

CONSTRUCTION LEGAL EDGE

SPRING 2008

This newsletter is informational only and should not be construed as legal advice.
© 2008, Pietragallo Gordon Alfano Bosick & Raspanti, LLP. All rights reserved.

Articles contained in this issue of the CLE:

- 1. Risks and Benefits of Fast-Track Scheduling in Design-Build**
- 2. Significant Changes in General Conditions of AIA Document A201-2007**
- 3. Low-Income Housing Tax Credits: The Advantage to Developers**

Risks and Benefits of Fast-Track Scheduling in Design-Build

Design-build is a construction project delivery system in which, in contrast to traditional “design-bid-build”, the design and construction functions are contracted for with a single entity known as the design-builder or design-build contractor. The design-builder is usually the general contractor, but in many cases it is also the design professional (architect or engineer). This system is offered in an effort to minimize the project risk for an owner and to reduce the delivery schedule by overlapping the design and construction phases of a project. Where the design-builder is the contractor, the design professionals are typically retained directly by the contractor.

Design-build combines the design, permit, and construction schedules in order to streamline the traditional design-bid-build paradigm. This system does not shorten the time it takes to complete the individual tasks of creating construction documents (working drawings and specifications), acquiring building and other permits, or actually constructing the building. Rather, a design-build firm works to harmonize design and construction professionals as a team, to complete these tasks on an overlapping schedule.

The main aspect of a design-build project is that one entity is responsible for both design and construction of the project. If the entity is a contractor, the process is known as “contractor-led design-build”. If the entity is a design firm, the process is “design-led design-build”. In both cases, the organization retained by the owner often subcontracts the construction work if design-led. Similarly, construction-led firms will subcontract with architects and engineers.

Cost estimating for a design-build project is a paramount concern because design documents often change over the course of a project. Thus it is important to draft design-build contracts to allow for unexpected situations without penalizing either the Design-Builder or the owner. Standardized form contracts are available for design-build application, but it is advisable for the design-builder and owner to negotiate the contractual documents to be used on the project.

Under design-build, the owner must rely on the accuracy of the design-builder’s estimators. Inaccurate estimating can increase the risk to both owner and the design-builder, and even result in losing the time that the design-build system was intended to save.

The truncated process potentially curtails governmental review. Projects that are designed as they are built provide less time for review of completed plans and specifications. Projects completed before governmental review can engender costly change orders to bring the project into compliance with regulatory requirements.

One of the main benefits of the design-build method is saving the owner money on the overall project. Obtaining a lower rate construction loan and an earlier delivery date may make the project more economically feasible to an owner than traditional design-bid-build projects. The design-build system also provides the owner with a one-stop resolution contact. This allows the owner to look to one entity with any questions or concerns regarding design revisions, project feedback, budgeting, permitting, construction issues, change orders, and billing. Furthermore, the owner and the design-builder can cooperate in order to maximize the owner's value on materials, designs, or construction methods.

Fast-track scheduling is well suited to the design-build delivery system. Fast-track is “a scheduling technique in which construction begins before plans and designs are fully complete.” Grant Armann Simpson, FAIA and James B. Atkins, FAIA, KIA, *Managing Risk in Fast-Track Projects*, AIA Architects Handbook of Professional Practice, 2006 update, at 92. See also *Roberts & Schaefer Co. v. Hardaway Co.*, 152 F.3d 1283 (11th Cir. 1998). Inherent in the fast track contract procedure is the risk that contractors on overlapping phases will interfere with each other, that work may proceed before the design compatibility can be determined and most importantly that many changes may be required to make the succeeding designs compatible with the completed work. *Boecon Corp. v. Catalytic, Inc.*, 1994 U.S. App. LEXIS 29181, 2-3 (9th Cir. 1994). Unlike the design-bid-build process,

submittals in fast-track delivery are typically reviewed out of sequence - often before adequate information is available to make a final coordinated submittal check. As a result, assumptions made by the contractor, subcontractors, and design team earlier in the process may have to be reconsidered when more information becomes available. *The evolution of the project design nearly always requires changes to previously issued documentation packages* and thus to the shop drawings. These changes have the potential to change and even delay progress on the contractor's work plan.

Simpson and Atkins, *id.* at 92. The authors of the Architects Handbook give examples of owner misperceptions of errors occurring in fast-track where the owner's design decision differs from the architect's assumption, where details are unavailable early and where the structure does not accommodate the final HVAC ducts. *Id.* Simpson and Atkins explain that these required changes do not equate to errors:

[T]he need for responsive adjustments as new information becomes available can create the illusion of poor performance by the design professional even when the professional standard of care has been met. Such perceptions underscore the difficulty in managing fast-track projects. *The crux of the matter is that such changes do not equal errors.* Design changes are inherent in the fast-track process, and only an architect who could see the future in a crystal ball would be able to avoid the need for changes to their documents.

Id. at 95. For these reasons, the likelihood of changes and change orders is greatly increased when fast-track scheduling is used. Thus design contingencies are a method for the owner and architect to accommodate the costs associated with these changes. The design-builder must anticipate, budget for, and rigorously manage the contingencies.

In the Construction Specifications Institute treatise *The Project Resource Manual, CSI Manual of Practice* (5th ed. 2005), the Institute supports the AIA description of fast-track:

With fast-track, the overall project cost may be difficult to determine, as certain portions may not be bid or contracted for until later in the project schedule. Adjustments to the contract amounts may be required as each portion of the design work is completed. The preparation of separate bid packages and contract documents for each additional portion of the work requires significant additional work and experience by the architect/engineer (A/E).

The nature of fast-track is such that the A/E may be simultaneously involved in design, construction documents, development of contract packages, bidding and negotiation, and contract

administration. This multiplicity of activities and required staffing may add considerably to the cost of the A/E services.

In order to monitor costs and keep the owner informed, the A/E, construction manager, or design builder must periodically prepare and revise estimates of construction costs based on constantly changing design documentation.

When portions of the work are completed, subsequent changes to in-place construction may be unavoidable and, hence, more costly as modifications become necessary.

CSI Project Manual, supra, at § 3.3.3.3, pp. 3.6-3.7.

The keys to making fast-track scheduling profitable in the design/build delivery system is the strength and accuracy of the firm's estimating department combined with the leadership of the design/build team, whether design-led or build-led.

For more information on the risks and benefits of fast-track scheduling in design build, please contact **Mark Caloyer** at MTC@PIETRAGALLO.com.



Significant Changes in General Conditions of AIA Document A201-2007

There are a number of significant changes in the General Conditions of the Contract for Construction in AIA Document A201-2007 when comparing it to the 1997 version. Below are several of the major changes.

Article 3: Contractor

- Imposes a new obligation on the Contractor to comply with applicable building codes in 3.7.2 and 3.7.3 regardless of whether the Contractor is aware of building code violations in the contract documents or has given notice to the Architect, and suggests a significant shift of responsibility from the design professional to the Contractor with regard to the building codes, and may have eliminated the prior safe harbor that existed under the prior 3.7.4.
- Imposes a new obligation on the Contractor to furnish the credentials of the proposed superintendent and gives the Owner and the Architect the right to reasonably object to the Contractor's choice.
- Imposes a new obligation on the Contractor to prepare and submit for the Architect's approval a submittal schedule, and then follow the submittal schedule.

Article 4: Architect (used to be called "Administration of the Contract")

- The Architect's role as contract administrator has been substantially reduced (and the Architect's contractual liability along with it).
- The Architect's role as administrator and Owner's representative stops with the issuance of the Certificate of Payment, instead of through the one (1) year warranty period (old 4.2.1).
- Replaces the Architect's general duty to keep the Owner informed about the progress of work and guard the Owner against defects or deficiencies in the work, with the limited duty to do so to the extent of the Architect's actual observations based upon actual site visits.

- Architect's role in dispute resolution significantly changed and all dispute resolution provisions previously included in Article 4 have been moved to new Article 15.

Article 5: Subcontractors

- Imposes the duty upon the Owner to assume the Contractor's obligations with respect to assigned subcontracts and permits the Owner to assign those subcontracts to a successor contractor without the subcontractor's prior consent.

Article 9: Payments and Completion

- The Owner is now permitted to directly pay subcontractors via joint checks once the Architect has published a decision to withhold a Certificate of Payment due to non-payment of subcontractors or suppliers.
- Contractor now required to pay subs no later than seven (7) days after receipt of payment from the Owner, replacing the previous duty to simply pay subs "promptly".

Article 11: Insurance and Bonds

- Imposes the new requirement of the Contractor to carry and maintain completed operations coverage until at least the end of the contractual warranty period.
- Now requires the Contractor to name the Owner, the Architect, and the Architect's Consultants as additional insureds for claims caused "in whole or in part by the Contractor's negligent acts or omissions" during construction and for the Owner during the completed operations period.

Article 15: Claims and Disputes (New)

- Replaces the previously mandated AAA arbitration with a choice between arbitration or litigation that the parties select in the primary contract and refers to the menu selection as "binding dispute resolution".
- Replaces the Architect as the decision maker with a generic "initial decision maker" that is a person agreed to by the parties to make initial decisions on claims and that person may or may not be the Architect.
- Requires all contract claims to be made in writing within twenty-one (21) days of the occurrence of the claim, and all claims must go through the initial decision making process and mediation before they can go to binding dispute resolution.
- Keeps AAA as the default ADR provider unless the parties specify otherwise in the contract documents.
- Keeps the mutual consequential damage waiver from the 1997 version.
- Requires the initial decision maker to respond to all claims within ten (10) days.
- Requires the initial decision maker to render a decision in writing, which decision shall be final and binding on the parties, but subject to mediation and then binding dispute resolution.

- Either party may file for mediation at any time following an initial decision. However, within thirty (30) days from an initial decision, a party demands that the other party file for mediation and the party against whom the demand is made fails to file for mediation within sixty (60) days of the initial decision, then BOTH parties waive their rights to mediation AND binding dispute resolution with respect to the initial decision.
 - ⇒ This is a way for the party who likes the initial decision to force the other party to either pursue mediation immediately or waive the right to contest the initial decision later. The implementation of this tactic prevents a party aggrieved by the initial decision from waiting until the end of the project to decide whether or not to challenge unsatisfactory initial decision.
- Consolidation and joinder are now permitted when arbitration takes place provided there are binding arbitration clauses involving all the parties subject to joinder. This reverses the position of the 1997 version, which prohibited joinder without consent. For example, the Owner can now consolidate claims involving the Contractor and Architect in one arbitration without the consent of either party.

For more information regarding AIA A201-2007, please contact **Joe Bosick** at JJB@PIETRAGALLO.com.



Low-Income Housing Tax Credits: The Advantage to Developers

Low-income housing tax credits were designed by Congress to increase the supply of affordable housing available to low-income households. However, low-income housing projects do not typically generate rental profits for investors because there is a limit to the income its occupants may earn and restrictions on the rents the landlord can charge. In order to provide developers and investors with an incentive to develop low-income housing projects, Congress enacted the low-income housing tax credit. 26 U.S.C. § 42. This statute provides a financial benefit to taxpayers developing or investing in a low-income housing project. Investors and developers receive a dollar-for-dollar tax credit (and other tax benefits such as business loan deductions) that are utilized to offset taxes. The return on investment then includes these tax benefits plus the possibility of cash proceeds from the sale of the project at the end of the compliance period.

Low-income housing tax credits are essentially a financing tool and method of raising capital to develop low-income housing projects. A developer can either construct a new building on a parcel of land or renovate an existing building into a low-income housing project. The method of financing the project often involves the sale of the low-income housing tax credits to a real estate or tax syndicate. The syndicate typically will serve as a limited partner of the project and make a substantial capital contribution in return for the partnership interest. Generally, fifty percent of the project is financed in this manner. The rest of the project is typically financed through traditional lending vehicles and commercial loans. A significant portion of the benefit to be derived from such projects is in the development of the building into a low-income housing project.

In order to qualify as a low-income housing project, there are enumerated rules that must be followed. It must be operated as a low-income housing project for 15 years, which is referred to as the compliance period. It will then receive tax credits for 10 years (the credit period) beginning generally with the date it is first in service or, at the election of the taxpayer in the subsequent year. There are specific income tests for tenants based on the Area Median Gross Income. Whichever test is utilized by the taxpayer, it must be met within the first year of service to qualify.

Only residential properties qualify for the tax credits. A mixed-use building is permitted but the non-residential units are not factored into the calculation of the amount of credits the project receives. It must be held out for general public use and it must be suitable for occupancy. The units cannot be used on a transient basis and units that are all inhabited by students do not qualify.

Developers may receive their fee out of the financing of the project, *i.e.*, the capital contributions made by the tax or real estate syndicate or the commercial loans. Specifically, Treas. Reg. 1.48-12(c) allows development fees for rehabilitation purposes. However, development fees are not defined in the Internal Revenue Code or in any case law. If there are insufficient funds, the developer may receive a note or an account receivable. Disguised payments for land acquisition services or syndication activities are not permissible.

The state housing agencies have the authority to set limits on the reasonableness of developer fees. The allowed developer fee is stated as a percentage of the project minus the land. These percentages vary from state to state. Some states apply this percentage to the aggregate of entities related to the developer for all services. However, some states allow separate entities to perform various services and receive compensation in addition to the developer fee. Thus, it is essential to obtain the Qualified Allocation Plan (QAP) from the state agency in which the project was awarded. The QAP will set forth the allowable developer fee percentage. The credit dollar amount allocable to a project can not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. The Housing Credit Agency will consider, *inter alia*, the reasonableness of the developmental and operational costs of the project. To put the matter into context, developer fees are generally over a million dollars on medium to large projects (\$10 million and greater).

If you are interested in learning more about low-income housing tax credit projects, please contact **Anthony Basinski** at AJB@PIETRAGALLO.com or **Albert Peterlin** at ANP@PIETRAGALLO.com.

**If you would like to be added to or removed from our electronic mailing list,
please let us know by e-mailing us at INFO@PIETRAGALLO.com
or by calling 412.263.2000.**

The Construction Legal Edge is a quarterly publication of the Construction Practice Consortium.

For more information about the Construction Practice Consortium visit www.PIETRAGALLO.com .

OHIO • PENNSYLVANIA • WEST VIRGINIA