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CONSTRUCTION CONTRACTS

2020 Categories: Construction Contracts

BLOG



CONSTRUCTION CONTRACTS

It's the heart of the matter. The controlling document if things go wrong. The most important document in your relationship with your home builder

Nature of the Construction Contract

A construction contract is not a real-estate transaction. It is a *personal-services* contract between the home builder and the home buyer for services to be rendered.

This creates interesting differences between a typical real-estate contract that many home buyers are aware of and a construction contract.

Differences Between Real-Estate Contracts and Construction Contracts

- Construction contracts are not recorded like real-estate transactions are.
- As a non-recorded contract, the actual amount of the construction contract is private and not recorded in any county record.
- Because there is no record of the value of a custom-home contract, the value is not available for appraisal purposes. This can become an issue, because custom homes are often more valuable than similar production (tract) homes, and appraisers can only access new homes that are real-estate transactions (builder-financed) for valuation purposes.
- A savvy custom home builder has recent transactions they can provide to appraisers for valuation purposes. Failure to provide such information may result in a low appraisal and project failure.
- Construction contracts have a specific duration.
- Typical construction contracts range from 9 months to 2 years, depending on the project's complexity and the home builder's schedule.
- For typical construction contracts, the clock starts ticking when the building permits are issued.
- If water availability (from a well) and septic engineering must be completed prior to submitting a building permit, this can add significant delays to the start of the project.
- If there is a delay due to pre-permitting requirements, the construction loan will start to run at the signing of the loan documents. This can create a situation where the home builder is within their contractual time limits, but the loan expires prior to project completion, and the



home buyer is forced to renegotiate the loan. This results in an additional expense for the home buyer. If the construction contract is for 9 months, it is good practice for the construction loan to be for 1 year.

Components of a Construction Contract

Although every construction contract is as different as the home builder creating it, most contracts will include the following items:

- Recitals: Who the parties are, addresses, and the intent of the contract.
- Contract Price: The actual contract amount which should include the taxable amount. (Taxable amounts are often broken out for the client to understand how much tax is paid.)
- Home Builder Services: A recital that includes the complete construction of the home, what is included, and what is excluded
- Home Buyer Responsibilities: A recital that includes the responsibility for the home buyer to make timely payments to the home builder if the lender fails in their responsibilities.
 - This clause can be an issue if the lender is not timely with their inspection and payment processes and systems.
 - Typically, the home builder submits a draw sheet for approval by the home buyer for the prior month's work completed and then submits the signed draw request to the lender. The lender then orders an inspection, and once completed, finalizes the amount requested and approved for payment to the home builder.
 - The home builder typically submits the draw sheet at the end of the month and makes all payments to their subcontractors and vendors by the following 10th of the month.
 - If the lender is not timely in paying the home builder, most construction contracts require the home buyer to make the draw payment to the home builder after X days. The home builder is not in contract with the lender but is at the lender's mercy for prompt payment.
- Allowances: The construction contract should state the key allowance categories and their respective amounts.
- Home Builder Disclaimers: Include items that, if they occur, the home builder is not responsible for them. Common disclaimers include excavation of rock, encountering water, strikes, "acts of god", weather-related issues, and material shortages.
- Warranty Section: Information about how the home builder warranty works and how the product and installation warranties work.
- Boilerplate: The legal components that make the contract viable, including jurisdiction, mediation requirements, etc.

A good construction contract is designed to define, explain, and mitigate issues that might arise during the course of construction. In case of either party's failure, the contract provides a legal framework for the resolution of those issues.

We Are Here To Help



At NewHomes.House, we believe in providing our home buyers with as much information as possible so they can make the right decisions for their custom home.

Please contact us to schedule a call so we can answer all your questions — it's free, and there is no obligation. We love to talk construction!

Call or text us at **(509) 370-8868**.