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## **Legal Considerations Involved in Home Construction Contracts**

### **LEGAL CONSIDERATIONS INVOLVED IN HOME CONSTRUCTION CONTRACTS**

The decision to build or renovate a home raises a number of important legal issues, including things such as contracts, liens, bank loans, payment applications, and builders warranties. What is the home owner to do?

This publication is designed to help answer some common questions and to give the home owner a chance to think about these issues before committing to a contract.

- **Do I Need a Written Contract?**

First, all agreements should be in writing. Even though you and the builder have orally agreed on the details of your construction project, put it down in writing. Have both parties sign and date the document. You should consider a construction specific contract in lieu of a real estate purchase contract or seek assistance from an attorney. Beware of forms which may not meet your needs.

- **Paying the Builder**

You and the builder must agree on the source, method and timing of payments to be made. Full payment to the builder in advance is not a good idea, although an initial payment to buy materials may be perfectly acceptable. All payments should be tied to accomplishment of specific work, not simply to the passage of time. On larger projects, it is wise to have provisions in the contract allowing you to hold back a portion of the money earned by the contractor to induce ultimate final completion of the work. This is called "retainage."

- **Deciding What to Build**

Regardless of what method is utilized to determine precisely the quantity and quality of work to be performed at your house, concrete standards for the work must be included in the contract so that all parties will know what is to be provided.

- **The Role of Architects and Engineers**

If the project is large, an architect or an engineer should be used who can not only detail the work to be done, but also reference standards for the quality of work. Of course, what you are paying for is a very important aspect of the project. This has to be carefully specified. Professionals in the construction field, such as architects, will help specify the precise work to be accomplished and will help administer the progress of the project, if administration is part of the contract with the architect.

Remember, home components come in an endless variety of quality, materials and colors. If details are not specified, the contractor will have discretion in fulfilling his obligations and you may not like what he chooses. If you do not know how to specify quality, and do not want to hire a professional, reference some tangible standard, such as the quality reflected in another part of your house, materials shown in a brochure or quality reflected in the project the contractor showed you when selling you on his work.

- **Controlling Building Costs**

Be careful about cost-plus contracts. These contracts provide that the builder simply keeps up with the costs of labor and material expended on your job, then bills you for that cost, plus a mark-up for the builder's overhead and profit. Cost-plus contracts can lead to large expenditures of money by the home owner. All

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of the builders' mistakes are paid for by you! If you do enter into a cost-plus contract, do so with a "guaranteed maximum price," that is, a price limit which the builder guarantees that he will not exceed. Most people find that a fixed price contract simplifies the building process.

- **What is an Allowance?**

Even fixed price contracts will include a section called "allowances." These are necessary for the protection of the contractor, but can be very problematic. An allowance is how much can be spent on a particular type of item, such as plumbing fixtures or carpet, without increasing the overall cost of the project. If the owner selects items that are too expensive, the allowance will be exceeded and the price will go up. You should thoroughly understand how realistic the allowances are prior to signing the contract.

- **Funding and Financing**

You will obviously need a source of funds for your project. These funds may be provided by cash, by a line of credit or by a construction loan where the funds are specifically to be used for the project. In the latter case, the construction lender may impose many demands and restrictions that can impact the project dramatically. While these restrictions may prove to be valuable in keeping the project free of trouble, they also have the potential to cause the home owner many problems. Usually, the loan documents require that all construction take place within a limited time period and that the loan proceeds are to be fully drawn before a deadline. These documents make the owner responsible for the completion of the construction within these deadlines, upon threat of foreclosure. While the owner can often buy him or herself out of trouble by paying penalty fees to the lender, these requirements can cause many problems when the contractor does not perform in a timely manner. They make the owner responsible for the contractor's failures. Before borrowing the money, carefully go over these time restrictions and requirements with the lender and the contractor. Make sure that your contract with the contractor requires the contractor to perform all of the obligations you have to the lender that are in the contractor's control.

- **Insurance**

Before starting construction, consult with your insurance agent to make sure that the new construction work will be covered with adequate insurance while it is under construction. Also, check to be sure that your chosen contractor has adequate insurance to cover both injury to his employees and to cover the value of any construction work on which he bears the risk of loss, such as for his tools and vehicles. Get a certificate of insurance from the contractor's insurance agent.

- **Building Permits and Other Governmental Approvals**

Make sure your builder gets a building permit from the city or county where the home is located. Inspections by the building inspectors help protect you during the construction process. Do not allow your builder or remodeler to cut corners by not getting a building permit.

- **Changes**

Changes are an expected part of any building project, and as an owner you should anticipate and allow for changes in your construction budget. Although builders are often blamed for costly changes in construction work, many changes are initiated by owners! This happens because as the project progresses, and the outlines of the job become clearer, owners see that changes may be desirable in their original plans. Expect this! Plan for it! Many owners allot a 10% "change contingency" in their construction budgets.

- **During Construction**

During construction, visit the jobsite at least weekly and take notes about what is happening on the job and any discussions you have with the builder. Remember that employees on the job may not be authorized to make commitments on behalf of your builder, so be sure to confirm any verbal agreements in writing.

Be sure to take lots of photographs or video during construction. On the back side of each photograph, write the date the photograph was taken, who took the photograph and what it depicts. If the job progresses nicely, these photographs will give you a great deal of

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enjoyment after the project is finished. If the job has problems, these photographs will be valuable evidence.

- **Warranties**

Construction warranties are given by the builder to the owner. There is an implied warranty in every construction contract that the builder will build the project in a workmanlike manner. Many builders also give a written warranty, agreeing to come back to the project to correct any defects in construction for a stated period, usually one year after completion of the project. Manufacturers' warranties for appliances, heating and air conditioning equipment and the like usually are passed directly to the owner by the builder.

- **Defects and Workmanship**

You should carefully review any warranty you receive, and should be prepared to give written notice of any construction defect that you discover in accordance with the provisions of the warranty. Many warranties set out a definition of what will be considered a "defect" covered by the warranty. For example, the warranty may spell out what size crack constitutes a defect in a concrete driveway. Cracks which do not reach the size set out in the warranty do not constitute a defect covered by the warranty. If the definition of a construction defect is not satisfactory to you, bring this up to the builder before you sign your contract, not after the contract is signed and the home is completed.

- **Owner's Responsibilities to Subcontractors and Suppliers**

Most contractors, subcontractors and suppliers for your home have the right to file a mechanics' lien in the event they are not paid. In Georgia, a mechanics' lien must be filed within three months of the last day labor or material is provided to the project by the contractor. Georgia law requires that a copy of the lien must be delivered to the owner by certified mail at the time of filing.

As the owner of the project, Georgia law makes you responsible for seeing to it that the subcontractors and suppliers working on your job

are paid by your contractor. Under some circumstances, unpaid subcontractors and suppliers can file liens against your home even if the contractor hired by you has been paid in full. Many owners require that the contractor provide a lien affidavit accompanying each application for payment attesting that all subcontractors and suppliers have been paid.

- **Resolving Disputes, Arbitration, and Litigation**

Many construction contracts contain arbitration clauses which require any disputes arising under the contract to be resolved by binding arbitration. To be effective, Georgia law requires such clauses to be initialed by each party when the contract is signed. Arbitration is a dispute resolution procedure which permits the dispute to be resolved without going to court. Under the usual procedure, a single arbitrator who is an expert in construction matters is selected to hear each side of the dispute and decide how the dispute should be resolved. Arbitration is more informal than a court proceeding, and can also be quicker and less expensive. However, filing fees and the cost of the arbitrator can make resolving a monetary dispute of less than \$10,000 by arbitration less practical than other means, such as small claims court. It is very difficult to reverse the decision of the arbitrator, which usually will be binding and enforceable in court.

Another alternative is small claims court. In Georgia, the Magistrate Court Division of the State Court in each county has jurisdiction of disputes up to \$15,000.00. Although attorneys may appear in this court, most parties in Magistrate Court appear without an attorney. Evidence is received informally and all trials are conducted before a judge. However, you must have witnesses who actually saw or heard what happened to prove your case.

- **Attorneys**

The foregoing are some of the issues which may arise in entering into a construction contract. You would be well-advised to consult with any attorney who is familiar with construction law issues before signing a contract to build or to renovate a home.

# Atlanta Bar Association Construction Law Section & Legal Considerations Involved In Home Construction Contracts

## Homeowners' Construction Checklist

- ☐ Do you have a written contract?
- ☐ Does it spell out precisely what you require of the builder and what the builder expects of you?
- ☐ Do you have an agreed method of payments?
- ☐ Have you confirmed your ownership of the property on which you intend to build? Have you completed a title search?
- ☐ Have you agreed upon a schedule or a date of completion? How will it be enforced? What would cause it to be extended?
- ☐ Have you and/or your builder purchased adequate insurance to prevent loss in the case of fire or other construction-period disaster?
- ☐ Do you need the services of an architect or engineer or both?
- ☐ Have you agreed on a precise method for calculating the amount the builder is to be paid?
- ☐ Are you certain that local zoning ordinances and building regulations will allow you to build what you want?
- ☐ Have you confirmed the availability of sewer, power, water, communications, and other utilities?
- ☐ Have you confirmed the existence of wetlands and other environmental restrictions on building at your property such as tree ordinances?
- ☐ Have you agreed upon a realistic, fair, and quantifiable method of adjusting the contract to allow for changes during the construction process?
- ☐ Do you have a plan for thoroughly documenting progress and construction?

- ☐ What warranties are set forth in your contract?
- ☐ Does your contract indicate how your builder must address defects in the work?
- ☐ Do you have a contractual mechanism (like lien waivers) for assuring that the builder is paying its subcontractors and suppliers - in order to avoid liens and other claims by third-parties?
- ☐ Do you have an effective punch-list and completion process in place? Does your agreement specify how call-back items will be addressed?
- ☐ Does your agreement specify how disputes will be resolved?

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