RM

NATIONAL ASSOCIATION OF Community Health Centers

RISK MANAGEMENT SERIES

Tips for Managing Facility Development Risks

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The Health Resources and Services Administration, Bureau of Primary Health Care (HRSA/BPHC) supported this publication under Cooperative Agreement Number U30CS08661-02-00. Its contents are solely the responsibility of the authors and do not necessarily represent the official views of HRSA/BPHC.

Anyone who has done a home or office renovation or construction project knows that facility development is a long and complex process. At each step in the process – from selecting a site and securing funds to approving a design and constructing the facility, there are numerous exposures to liabilities, including environmental damage, harm to staff or patients, and cost overruns. Although a renovation or construction project may seem daunting and risky for a health center, there are guidelines and action steps to reduce liability exposures, manage risks, and reach the vision of a new, updated, and expanded facility.

This information bulletin:

- Describes major areas of risks related to facility development.
  - Acquisition
  - Legal and regulatory issues
  - Financial
  - Organizational
  - Contracts
  - Cost Control
  - Design and materials
- Identifies action steps for health centers to reduce exposure to liabilities related to facility development.

In general, the best ways to manage facility development risks are to:

1. **Plan thoroughly in advance to ensure organizational preparedness for the challenges of the construction project.**
2. **Use a qualified project manager.**
3. **Supplement the health center's staff with outside experts.**
4. **Share risk via contracts and insurance.**

ACQUISITION RISK — ESTABLISHING SITE CONTROL

The first development issue to consider is establishing site control of the right property for the health center, either by acquisition or lease. Before deciding on a specific construction project, executing a construction or design contract, or most importantly securing site control, the health center should complete certain due diligence to ensure that the property will meet its needs and that it will have the right to develop the site as it desires. A health center should take all necessary steps before locking in its site control to ensure that it prevents cost overruns and to avoid buyer's remorse.

Mitigation steps include…

Due Diligence

A health center should complete pre-development due diligence as discussed on page 29 in Capital Link's ***Developing a Health Center: A Guide for Health Center Staff and Boards on Managing the Design and Construction Process*** *(hereafter referred to as Developing a Health Center)*[1]. This will involve:

- Determining whether the site suits a health center's needs;
- Ensuring that any legal risks have been identified and, if possible, eliminated; and
- When purchasing a property, completing a survey to know its exact boundaries and the size of any existing utilities connections.

Zoning Analysis

When considering a new location, a zoning analysis should be done to make sure a health center is a permitted use on the property. The proposed design may not be legal by local standards. It depends on how the specific lot is zoned. Even if the proposed uses and design are not permitted "by right", a local jurisdiction's zoning laws may allow for exceptions or "variances" to the property's zoning restrictions.

Although health center staff could independently investigate the zoning requirements of a proposed property by contacting the local zoning commission, a health center should consult a zoning attorney with experience in the project's jurisdiction to determine whether it is realistic that the health center will achieve any needed zoning variances or exceptions. The project architect is also able to determine how the site's zoning designation will impact the planned facility.

1 Please click on this link to request a free copy of the referenced manuals: http://caplink.org/FreePubs1.html

Example 1:
Negotiating Property Lines

One health center discovered that a neighbor's home was encroaching onto the property it was purchasing by less than one foot over the property line; the neighbor was notified and an "easement" agreement was negotiated allowing the encroachment. The easement limited and specified the rights of the adjacent property owner to maintain the existing structure while acknowledging it was partially located on the health center's property. As a result, the health center was able to move forward with the purchase and to design its new facility on the remainder of the property without risk of future litigation by the owner of the encroaching property seeking to obtain ownership of the land beneath its house.

Environmental Assessment

A health center will also want to ensure that there are no environmental hazards on the site that will make development too expensive due to the cost of remediating possible contamination.

Phase I Environmental Assessment

A Phase 1 Environmental Assessment is due diligence for assuring that there is no soil or ground water contamination that could result in liability because of human exposure to contaminants or could decrease the value of the property or neighboring properties. The Phase 1 report should adhere to American Society for Testing and Materials (ASTM) Standard E-1527-05 in order to provide Landowner Liability Protection.

Because many lenders will be reluctant to lend to a project on a contaminated site, depending on estimated remediation costs, commercial lenders will likely require a Phase 1 Environmental Assessment as a condition of any loan. If there are any findings from the Phase 1 assessment, a more thorough Phase 2 Environmental Assessment may be required.

The health center, working with its project manager, should contract with an environmental services firm to complete a Phase 1 Environmental Assessment. Since lenders often require specific approved engineering firms to conduct environmental assessments, it is wise to check with your lender about this requirement before hiring your own environmental assessment firm to avoid paying twice for the same assessment.

Title Insurance

When purchasing a property with a typical bank loan, a mortgage lender will require title insurance – a commitment by a title company that there are no competing ownership interests or legal claims against the property that would need to be resolved before initiating the project. If a health center is purchasing a property with grant funds, a title search and title insurance may not be required, but are still a wise investment.

A health center will also want to ensure that there are no environmental hazards on the site that will make development too expensive due to the cost of remediating possible contamination.

Clean-Up

Although remediation costs can sometimes be covered by public funding related to "brownfield" development (development on a contaminated site), any site clean-up will likely delay the project and should be considered an important factor when selecting a site.

In the event the environmental assessment identifies contamination on the site, a health center should consult an environmental attorney to discuss its options.

Underground Storage Tanks (UST) – Some environmental issues include the presence of contaminated soil or underground storage tanks (UST). These challenges can be addressed – often at minimal net expense -- but it is best to purchase a property only when a health center knows the challenges and costs in advance. The presence of a UST should be identified as part of the survey of the property, but a health center should specify that it wants a full "ALTA" survey that meets the standards of the American Land Title Association (see www.landsurveyors.com). The tank (usually for fuel storage and as large as a tractor trailer in some cases) can often remain in place, following a successful tightness test, but may need to be removed. Ongoing monitoring of any tank left in place may also be required.

Contaminated Soil – Contaminated soil requires controlled removal of soil and disposition to a special treatment or containment site. If a project does not require a basement or other disruption of the soil, a health center may be able to contain the soil in place under the building at no additional cost. If a health center needs to dig out a basement or below-grade parking structure, project costs will already include excavation expenses; only the specific disposal costs will be added.

LEGAL & REGULATORY RISKS

Any real estate development project is subject to multiple regulatory and legal reviews that could derail the project. Regardless of the community benefits generated, the challenges are the same for a health center. These include such hurdles as:

- Gaining approval of the site plan from a planning or zoning board;
- Securing neighbor support for the project;
- Undergoing a certificate of need process;
- Receiving a building permit before beginning construction and a certificate of occupancy allowing use of the facility after construction; and
- Securing various licensures required to operate a health center, which vary by state.

Failure to receive any of these could keep a project from being built or ultimately used for its intended purpose. Even a delay in receiving one of these approvals will have consequences, often costly ones.

Mitigation steps include…

Project Team – Ensures Expertise

A health center must assemble a project team with the right skills to manage each of the necessary approval processes. As discussed in greater detail in ***Developing a Health Center***,[2] this team should include at a minimum the:

2 http://caplink.org/FreePubs1.html

- Project manager to coordinate the team and track each of the approvals,
- Lawyer,
- Architect, and
- General contractor.

Larger projects may benefit from such specialists as a permit expeditor or a community outreach coordinator.

Allocate Responsibility – Ensures Completion

A health center can reduce its risk by sharing responsibility for various approvals with other team members. The general contractor, for example, frequently agrees in its contract to be responsible for securing the building permit and the certificate of occupancy. The contract should include timeframes and penalties for not meeting them. Also, a health center may encourage or require its general contractor to hire a permit expeditor to meet its deadlines.

Community Outreach – Ensures Support

It is always helpful to have the support of the community and of elected officials. It is even better to have this support in writing.

- **Early in the project** – a health center should work to inform the community and public officials of its plans and seek input into those plans in advance of construction.
- **During the project** -- it is always helpful to hold project-related events to build excitement and support, as long as care is given not to leave anyone off of the guest list who may be likely to oppose the project.
- **Groundbreakings and grand openings** -- are great opportunities to align a health center project with key supporters, particularly elected officials.

It will be beneficial for a health center to prepare a list of public officials, neighborhood organizations and active individuals, patients and other health care organizations early in the process and to lay out a plan for keeping these people informed and engaged with the health center project.

FINANCING RISKS

A health center's financing risks depend on:

- The sources of its project financing,
- Its debt capacity,
- Any collateral it has pledged, and
- Systems it has put in place to manage timely access to funds.

Even a project with one hundred percent grant funding will require a health center to effectively manage the timing of its draws from its grantmaker in conjunction with the billing and payment terms of its vendors.

In order to mitigate risk, it is critical that a health center have all sources of capital secured before beginning construction. If a health center starts its project before all financing is in place, the health center may need to make payments from its operating cash flow until it is able to secure reimbursement from its funders. Depending on the size of the project, this could be a significant cash outlay. If the health center lacks the operating funds to cover costs, the project will likely be delayed mid-stream. This would result in additional costs related to the architect and/or the general contractor either shutting down and eventually re-starting its staff and work on the project, or requiring payment

by the health center of general conditions (contractor operating costs) during any delay.

When combining multiple sources of funding, a health center may need to segregate project costs into categories of expenses covered by one source of funding, but not another.

A health center using debt to finance its project is responsible for making regular payments to its lender, whether a public agency, a private bank or even a tax credit buyer. The terms of these payments – when they start and stop, how much, and whether the amount will change over time – are crucial aspects of any type of financing. Most often, debt financing will involve two different stages of debt: a construction loan to pay for constructions costs (typically higher interest rates) and a permanent loan to "take out" or replace the construction loan (lower interest rates). Lenders generally prefer to finance projects in this manner because there is more risk involved in lending money to a project that is not complete, occupied and generating income to pay debt service. Once a borrower overcomes that hurdle, and begins to realize cash flow from the new facility, a lender will provide the permanent loan at a lower interest rate commensurate with the lower risk. This is just one of the many nuances of the timing and terms attached to financing sources.

Example 2:
Coordinating Multiple Funding Sources

One health center in Washington, DC received a pre-development grant from the local government that covered certain due diligence costs incurred prior to breaking ground for construction, so long as the expenses were incurred after a date specified in the grant notice. Eligible costs included such items as financial analysis, survey, site assessment and initial design work to determine whether a proposed site works for the project. The grant did not cover any construction costs.

The health center also received a federal grant that only covered costs incurred after a later date specified in the federal grant notice. (The date had to do with when the grant program was enacted by Congress, but was not relevant to specific project benchmarks). Neither the local nor the federal grant covered expenses incurred in the earliest stages of the project. This meant that even though the health center had obtained significant grant funding for the project, it still had to spend hundreds of thousands of dollars up front.

Then, the health center had to wait to be reimbursed for some but not all of its predevelopment costs via the grants and a traditional bank loan once it submitted the required documentation. The bank loan covered some of the predevelopment costs, but only after the health center closed on its loan – over a year after some of these costs were incurred.

The key consideration is that given the time periods covered and the timing in which each source of funding is locked in, some costs may not be covered by any source other than the health center's own operating resources, while others may need to be paid by the health center several months before they may be reimbursed by a funder.

Mitigation steps include…

Financial Planning

A health center should prepare a thorough financial plan before initiating any construction project. (See page 18 of Capital Development Work Plan.)[3] It is crucial to the success of the project and to the long-term viability of the health center that the health center does not assume financial obligations it cannot meet. This includes planning for the ongoing operating costs of the facility on top of any debt service. Grantmakers and lenders will want to see that the health center has projected its operating cash flows and that there is sufficient net revenue to support operations, operate the building, service debt, and cover

3 http://caplink.org/FreePubs1.html

depreciation. The proposed operational budget should include the following expenses:

- A regular schedule of upkeep to fixtures and finishes,
- Renewal of furnishings,
- Seasonal cleaning,
- A reserve fund for making capital repairs and replacing such features as the roof, mechanical systems and medical equipment at the end of their useful lives.

When possible, conduct a capital campaign well in advance of a project and know what the health center can afford to spend before assuming any obligations.

Financing Requirements and Collateral Management

In addition to doing the initial financial analysis and planning needed to confidently initiate a project, a health center should know the conditions and reporting requirements before finalizing any financing agreement – whether a grant or loan, public or private. Most debt financing for building projects will require the land, building and associated improvements of the project that is being financed to be pledged as collateral. In addition, many banks will also require an All Business Asset lien, which will tie up a center's accounts receivable. If a center later needs a line of credit for working capital needs, it will need to ask the bank to release that collateral, which banks are reluctant to do. To mitigate this risk, a health center should work with its lender to discuss how the lender and the health center would deal with the center's future financing requirements.

Reporting Requirements

Reporting requirements can present another challenge. If a health center does not already generate audited financials, or only prepares annual (but not quarterly) financials for internal use, it could be a difficult hurdle to clear if these reporting requirements are conditions of its loan. To meet the requirements, a health center should bring together its financial team – its executive director, controller or chief financial officer, and any outside accountants or auditors – to prepare a plan for tracking the relevant data and generating the required documentation within the necessary time frames. Failure to provide these financial documents on time could create a default on the loan or grant. If a loan is in default, the lender generally has much more power to pursue alternative means of repayment, such as foreclosure sales.

Capitalized Interest

If the funds to make debt payments for the project are to be generated by the operations of the health center's new or expanded facility, those funds will not be available until the new space is up and running.

- If possible, a health center may want to include in any loan agreement an interest-only period during construction, to reduce the amount of the health center's payments while the building or renovation is under way.
- Alternatively, if the health center can afford the additional debt, some lenders will agree to "capitalize" interest payments during construction. This means they will lend additional funds to cover the cost of interest accrued during construction. A health center will be taking on more debt to do this, and should make certain this is considered in its financial planning for the project, but doing so will allow the health center to delay payments on the debt until the health center is operating at full capacity in the new space.

Draw Schedule Management

Most loan agreements (and many grant agreements) will detail a schedule for the recipient to draw down funds. Monthly draws are typical and a health center should make sure that:

- The billing and payment terms of its contracts with its architect, general contractor, and other vendors align with the draw schedules;
- Its project manager and its accounting department have a system in place to track expenses that are project-related and part of the project budget approved by any funders;
- Invoices will be collected and copies provided with draw requests;
- Accounting procedures are agreed on specifying who must approve each vendor invoice to authorize payment.

A lender (and possibly a grantor) will have its own inspector visit the project site on a monthly basis to verify that vendors have completed the work for which they are billing. A lender's inspector may also conduct occasional lien searches to verify that the health center, the architect, and the general contractor are all making the approved payments to their subcontractors and there are no legal claims (called liens) against the property.

The general contractor will be required to provide a release of liens from each subcontractor and the general contractor itself as a condition of receiving its final payment, including the release of any retainage.

Contractor's Financial Strength

When selecting a general contractor, a health center should consider the capacity of the contractor to finance its work on the project. This means that the contractor should have sufficient funds or credit to pay for its materials and payroll upfront, so that a health center is only reimbursing the contractor for work that has already been completed. Whether a home renovation or construction of a new state-of-the-art community health center, it is a red flag when the contractor asks for payment in advance. Just like the project's lender, a health center should ensure that it does not pay a contractor more than the value of the work completed to-date. There are occasionally exceptions to this rule of thumb, but a health center should be cautious and should verify these requests for advance payment with its lender, if applicable.

A health center may need to make an up-front down payment on certain large materials purchases, like new mechanical equipment for heating, ventilation and air conditioning (HVAC), in order for the general contractor to secure the equipment from a supplier. Such a down payment should never be for one hundred percent of the cost of the equipment. Usually, the most required up front is fifty percent, with the balance due upon delivery.

ORGANIZATIONAL RISKS

As discussed in Capital Link's ***Developing a Health Center*** manual (Introduction and Chapter 1)[4], a health center must accept that it is responsible for several aspects of the development process. The efficiency of the health center project team – how staff and board deal with project related decision-making – will dictate how successfully the project is implemented.

- The risks associated with this process include delayed actions or decisions leading to design or construction delays.

4 http://caplink.org/FreePubs1.html

- Contracts should be clear that architects, general contractors and others will need to be compensated for owner-caused delays (beyond agreed upon time frames for owner decisions). A list of potential project team members can be found in ***Developing a Health Center*** (Appendix D, pages 65 and 66).

Mitigation steps include…

Clear Decision-Making Process

A health center should develop a decision-making process and clearly designate decision-making authority for various aspects of the project.

- The health center's project manager is responsible for coordinating those decisions. It may be that the designated project manager does not have any decision-making authority (though this is a recipe for inefficiency).

- Regardless of who has primary day-to-day authority, a health center should establish a clear written policy identifying what issues or circumstances require an executive director decision and which require board approval.

Board's Role

Ideally, the project should not be managed by the board. The board of directors should:

- Make the initial decision to move forward with the project;

- Review and approve any funding decisions or obligations;

- Be informed of issues that affect the project budget, timing, or legal standing of the center.

Board approval should not be required for the various stages of project implementation. The timing of any required board approvals, project updates, and events should be built into the project schedule.

Assigning a Champion

To ensure that the project does not get lost among other priorities, or suffer from a lack of staff participation at crucial times, a health center should identify a champion for the project. This could be the executive director or another executive staff member (frequently the health center's medical or development director). The champion's role will be to make certain that necessary information and decisions are treated as priorities by health center staff. The health center's champion does not need to be an expert in development or construction, but they do need to be committed to the project's success.

Project Management

It is important that the health center hire or assign a staff member who is qualified to oversee the design and construction of the project. There will likely be multiple solutions to problems that arise during design or construction and not all of them will have the same cost or impact for the health center. A project manager, also referred to as a development manager, serves the role of protecting the owner's interests in its relationship with the architect and the general contractor. The project manager will have sufficient expertise to foresee and prevent problems where possible and to help address them when they inevitably arise. See Chapter 3 of Capital Link's ***Developing a Health Center***[5] manual for information on selecting a project manager.

Depending on the size of the project, due diligence, design, and construction could take as little as nine months or as long as three years or more. For a longer duration project, a health center may consider hiring a project manager as a member of the health center staff, but

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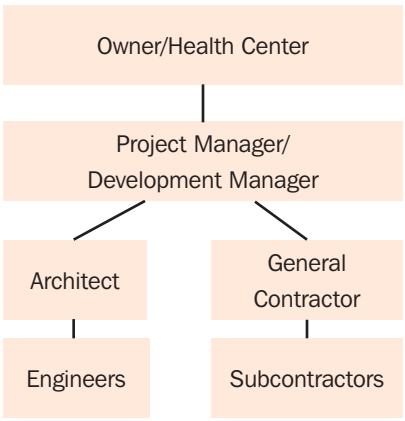
all parties should agree on how and when the employment will end. A health center would be in a bad situation if its project manager left with six months remaining on the project to accept a new job, rather than risk being unemployed at the end of the project.

Many health centers have asked whether their project manager should be bonded. Independent project managers generally do not assume responsibility for the project being completed. They represent the owner and manage the project, but are not ultimately responsible for the design or construction. They do not have full control, so they do not assume liability for the work. The same is true for architects, unless they are part of a design-build team (discussed later in this bulletin).

The project manager serves as a translator for the owner of technical terms and allows the owner to focus on providing health care rather than managing construction. The project manager also helps to mediate issues and disputes in which the architect and the general contractor have different opinions of what must be done. For this reason, on larger projects it is often not sufficient to rely on the architect to provide "construction administration" services in which the architect oversees the general contractor's performance. The typical relationship of the project manager to the development process is shown here:



General Contracting

Depending on the size of a health center's construction project and the expertise of health center staff in managing such a project, a health center may choose to serve as its own general contractor. This means the health center would hire and coordinate all of the subcontractors (for example: carpenter, plumber, electrician) directly, rather than hold a single contract with the general contractor who would then hire the subcontractors. While this approach would eliminate the mark-up that a general contractor will charge on the work of subcontractors, the health center would not be able to push some of the construction-related risks to a general contractor. There is also a legitimate risk that any savings on the expense of a general contractor would be offset by higher costs resulting from the owner's inexperience.

Any health center considering acting as its own general contractor should consider:

- Subcontractors may charge higher prices, knowing that the health center does not have a frame of reference for gauging market rates.
- Change orders (requests for additional payment beyond the contracted amount) may be submitted for items that were covered in the subcontractor contracts.
- Construction expertise is needed to prepare an accurate project schedule, coordinate delivery of materials to the site, and sequence various subcontractors to get the work done most efficiently.

Each of these issues suggests that any health center acting as general contractor should make liberal use of specialized consultants, including but not limited to a schedule reviewer, attorneys, and a project manager.

CONTRACT RISKS

As much as we may like to conduct business on the basis of a handshake, legal written contracts that health centers negotiate should specify exactly:

- All of the work that will be done and by when;
- Who is responsible for all parts of the work;
- The professional standards expected in the work;

- How disagreements will be resolved.

Contracts should also state that no additional costs will be covered beyond those negotiated in the contract. When this does not happen, a health center will find itself in the difficult position of being obligated to raise and pay additional funds to complete the project, likely much later than planned. Most of the costs relating to the following Mitigating Steps are included in the "soft cost" (fees for professional services) portion of the health center's project budget and can be included in the amounts that are financed by banks and other financing entities.

Mitigation steps include…

AIA Contracts

A health center should use standard contracts developed by the American Institute of Architects (AIA) for the health center's architect, general contractor, project manager and others. These contracts are available, for a fee, at www.aia.org, though larger contractors likely already use them and can secure the basic contracts at no charge to a health center. These contracts will be amended to reflect the particulars of a project, including the project schedule and budget, and will clearly define who is responsible for completing various tasks.

Legal Counsel

A health center should always have an attorney review the contracts before signing them. Ideally, this will be an experienced real estate/contracting attorney. If a health center's project manager, either an employee or an outside owner's representative, is experienced in construction and architectural contracts and has helped to shape the contract, a general review by a contract attorney may be sufficient. See page 27 of Capital Link's ***Developing a Health Center***[6] for a list of attorney responsibilities.

Phased Contracts

One specific aspect of contract management is to make sure a health center's contracts with its architect and general contractor specify that the health center will give a separate "notice to proceed" (NTP) for each phase of work under the contract. In this way, along with specific language regarding any work stoppage requested by the health center, the health center will not be obligated to pay for work that it has not authorized. A typical example of this approach is to hire a general contractor to provide pre-construction services during the design phase – to give advice to the owner and the architect on construction materials and methods, as well as to provide cost analysis at various stages of the design process – with no obligation by the health center to pay for construction services if the project does not move forward to the construction phase. Similarly, the architect's contract should include a separate fee and NTP for each phase of the architect's work (i.e., schematic design, design development, construction documents, permitting and construction administration).

Retainage

To ensure that the project is completed according to the terms of the contract, two helpful standard clauses to include in any contract with a general contractor are:

- Retainage – withholding an agreed percentage (frequently 10 percent) from each monthly payment to the contractor until the project is completed, and
- The right of the health center to "supplement," or replace the contractor to get the work done by another contractor using any remaining funds previously committed under the contract.

6 http://caplink.org/FreePubs1.html

Payment and Performance Bonds

Another important way to ensure that the project will be completed as defined in the contract is to require the general contractor to be fully bonded. Such "payment and performance bonds" are frequently required by private lenders and public funders.

- A payment bond is a commitment from a third party (like an insurance company, but not exactly) to pay whatever debts are owed by the contractor to subcontractors or suppliers.

- A performance bond is a similar commitment by the bonding agency to complete the terms of the general contractor's contract even if the general contractor no longer has the resources to do so on its own.

Such bonding has helped developers of all types when general contractors have had to declare bankruptcy in the midst of a project, though significant delays can result from the transition to a new contractor.

Dispute Resolution

Contracts should include dispute resolution clauses that require the contractor to continue working to complete the project even if there is a dispute. This clause will require the contractor to complete any work even if it is a change from the original specifications, and resolve any dispute over payment following the project's completion. This provision would be relevant if there is a dispute regarding whether certain work was included in the original contract, but is not likely to apply in cases where a health center has not made required payments to the contractor.

Regulatory Compliance

All contracts should specify that the contractor will comply with whatever local, state or federal regulations are dictated by the project's funding sources. Relevant requirements should be included in the contract, with direct reference to the legal codes or clauses.

- Failure to comply with these funder requirements will result in penalties to the health center, so contracts should specify that the general contractor will be financially liable for meeting these criteria.

- One frequent requirement is that the general contractor and all of its subcontractors will comply with the Davis-Bacon Act, which requires that all laborers and employees will be paid prevailing wages as set for each job category by the federal government. The general contractor will be obligated to provide certified payrolls demonstrating that it pays prevailing wages.

COST CONTROL

A successful project will control costs. Once the health center sets the project budget and secures funding, any cost increases can not only impact the health center's ability to complete the project, but to maintain its ongoing operations if operating cash flow must be used to fund the project overages. The best time to limit cost overages is before construction starts.

Common risks associated with cost increases include:

- Discovery of unforeseen conditions in an existing building or on a piece of property;

- Initiation of construction with incomplete architectural documents;

- Requests of changes in the plans from the owner and delay caused by any of these or other issues.

All of these can result in "change orders" from the general contractor, requesting additional payment for the additional work.

Mitigation steps include…

Due Diligence

A health center should complete site and building due diligence in advance to ensure that the architect's and the contractor's pricing includes all the possible work that will need to be done. This investigative work usually includes identifying such factors as the soil's ability to support a building, the presence of any underground water that could impact construction, and determining the level and size of water and utility connections to the site.

Design Review

Once a health center knows as much as possible about its site, it should make sure the architectural documents are complete. This is covered in the architect's contract, which should allow for owner approval and feedback at multiple stages of design (schematic design, design documents, and construction documents). Architects are required to deliver the documents specified in their contracts and they must maintain sufficient insurance to cover any claims against them for errors and omissions. Architects are not generally bonded, however, as they are liable only for completing their design contract, not for the final construction of the building.

Ways to ensure architectural documents are complete include:

- Employ an experienced project manager who can review the plans for completeness.
- In conjunction with hiring a project manager, involve the general contractor in the design. The contractor ultimately agrees in its contract to build what is reflected in the architectural plans, so involving the contractor in the design process makes it more difficult for the contractor to claim it did not know exactly what it agreed to build.

Project Approach Selection

Traditional development practice has generally involved an architect designing a project, then a contractor being hired to build it; this is the design-bid-build approach. Over the past decade, the development industry has moved toward bringing the general contractor into the process earlier, both to avoid situations where the contractor may claim the design is incomplete and to speed the development process. Health centers should consult with their project manager to select some variation of the following options:

- **Design-bid-build approach** – the traditional development practice that has generally involved an architect designing a project followed by a contractor being hired to build it.
- **Design-build approach** -- the architect and the general contractor are hired under a single contract, as a team. The architect designs the building to a pre-set price, with the contractor providing cost information at various stages of the design. The contractor then agrees to build the project within that budget.
- **Design-assist approach** -- the contractor is hired separately from the architect, but early in the design process. The contractor provides pre-construction cost estimating during design and then submits a price for completing the work; the price should be consistent with the estimate.

Value Engineering

This input from the general contractor contributes to a process known as "value engineering" (VE). VE involves the identification, consideration and selection of alternative materials, systems and approaches to engineer the best value for your project. This does not always mean the least expensive option. Value engineering should occur at each stage of the design process.

Contract Type Selection

Cost control can also be achieved via certain contract types.

- A "**cost-plus**" contract – paying for the actual cost of construction plus a predetermined fee as a percentage of the costs – discourages the contractor from keeping costs down and significantly limits the health center's control. This type of contract is frequently forbidden as a condition of federal grants and should be avoided by health centers.

- A "**stipulated sum**" or "**fixed price**" contract allows the health center to lock in a price from the contractor to build what is in the plans; any cost savings go to the contractor.

- A "**guaranteed maximum price**, or **GMP**" contract is similar to a fixed price contract, but cost savings do not automatically go to the contractor – they are generally shared by the owner and the contractor.

A health center should propose the type of contract it would like to use as part of the contract solicitation process or in the request for proposals (RFP). It may also be helpful to include a copy of the basic contract document (AIA version with health center's proposed edits) with the bid materials so that the contractors responding to the RFP will know and commit to the contract structure and specific clauses in advance. In this case, the general contractor is not agreeing to a price yet, just the structure of the contract.

Space Programming

One of the best cost control tools for the health center is preparation of pre-development space programming. A well thought out and vetted plan identifying the mix of uses and space needs for the new facility, prepared and finalized before design begins, is crucial to mitigating the risk of owner-directed changes to the design later in the process. This early resolution of exactly what the health center wishes to have built will ensure that the health center will not need to pay its architect to re-design the facility later in the process and the general contractor will not be able to change its pricing to build the new design. Working with its project manager, its architect, and perhaps a separate space planner, the health center should involve representatives of each category of end-user of the new facility (patients, medical providers and support staff, management, information technology and telecommunications staff, and others) to help define exactly what spaces are needed. The health center's staff frequently knows best what layout of the clinic, administrative offices, and other spaces best supports patient flow and ease of use for staff and patients alike.

Example 3:
Exam Room Planning

One clear example of where end-user input is crucial is the design of a typical exam room. Health center staff will know best whether the door to the exam room should open to face the exam table, or whether the exam table should be behind the door. Health center staff will also know where medical equipment, a sink, writing surfaces and chairs should be located in relation to the exam table and whether there needs to be a phone in the room. Where should exam rooms be located relative to clinical administrative space? Would health center staff prefer workspaces in hallway alcoves, separate offices or in exam rooms? If the health center does not answer these questions before the space is designed, costly redesign may be needed. If it does not address these questions before it constructs the facility, the facility will not function as well as it could and may need remodeling after completion.

- Prior to the development of schematic architectural drawings – the health center's project manager and architect should coordinate meetings with the key stakeholder groups for input on how they use their current facility and what improvements they would like to see in the new facility.

- Stakeholders should receive copies of meeting minutes to acknowledge that the minutes accurately reflect their input or to suggest changes.

- Once the space-programming plan is complete, the project director and architect should share the plan with stakeholders for their approval.

- A health center may choose to have its staff – including the executive director, medical director and other senior management – sign the space-programming plan document as a symbol of their commitment not to propose changes at a later time.

- Approval signatures may be useful following presentation of the schematic design -- the stage at which the floor plans are initially laid out, and again after design development – the stage when the layout is finalized.

Design Alternatives

Although the health center may be committed to a basic design and should avoid making changes, there are ways to plan for a potential change in materials or space. For example, during a large renovation project, a health center had the architect design an enclosure to an existing balcony and requested a price estimate for construction from the general contractor. The center did not move forward on this plan until learning that construction costs of the large renovation project were under budget and funds existed to cover the additional work. Requesting architectural design and contractor pricing for additional/alternative building elements is referred to as an "add/alt."

As part of the VE process, these alternatives can be considered in the final construction and pricing documents.

- A health center may want to list some elements that would enhance the basic structure of the new facility, but only as future additions to the building once it becomes clear that there are project savings or unused contingency funds available.

- Savings could pay for adding a decorative awning at the building entrance, to upgrade the signage on the building's exterior or interior, to fund new equipment for the exam rooms, or some other hoped-for use that is not part of the original budget.

Contingency Funds

Budgeting contingency funds assures availability of resources for unforeseen cost overruns. Project budgets include different types of contingency funds, which are typically five to ten percent of the relevant costs.

- A design contingency allows for unplanned design changes dictated by site conditions or permit review.

- A construction contingency will likely be required by the general contractor to provide a cushion on its committed price.

- An owner's contingency would fund any owner-dictated changes, including the decision to implement an add/alt feature.

Unused construction contingency generally reverts to the owner, but must be negotiated as part of the general contractor's contract. Some agreements include a shared savings clause in which the unused budget is split between the owner and the contractor.

Schedule Review

Cost overruns due to schedule delays can and should be mitigated by the health center. Generally, any vendor contracted by the owner -- including the project manager, the architect and the general contractor -- will base their fee on a specific project schedule. If the duration of the project exceeds the duration specified in the contract, the contract will dictate how the vendor is to be compensated for that time. In many contracts, a project delay such as work not being done until financing is finalized, will be compensated by paying the vendor an hourly or daily rate.

- Depending on the complexity and duration of a project, the health center may benefit from hiring a schedule consultant to review all of the assumptions and durations in the general contractor's schedule.

Donated Goods and Services

Health centers may attempt to control costs by securing donated goods or services as part of their construction project. This can be a viable strategy, but unless it is coordinated with the general contractor's schedule, subcontractors' work may be delayed and the health center would be required to compensate subcontractors for the entire delay.

Project Management

Ultimately, all of these contract issues dictate the importance of having a project manager qualified to manage the vendors and their contracts. The architect may have been responsible for anticipating some unforeseen conditions. Some delays may not require compensation if they are concurrent with a delay caused by the contractor. An experienced project manager will know this and will protect the health center's interests.

DESIGN RISK – MATERIALS

As part of the design process, the development team will ask the health center to select materials, including flooring, chair upholstery, wallboards, and counter-tops, which will need to be ordered well in advance of their installation in your facility. If a health center does not like what it sees once it has been installed, its options are limited. It is important to realize that the risk of selecting a material the health center does not like when it is installed in the facility is different than receiving defective materials or having the materials installed incorrectly.

Mitigation steps include…

Consider Alternatives

A health center should work with its architect during the design phase to:

- Understand exactly what performance it requires from its materials and
- What maintenance the materials require.

Prior to selecting materials, a health center should ask its architect to:

- Explain the relative merits of each alternative,
- Provide samples, usually mounted on a sample board, for health center staff to see and touch, and
- Let the health center know where staff can go to see the materials in place in an existing building. A health center will have to live with its choices or pay to change them for a long time, so staff should take the time to investigate before they are selected.

It should be noted that if a health center chooses to contract with an architect that lacks health care design experience (a choice that is not recommended), it would be wise to also contract with a health care facilities specialist for interior design services. Such a specialist can advise not just on materials, but also furniture, fixtures and equipment. An alternative for certain rooms and equipment is for the health center to coordinate with manufacturers and equipment brokers to lay out equipment and furniture based on floor plans provided by the architect.

Standards and Warranties

The health center's contractor will be obligated by its contract to install materials to a professional standard and the center should not accept substandard installation.

- A health center's project manager or architect will be responsible for signing off on the installation as part of the project's "punch list" – a phase of work by the general contractor after your project has been substantially completed and only touch up work and final pieces remain.

For materials that fail to perform as specified, the health center should have warranties in place as part of the contractor's purchase of the materials for construction.

- A health center should receive a warranty book for all furniture, fixtures, and equipment (FFE), as well as for larger building systems, as part of the project close-out process with the general contractor. Providing the health center with a warranty book should be a condition of the health center releasing the retainage withheld from payments to the contractor.

INSURANCE RISKS

As owner or leaseholder of a property, a health center will be liable for certain injuries that occur on the property or that result from the project.

- If a health center is doing new construction or renovation of an empty structure, many of these risks can be passed on to the general contractor.

- If a health center is renovating a building or a portion of a building in which staff and patients continue to work and receive care, or in which other tenants continue to function, there are risks that cannot be deferred to the contractor.

Mitigation steps include…

Risk Management Review

A health center should consult with a risk management specialist, starting with a health center's current insurance broker, but perhaps also including a specialist in construction contracts and projects, to identify the full list of risks associated with the project and how best to mitigate them. In general, a health center should:

- Make certain that its general contractor is following a clearly defined safety plan for all on-site activities and personnel;

- Carrying sufficient insurance to cover potential risks;

- Consider potential general contractors' safety plans and performance records when selecting a contractor;

- Have its project manager monitor the construction site to ensure that workers follow basic safety practices, such as use of hard hats, safety glasses, workboots, safety harnesses when working from scaffolding or heights, and maintenance of a clean work area.

For facilities expansion or renovation projects, a health center's clinical risk manager should:

- Consult with the project manager and architect to perform a pre-construction life safety risk assessment, including air, water quality, and contaminate exposure;

- Prepare a plan for eliminating or minimizing each potential health safety risk for staff, community, and patients;

- Establish temporary emergency management procedures to avoid or exit the construction zone.

- Proof of Insurance

A health center should require its general contractor to:

- Provide copies of its insurance policies -- not an insurance certificate, which summarizes coverage, but does not go into detail on coverage or exclusions;
- Name the health center and its lender(s) as additional named insured.

Public funders, whether federal, state or local, may also require that they be named as additional insured as a condition of their funding.

Property Insurance

When renovating a building with ongoing operations, a health center should verify with its risk consultant whether the health center's property insurance will cover injuries or claims filed during construction. The contractor's "builder's risk" policy may be the primary coverage. A health center should also ask its consultant whether its policies cover only claims made while the insurance is current, or if it covers any claims resulting from the work done while the insurance was in place – even if the policy has expired. Depending on the answer, a health center may choose to purchase or have its general contractor purchase an extension on certain insurance policies to extend coverage for a realistic period beyond completion of the construction.

CONCLUSION

Community health centers fortunate enough to be upgrading the facilities in which they provide care should be sure to take the steps necessary to efficiently manage their construction projects and the resources funding them. This will require working with development experts – a project manager, architect, general contractor, lawyers and engineers – to ensure the health center team anticipates potential problems and acts to prevent them when possible.

It will also require internal planning with the health center's accounting team, board and staff to make certain the health center can efficiently meet any funding requirements. Input from patients and staff will ensure the facility meets the center's needs. By planning upfront, a health center can minimize costly delays and maintain its focus on health care.

Resources

- Capital Link capital project materials www.caplink.org
- The American Institute of Architects www.aia.org
- Land Surveyors www.landsurveyors.com
- National Association of Community Health Centers www.nachc.com

Input from patients and staff will ensure the facility meets the center's needs.

HIRING A PROJECT MANAGER

When selecting a project manager or development manager, a health center should solicit proposals from multiple firms or individuals. Any request for proposals (RFP) should request information on the following, to be used to evaluate the best representative for the health center:

1. **Experience with similar projects** — building a health center, working with health centers or non-profits, new construction or renovation, managing architects and contractors on similar size projects.

2. **Experience in the jurisdiction where the project is being built** — working with zoning approvals, building codes, local contractors and architects.

3. **Experience managing public grant funds** — preparing reports to support any draw requests and grant reporting requirements.

4. **Communications plan** — proposed schedule of meetings with the health center and with the project team, sample meeting minutes and issue-tracking forms, budget tracking tools and reports, etc.

5. **Experience preparing project budgets and schedules** — request copies of budgets and schedules from other projects.

6. **Experience preparing and editing contracts** — Do they use AIA contracts? What contract issues do they feel are important for the project?

7. **Experience working with local attorneys on construction project issues** — zoning variances for issues like parking, building height, use restrictions, etc.

8. **Proposed development approach for the project** — design-bid-build, design-build, design-assist?

9. **Price and fee structure** — Hourly? Fixed fee for a specified project duration? Hourly until the project schedule and budget are fixed?

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