

The Accidental Construction Owner: A Checklist of Considerations for HOAs Engaging in Construction

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Homeowners associations ('HOAs') do not typically act as construction owners.

HOAs are set up as entities to maintain and manage planned unit communities. The most important and common role of the HOA is to maintain the common elements of the community. However, in that capacity, HOAs will typically be compelled to undertake a

construction project. In these circumstances, the HOA plays the role of a commercial construction owner but is doing so without the experience that a commercial construction owner has in managing a construction project. The following is a list of considerations for the HOA that is engaging as a construction owner:

Written Contract

The HOA will typically hire a contractor to perform the construction work. Sometimes the HOA will also hire a designer to develop a design for the work and to inspect construction of the work. In each instance, there should be a written contract put in place between the owner and the contractor (and between the owner and designer, if the latter is involved). The contract should have express terms and be clear and understandable.

Payment

Payment for the work should be set out in the written contract. The two most common types of payment are cost-plus or lump sum. In a cost-plus situation, the contractor will be paid for the materials and labor it provides to the project, plus a markup which is intended to compensate the contractor for its overhead and profit. In a cost-plus situation, the HOA should strongly consider requiring a guaranteed-maximum-price or GMP. A GMP caps the total costs and fees for which the HOA will be responsible — there is a maximum cap above which the HOA does not have to pay.

The second arrangement is a lump sum whereby a fixed price is paid by the HOA to the contractor for the work. This price is negotiated at the outset of the project and set forth in the contract. Unless unforeseen conditions are encountered, or the scope of work is changed for some reason, the owner is required to pay the lump sum, no more or less, to the contractor for completion of the work, regardless of the actual costs. This

arrangement is generally more favorable to an HOA but is generally disfavored by contractors.

The HOA should also have the written contract set forth a process for the timing of payments (i.e., when and how payments are made) and the paperwork that must be submitted in order for the contractor to establish its entitlement to payment.

Scope of Work

Written contracts should set forth the scope of work to be performed. There should also be some provision that determines how the work will be accepted, including whether there will be inspections by the owner and/or the designer, and what happens if work is rejected.

Time

The contract should set forth the time in which the contractor is required to complete the work and the remedies available to the HOA if the work is not completed in the time required. Remedies for late completion are typically in the form of liquidated damages, which are a daily rate fixed at the beginning of the project. For each day late that the contractor finishes the project, the contractor will pay to the owner an amount equal to the daily rate. It is important in the contract to not turn the liquidated damages into a penalty. The liquidated damages should be a reasonable approximation or estimate of the actual damages that the HOA will suffer if the project is not completed in the time required.

Liens

In the event of a dispute with a contractor, there likely will be liens asserted against the project. These liens can be asserted not only against the common elements, but also the individual units in the planned unit community. Thus, the HOA's members, the unit owners in the community, are subjected to being defendants alongside the HOA. This can create problems between the HOA and its members. The HOA should keep its members informed of the construction project. In the event of a dispute or if a dispute looks likely, the HOA should try to get ahead of the problem by informing its unit owners of the problem. Although the assertion of a lien by a contractor or subcontractor cannot be wholly prevented, certain key provisions, if present in the contract, can reduce the likelihood that liens can be successfully asserted against the common elements or the individual units.

Insurance

A written contract between the owner and the contractor (or between the owner and the designer) should set out insurance requirements for the contractor or designer, including specific dollar minimums and types of insurance the contractor is required to maintain.

Sequence

All of the above considerations must be considered in light of the sequence in which negotiations with the

contractor are conducted. If the HOA gets too far into negotiations with a specific contractor and becomes wedded to using that contractor, then the HOA has little leverage to negotiate contract terms with the contractor and likely will be forced into a situation where it must sign the contract presented by the contractor as a *fait accompli*. Therefore, an HOA proceeding as an owner on a construction project should make sure the issues listed above are put forward, considered, addressed, and made part of negotiations at the earliest stage so as to prevent a loss of leverage and avoid being forced into a contract with inappropriate, unfair, or harmful terms.

Conclusion

The HOA should consult with its attorneys, and if necessary, have its attorneys refer them to a competent construction attorney to advise them at the very earliest stages of the construction project. Doing so will allow the HOA to avoid or at least mitigate the risks and losses associated with acting as a commercial owner when the HOA lacks experience doing so.

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