

# BURDMAN & WARD

## ATTORNEYS AT LAW

**Construction Defect Attorneys**  
**Tel. 888-350-9080**  
**[www.burdmanlaw.com](http://www.burdmanlaw.com)**

**Law in Hand**

### **RECONSTRUCTION SAVVY: NEGOTIATING THE CONTRACT**

This is part two of a three-part series providing an overview of the steps necessary for a successful reconstruction project. This second segment focuses on negotiating the reconstruction contract.

Now that your association has received several bids from general contractors for their reconstruction or renovation project, what's next? The board should first check each contractor's qualifications and references. When selecting a contractor, do not focus on the lowest bid. Go with the contractor whose bid is not only competitive, but one who is recommended by other property managers and associations. Once the board has selected the contractor it wants to hire for the job, it must now negotiate the reconstruction contract terms. As community manager, you should assist the board in assuring that everything is put in writing and making sure that the association's interests are protected.

As with any contract that involves a substantial sum of money, the board should seek the assistance of an attorney who practices general homeowners association law and is knowledgeable in dealing with reconstruction contracts. An attorney will be able to assist the board in drafting and negotiating the contract's basic terms.

When evaluating the individual proposals, be careful not to accept gifts, or allow your board members to accept gifts from a contractor soliciting business. In addition to creating a conflict of interest, you or your board members could be guilty of a misdemeanor for accepting any gift worth more than five dollars from a contractor as an inducement to enter into a contract.

## **Put It in Writing!**

Under California law, if the total cost of the project, including labor, services, and materials exceeds \$500, the contract must be in writing. Any changes made to the contract must be also be in writing. California law requires certain specific information to appear in a home improvement contract.

The contract must, among other things, contain the contractor's name, address, and license number. If the contract was solicited or negotiated with a salesperson, the name and registration number of the salesperson must be included as well.

The contract must also specify approximate starting and completion dates. The law requires the contractor to begin work within 20 days of the start date, unless there is a lawful excuse. The contract must define what constitutes substantial commencement of work.

The contract must describe the work to be done, including materials and equipment to be used or installed. To protect the association from any later misunderstandings, the description of work should be as detailed as possible.

The contract must specify the price, and a schedule of payments expressed in dollars and cents. It is not sufficient to specify payment amounts in percentages. The down payment for the work must be no more than ten percent of the total cost of the project or \$1,000, whichever is less. With the exception of the down payment, the payments made to the contractor may not exceed the value of the work completed at the time the payment is made. These payment limits do not apply if the contractor provides a performance and payment bond, lien and completion bond, or if the payments are handled by a joint control company.

Finally, the contract must provide several other legal notices, including notices regarding arbitration, liens, right to cancel, and right to a bond or joint control. There are other required provisions for the reconstruction contract. The Contractors State License Board's website ([www.cslb.ca.gov](http://www.cslb.ca.gov)) lists these requirements and contains other valuable information regarding contracting with a contractor.

In addition to these provisions, the contract should clearly specify whether the contractor or the association will be responsible for the cost of any necessary permits, fees, notices, approvals, easements, assessments, or other charges required for construction. These items should be in the association's initial request for proposals and should be spelled out in the contract.

The contract should require the contractor to keep the site clean during construction, and to leave the site "broom clean" or better at the completion of work. The contract should give the association the right to hire a cleaning service and withhold the cost from the contractor if the contractor fails to keep the site clean. Should the cleaning of individual units be needed following reconstruction, a provision should be included in both the initial request for proposal, as well as the contract itself.

The board should insist upon a clause in the contract that states that the contractor indemnifies and holds harmless the association, its individual homeowners, and the property management company for all claims arising out of the negligence of the contractor or subcontractors, including workers injured on the job. The contract should require the contractor to provide the board with copies of all subcontracts, insurance policies, and evidence of performance and payment bond, or lien and completion bond, upon request.

The board should work with the contractor to include in the contract a specific definition of what is considered “substantial completion.” This definition may vary depending on the nature of the reconstruction project. The contract should further provide that when the contractor considers the project substantially complete, and before final payment is made, the association will provide the contractor with a punch list. The contract should specify that final payment is not due until the punch list is complete to the association’s satisfaction. The final holdback payment should be at least ten to twenty percent of the total cost of the project. The contract should provide a specific penalty for late completion of work, without good cause for the delay, which is proportionate to the overall size of the project.

Most contractors will offer a one-year, or more, warranty for their work. Your board should further ensure that the warranty details are included in the reconstruction contract. Such details can include how the contractor is to be notified of a warranty claim, when the claim is to be addressed by the contractor and a mechanism to resolving any dispute which may arise.

Finally, the contract should require the contractor to maintain a comprehensive general liability insurance in an adequate amount for the size of the project. This insurance should be proportional to the value of the contract.

### **Protect Your Association from Mechanic’s Liens**

Under the California Mechanics’ Lien Law, any contractors, subcontractors, or other entities who participate in the improvements but are not paid for their work have a right to place a lien on the property and sue the owner for payment. A subcontractor can place a lien on the property - even if the association has paid the contractor in full - if the contractor fails to make payment to the subcontractor.

To protect your association from this risk, insist that the contractor supply the association with a payment and performance bond. The payment and performance bond and a copy of the construction contract should be filed with the county recorder. The board may wish to also consider having the contractor submit a declaration stating all subcontractors and other bills and taxes for which the association may bear responsibility have been paid.

Additionally, you may require that payments to subcontractors and material suppliers be made directly through a joint-control company, or you may have the association pay the contractor by writing joint checks to the contractor and the subcontractors.

Upon making payment on any completed phase of the project, and before making any additional payments, the association should have the contractor provide an unconditional “waiver and release” form signed by each supplier, subcontractor, and laborer involved in that portion of the work. This “waiver and release” form is found in California Civil Code section 3262.

If any mechanic's liens are filed against the property of the association or any homeowner, you should consult with the association's attorney immediately. The association should not make any further payments to the contractor until all issues surrounding the liens are resolved.

### **What Ifs?**

In negotiating the contract's terms, consideration should always be given to the "what ifs." To protect the association, consider a clause calling for alternative dispute resolution in the event a conflict arises with the contractor. Methods of alternative dispute resolution include arbitration and mediation. Arbitration places your dispute before a neutral individual or panel, who then listens to the case presented by each side of the dispute. After considering each side, the arbitrator provides a decision, which can be binding or non-binding, depending on the agreement. Mediation typically involves a neutral individual who works with each side to find any common ground that may exist. Mediation can be carried on concurrently with arbitration or during a pending lawsuit. Mediation and arbitration can often be less expensive alternatives and typically take less time than pursuing litigation through the court system. The board should consult an attorney who can give consideration to your association's specific needs.

Before allowing your board to sign any reconstruction contract, make sure with the assistance of an attorney that the contract contains all the necessary provisions to protect the association's interest. Careful planning and negotiation of the reconstruction contract will help protect your association from many unforeseen problems and misunderstandings.

**If you think you have potential construction defects, contact Burdman & Ward for a free, no obligation inspection with a licensed contractor.**

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