



## Rebuilding 101

### A Guide to the Reconstruction Process

**“Better to be wise by the misfortunes of others than by your own.”--Aesop**

Getting an education about the process of rebuilding your home can be very expensive, especially when those lessons come from looking out for your own money. Rebuilding after a loss can be very exciting, creative, and fulfilling, but it can also seem like a never-ending nightmare that bleeds you dry, both emotionally and financially. The difference between a good and a bad experience comes down to two things:

1. How well prepared you are for the journey.
2. How resilient you are when things change.

Our mission in this article is to help you prepare for the rebuilding journey through six important lessons. Remember that even in the best-planned projects, changes and surprises will occur. Whether it's the weather, the contractors, the building department, or any of a zillion things that can throw a wrench into your project, one thing is certain: things will change. Some people deal well with change and find opportunities in the dynamics of the situation. For some, however, the construction process with all its uncertainties only leads to disappointment and frustration. The construction game is best played by those who have a clear vision of what they want, and, at the same time, an open mind for the possibilities that will emerge.

***Lesson 1: Do business with the right people.*** This is perhaps the single most important thing that you can do to obtain the best outcome. Spend the time it takes to check references on those you do business with. Surprisingly, bad contractors will sometimes refer you to past clients who will tell you, "Don't hire that guy!" Just because a contractor gives you what looks like a nice list of references, don't assume that they are all happy with the job they did.

You can also turn to the Internet to find out what past clients have to say about the contractors you are considering. Do some Google searches for things like "<contractor name>" "problems", or "<contractor name>" "lawsuit" (or "lien", "damages", etc.) and see what comes up.

Check a contractor's license status with your state's licensing board. Visit UP's State by State

Help Section ([http://uphelp.org/state\\_help.html](http://uphelp.org/state_help.html)) for links to state licensing boards in every state<sup>1</sup>. If he/she doesn't have a valid license, find someone else. You can also check with the Better Business Bureau (<http://www.bbb.org/us/Find-Business-Reviews/>) to get a report on the contractors you are considering. If he/she is not a member, ask why not.

Your architect can also be a source to find good contractors, but don't just take the architect's recommendation and stop there. There is a much greater chance that the architect and contractor will do business together in the future than work with you again. Know that in residential construction, contractors and architects often look out for each other, to the owner's detriment. This can range from the contractor paying a "finder's fee" to the architect, to an arrangement where the contractor will not charge you for correcting the architect's mistakes in exchange for the architect recommending the contractor's billings for payment. In either event, they are helping themselves to your money.

We suggest that you develop a final list of three prospective contractors, request from them an outline of their qualifications and references, and then interview each one. Create an interview committee made up of you, your architect, and a trustworthy friend in the construction business, or someone who has been through the rebuilding process him- or herself.

***Lesson 2: Bid or Negotiate?*** Most of the best custom home contractors will not agree to participate in a simple bid project because they typically have enough business without the hassle of bidding for it. You can, however, get a good deal on a construction project by "bidding a negotiated contract". Here is how that works:

1. First, understand that you are setting out to enter into a negotiated Guaranteed Maximum Price (GMP) contract. This is a commonly used delivery method for private work where you can engage the contractor early in the design process and pay them for the cost of construction, plus a fee for their services. The American Institute of Architects (AIA) has a good sample contract to use for this (the AIA-A101 (2007), "Standard Form of Agreement between Owner and Contractor.")
2. Have the contractors who you have interviewed and who you believe would be good to work with (from the process in Lesson 1) give you a quote on:
  - The fee they would charge on top of costs
  - The time of construction based on the conceptual plans
  - The "mark up" on change order work
  - Charges for "General Conditions", the cost of project supervision, and all temporary facilities, including temporary toilets, fences, etc.

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<sup>1</sup> If you live in California, visit <http://www.cslb.ca.gov>. Go to the Consumers tab, select "Check License or HIS Registration" and enter the contractor's license number to verify their status with the CSLB. Note: the CSLB won't show any adverse information, but will show whether the license has been suspended, and you can find out whether they have had bonding changes (lots of bonding changes should be a red flag.)

- Profit and Overhead
  - Construction supervision
3. Be sure you stipulate that you intend to use the AIA-A201 (2007) form (“General Conditions of the Contract for Construction”), and that you expect them to obtain at least 3 quotes on all major subcontract trades.

**Lesson 3: Negotiate the right contract terms.** The process of constructing a home is a virtual orchestra of diverse talents, some working together for the first time, to create something that is unique, and which has never been assembled in this form before. *They are all looking out for their own interests first, and they all want your money.* They all have the objective of getting considerably more of your money than what it will cost each of them to produce their contribution to your project. Depending on local economic conditions, there may be a lot of available contractors or the opposite—demand may exceed supply. Your ability to get the most for your money will depend on when you are rebuilding, and how well you negotiate the deal.

There is an old saying in construction contracting: “The owner gets to play offense until they sign the contract, after that they only get to play defense.” So make sure you have left yourself in the best position possible when you sign the contract.

Some tips on negotiating contracts with your contractor:

1. *Never do an open-ended “cost plus” agreement.* If the total scope and cost of your project can’t be fully calculated at the outset, then contract in phases. If you must go “cost plus”, be sure you have defined what is project cost, and what is covered in the contractor’s fee. Nail down the rates that will be charged for any labor and the process the contractor will use for getting subcontractor quotes and buying materials.
2. *Never simply default to the contractor’s form agreement—it is written to protect him, not you.* There are many good industry standard agreements out there that you can review and learn from. The American Institute of Architects (AIA) has developed perhaps the most commonly used form agreements in the industry. Visit <http://www.aia.org/contractdocs/index.htm> to purchase.
3. *Have the contractor indemnify you, hold you harmless, and defend you from all losses arising out of his work.* If you don’t know what these phrases mean, consult your attorney or read up on the subject. If something goes wrong at the project, if someone gets hurt, or if there is a serious defect with the construction later, this clause and the insurance provisions may be the most important paragraphs in your contract.
4. *Be sure the contractor has good general liability insurance, and make sure you are named as an additional insured under his policy.* You should also make sure that the General Contractor requires all of his subcontractors to have proper insurance, and that all of them name you as an additional insured as well. Have your insurance agent review the general contractor’s insurance coverage.
5. *Be sure you have a property loss policy on the construction project.* In the industry this is referred to as a “Builder’s Risk” policy. I recommend that this coverage is purchased by

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the owner, and not by the contractor. This policy will cover the project for property loss (such as fire) while under construction, and should be discussed with your insurance agent.

6. *Be sure you agree upon a project completion time and liquidated damages in the event that the project takes longer than anticipated.* Stipulated liquidated damages are a set cost per day that should reflect the cost to you, should the home not be completed per the contract completion date. These damages usually include costs for alternative living arrangements, interest charges for the construction loan, and property taxes.
7. *Look carefully at the termination language and have an open discussion with the contractor regarding what happens if unforeseen circumstances arise.* Perhaps your partnership won't work out. You might decide to terminate before construction starts, or the contractor or you might get hit by a bus, etc. The project is generally honeymoon time, when everyone is looking through rose-colored glasses, but *remember that contracts are much easier to get into than to get out of.*
8. *Never pay a big deposit to a contractor up front, or any other payment up front--never!* The California Contractors License Board (CSLB) limits upfront payments to a contractor to 10% of the contract, or \$1,000, whichever is less. Check with the license board in your state to find out about local limitations.

**Lesson 4: Payments to the Contractor.** Contractors, subcontractors, and material suppliers who perform work or send materials to your project have *lien* rights to your property. If you pay your general contractor and he or she fails to pay subs and suppliers, those subs and suppliers can put a *lien* on your property, and you may have to pay them directly to remove the lien – even if you have already paid the money for the work to the general contractor. You should periodically check your county recorder's list<sup>2</sup> of "Grantor/Grantee" recordings for any liens, notices, etc. Be sure to search for different spellings of your name - with/without middle name, middle initial, first name variants, etc. - sometimes the documents are recorded in strange ways.

There are basically three ways to avoid liens:

1. Require that your General Contractor provide a Payment and Performance bond. This is a bond (that you will have to pay for) that protects you from the contractor's failures to perform the work, or failures to pay his subs and suppliers. This is a fairly expensive way to go, and will cost somewhere in the neighborhood of 2% of the contract price. The cost goes down based on the financial strength of the contractor and the contractor's bonding history. Even if you don't intend to require a bond, it may be a good idea to ask your prospective contractor to tell you their bonding rate – the rate is very telling in itself. Many residential contractors do not have a history of bonding, so they may not be able to bond the project.

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<sup>2</sup> In San Diego County, you can visit <http://arcc.co.sandiego.ca.us/services/grantorgantee/search.aspx> to check for liens.

2. Fund Control is another alternative to protect you from a contractor's failure to pay his subs and suppliers. This is a service where a company, such as Dixieline Fund Control, will disburse payment vouchers to contractors upon your approval of the work. The fund control company will collect the proper lien waivers from the contractors and help to protect you from liens against your property. Fund Control is much less expensive than a bond, and is typically required by construction lenders.

The contractor has the right to require some form of assurance that you are able to pay for the construction. The fund control process is also a good way to provide that assurance. The fund control will require that funds are secure in an amount to cover the contract for construction and will provide a process for line item budget management for the project.

3. Once hired, make sure you get unconditional lien releases from any subcontractors at each step of the job - ideally before releasing the next payments. Beware of "unconditional" lien releases that say "we received payment, and upon clearance of the payment" - these are NOT unconditional, and you are still at risk until the contractor's payment to the sub clears. If the check never clears, your lien release is worthless.

Many disaster survivors that UP has helped over the years have told us that although they followed most of these suggestions, they still wound up with some liens and lawsuits. However, they were able to prevail through diligence and good record keeping, so it didn't cost them much more than a lot of time and effort.

**Lesson 5: Change Orders.** One thing is certain: things will change. The contract provides for a cost and time for construction based on the construction documents, plans, etc. Changes will occur primarily due to:

- Errors and omissions in the plans
- Unforeseen conditions
- Regulatory agency directives
- Owner elective decisions

Basically, the contractor is responsible to have made a reasonable anticipation of the requirements of the project. When things occur beyond reasonable anticipation, the contractor is entitled to receive a reasonable adjustment in contract price and time. The work will cost quite a lot more when it occurs due to a changed condition compared to what it would cost when it is purchased as a part of the base contract. Project studies have shown that the premium for change order work will be around 40% or more over base contract work, due to the inefficiencies in buying and administering change order work. Change order work can be avoided by:

- Allowing ample time for the development of plans, and careful advance review of plans.
- Due diligence in soils investigations and research into past construction on the site to minimize unforeseen subsurface conditions.

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- Spending time with the architect reviewing the plans to make sure that you both have the same vision. Get the architect to help you visualize each room, and study the orientation of the structure on the site for view corridors, etc.

When changes do occur, follow the process outlined in the contract for administration of changes, and *make sure all changes are in writing!*

**Lesson 6: Administering the Process.** The AIA contract does a pretty good job of outlining the process for administering the construction contract. Some architects are good at contract administration, and some are almost worthless. There are also “owner advocates” or owner’s representatives out there who can help to administer the process. A few key concepts in contract administration can go a long way in keeping you out of trouble:

1. The AIA contract has an attachment (AIA-A201), referred to as the “General Conditions of the Contract for Construction,” which sets forth how to deal with payment, change orders, etc., and if followed, will help keep the project on track and trouble-free.
2. Have regular team meetings at the site with the contractor, the architect, and owner present. Document each meeting with written minutes that establish:
  - Each issue discussed
  - Who is responsible for what action
  - When the action is due
3. At the end of every meeting, wrap up with a question to the contractor: “Other than what we have already discussed here today, is there anything that is holding you up, or that you think will result in any additional cost to the project?” Then document the contractor’s response to that question in the written meeting minutes.
4. The importance of the written meeting minutes cannot be overstated. He who controls the meeting minutes controls the project, and the meeting minutes are often the best-written documentation for the project. When a project goes into litigation, the reality established in the written documentation is the reality that counts.

Project issues are more like fish than fine wine; they don’t improve with age, and only get stinkier as time goes on. Deal with issues promptly and in writing to keep them from disrupting and dominating the project.

Volumes have been written and careers have been spent exploring all of the strategic aspects of construction project management. We have tried to “dispense with the trivial many, in favor of the critical few” as it relates to staying out of trouble on your home rebuilding project. Most contractors will hate being asked to prepare written documentation. They will also hate reading the contracting provisions, and living them as well! We can tell you with certainty that if you follow the concepts outlined above, your chances for a successful project and your chances of avoiding litigation will be greatly enhanced.

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**Sample claim forms in the UP Claim Help Library:**

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