

GUEST COLUMN

Closing Out Construction Projects

By **Carl de Stefanis***

These days, construction lenders are looking at just about every ongoing construction project as a potential workout candidate and themselves as possible owners. Closing out a construction project is now taking on importance because many loans may go through a period of forbearance prior to foreclosure or receipt of the deed-in-lieu.

Should the mortgagee become the owner or a borrower cram-down ensues to relegate his position to just earning management fees, the close out process will be necessary for a lender's disposition strategy, not only to expedite an eventual sale, but to receive highest value. For condominium projects, whether newly completed or sitting abeyance waiting for sales, the close out process takes on even more importance because the construction lender may find itself in the role of the sponsor and in the building maintenance business.

During the heyday of construction lending, construction lenders gave little thought to a construction project's close out process because few contemplated their projects as possible workout candidates. During construction, so little attention was paid to a project's close out that most lenders often instructed their construction loan monitoring consultants not to bother to visit projects once substantial completion was realized. This would preclude any lender involvement in the retainage release or close out document solicitation process. A review of most construction lending agreements would either find them silent on the close out process or addressing it sparingly.

On most projects, the close out phase is difficult. Contractors have started other projects; contentious, previously submitted change orders need to finally be reconciled; new change orders appear; and contractors and consultants simply want to be paid in-full. Essentially, the construction team gets tired, subcontractors have started

other projects, and the thrill is gone. It is time to move on.

A construction close out is defined as the process upon project completion by which the contractor is to collect necessary documents and services from the various subcontractors and vendors, verify same for accuracy and completeness, prior to submittal to the architect-engineer for review. Upon the architect-engineer's acceptance, and complemented with other documents prepared by the architect-engineer, the documents are submitted to the owner for final acceptance of the project. Upon acceptance, retainage is often released to subcontractors within a certain time period.

The process is usually triggered by the project realizing substantial completion. But closing out a construction project is more than just obtaining the certificate of occupancy and a final waiver-of-lien. Typically, a schedule of required close out items will contain 30 to 50 documents to be procured and numerous time-consuming tasks to complete. The process is time intensive and arduous.

Depending upon the asset type and scope of construction, consideration should be given to obtaining the following:

- **A complete set of as-built drawings, inclusive of an as-built survey, reviewed and approved by the designers-of-records.** The construction is not always implemented as per the construction documents as a result of field conditions or conflicts encountered in the field. As a result, as-built drawings are prepared. Many times, a set of as-built drawings are submitted to the owner contain the annotations directly applied to the paper drawings. It is important that the corresponding designer-of-record incorporate any revisions to the digital set.
- **A complete set of shop drawings and product submissions.** Shop drawings are typically prepared by the

subcontractors and represent exactly how the component or assembly is to be fabricated, whereas the construction documents prepared by the designers will provide the performance requirements and design concept for the desired end product.

- **Record copies of the construction contracts and all change orders.** These documents may be needed in the event of possible claims, for construction cost segregation studies, or reproduction cost studies for tax certiorari proceedings.

- **A schedule of all implemented alternates and material/system substitutions.** Due to availability, delivery, and especially cost issues, substitutions of materials or specific equipment are common. However, such substitutions may have an adverse impact on operating and life-cycle costs, compliance with condominium offerings plans (if applicable), and building performance.

- **Confirmation of final testing of mechanical and electrical systems.** Balancing and commissioning reports should be submitted attesting to the systems operating as designed.

- **Certificate of Substantial Completion:** There are many variations of this document; the AIA has issued form G704 for this purpose. It affirms that the owner and the appropriate designers-of-record have accepted the work as substantially complete with the exception of punchlist items that will need to be complete by a certain date. It also establishes the commencement date of contractor guarantees and warranties.

- **Contractor guarantees and warranties.** Guarantees and warranties are often difficult to obtain once the project is closed out or after a deficiency becomes apparent. Generally, these are limited to a one-year period from the date of Substantial Completion. Unlike insurance policies kept in the bottom drawer and never used, these most probably will be needed. As a facility is stressed by occupant use and goes through four seasons of operation, latent defects often become apparent.

- **Building system manufacturer and vendor warranties such as roofing, coatings, curtainwall, sealants, specialty systems, conveying systems, emergency generators, window washing scaffolding, etc.** Unlike the contractor issued guarantees and warranties, these documents are generally for much longer periods than a year. Inasmuch as most building problems involve water/moisture penetration through the envelope or failure of an envelope's system/component, make sure that all pertinent documents are received.

- **Confirmation that subcontractors have provided an in-house mechanical equipment operating training program, if required by their subcontracts.**

It is not unusual for pumps to leak, gauges to malfunction, and other mechanical equipment to prove defective. Defects can be aggravated by the lack of or improper maintenance.

- **Mechanical equipment guarantees, warranties, start-up, and operation and maintenance manuals complete with preventive maintenance schedules including job steps and cycles – tri-annual, annual, monthly, weekly, daily, etc.** Make sure the building staff has been provided with sufficient training in the systems' operation and maintenance. Should a claim be made against a mechanical/electrical contractor, this will prove necessary in the event of a contractor counter-claim where a contractor may claim that a deficiency resulted from the owner's contributory negligence.

- **Copies of all controlled testing reports and designer site visit reports.** These documents will generally prove necessary should there be a claim relating to a construction failure and the responsibilities of the designer during the contract administration phase, if the designer was retained to provide such services. It should be noted that not all design agreements require the architect or engineers to conduct such site visits.

- **Punchlists certified as 100% complete by the designers-of-record and owner.** Consult the certificate(s) of substantial completion as for the punchlists' target completion dates. Make sure that all items are thoroughly inspected and signed-off as completed. Sometimes, there are minor things that need to be done that if not addressed at this stage, may never be taken care of or, if completed at later date, at a substantial cost.

- **Final, unconditional waivers-of-lien from all subcontractors, vendors, and designers.** Close all doors for post construction claims relating to unresolved change orders, scheduling delays, etc.

- **Tenant or hotel management operating entity affidavit of acceptance, if applicable.** With some projects, end user acceptance is critical. Consult the lease or management agreement. This formality is commonly overlooked.

- **LEED certification paperwork and final certification, which is usually granted 3 to 4 months after completion, if applicable.** Occupants may have a cause of action should the building not comply with its LEED marketing representations or an anticipated tax abatement may be lost. Obtain all USGBC submittals, forms, studies, benchmarking reports, and LEED consultant agreements. This paperwork will be helpful in future building monitoring and energy auditing.

- **Consent of Surety to Final Payment for any contractor and subcontractor performance and payment bonds.** With this document, the owner preserves its rights under bonds with the surety's approval of final payment to the contractor or subcontractor. With the surety agreeing to final payment, it typically reconfirms that non of the surety's obligations will be relieved by the final payment. AIA form G707 is designed for this purpose; however, there are many variations

used by owners.

- **A schedule of all subcontractors and vendors complete with contact information.** As an owner, you will be making call back telephone calls, especially during the first year of operation. This schedule will save a lot of time.
- **Collecting of residual tools and equipment purchases under a CM agreement's general conditions provisions.** Most CM agreements allow the purchasing of tools and equipment on behalf of the owner that are necessary to implement general conditions of construction.
- **Designer-of-Record's Certification of Final Completion.** The AIA does not provide this certificate; it is usually prepared by the owner. Once executed by the designer-of-record, it generally ceases the designer's construction administration responsibilities.
- **Designer-of-Record Certificates of Compliance with the contract drawings and specifications.** The purpose of this document, which is also not a standard AIA form, is to certify that the as-built conditions have been completed in compliance with the designer's contract drawings and specifications as revised during the construction process. It is important to verify that the appropriate designer-of-record is executing this document.
- **Designer-of-Record affidavit to complete and certify a post-construction condominium offering memorandum, if applicable.** Post construction claims by CIRAs against the sponsor and designers are common. Post construction certification of the offering plan should be viewed as a measure to mitigate such possible litigation.
- **Design-of-Records' Site Visit Reports and RFIs:** These documents could prove valuable in determining the cause of post construction defects or responsibilities of certain parties in the event of a claim.
- **Certificate of Occupancy.** If only a temporary certificate of occupancy is issued, then obtain an itemization of all outstanding issues that need to be resolved in order to receive the release of the final or permanent certificate of occupancy. The temporary certificate of occupancy should be accompanied by a target date to receive the final CO.
- **A schedule of finishes and equipment that may require**

replacement on a recurring basis. This schedule would typically identify paint, wallcovering, wall and floor tiling, acoustical ceiling tiles, etc. and should be complete with model types; specification numbers, and manufacturer in the event of needed replacement.

- **Attic stock materials (wall and floor tiling, acoustical ceiling tiles, wallcovering, kitchen disposal units, heat pump units, etc.) properly identified and stored.** Should a single tile be needed in the event of a repair or replacement, it might be difficult to locate, out of stock, no longer manufactured, or the threshold quantity to purchase simply too large.

- **Key and Sign Schedules.** Most buildings have dozens of various individual door or security keys and master keys. All keys should be clearly identified on a door schedule correlated to the hardware manufacturer and type. The same applies to building exterior and interior signage with respect to manufacturer, dimensions, material, color, and font type size.

- **Release of all municipal required bonding for infrastructure and site work.** It is common for certain municipalities to require bonds for infrastructure work and site improvement work. Determine if such bonds exist and obtain their release. Most probably, this will require the involvement of the civil engineer of record and environmental or landscape architects, if applicable.

As trades complete their work and the project realizes substantial completion, it is customary to reduce the percentage of retainage held on certain subcontracts. However, it is important that the aforementioned documents and tasks be submitted and completed, respectively, prior to final retainage release to each respective designer, contractor, subcontractor, or vendor. Otherwise, there is little incentive for them to fulfill their contractual obligations. Keep in mind that as a project nears completion with a potential that the mortgagee will eventually be in possession, there may be minimal incentive for the borrower to be tenacious in obtaining the required close out documents.

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