

The Risk Illuminator

A Quarterly publication for our clients by **Lender's Quality Assurance**, a *Critical Edge Group* company

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Dear JP:

Q: During our last construction loan I funded 2 of 10 draws without using our 3rd party inspector; this is because we always seemed to be substantially "ahead" of the contractor. Numerous problems surfaced at close-out. How is this so? BM, NY

A: It is critical that inspections & draw reviews occur on a continuous basis. Funding draws without inspections can not insure that the construction methods & (continued on page 2)

Troubled Hotel Project Needed PCA

The combination of an existing borrower/developer and a large, experienced contractor, both of whom are well known to the lender, is not sufficient reason to forgo a **Pre-Construction Commitment Analysis (PCA)** of a construction project as re-

"...competition can result in threadbare margins and questionable bidding practices..."

cently demonstrated by the ongoing dispute surrounding a Santa Monica, CA hotel. Heightened competition among contractors can

Spilled Milk: Walking Papers?

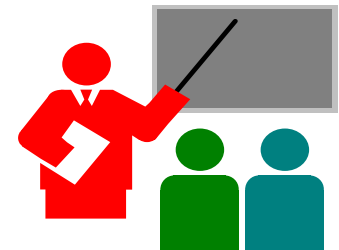
Rarely does a **LQA PCA** conclude that our lender's best interests can be served by considering walking from a project unless certain changes can be implemented. **LQA** recently completed analysis on a small (3) story condo project in

result in threadbare margins and questionable bidding practices to the detriment of the lender and its client. The original contractor for the subject hotel, Gosnell Development Corp., filed a Chapter 11 bankruptcy on 8/8/97 to avoid a \$53.2MM fine imposed by an arbitration ruling in favor of the developer. The developer, who was forced to declare bankruptcy when his lender would not approve increased funding for the project which was over budget & behind schedule, accused Gosnell of underbidding the project and

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the Western U.S. that confirmed the enormous importance of reviewing the plans, specs, budgets, soils reports, etc. **LQA's PCA** revealed numerous concerns including substantially incomplete plans,

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Hard-hat

Soils Reports

Definition: A geotechnical engineer's opinion of a specific site's suitability for construction of a specified structure.

A thorough soils report is the foundation for all construction projects. They generally cost \$3-8K + \$1-1.5K/boring. Based on a review of the intended use, US Geological Survey & topo maps, test borings, flood & seismic maps, and site inspection, a good report will dictate construction materials & design recommendations for site prep, foundation & floor slab. It will also address

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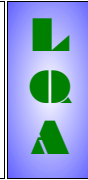
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materials called for in the plans & specs were adhered to; once completed, certain items cannot be inspected. How can your inspector certify as to the electrical routing, installation methods, foundation issues, plumbing, type & amount of fill used, or termite treatment if it is not accessible? Being "ahead" doesn't

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construction concerns

PCA - from page 1

performing defective work. Even though the project was reportedly 85% complete when the lender ceased funding, millions have since been expended backtracking to replace plumbing and HVAC systems by the new owner. A properly performed **PCA** could have identified, **prior to loan funding**, the questionable specifications, materials, construction techniques, and practices that obviously surfaced at the most inopportune and costly time for all parties involved.

Soils - from page 1

groundwater & enviro findings and their effect on construction. A flawed report will create a domino effect. Problems identified OR un- identified may include expansive soils, high water tables, large quantities of over-excavating & importing of engineered soils, "hard digs", improperly engineered footings, foundation, floor slab, drainage plans, or building loads, and poor enviro planning. **PCA's** help ensure that all issues have been addressed **AND** are budgeted for.

specs, & budgets; potential design flaws included a 14' water table & a basement floor 15" below grade, a (4) story load on grade vs. the (2) story described in the soils report, "OSB" board on exterior walls & floors (disintegrates when wet), (3) story brick veneer (water & grout failure could cause collapse), no ADA considerations, major contract flaws. Although the project may proceed, with certain modifications, the lender's best interests were served by a thorough **LQA PCA**.

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