

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: What is a "Contractor's Qualification Statement" (CQS) and why is it important? TM, TX

A: The CQS (AIA A305) is an essential resource for both Owner & Lender in evaluating the suitability of a contractor. It is a signed & notarized document that outlines a contractor's organizational background & legal structure, licensing, project experience, references, and financial status. Both Owners & Lenders utilize it as a starting point to qualify a contractor. It also

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BONDING ... practices & pitfalls

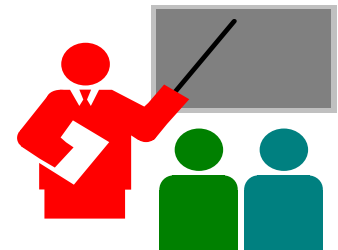
All construction lenders should possess a basic understanding of surety bonds and the protections they **will** and **will not** afford them. A bond is a three (3) party agreement among the surety (guarantor), the owner (obligee), and the contractor (principal) whereby the guarantor agrees to perform the contractual obligations of the principal to the obligee in the event the principal refuses or is unable to perform. The lender is typically named as an additional obligee (dual obligee).

The primary types of bond obligations include a) Performance Bond (AIA A311) - Surety agrees to fulfill a construction contract according to plans & specs, and price; b) Labor & Material Payment Bond (AIA A311) - Assures owner & lender that labor & materials suppliers will be paid; c) Maintenance Bond - Usually included in Performance Bond; guaran-

tees against defects in materials & workmanship for a set period time after the "Substantial Completion" date; d) Completion Bond - Assures that the project will be completed and that funds will be available for completion. The most common forms seen by lenders are either separate Performance (a) and Labor & Materials (b) bonds, or the combined Performance & Payment Bond (AIA A312).

The most important thing for lenders to remember about bonds is that they are **reactive** vs **proactive**; they only remedy a problem - they don't help prevent them. Only a thorough Pre-Construction Analysis (PCA) and effective enforcement of project tracking mechanisms can help mitigate risk. LQA believes 70% of risk can be mitigated by doing so. Recoveries from bonds typically average 65%. That may not be sufficient to

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Hard-hat

Substantial Completion (SC)

Definition: The date at which construction is sufficiently complete so that the Owner can occupy or utilize the building for its intended use.

SC is a very important construction term which has a specific legal meaning for construction projects. It is the date which essentially indicates a project's completion and when Lender collateral value becomes real. It is recognized when 1) improvements are substantially complete in accordance with Plans &

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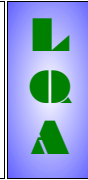
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enables the Lender to verify whether or not an arms length relationship exists between Owner and Contractor ; if not, the CQS will aid the Lender in assessing the nature of these ties. This type of relationship MAY be detrimental to the Lender because of inherent conflicts of interest in this type of arrangement.

Call our **LQA**
Construction HOTLINE:
(602) 604-8573
For a free consultation
or to discuss your
construction concerns

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revive a stopped project. In addition, the actual negotiated recovery may take from 1 - 10 mos. to realize. Bond costs range from 75 - 300 bp of the construction budget, depending on the contractor's ability & strength, the project type risk, and the bonding company's experience with that project type, and pricing may vary widely between bonding companies. Certain LQA clients have gained a competitive advantage feeling that bonds aren't always necessary as long as LQA is performing its PCA and administering & inspecting

their project.

Should a lender require bonding, they should: 1) be named as "Dual-Obligee"; 2) utilize industry recognized forms (i.e. AIA); 3) obtain executed originals of bonding documents; 4) require evidence of payment of Bond Premium; 5) require a bonding company rating of A- or higher by Best; 6) make sure the bonding company is licensed; 7) require any price increases above a pre-approved range be approved by lender & surety; 8) have all construction docs be "signed-off" by contractor. 9) CALL LQA to analyze & administer your project.

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Specs, 2) the Architect has issued a "Certificate of SC" (AIA G704), and 3) an irrevocable C of O has been issued. This date is also important because: legal responsibility for the improvements shift from the Contractor to the Owner, insurance shifts from Builder's Risk to Owner's All-Risk, and statutory lien periods begin. It is also one requirement for release of retention's and construction contract completion's are tied to them. SC's are a significant requirement in LQA's administration of your construction project.