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Managing Construction Risks	
RISK #1 The project's budget is understated, and money runs out before the project is completed.	(1) Develop a detailed budget with a contingency. The contingency for new construction is usually 10% for new-construction hard costs, 15 to 20% for renovation hard costs, and 5% for soft costs. The budget should provide a realistic estimate of all project costs, with construction costs based on a guaranteed price contract or bid and with individual line items for each soft cost. (2) Execute a fixed-price contract (i.e., stipulated sum or guaranteed maximum price). The contract price is fixed, determined in advance of any construction, and based on defined construction specifications that are prepared by the architect and agreed to by the owner. Carefully review the GC's exclusions. Ask contractors to use the AIA contract formats since they are industry standard. This format is also extremely helpful for borrower and lenders. It ensures accurate information, legal requirements, etc. These contracts are detailed and use standard language. (3) Make monthly disbursements to the contractor through the construction lender, based on an application and certification for payment. This is a generally accepted process for disbursing construction loan proceeds, whereby the GC requests payment from the owner (borrower), according to a schedule outlined in a construction contract. The applications for payment provide detailed information about how much work has been completed to date, and are signed off by the architect. The lender's inspector provides a separate report on payment applications. Do not sign a contract which allows payments in equal monthly installments over the term of the contract. (4) Hire a project manager to oversee the development/construction project.

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RISK #2 The GC runs into cash-flow problems. He or she doesn't have cash available to purchase supplies or pay subcontractors. Or the GC diverts loan proceeds earmarked for the construction project to another purpose.	(1) Make sure the GC posts payment bond and performance bonds. These are bonds issued by a surety company that are similar to an insurance policy. If the GC does not pay his or her subcontractors, or the GC is unable to complete the project, the borrower can make a claim to the surety company. For a smaller GC, have the GC obtain a letter of credit that equals 25% of the hard costs. (2) Require a lien waiver and release upon each application for payment. By using this release, the GC, subcontractors, materials suppliers, and mechanics acknowledge that upon payment, any right to place a lien on the property for work performed on the project to date will be waived. (3) Obtain a satisfactory contractor's qualification statement, which indicates the experience, availability, and capability of the proposed contractor. The statement should include financial statements, a resume of significant (and similar) work experience, and references. (4) Check the GC's references for work on similar projects.
RISK #3 The GC (or a subcontractor) places a mechanic's lien on the property, thus placing the senior lender's first deed of trust (or mortgage) at risk.	(1) Require a release of conditional lien upon each application for payment, and for each new request, require an unconditional release of lien for the prior payment (see risk 2, #2 above). (2) Obtain title insurance. This is an insurance policy assuring that the senior lender will have a first deed of trust. Depending upon the state, "bring downs" or "bring to dates" may be required for each construction loan advance, so that the bank is insured only up to the amount advanced by that date.

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RISK #4 The GC has completed 95% of your project, but has started another large project and doesn't show up to complete your project.	(1) Obtain a satisfactory contractor's qualification statement (see risk 2, #3 above). (2) Make sure the GC posts payment bond and performance bonds (see risk 2, #1 above). (3) Hire a project manager to oversee the development/construction project. (4) Require retainage. This is a standard payment plan by which a certain percentage (typically 10%) is withheld from the progress paid to the GC to ensure he or she will not walk away from the project prior to 100% completion. This is standard practice for many construction lenders. (5) Contact the GC's bond company. (6) As part of your architect's contract, a punch list should be created by the architect to address any unfinished or unsatisfactory work the GC must fix prior to retainage release.
RISK #5 An environmental problem is discovered on the property (e.g., contaminated groundwater due to a previous facility located on or adjacent to the property).	(1) Obtain a Phase 1 Environmental Site Assessment Report. This is a report from a third party (prior to construction and usually required by your lender) that identifies any existing, potential, or suspect conditions that may pose an environmental liability to the property. (2) Hire a project manager to oversee the development/construction project.

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RISK #6 When the building is completed, the city inspector determines that it does not meet code requirements, and will not issue a final permit until corrected.	(1) Make sure your architect has certificates of general and professional liability (errors and omission insurance). The architect's professional liability insurance covers negligent work performed by the architect and protects the owner if there is damage due to such negligence. (2) Obtain an architect qualification statement. This is a statement verifying the architect's qualifications and experience with similar projects. (3) Check the architect's references for work completed on similar projects. (4) Require certificate of occupancy prior to release of final loan funds. This is a certificate issued by the appropriate government authority indicating that the project is ready and fit for occupancy, and that there are no building code violations. (5) A construction inspector is appointed by the lender and serves as her or his representative to monitor construction progress on a monthly basis. This individual warrants the work on the lender's behalf only. (6) If possible, review a construction inspector pre-construction report. This is a written report from the lender's construction inspector that provides an analysis of the feasibility of the project, specifically the reasonableness of the price that the GC is bidding and the time frame proposed. (7) Obtain satisfactory contractor's qualification statement. (See risk 2, #3 above). (8) Hire a project manager to oversee the development/construction project.

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RISK #7 An accident occurs during construction, and a worker is seriously injured. The worker sues the GC, thus tying up the GC and impeding completion of your project.	(1) Ensure that either the GC or the school acquires builder's risk coverage on the property during construction. Also, make sure the school's general liability insurance policy covers the increased value of the new property (with proposed improvements). (2) Confirm that the GC has his or her own liability policy and has sufficient workers' compensation insurance to cover workers and subcontractors in case of an accident.
RISK #8 A flood, fire, or other disaster occurs on the construction site, causing serious damage to construction in progress.	(1) Confirm that the GC or the owner has obtained builder's risk insurance in an amount that is at least equal to the GC's contract but no less than the as-built value per the appraisal. (2) Determine whether the property is in a flood zone, and perform a search for flood compliance (usually completed by the lender).
RISK #9 There's a downturn in the real estate market, and once the building is completed, it is appraised for less than what it cost to construct it. The senior lender's loan-to-value is insufficient, and requires additional collateral coverage.	(1) Obtain an as-built appraisal reflecting adequate collateral coverage. This is a third-party estimate of the property's value once constructed, based on plans, specifications, and current market conditions. Lenders typically allow a maximum of loan-to-value percentage of the property's value to be in the form of senior debt to make sure the property can be sold to cover the outstanding loan in a liquidation scenario. The lender providing the loan orders the appraisal. (2) If possible, obtain a construction inspector pre-construction report. (See #6 above). (3) Ask your lender for construction inspector's reports throughout the project, if possible.

RISK #10 The charter school's current operations suffer because management is focused on the new development project and "no one is minding the store."	(1) Hire a project manager to oversee the development/construction project.
RISK #11 The building is constructed with a small portion encroaching on a neighbor's property.	(1) Obtain site survey. (2) Obtain site plan from the architect, and ensure approval by city/state building department (same organizations who approve the plans and specification in order to receive building permit). (3) During construction and at the time the foundations have been poured, request a foundation survey be completed, to ensure proper placement of building.