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How Different Is Construction From Online Dating? Not Too Much

BY RICHARD J. SLAVIN

Growth in Philadelphia's core has invited a plethora of millennials to try their hands at real estate development. With many experienced contractors hard at work with established developers, young developers, therefore, have to evaluate the risk of hiring an inexperienced contractor versus an experienced one who is very busy. As it turns out, engaging a contractor may be no different than finding a date for Saturday night: read a brief internet profile; look at a few (carefully staged) photos; send some messages; and you're off on a date IRL (in real life). This article will help you navigate the crucial developer-contractor relationship.

Lessons from Online Dating

In helping young developers build up their businesses, I have found that contractor issues hurt profitability the most. Here are some common construc-



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tion occurrences and how they may mirror your online dating experience.

Ghosting: Your contractor hasn't been on site for weeks and won't return your calls. Often this forebodes cash flow issues that may result in unpaid subcontractors filing mechanic's liens against your property. If your contractor has "ghosted" you, review your contract and give formal notice as the contract requires to preserve your rights. Review whether there are any penalties for late delivery, and don't be afraid to pursue your rights and remedies.

Catfishing: Your contractor doesn't have the experience it represented during your "first date." This can mean code viola-

tions and stop work orders, setting your project back months. Call the regional L&I office to understand what will be needed to clear any violations. Understand if any fines will be imposed. Begin negotiating with the city early because the city will have less flexibility to waive fines after filing against you in court. And then, next time, verify all contractor licenses online; otherwise, "swipe left."

DTR (Define The Relationship): Poorly drafted construction contracts can be a death knell for a young developer. The overriding principle in contract drafting is clarity. If something isn't clear to you, then rewrite the document to make it so (or, better yet, have an attorney review it). Are you clear about deposits and milestones? What about payment mechanisms and penalties for late delivery? What about who is pulling the building permit and filing for the tax abatement? And, most importantly of all, does the defined scope of work reflect what is actually supposed to be built?

Keep Them Wanting More: Young developers may forget to negotiate retainage. This is an amount, usually 5 to 10 percent of the total contract price, that gets held back until the contractor substantially completes the work, as both parties will review and certify. Remember to insist on this important performance incentive.

**• Unhappily Ever After:
Mechanic's Lien Basics**

When things go wrong, a contractor may file a mechanic's lien under the Pennsylvania Mechanic's Lien Law of 1963, as amended (the Lien Law). This lien will likely hold up your property sales and cause uncomfortable conversations with your lender. Just as a divorce proceeding, mechanic's lien disputes can get ugly. What do you need to know about liens to protect yourself?

Is a Lien a Judgment Against You? No. Understand that a mechanic's lien is not fatal and is just the beginning of a longer claim process. A mechanic's lien is a foot in the door for contractors so that they may state a possible claim. I find that the most frequent circumstance is when a general contractor fails to pay a subcontractor, and that subcontractor liens the property after some unfruitful discussion with the owner. The answer, though, is not to "ghost" your subcontractor;

it's the owner's obligation to make sure all contractors are paid even though the general contractor often performs this role.

Who May File a Lien? Young developers often take the risk of hiring unlicensed contractors. Philadelphia requires "any contractor who performs work with a value exceeding \$500" to have a contractor's license. Some developers make the assumption that an unlicensed contractor may not file a mechanic's lien. In fact, the definitions of "contractor" and "subcontractor" in the Lien Law do not mention licenses at all. Generally, a contractor or subcontractor just needs to be someone who worked at your job site or provided materials for it in the last six months. Also be aware that architects and engineers can file a mechanic's lien when they "superintend or supervise" the work on-site.

Are There Different Rules for Subcontractors? A subcontractor may file a lien only if the subcontractor serves the owner with a 30 day notice to lien. This means that the subcontractor must begin preserving its lien rights five months after last performing work or supplying materials. Keep detailed records of what the subcontractors are doing and when to prevent them from exercising lien rights outside of these applicable time periods.

Can Liens Be Waived? There are very particular situations where the Lien Law permits a contractor to waive its lien rights, and the formal requirements to do so are even more particular. One important rule to know for young developers: If it is a residential project and three stories or fewer (not including basement level), then the contractor can waive lien rights at the outset of the project. This is an exception to the Lien Law that first-time developers don't often take advantage of.

How Can You Know If a Mechanic's Lien Has Been Filed? Liens will appear in a title search when you request one. If you are worried about a lien and don't want to wait for your title agent, the Philadelphia court records are also searchable on-line at the Philadelphia Court of Common Pleas website. Look for "Search Trial Division—Civil Docket" and then "search by person name or company name" and enter you or your company's name. Note, however, that every county in Pennsylvania has a different filing system, so this won't be as easy elsewhere.

What If You Never Received the Lien? If the subcontractor threatens a lien, know that a lien is considered an extraordinary right granted by law. For that reason, formalities must be followed,

including formal service of process as in any court action. I have seen liens “served” via text message. That won’t work. Service of a lien must be in accordance with the Pennsylvania Rules of Civil Procedure, so even regular mail may not be enough. The contractor has 30 days to serve the lien after filing and then another 20 days to file an affidavit of service with the court. If the contractor has not done this, then the lien can be stricken. Of course, it is not wise to notify a contractor of defects in its service until the time period to complete service has actually run.

How Do You Get Rid of the Lien? An attorney can help strike the mechanic’s lien if formalities have not been followed. However, just because a lien is stricken doesn’t mean the contractor has lost its underlying contract claim; the contractor could still bring an action within the four year statute of limitations period for contract claim. Note also that claims in Philadelphia below \$12,000 should be pursued in Municipal Court and greater claims should be pursued in the Court of Common Pleas.

• Who Picks Up the Check? Construction Draw Basics

Some first-time developers don’t realize that a lender most likely will not fund construc-

tion costs upfront. Lenders see it as risky and will want to have some oversight on the value being added to its collateral. The common practice is to set up a series of draws. To the chagrin of developers and contractors, most lenders will insist on monthly draws to keep administration down.

Organization is critical in the construction draw process, so do pick a contractor who doesn’t lose paperwork. The lender will want to see what its money was used for before disbursing more funds. The lender may also require lien waivers from the general contractor and some or all subcontractors—meaning that those contractors will acknowledge payment of all work performed to date. If possible, negotiate a minimum threshold for lien waivers, such as only subcontractors providing more than \$5,000 in materials or services.

Construction draws also make title insurance more complicated, and I have seen many closings delayed because of title insurance underwriting issues. If a loan will be used for construction, ask your lender if it will need mechanic’s lien title coverage ahead of closing. Title companies need time to underwrite that coverage and will need to review your contract with the general contractor. At each draw, the title company will

issue a “date down” endorsement to increase the amount of coverage and update the date of the title policy.

Conclusion

Being a new developer means learning to quickly navigate a dozen different industries, construction most of all. I hope this piece helped you understand some of the legal dynamics among developers, contractors, and lenders to ensure that your real estate empire keeps growing. May your budding relationship with your contractor soon become a happy marriage.