

## Real Estate Law: Why developers shouldn't put construction contract on the back burner

For a lot of property owners and developers, the construction contract is one of the last documents in the overall development transaction they typically negotiate, with negotiation of acquisition and financing documents taking priority over everything else. This is understandable as the developer must first acquire the property and secure the funds necessary to develop such property before thinking about the actual construction.

Although the foregoing sequence and prioritization approach makes sense, developers should start thinking about, and preferably negotiating, the construction contract in the early stages of the transaction. This early approach to negotiating the construction contract has many benefits, including the following: (i) it allows the construction contract to be in sync with other requirements of the transaction; (ii) it increases the developer's leverage in its negotiation with the general contractor; and (iii) it gives the developer sufficient time to negotiate the often contentious risk allocation provisions of the standard forms of construction contract.

Lenders financing construction projects want to make sure that the funds loaned to developers will be used for the purposes for which they are loaned, and that the project will be constructed properly and timely, therefore allowing them to profitably recoup their investments. Accordingly, construction financing documents typically contain requirements that need to be incorporated into the construction contract, such as lenders' right to review payment applications and change orders, requirements of lien waivers, lenders' right to inspect the project, insurance, bonding, and indemnification requirements, etc. Further, depending on



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the nature of the project, there may be other interested third parties such as landlords, governmental entities, homeowner associations, etc. whose interests must be considered and addressed in the construction contract. Therefore, it is good practice to start working on the construction contract in the early stages of the transaction to avoid missing or overlooking any of those lenders' or third parties' requirements.

In addition to the foregoing, waiting until the last minute to start negotiating the construction contract puts the developer in a tough negotiation position. The interested parties' desire to close the deal and start construction activities leaves little time after the acquisition and financing documents have been negotiated to timely and effectively negotiate the construction contract and limits the developer's ability to hire a different contractor in the event the developer and the contractor cannot agree on important issues. This in return has the effect of cornering the developer into accepting the unmodified provisions of the contractor-favorable standard

forms of construction contract such as the ConsensusDocs or the American Institute of Architects (AIA) forms.

Furthermore, while the standard forms of construction contract do a decent job in addressing most construction issues, they still need to be tailored to the specific project and to account for all interested parties' requirements. More importantly, certain risk allocation provisions such as insurance, indemnification, force majeure, liquidated damages, project safety, mechanics' and materialmen's liens, etc., are so critical that, in light of the contractor-favorable nature of standard forms of construction contract coupled with contractors' tendency to resist modification to such provisions, the developer must set aside sufficient time to allow its construction lawyer and business team to effectively negotiate those provisions with the contractor.

It is understandable for developers to prioritize the acquisition and financing of a development project. After all, there would be no construction without financing. However, it is good practice to negotiate the construction contract in the early stages of the transaction to ensure that the requirements of all interested third parties are addressed, and that there is enough time to effectively negotiate the often-contentious risk allocation provisions of the standard forms of construction contract. In the end, a well negotiated construction contract makes for a smooth construction process and benefits all parties involved in the transaction.

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