

Preventative Measures to Avoid Problems with Construction Contracts

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When it is time to paint the Association's buildings or replace the roof or install a fire alarm system or undertake any other major project in your community, the Board of Directors needs to address much more than getting the best price. If an Association naively assumes that all it needs to do is raise the necessary funds, hire a contractor, and presto, the job will be complete, it becomes vulnerable to being taken advantage of by an unscrupulous contractor. Associations need to be aware that there are steps it may take to curb abuses by contractors. This article is a basic primer on how an association can avoid being victimized.

Seek References

Secure the names of persons in a variety of communities that have had projects done by the same contractor. Call them. Was the job completed on time? Were any liens placed on the property? Were any promises broken? Did the contractor respond in good faith to warranty claims? Would they have them do another job for them?

Secure the names of the subcontractors. Call them. Is the contractor a "good pay?" Have they had to file liens on their jobs? Does the contractor properly supervise their jobs? Does the contractor try to cut corners?

Talk to the building departments where the contractor has worked. Have there been complaints filed? Talk to the construction industry licensing board. Have complaints been filed?

Hire an Engineer, Architect or Construction Manager

We will not attempt in this short article to discuss the advantages of retaining an engineer or architect to design and develop specifications for your project vs. working with plans prepared by the contractor. However, unless you have construction experience, retaining an engineer, architect or other qualified construction consultant to administer your construction contract is essential.

The cost of day-to-day supervision is generally prohibitive. More realistic would be to have your engineer, architect or construction consultant perform periodic inspections to determine if the work is being performed per specifications, and to review change orders and pay requests, verify payments to subcontractors and otherwise keep the job on an even keel financially.

Negotiate a Consumer-Oriented Contract

Consult with an attorney experienced with construction law before you sign anything or give anyone money. It generally is a big mistake to sign the form of contract or proposal offered by the contractor. They are not written to protect the Association. The terms should be negotiated, and if the contractor is not willing to allow the Association time to confer with its attorney, the Association should look for another contractor.

A good contract will provide, among other things, a well-defined scope of work, protection against hidden costs, strict time limits, procedures for verifying payments to subcontractors, payment schedules, retaining funds until completion, inspections, warranty protections, insurance requirements, payment and performance bonding requirements (if desired) and tough sanctions for breach.

Know What You're Getting Upfront

The more detailed the plans and specifications, the less likely you are to get stuck with expensive "extras." Be sure the plans and specifications are referenced in the contract and initialed by both parties and be sure that the contract spells out all items which are included and excluded from the contract price. During the project, all "extras" should be documented with written change orders. Keep a log of all discussions with the contractor and confirm all important matters in writing.

Control the Purse Strings

The Association retains the greatest leverage when the contractor has more invested in the project than he has been paid. The biggest danger for an Association is a situation in which, for example, a job is 60 percent complete, but the contractor has been paid 80 percent of the contract sum. In such an instance, if the contractor abandons the job, it is assured that the Association will exceed the total contract amount in securing completion by a replacement contractor. Have an engineer or construction consultant review the payment schedule and verify before each payment that the work claimed to have been completed has indeed been completed.

Have the contract provide for the retainage of 10 percent of each payment request until completion of all work is done in a satisfactory fashion.

Avoid Liens

Review the construction lien law (see the January, 1996 issue of the Property Management & Construction Review) and utilize it to your advantage. Record and post a Notice of Commencement before the work begins. Secure a

“schedule of values” from the contractor indicating the cost of each segment of the work. Get a list of subcontractors and their phone numbers. Keep an accurate record of Notices to Owner filed by subcontractors and materials suppliers. Secure properly completed partial lien waivers from the contractor and subcontractors before paying draw requests.

Check the partial lien waivers against the schedule of values to assure, for example, that if 70 percent of a particular subcontractor’s work is claimed to have been completed, that the subcontractor has been paid 70 percent of its contract. Also, check to see that the contractor does not request payment for a subcontractor’s work in excess of the percentage of the subcontractor’s work which has been completed.

Before making final payment, call all the subcontractors who have filed Notices to Owner and find out what they claim to be owed. Make sure this is consistent with what the contractor’s records reflect.

If necessary, issue joint checks for final payment to the subcontractors and contractor. Secure final waivers of lien from the contractor and all subcontractors.

Don’t Depend on Your Lender or Building Department

If the Association is borrowing money to complete the project, it might be under the impression that the lender will be there to watch out for the Association’s interest. Some loan officers are very prudent in this regard, and carefully scrutinize pay requests prior to each draw. However, lenders are there to protect their interest, not the Associations. If a lender errs and the Association is left with \$20,000 to pay off \$40,000 in liens and complete the job, the lender will not be responsible for paying the difference.

Inspections by City’s building officials are generally quite limited. The building department focuses on code violations and is not there to assure compliance with the plans and specifications of good workmanship. The building department does not involve itself in the financial aspects of the construction.

In addition to picking a contractor and budgeting for the project, the Association must take measures to be sure that the project is properly managed and the work is performed in accordance with the specifications, for the price originally quoted. By following the basic steps outlined in this article, the Association will stand a better chance of avoiding contractor fraud and abuse, and will be more likely to achieve a satisfactory job within the original budget. Keep in mind, however, that this short article is not meant to be inclusive of all protection available, nor may each of these steps be appropriate for your particular situation.

Consult your attorney and engineer, architect, and construction consultant for more specific advice.
