building-related contractual obligations.

Often, the assets of these landlord entities are limited to interests in the building, and most commercial office leases will contain language that limits the scope of the landlord's liability (and, accordingly, a tenant's recovery) to those interests.

Accordingly, tenants should consider requiring guaranties from a creditworthy parent, affiliate or principal of the landlord to secure the landlord's obligation to pay the improvement allowance.

### **Conclusion**

Tenants and their advisers need to be mindful of the current market conditions that are putting pressure on landlords to offer aggressive concessions to attract tenants and fill vacant commercial space. These pressures, coupled with high financing costs and a persistent inflationary environment, compounded with the financial strain on many landlords to satisfy contemporaneous financial obligations to other tenants, raise the risk that landlords will be unable to satisfy (or timely satisfy) their payment obligations to tenants.

To protect against these risks, tenants must jettison the outdated paradigm that holds that a tenant's lease obligations are independent of the landlord's lease obligations, and advocate for express rent offset rights following a landlord default.

Additionally, tenants must perform financial due diligence on their prospective landlords to make absolutely sure landlords are financially solvent with access to capital to fund their obligations.

Beyond that, tenants can push for other protections including escrow holdbacks or letters of credit to ensure that immediately payable funds exist to pay construction expenses.

---

*James P. Carlon is a partner and Janet Scognamiglio is an associate at White and Williams LLP.*

*The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

[1] Lori Albert and Steven Fiore, Marketbeat Fairfield County Office Q1 2026, <https://www.cushmanwakefield.com/en/united-states/insights/us->

marketbeats/connecticut-marketbeats.

[2] One Hundred Norwalk, LLC v. Trilegiant Corp., 2008 U.S. Dist. LEXIS 103263; 2008 WL 5381509 (D. C.T. 2008).

[3] 49 Am. Jur. 2d, Landlord and Tenant §84 (1995).

[4] Id.at §84.

[5] Sir Francis Bacon, *Meditationes Sacrae* (1597).

[6] Tenants are often required to provide financial information to the landlord for underwriting purposes and/or mortgagee approval. That gives a tenant the opportunity to request the same from the landlord to verify that the landlord has the necessary access to capital (be it debt or equity) to fund the tenant improvement allowance. A mutual confidentiality agreement can be executed to protect both parties.

[7] See, e.g., *Keene Corp. v. Acstar Ins. Co.*, 162 B.R. 935, 942 (Bankr. S.D.N.Y. 1994).