

By Drew Colby-How owners/developers can leverage this "near perfect" construction environment

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This is a great time to build if owners/developers understand the risks this environment presents and take steps to minimize or eliminate the same. Despite the near perfect conditions for construction (e.g., decent land acquisition costs, manageable construction costs, low interest rates, etc.), owners/developers must be mindful of the potentially catastrophic threat this unique environment creates; namely, encumbrances arising from payment issues. This article will briefly describe how these encumbrances arise and further provide cost-effective mechanisms to minimize or prevent the same.

Here is the scenario: The owner/developer hires a contractor who, being desperate for work, takes the project at minimal profit. The owner/developer and contractor get into a disagreement resulting in payments being delayed or withheld from the contractor. The subcontractors and material suppliers file mechanic liens, attachments, etc. encumbering the property. At this time, the owner/developer realizes the contractor has been paid amounts for the subcontractors' work and material costs, but has not paid its subcontractors and material suppliers.

The conditions to blame for this situation are the "near perfect" construction environment. Specifically, the reduced number of projects has caused great competition among contractors resulting in bids with marginal profit margins. Contractors taking projects at marginal profit margins become extremely vulnerable to payment discrepancies. Indeed, a payment discrepancy on one project often causes the contractor to underperform on all of its projects.

The good news is there are a number of mechanisms owners/developers can employ to minimize or prevent payment encumbrances. This list includes, but is not limited to, the following:

1. "Do not hire strictly on price" As the old saying goes "it's not what you pay, it's what it ultimately costs." Hiring a slightly more expensive, but more qualified contractor almost always yields much better results for owners/developers. Owners/developers should consult with industry professionals, including their architects, construction lawyers, etc. to seek quality referrals.
2. "If it is too good to be true, do not buy it" Owners/developers should avoid the temptation to select, without further scrutiny, a bid disproportionately lower than the others. While owners/developers can sometimes hold contractors legally responsible for bids containing errors, those "rights" are of little benefit if the bidder goes bankrupt. Upon receipt of disproportionately low bids, owners/developers should contact the bidders to ensure the bids accurately reflect the scope of work. Further, owners/developers should seek assurances the bidders can perform at the bid prices.
3. "Use the best lien waivers your state allows" Lien waivers are essential, but some states put restrictions on what can be used. Moreover, many owners/developers fail to use the most protective lien waivers their states allow. Whenever possible, we recommend a lien waiver with an Indemnity

component that requires the contractor to indemnify the owner/developer for putting erroneous information in a lien waiver.

4. "Use properly worded contracts" Owners/developers must use properly drafted contracts that include provisions allowing, for example, owners/developers to contact each subcontractor and material supplier before issuing payment to ensure they have been paid. If they have not been paid, owners/developers are then permitted to issue joint checks. Owners/developers should also use language permitting them to ensure their contractors have the financial ability to complete the projects in question. Another important contract clause requires contractors to use all payments received on a particular project to fund that contractor's obligations on that particular project. The contract should also permit owners/developers to terminate contractors who fail to fulfill their obligations including payment obligations to subcontractors and material suppliers.

These are just some practice suggestions that should enable owners/developers to take advantage of these "near perfect" construction conditions while minimizing or preventing the very real threat this environment creates.

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