

## Real Estate and Construction Newsletter, June 2018

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### TABLE OF CONTENTS

[How the 2017 Changes to the AIA Construction Contract Documents May Affect You: Part 2](#)

[The New Normal of Commercial Leasing](#)

[How the Tax Cuts and Jobs Act Will Affect the Real Estate Industry](#)

### **How the 2017 Changes to the AIA Construction Contract Documents May Affect You: Part 2**

By: Reilly S. Noetzel

Related Practice Area: Real Estate

Related Industry: Construction

*This article is the second part of a three-part series addressing the American Institute of Architect's (AIA) 2017 changes to its contract forms. The article will highlight the significant changes to the AIA Owner-Architect contract forms, while the third and final part of the series will discuss changes to the contractor-subcontractor contract forms. [Click here to read Part 1.](#)*

It is important for all participants in a construction project to become familiar with these new changes to the AIA contract forms, since many of the changes reflect the latest developments in the industry and fix common issues that arose from the prior contract forms.

**Major Changes: B101 and B103 Forms:** The B101 form is the standard form contract between an owner and architect, while the B103 form is used for more complex projects. Both forms have retained their respective titles and purposes in the 2017 updates, except that the B103 form is now specifically designated for "Complex Projects," rather than "Large or Complex Projects."

#### **1. Representation of Architect and Communication with Architect**

A new provision has been added to the Owner-Architect forms, which serves as a representation from the architect to the owner that the architect is licensed in the jurisdiction of the project to provide the services it is rendering under the contract. Additionally, the AIA has modified both forms to no longer require the owner to communicate through the architect during the project, but instead to merely keep the architect in the loop on matters affecting the architect's responsibilities or services.

#### **2. Introduction of Sustainable Projects Exhibit (E204-2017)**

Both forms now include the option for an owner to identify any sustainable objectives for the project and attach exhibit (E204-2017) to the contract. This exhibit sets forth the owner's sustainable objectives for the project and

requires the terms of the exhibit must be incorporated into the architect's future agreements with consultants or contractors performing work on the project.

### **3. Additional Services Redefined; Introduction of Supplemental Services**

Within both forms, the term "Additional Services" has been redefined and is no longer used in the same way as it was previously used by the industry. Additional Services are now primarily limited to those services of the architect that are not contemplated at the start of the project, but surface during the project (such as revisions to an architect's instruments of service due to changes in laws). The concept of Additional Services is now more akin to a change order, in that these services represent services of the architect that were unforeseen at the time the parties entered into the contract.

The services contained in what was originally a table of Additional Services now fall under a new term and table called "Supplemental Services." An architect's Supplemental Services are comprised of those services that are not included as part of "Basic Services," but are identified up front at the time of the contract. The table of Supplemental Services contains similar columns as the Additional Services table, which allow the owner and architect to select which Supplemental Services the architect will provide.

### **4. Termination Fee and Termination Date**

Similar to the A-Series Owner-Contractor forms, both forms now provide a suggested remedy to the architect in the event of an owner's termination for convenience. Specifically, the concept of termination expenses (including anticipated profits), which were to be paid to the architect in the event of an owner's termination of the contract for convenience, has been replaced with a "Termination Fee" to be paid to the architect. The new Termination Fee provision does not define the amount of the fee, and we recommend that the parties define the amount of the fee or identify an appropriate formula for calculating the fee. In addition, the AIA has added a new provision, which states that absent any other termination date specified in the contract, the Owner-Architect contract will terminate one year from the date of substantial completion.

### **5. Licensing Fee and Licensing Requirements**

To protect an architect's intellectual property and copyrighted materials, a new provision has been added to both forms that extends the Copyright and Licenses provisions of both forms beyond the termination of the contract. In addition, the AIA has added a new provision that requires an owner to pay a "License Fee" in the event that an owner terminates for convenience and the owner wishes to retain the architect's instruments of service. The License Fee is designed to be established by the parties, just like the Termination Fee.

### **6. Compensation**

The AIA has added prompts within the documents for parties to select the applicable compensation method (either stipulated sum, percentage basis of the owner's budget for cost of work, or such other formula determined by the parties), rather than leaving the architect's compensation open-ended, as was the case in previous B101 and B103 forms. With respect to the percentage basis compensation approach, both forms now have a designated blank for the parties to fill in the percentage of the owner's budget for the cost of work that will be used to compensate the architect.

### **7. Insurance**

Both forms now set out more specifically the requirements for insurance (including detailed limit and coverage thresholds) and now include the owner as a required additional insured.

## 8. BIM and Digital Data

The AIA has accounted for the latest trends in digital data and Building Information Modeling (BIM) software by introducing new provisions to both forms that address the exchange of digital data. Both forms expressly reference E203-2013, Building Information Modeling and Digital Data Exhibit, which establishes more detailed protocols for the exchange of digital data. Although parties are not required to include the E203-2013, we recommend it be included on projects that require use of BIM.

## 9. Architect's Liability

Both forms now provide further protection to the architect in rendering the architect's Basic Services. In particular, the architect is not responsible for accuracy and promptness of information and services provided by the owner and owner's consultants. Additionally, the architect is not responsible for the owner's acceptance of nonconforming work done to the project, unless the owner obtains the architect's approval in writing.

*Major Changes: B104 and B105 Forms:* The B104 form has been retitled as the "Standard Abbreviated" form, while the B105 form has been retitled as the "Standard Short" form. The B104 is no longer explicitly designated for "Projects of a Limited Scope," and the B105 is no longer explicitly designated for "Residential or Small Commercial Projects." Both forms incorporate many of the same changes implemented in the B101 and B103 forms discussed above, but these are some of the more specific changes to these forms:

### 1. B105: Description of Architect's Responsibilities

The B105 now sets forth a more detailed standard of care that the architect must follow when completing its responsibilities under the contract. Changes to the standard of care include a narrower definition of the locality used to measure the architect's professional skill, and the speed with which the architect must complete its services.

### 2. B105: Owner's License to Use Instruments of Service

The AIA has added a provision to the B105 whereby the architect grants the owner the right to use the architect's drawings or other Instruments of Service in connection with any alterations or additions to the project, as long as the project has been constructed and the owner has substantially performed its responsibilities under the contract. In connection with the license to use the drawings, the AIA has also added a provision requiring the owner to indemnify the architect from any claims or costs stemming from the owner's use of the architect's drawings or Instruments of Service.

### 3. B104: New Insurance Provisions

The B104 form now contains new insurance provisions and requirements that did not exist in previous versions of the document, including detailed insurance coverage requirements.

To update your personalized construction contracts to reflect the 2017 updates, or if you have any questions regarding the new 2017 AIA contract forms, [please contact me](#) or any of the attorneys in [Barley Snyder's Construction Industry Group](#).

[Back To Top](#)

## The New Normal of Commercial Leasing

By: John M Coles

Related Practice Area: Real Estate

Related Industry: Construction

Given the constantly evolving market in the commercial office sector, there are always considerations for landlords to keep in mind as they enter into new leases. Or perhaps a lease is up for renewal or extension, and the original agreement came under vastly different local market conditions. A number of these terms seem to be garnering recent attention and should certainly be part of the discussions and negotiations when looking at commercial office leases.

Many renters remain interested in tenant improvements to their planned office space and continue to look for landlords to assist in paying for those improvements. It could be to fund an initial buildout or to freshen up stale space at the time of an extension or renewal. Sometimes a tenant will ask a landlord to provide cash allowances to tenants who then complete their own improvements, but many times the landlord will be asked or will choose to complete the work themselves. In either situation, the lease should be clear as to what the allowance amount will be and how and when it may be used. In the cases of tenant-completed improvements, issues to consider range from the approval of tenant contractors to insurance requirements to mechanics' lien concerns. If the landlord is doing the work, it would be prudent to have a well-developed work letter that clearly establishes the specifications and tenant inspection rights for the work to avoid any disputes.

Timing is also key. The lease should be clear as to what happens if the improvements are delayed beyond an agreed upon completion date, as most office tenants need to get settled quickly to avoid business disruption.

If an allowance is provided, it is also important to be clear as to how it's wrapped into the lease. For example, if a tenant is to repay an allowance as part of the rent, landlords should consider what might happen if a tenant defaults or requests an early termination of the lease.

In the case of a default, the remedies section of many leases often provide for accelerated rent for at least some portion of the remaining term of the lease. As landlords know, these provisions can be very difficult to enforce, because defaulting tenants no longer have any resources to pay and because courts can be reluctant to enforce accelerated rent provisions over long periods of time. It's particularly difficult if a landlord rents the space to another tenant, bringing "double dipping" into play. It might be worthwhile to consider a liquidated damages provision to establish a fixed or easily quantifiable damage amount as part of - or instead of - a pure accelerated rent provision. That can provide some better clarity for the damage amount and may be more likely to be enforced by a court than an open-ended accelerated rent provision.

Another hot item in the office lease sector is the implication of assignment provisions. Historically, office tenants may have been more stable than retail, but with corporate restructuring, downsizing and reorganization happening all the time as business models around the world change at an alarming rate, the office tenant a landlord initially bargains with may not end up being there long-term. Tenants may be looking to assign a lease to a new corporate owner or perhaps a third party altogether when unforeseen changes occur. Considering these matters up front and addressing them in the lease can often eliminate future uncertainty and ambiguity. For example, if a tenant remains the same legal entity, but its ownership changes, should that trigger a lease assignment provision and therefore possible landlord approval? If a tenant wants to assign the lease, should the original tenant be fully released? What if

the original tenant is going out of business or is being absorbed by merger? While incorporating these types of provisions into leases often takes some more time and effort up front, the longer term benefit can be great if - or perhaps more likely when - these issues arise.

[Back To Top](#)

## How the Tax Cuts and Jobs Act Will Affect the Real Estate Industry

By: Timothy P. Malloy

Related Practice Areas: Real Estate and Tax

Related Industry: Construction

Congress enacted the Tax Cuts and Jobs Act in December to provide the most substantial overhaul of the United States tax code in decades. There has been plenty of publicity surrounding the personal income tax effects stemming from the enactment of this act, however, there are a number of other areas of the tax code which are significantly affected.

There are a number of provisions in the act that will directly affect the real estate industry:

**Bonus depreciation.** The act will now allow certain taxpayers to elect to treat qualifying property as a deductible expense rather than as a capital expenditure. This will allow many business to immediately expense large expenditures made in connection with certain real estate purchases. This particular provision will be phased out by 2023.

**Real property asset lives.** The act now is intended to provide that qualified improvements to real estate will have a useful life of 15 years. A technical correction to the law will be necessary in order for this piece of the law to actually come into effect.

**Like-kind exchanges.** Generally, tax-free like-kind exchanges have been eliminated. However, the like-kind exchange of real estate has been preserved. The impact of this is that, upon each purchase of real estate, the buyer will need to consider what the tax effect is for the tangible personal property associated with the purchase.

**Business income deduction.** There is a new deduction for business in the amount of 20 percent of qualifying business income, however this deduction is limited to 50 percent of the W-2 wages paid by the business or the sum of 25 percent of the wages paid plus 2.5 percent of the unadjusted basis of certain property the business uses to produce qualified business income.

**Changes for a tax-exempt investors.** The unrelated business taxable income rules have been modified significantly in that you can no longer offset the income from one unrelated trade or business with the loss from another. It is possible that the IRS will treat each real estate asset as a separate business, thus losses from one property may not be able to be used to offset income on another property. This can effect nonprofits across the board.

**Net operating losses.** They can no longer be carried back but may only be carried forward indefinitely, and a net operating loss arising in a tax year may only reduce 80 percent of taxable income in a carryforward year. This provision will affect many business who have experienced gains in prior years and losses currently.

These taxpayers will no longer be able to apply some of the losses to previous tax years.

**Personal real estate.** There are two major provisions that are not necessarily specific real estate business but will affect significantly individuals who own a home. The first is the home mortgage interest deduction which is now limited to interest on \$750,000. The second is that state tax deductions will be limited to \$10,000. While the increased standard deduction has been increased, many individuals paying more than \$10,000 in real estate property taxes will no longer get a deduction for payment of such amounts.

[Back To Top](#)