

Why have a contract?

This section deals principally with the purchase of a home direct from a builder, however, in many cases, you will be working with a Realtor. The Realtor will be paid a commission on the home and this is part of the cost of the home. When buying a new home an experienced Realtor is a good person to have in the mix. Ask the Realtor how many new homes he/she has sold. You want someone who has experience working with a contractor and advocating for you. Your contract should be lengthy enough to cover as many contingencies as possible. When preparing your specifications for a custom home be sure to specify the exact brand name and quality items to go into the home. Most builders have a comprehensive specification form that is usually several pages. Look over it carefully and be sure that you are ordering exactly what you want.

If you are buying a previously owned home you will have many questions. This is covered in another part of this site.

“Why do I need to have a written contract, isn’t my word good enough?!”

Whether you are dealing direct with the general contractor or through a Realtor, it is absolutely necessary that you have everything in writing. If there is anything in a contract that you do not understand, you should have an attorney who is well versed in real estate law and construction. In addition to being a Real Estate Attorney, I have been involved in building residential and commercial properties since the mid sixties and hold a general residential builder’s license.

I have had many clients who did not have a written contract, claim that a certain term was agreed to as part of the project; however, when we got into the facts of the situation, one party or another just didn’t seem to remember that they agreed to that specific term, or that “wasn’t really the way they remembered it.”

What is a contract? A contract is an agreement between parties, typically an offer and an acceptance, bound by consideration (generally, money tendered), of some sort. Or, as my contracts professor in Law School defined a contract: A mutual manifestation of intent between two or more persons or entities to perform certain acts and reduced to writing.

The two types of contracts important to buyers and homebuilders. That is between the homebuilder and their owners; and, between the homebuilder and their subcontractors.

As between an owner and a contractor, there are generally two types of contracts: Custom Contracts and Spec. Contracts.

A contract for the construction of a Custom home is between an owner and a contractor that relates to the actual design and construction of the house on a piece of property owned by one or the other. These contracts fall into either one of two categories, generally: “Flat rate” or GMP (Guaranteed Maximum Price) contracts, or “cost-plus” or T&M (Time and Material) contracts.

The contract for a Spec. house is really a “contract after the fact”--the owner has no, or little, input into the construction design, means, and methods, and is really just purchasing the house from the builder for a set price. The contract for a Spec. house is a little less complicated than the contract for a custom house, and typically reflects more of a contract for the purchase of real estate.

With regard to Custom contracts, these contracts are more complicated. They are there to govern a relationship, and deal with issues like who is responsible for the design, soil testing, change orders, payment and insurance, amongst other things. Equally important in a Custom contract is the issue of warranties, and with Spec. contracts, dispute resolution and waivers.

Important in Custom contracts--that you don't have with a Spec. contract--is the issue of when and how the contractor gets paid. That's why is more than one type contract. Two separate types of Custom contracts: Flat rate and cost-plus. Flat rate contracts require the builder to build the house in accordance with the set of plans and specifications for a set price. There are dangers for the contractor with the flat rate contract. If the contractor is not a good estimator, then he may be building the house for a loss.

In contrast, the cost-plus contract merely provides that the builder will build the house for the “cost” of what the owner wants, plus a certain agreed-upon percentage. Sometimes these percentages are capped at an amount, sometimes not. This arrangement places the burden on the owner for any changes made in the contract documents (whether deductive or additive); when the purchaser makes a change in the specifications, there must be a change order to indicate the additional cost that will be incurred. If an item is omitted, the owner, at law, cannot demand that the contractor perform the omitted work without first having paid the contractor for it. To require otherwise would be what is called “betterment.”

If you are buying a custom built home you should require that the General Contractor have a binding contract with their Subcontractor. The purpose of having a written agreement between a contractor and a subcontractor is several fold: To set forth the subcontractor's scope of work, to state the amount to be paid and the payment schedule, and to provide protection to the general contractor in the event that the subcontractor's work is either deficient or defective. The most important language in a subcontract agreement deals with the latter. Indemnity language, insurance provisions (including, “additional insured” language), and dispute resolution mechanisms, which mirror those contained in the general contract with the owner, are essential.

As a buyer of a custom built home, you should require that the general contractor be properly licensed with the Mississippi Board of Contractors. In the past, a person could build up to two houses a year without a license, however, the legislature passed a bill in the 2013 session requiring that a contractor's license be held for all home building. The new bill also requires liability insurance. In my opinion, the requirement is not high enough. You should require your builder to have at least one million dollars general liability, worker's compensation insurance (that meets the state law for workers comp) for every worker who sets foot on the property, builder's risk insurance and completed product coverage.

You must require that your general contractor provide you with an 'accord' form from his insurance company for each of the aforementioned types of coverage, naming you as an additional insured and also with a clause in the 'accord' form guaranteeing that you will be notified 30 days in advance of cancellation of the policy.

If a subcontractor does not furnish a proof of liability and worker's comp insurance, your general contractor is required to report all money paid to the subcontractor on his policies and pay the proper premium. This is very important.

And all these provisions can only be effectuated if they are in writing and signed between the parties, they cannot be on a hand shake.

A good contract is like a seat belt, you hope that you never ever have to rely on it, but when you do, and you have one, you are awfully thankful that you do.