

BUILDING TRUST

BEST PRACTICES IN WORKING WITH VENDORS & CONTRACTORS

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Transforming the home you have into the home you want can be an immensely rewarding venture. Whether restoring an historic property, adding space to accommodate a growing family or even knocking it down and building a new dream home, a substantial renovation or construction project is an exciting time for your family. These projects can also quickly devolve into cost overruns, disruption and frustration. The difference is in the processes you employ to hire the right people, and the clarity with which you communicate your ideas and expectations.

In our first paper, “Harmony at Home,” we explore best practices in the employment of household staff. In this paper, we’ll discuss how to identify, hire and work with the contractors, subcontractors and vendors you need to maintain, expand and renovate your home. We will also discuss some special considerations when undertaking major new construction projects. While our primary focus will be on the substantial, multi-million-dollar projects that have the capacity to generate significant financial risk and lifestyle disruption, many of these practices apply to the simplest maintenance jobs. The goal is to help you adopt a professional approach to finding the right people and working together productively and harmoniously.

GENERAL CONTRACTORS, SUBCONTRACTORS AND VENDORS

Most household construction and renovation projects involve three

categories of outside professionals: general contractors, subcontractors and vendors. A general contractor is the primary person or company you hire to see the project through to completion. Subcontractors are the tradesmen and other specialists hired by the general contractor to handle different parts of the project. Vendors sell the goods needed for the project at hand.

All the professionals you hire to design your project also fall into one of the three categories above. Typically, you contract directly with an architect, who may subcontract with an engineer. While they clearly provide a service, interior designers are generally considered to be vendors. This is because they charge a markup on the goods you purchase to decorate your home, instead of a fee for their services.

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BRINGING IN A CONSTRUCTION MANAGER

For exceptionally large renovations and major new construction, many ultra high net worth families hire a construction manager to oversee the project. Unlike general contractors, who generally bid a set price for a given project, construction managers work with an open-book basis and are typically compensated with a management fee and an incentive bonus basis. There are several advantages to this arrangement. First, as residential construction projects approach eight figures, there are very few general contractors who can accept the risk of a fixed-dollar bid. Second, those building “couture level” homes often wish to have greater control over which subcontractors do key components of the work. In a general contractor arrangement, natural conflicts can arise where an owner wishes a certain high-priced subcontractor and the general contractor wishes to limit the costs in that component of the project. Of course, subcontractor can, and should be, designated in the process of developing a fixed bid contract, but there is still a natural tension between cost and quality as the project moves forward.

David Cohen, CEO of I. Grace Company, has served as a construction manager in the building of some of the most prominent private residences in the country. He views the role of construction manager as akin to a portfolio manager, working with owners to understand their needs and tastes and develop a transparent award structure that meets their specifications. With an award structure in place, the manager can then identify the contractors and subs that meet the owners’ criteria, and negotiate costs as the owners’ representative. Cohen believes that construction managers should be

brought into the process at the earliest stages, preferably before architectural firms begin their drawings. “Architectural firms have aesthetic concerns that may compete against the practical considerations of budget, schedule and permitting processes,” he notes. A qualified construction manager can have input at the planning stage that can save cost overruns and delays later in the project.

COMPILING YOUR SHORT LIST

Assuming that you have not engaged a construction manager to assist in this process, the best place to start looking for qualified contractors, subcontractors and vendors is closest to home. Ask friends, family and neighbors who they used for projects of similar scope and what the experience was like. Of course, it’s important to know if they were happy with the result, but dig deeper. Did the subcontractors keep the work site relatively clean? Did they respect the privacy of the owners? Did they come in on time and on budget and, if not, why not? These sorts of referrals are the only chance you have to get proactive references from people you trust in circumstances where your prospective vendors and contractors can’t stack the deck.

Your architect may also be a solid source of referrals for general contractors, but a little healthy skepticism may be in order. Architects and general contractors get a significant portion of their business through mutual referrals. So, ask about the recent projects the architect has done with each of the contractors he or she recommends. How did the architect get the referral for that job? Why do they believe that each of the contractors they are recommending is appropriate for your situation? There is nothing innately wrong with architects and contractors referring work to each other, you just want to be sure you are

being referred to those best qualified to handle your project, not the one most likely to refer future work back to the architect.

Affluent families should be particularly cautious about using online referral services to find a vendor or contractor. These services will not likely be predictive of how well a contractor can cope with the complexities and service standards of multi-million dollar homes. Many of the services can be gamed by fraudulent posts by contractors and their friends and, in the worst cases, may even create a security risk. If an online referral is your only source of real information on a contractor or vendor, do not invite them into your home until you or a qualified consultant has checked them out.

ASSESSING YOUR ABILITY TO ASSESS OTHERS

In the course of accumulating their wealth, many successful individuals have developed finely tuned abilities to judge talent. Be careful that your pride in those skills does not lull you into a false sense of security, particularly if major household construction or renovation is a new arena for you. Seven-figure projects can become very complex, requiring very specialized expertise across a broad range of trades and product categories. If you are making this sort of investment, seriously consider hiring a consultant or construction manager to sit on your side of the table throughout the process. A qualified consultant can help you evaluate the qualifications of prospective contractors and vendors, review invoices, clear up disputes and help you understand what to expect at every point of the proceedings. Should you decide to go that route and need a referral, ask your Private Wealth Advisor.

Key Questions to Ask

ONCE YOU HAVE A SHORT LIST OF CONTRACTORS AND VENDORS, WHAT DO YOU ASK THEM? START WITH THE FOLLOWING:

1

WHAT WERE THE PRICE POINTS FOR YOUR RECENT PROJECTS?

It's important to make sure that your contractors, subcontractors and vendors are comfortable working in the ultra high net worth environment. Your project is likely to be larger and more complex than the average family's, and you may have higher service and quality expectations. You may even have confidentiality and security concerns most tradesmen never encounter. Asking for budgets, and addresses, of recent projects gives you a sense of what league they are playing in. If they typically work on \$100,000 projects and you have a \$3 million budget, there's no reason to assume they will be able to scale up. This is a particularly important point when undertaking a major new construction project. A 25,000+ square foot home requires multiple crews working in unison, presenting budgeting and scheduling concerns that the builder of a 6,000-square-foot home would never have experienced.

2

WHAT ROLES DID YOU PLAY IN RECENT PROJECTS?

Don't assume that a contractor or vendor handled every aspect of the jobs that are in their promotional materials, or even those they give you as references. Ask what their specific responsibilities were on those projects. Just because they worked on a large project in a prominent home doesn't mean they ran the project.

3

CAN YOU SHOW ME YOUR CERTIFICATE OF INSURANCE (COI)?

Ask for a copy of their COI, read it carefully or, even better, have your attorney review it. Make sure that they have at least several million dollars in coverage, and make sure there are not already claims against them. If you are undertaking a particularly large or complex project, you may want to ask them to increase their liability coverage significantly. This is all the more important if you are working on a waterfront project or in any other environmentally sensitive area.

4

WHO IS RESPONSIBLE FOR SUBCONTRACTOR LIABILITY?

While most general contractors are insured to cover liability suits brought by their subcontractors, this is not always the case. Make sure that you understand any limitations in this coverage. For example, if you pay any of the subcontractors directly, they may not be covered by the general contractor's liability policy. "When working directly with subcontractors, it is best to check with your agent or broker to make sure that liability is extended from your homeowner and excess liability policies," advises Kelley Beach, managing director at Marsh. "This will prevent a gap in coverage if the subcontractor has a low limit of liability or fails to pay his insurance premium and has his insurance cancelled."

5

DO YOU HAVE THE SPECIAL EXPERTISE THIS PROJECT REQUIRES?

Even exceptionally talented and ethical contractors can't be good at everything. A contractor who did a fantastic job on your neighbor's kitchen may not have the experience to install a state-of-the-art home theater. The same rule applies to certain types of topographies. For example, if you are rebuilding a seawall at your beach house, you will want to work with people who have successful experience working in a sensitive marine environment.

6

WHY HAVE YOU CHOSEN THESE REFERENCES?

In asking for at least four references, understand what products or services were provided to the client, when the work was done, and if there was a personal relationship involved. Be sure that the references they have provided are for projects of similar size and scope to yours. Of course, you should call every one of the references to verify all of the information you received from the vendors, as well as to determine their level of satisfaction with the work and the process of getting it done.

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EVALUATING BIDS AND CONTRACTS

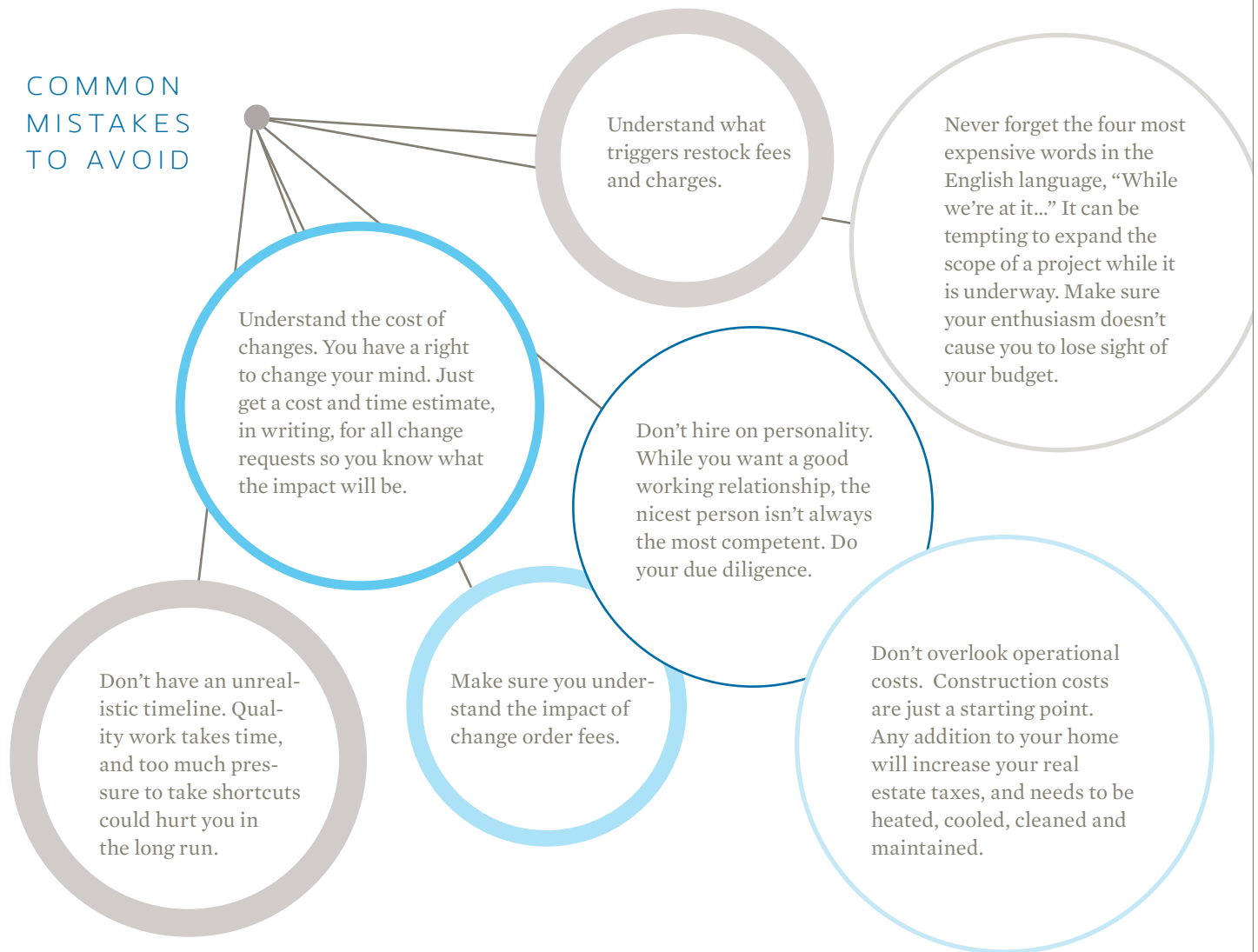
Now that you have selected and properly vetted several contractors or vendors, it's time to ask them for a bid. For any sort of substantial project, you should seek at least three bids with identical project specifications. Be as precise as possible, so that you can make a proper apples-to-apples comparison. In addition to the prices and timelines, you want to make sure that you understand all the variables in the process. These may include:

- Will the general contractor oversee the work personally, or will it be assigned to junior staff?
- What accommodations will be made for weather delays?
- If your bid includes any on-time completion bonuses, how will those be impacted by weather delays and/or change orders?
- What are the warranties for all the equipment, appliances and materials purchased for the project? Make sure you are provided all serial numbers and physical copies of warranties, so they will be easily accessible should something be damaged or malfunction.
- What is the contractor's policy if a warranty is invalidated due to improper installation?
- What will be the restocking fees for any returned products and supplies?
- What is the charge for change orders and how will that be defined? (i.e., are all the changes on a given day counted as a change order, or is each item on the list a change order?)
- Why has the contractor chosen each of the subcontractors and vendors?
- If there is a problem between a subcontractor and the general contractor, how will it be mediated so that the project can continue?
- How will any disputes between you and the general contractor be mediated?

MOST IMPORTANT, CAREFULLY READ EVERY LINE OF EACH BID AND MAKE SURE YOU UNDERSTAND EVERY WORD.

"It's the small print that will get you in trouble," suggest Teresa Leigh of Teresa Leigh Household Risk Management. "If the contractor or vendor can't clearly delineate what they will deliver and what it will cost, don't hire them." If you are not sure that you have the experience and specific knowledge to properly evaluate the bids, engage a consultant who does. In either case, always have your attorney review a contract before you sign it.

COMMON MISTAKES TO AVOID



Day-to-Day Management

Once you have hired your general contractor or construction manager, it’s a good idea to sit down with him or her and your architect, and establish a process for clear and open communications. If you have decided to hire a consultant to represent your interests, make sure they are in attendance at this meeting. In the course of a major construction project, all sorts of issues may arise that can get you off track. It may be adverse weather, a major rock that needs blasting out, an underperforming subcontractor or even problems of your own making. You want to make sure you have a system in place, where you can get all issues out in the open and reach a mutual understanding of how

those issues will impact the cost and timeline of your project. However you decide to schedule these discussions, make sure that detailed notes are kept, so there is no future confusion about what was said.

Your initial meeting is also a good time to communicate your questions and concerns about the work process. Are there special places the workers need to park? What days and times is work prohibited? Are there areas of your home that are strictly off limits to any workers? Whatever special concerns and requirements you have, make sure you communicate them clearly. If the work is being done in a co-op or condo, or you are part of a

homeowner’s association, the contractor should also be aware of any rules and limitations imposed by your board. As you well know, those who live in high-end neighborhoods and exclusive co-op buildings can be acutely sensitive to the sort of disruption created by major construction. Make sure your contractor understands the norms in your area and takes all reasonable precautions to minimize disruption to your neighbors.

Before the project begins, you should also have a clear understanding of who will be the on-site supervisor of your project. Make sure that you understand who is responsible for all workers in your home at any given time.

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THINKING ABOUT ACTING AS YOUR OWN GENERAL CONTRACTOR

It's been said that a lawyer who represents himself has a fool for a client. The same goes double for homeowners who act as their own general contractors. Spare yourself the agony unless you are positive you have the time, experience and specialized expertise to define a critical path for the work on a major project and properly screen, hire, contract with and supervise subcontractors.

Understanding the Critical Path

There is a certain order to any construction or renovation project that calls for the careful scheduling of every subcontractor who will come on-site. For example, an addition has to be framed out before the wiring can be roughed in, and that has to be done before the wallboard can go up. If one contractor is behind schedule, it doesn't just delay their work. It pushes back the schedule of all the work that can't be started until he or she is done. If any of the other subcontractors have other commitments (and all the good ones will), work will stop until they can be rescheduled.

THERE ARE TWO VERY IMPORTANT IMPLICATIONS TO THE CRITICAL PATH:

- First, you should understand how your general contractor mediates disputes with subcontractors, so that a problem with one won't grind the entire project to a halt.
- Second, you should understand how the timing of change requests impacts the construction schedule. Sometimes the timing of a request can have a greater impact on the project than the nature of the change itself. For example: if you decide to move a non-weight-bearing wall back one foot after the rough framing is

done, it's a fairly moderate change. If you make that decision after the wall has been framed, wired, insulated, wall boarded and painted, it's a totally different matter. A lot of material gets thrown out, half a dozen subcontractors have to be rescheduled and any work that required that wall being in place would have to wait.

The impact of changes on the critical path is a great issue to discuss with your architect and general contractor early in your project. Ask them to educate you on how the decisions you make impact time and budget, and make sure they raise a red flag when a change you request might be unduly expensive. Even better, ask for a written estimate on the cost of changes, before you make any change request official.

THEY'RE NOT JUST WORKING ON YOUR HOME, THEY'RE WORKING IN IT

According to Teresa Leigh of Teresa Leigh Household Risk Management, approximately 110 different companies will work on the average ultra high net worth home at some point in its life cycle. So, whether you decide to take on a major construction project or just need standard maintenance work, you will probably have to evaluate the capabilities of subcontractors and vendors at

some point in your future. Even if you outsource these tasks to a household manager or outside service, it's good to understand the basic best practices.

When hiring subcontractors and vendors to work in your home, there are two equally important factors to consider. The first is obvious: they should have clearly demonstrated that they are capable of doing quality work on time and on budget. The second is all too often overlooked: Do you trust them in your home? As Teresa Leigh notes, "You are giving dozens of people access to your home. Imagine what they will know about you by the end of the project."

The unfortunate reality of the American construction industry is that there is a general shortage of highly skilled tradesmen, and not everyone with the requisite skills has the cleanest record. In your earliest conversations with your general contractor, stress that you are very serious about security issues and that he or she will be held responsible for maintaining a safe and secure site. Make sure you are comfortable with the precautions being taken and the procedures for securing the site, particularly if the nature of the construction allows unlocked access to

your home. “In addition to the scores of workers coming into your home, ongoing deliveries, probably on a daily basis, will be arriving at your home. Make sure the delivery men are with reputable companies and have proper identification,” recommends Andrew O’Connell, President with Guidepost Solutions, LLC.

SERIOUSLY CONSIDER TAKING THE FOLLOWING SECURITY MEASURES:

- Remove easily portable valuables, like jewelry and small collectibles, from your home before the construction.
- Review your insurance policies before construction begins to make sure that artwork and other valuables are properly insured against both theft and damage.
- Make sure your contractor understands which areas of the home are off-limits and lock those rooms.
- If children will be living in the home while construction is in progress, all workers should be checked through the Federal Sex Offenders Registry.
- Have on-site supervision at all times.

If you have a particularly sensitive security profile, you may want to consider taking extra security precautions. Some have gone as far as having full background checks conducted for every person who will work on the project. Every worker is then issued an ID badge, which must be shown to an on-site security officer before entering the site. Andrew also suggests, “Considering the revolving door of contractors and their workers entering your home, it may be necessary to rescreen them throughout the course of the project.”

WHEN IT DOESN'T WORK OUT

Despite the best efforts to properly screen and hire contractors, subcontractors and vendors, there are times when it becomes clear that a relationship is not working out. Should this come to pass, have your attorney review your contract to determine what your options might be. You should identify the nature of the conflict to see if there is a proscribed mediation procedure in your contract. Was a mistake made? Is the project chronically behind schedule? Do you suspect fraud?

Teresa Leigh recommends that you start gathering paperwork and audit the expenses to date. She notes that periodic audits over the course of a longer project are a good idea under any circumstances, as they identify possible discrepancies between budgeted and actual expenses, and provide an early alert to possible fraudulent billing activity. The results of your audit and the terms of your contract will likely dictate the best route to dismiss your contractor. As this can involve substantial amounts of money and somewhat complex contractual issues, consider having your attorney or an outside consultant assist you with the termination process. Be sure to collect any keys you have given your contractor and change any relevant security or access codes.

The finishing touches

Whether you are undertaking a major construction project or redecorating a single room, the same principles apply. The more careful you are in screening potential contractors and vendors, the more likely you are to find the right people for the job. The more clearly you can express your wishes and expectations, the better the experience you are likely to have. The more meticulously you document the process, particularly any departures from the original plan, the easier it will be to resolve any disputes and misunderstandings that may occur along the way. So, be clear, be fair and make all your decisions with your head as well as your heart. And enjoy the process of improving your home as much as the final result.

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