



10 MISTAKES TO AVOID

WHEN DEVELOPING A

COMMERCIAL BUILDING PROJECT

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introduction

Before embarking on the development of a new commercial building, or renovating existing commercial premises, it is important to ask the hard questions.

You may have been involved in commercial development, and be familiar with some of the common pitfalls we have highlighted in this document.

You may also be aware that the hard questions need to be asked early, to put measures in place to be able to stay in control of a project.

In many instances it is not that the hard questions were not asked, it is that they were asked too far down the track, or that the answers came too late.

We prepared this document so that the hard questions are set out for you as a checklist and reminder to tackle these issues early.

We have formulated the hard questions around the 10 biggest mistakes that you want to avoid in the development of your commercial project, based on our extensive experience in the building industry.

On all commercial projects, the main goal is to generate a good financial return, and as building is expensive, and a high risk enterprise, it makes sense to avoid the common mistakes that can impact the bottom line, or worse still, bankrupt a project.

As you know, everything is underpinned by cost on a commercial project.

1. do you have experience developing commercial projects?

The issues you encounter when developing a commercial building differ from those involved in building a home for yourself.

It is less about your personal preferences, and more about making smart decisions that affect your organizations users, customers and the general public.

Key issues include functionality, economy, life safety, security, efficiency, flexibility, and the environment, and to reconcile all these with the various requirements of all the end users is a complex problem.

You could eliminate some of the variables in an effort to make the design process a lot easier, however, this will adversely affect end users, and in a commercial situation this will affect productivity, and the bottom line.

This approach is often taken by inexperienced developers in an effort to save up-front costs, at the expense of increased construction costs and operating costs, further down the track. This is false economy and exposes a developer to high risk.

Why take on board this risk, when you can delegate this responsibility to experienced consultants?

Commercial development is complex, and this requires investment in specialist building consultants, starting with an architect, to bring in valuable knowledge and skill, to the project.

2 have you considered all the options for use on your property?

While you may already have a plan in mind, you may be underutilising your property's development potential.

In many cases it may not be the right project for the site, or it may be overly ambitious.

Ask any architect, they will have a pile of unrealized design ideas in their heads, to best fit with commercial projects, however, most will agree the odds at stumbling on the perfect match are akin to winning the lottery.

To persist with this approach is a bit like trying to jamb a square peg in a round hole, and yet this is a common way that many developments come into existence, and why these developments do not function to potential, due to the inevitable compromises that this process generates.

Not only is the end result compromised, but also this often goes hand in hand with a blowout in design costs through the process. When multiple design concepts are produced, this is a costly exercise, and highlights a lack of clear [commercial] direction at the beginning.

And yet, we see this happen on projects time and time again, where multiple design concepts become the options, and the final choice comes down to aesthetics and personal preference [which are not the fundamental drivers of a commercial project].

This is not to say that you can't start out with a vision, or a handful of visions from the various people involved in the project, but:

It is important to start at the beginning and model the costs of various options, to arrive at the ideal scenario, before any design work is commenced. That way the cost and area variables are set early, and become part of the design brief.

Having the commercial drivers baked-in to the design ensures that your commercial project will be a success.

3 how clear are you on exactly what you need to do to successfully complete this project?

This is related to question 1, but a little more specific, in that it refers to the role of the developer in the project team.

Generally the developer is the person that makes all the big decisions relating to the overall direction of the project, such as: delegation of the various roles, finance, marketing and leasing, procurement contracts, coordination of tenant requirements, payments to consultants and contractors, on-site instructions and clarifications, change orders, health and safety, programme review, budget review, compliance, quality management.

Many of these responsibilities are overlooked, based on the assumption that someone like the contractor, the consenting authorities, or building component suppliers, might take care of some of the technical issues. This may be the case with a very basic residential project however, by leaving it up to chance on a commercial project there is a high risk of re-work, delay, and additional cost.

Starting with delegation of the various roles, this requires a clear understanding of what each team member is best at [to maximise the talent pool] and how the various members of the team are expected to coordinate with each other.

On many projects this is based around a general understanding, rather than anything specific, and often this leads to gaps, or double up's in responsibility, which can either cause delays, and/or result in rework.

Architects are trained to take care of most of the developer roles on their behalf, and as they have a detailed understanding of the plans and specifications, they are the most knowledgeable when it comes to all the details of a particular development.

Knowledge on how construction and design interrelate is also critical, as there is often a tendency for developers to overstep the mark and try to project manage the construction process or get someone else to do this on their behalf. It is important to remember that this is the contractor's responsibility and this is why they are paid margins to take on this risk.

4 do you have a budget and is this figure realistic?

Many commercial projects get over the start line due to optimism, but are handicapped prior to reaching the finish line when funds begin to run out.

It is true that many projects would not have got off the ground, if the true cost had been understood at the beginning, however, if the project has a commercial imperative and this is not realized, then it would be fair to say the project was a failure [in a business sense].

We don't know any developers that intentionally set out to fail, or that enjoy the stress of having to raise more capital to see a project through to completion.

Setting budgets is a skill that requires professional input from a quantity surveyor, who can provide the checks and balances based on similar projects that they have worked on recently. This also requires the skill of an architect to assist the quantity surveyor with fixed scope items and general scope items for pricing.

A quantity surveyor, at certain project milestones, also undertakes verifying budget as the project becomes more defined.

Generally a budget blowout can be put down to unrealistic expectations set at the beginning, or failure to review budget during the design and documentation phases.

5 do you know how long it will take to complete the project and does this take any contingencies into consideration?

This is another area where optimism shines through, and while this might generate some positive sentiment around a commercial project, reality will bite when milestones, and deadlines, start to be missed.

If the development hinges on completion by a certain date, and this triggers rental, or building purchaser payments, a delay will cause a major cash flow issue for a developer.

Sure, it is possible to fast-track a project, or even accelerate construction, if things are getting behind, however there are physical limits to how fast you can construct, and it also means significant additional cost.

Keep in mind that a rushed project increases the risk of error and quality problems. Making a huge effort, to meet deadlines on an unrealistic timeline, only to have to come back and correct major defects, is false economy [the project is not practically complete if there are major defects].

In order to understand the timelines it is important to prepare a programme that overlays all tasks in order to identify the critical path. There is no point estimating design time and construction time and adding these together, if in between these phases, approvals, for instance, may hold up work commencing on site.

Under this scenario the design and construction may come in on time, but not necessarily on programme, in which case the developer ends up taking on board all the timing risk.

Do not underestimate the potential for delay in gaining approval to build, or from all those unforeseen problems, that always crop up on commercial developments.

6 what are the expectations in regard to quality or is the project to be designed to only meet minimum standards?

Setting and maintaining a quality benchmark on a building project is essential, as it provides certainty for the project team, and delivers a final product, that meets expectations.

To allow or promote flexibility in quality will mean that it will be impossible to determine whether the price paid for the project represents good value, for the developer, tenants and future purchasers.

Don't be fooled by the rhetoric that more expensive is the same as quality, and that by engaging an architect that they will naturally specify expensive features to raise the quality of the project.

If the project feasibility is worked on meeting the minimum standard then all effort should go into working to this level of quality, instead of setting up the contractor and the architect in a competition of cost versus quality throughout the building phase.

Prioritising expensive features at the expense of good construction and detailing may come back to bite you, if the building fails on durability, not long after completion.

Keep in mind that to work to minimum standard requires additional effort, to consider all the knock-on effects that a minimum standard may have on seemingly unrelated parts of a development. [running to minimum requirement on one part of the Building Code can affect compliance on other parts, which may not be obvious – the leaky building crisis is a classic example of unintended consequences of working to the minimum requirements].

7 have all the legal and compliance issues been addressed and are these costs included in the budget?

Compliance with the Resource Management Act and the Building Act should be at the top of the list and these will generally cover most of the issues affecting your building project and the associated compliance costs.

Development contributions and costs to upgrade [building alterations and change in use] are significant sums that should be included in the budget, also.

These are typically excluded from quantity surveyor estimates, along with consultant and council consent costs, due to these costs being variable. This means that they can be easily overlooked or underestimated.

If a development is already on a tight feasibility, this can be its undoing, therefore it is important to be on top of this and make conservative allowances, based on experience and skill. Do not fall into the trap of using costs from previous projects, that may have been subsidized by other operations, and do not represent the true market value.

An important point to note is that councils operate on time charge, for consent processing, therefore it is a good practice to have all bases covered with strategies to demonstrate compliance, to reduce the cost, [or to avoid the possibility that the consent may be rejected after a significant investment in the submission].

There is a lot of misconception about the discretionary powers, and responsibility of the Councils role in compliance, and many developers take make it hard for Councils to grant approval for their projects.

8 how will the project be run and what contract or set of contracts will be used to formalise agreements?

Formal [written] consultant agreements and construction agreements are a must. There are plenty of options out there to suit project requirements.

Sticking to industry standard consultant and construction contracts is best, simply for the reason that they are tried and tested, and credible contracting parties, and the legal fraternity, will understand the general requirements of these documents.

The fundamental requirement of a contract agreement is to allocate responsibilities between the contracting parties. It is not to favour, or give advantage to one party [which is a popular misconception].

In this regard it is important to remember that building case law is well established, and these standard contracts are designed to fit within this legal framework. This will be the ultimate test in any dispute that ends up arbitration, or in the courts, regardless of what might be written in any formal contract.

Construction contracts come in under three basic types [lump sum, cost reimbursement, and integrated project delivery] and there are standard contracts available for use, so there is no need to reinvent the wheel.

This does not stop some developers producing their own contracts, in order to try to shift risk off parties that would normally be responsible for that risk. This means a reallocation of costs for the additional risk that this party is agreeing to undertake [higher contractor margins is a typical example where the contractor agrees to take on more of the development risk].

Bespoke contracts generally come in the form of re-written versions of standard contract clauses, or modifications to standard contract clauses through special conditions. As these change the legal intent of the base contract, it is important that they are written and reviewed by professionals that are experienced in building law.

Modified contracts can be costly to produce as lawyers need to be engaged to draft the new clauses, and independent legal advice will also need to be sought by contracting parties to provide legal interpretation of any new requirements, before agreement.

All this additional legal cost will be borne, either directly or indirectly by the developer, and if there is still some uncertainty or unallocated risk in the formal agreements this can mean significant additional cost if the contract ends up in dispute.

9 what is required in terms of documentation and how does this relate to the how the project will come together?

Plans and specifications are an important part of any building project, however the level of documentation and what this documentation might be for, is not widely understood.

Plans and specifications for construction have an entirely different agenda to documentation required to demonstrate compliance for consent, and the popular approach these days is to produce hybrid sets of documents that try to cover all bases.

These sets of documents can be huge, and difficult to navigate, as a result, and the risk of error in interpretation is high.

If the project is to be fast-tracked then this is not necessarily a problem, as long as the developer is aware that the extra effort in detail clarification, site instruction and re-work will lead to additional project cost, and that this is factored into the budget.

The difference between documentation for required for construction and documentation for design/build also needs to be understood, to ensure that effort is not wasted in fully documenting for construction, when the design [or one part of the design] is to be revisited and will have to be documented for approval and construction again [effectively designing and documenting twice].

It is not uncommon for this to be left up to chance on commercial projects, in the hope that the additional time and cost might be absorbed by consultants and contractors, however, it is important to remember that astute contractors and consultants will generally claim for legitimate additional cost, and if not there is a good chance that the compromise will manifest itself in the overall building quality.

10 do you know how to process payment claims and are you able to determine if the amounts claimed are valid?

Payment processes on commercial developments are critical to ensure that construction progress proceeds in accordance with the contractor's cash flow. Major problems occur if this balance is not maintained.

On commercial projects the project costs are high, and monthly payment claims and invoices can be for significant amounts, so it is important to keep on top of progress to reduce the risk of overpayment, for the work that has been carried out. Generally a financier is involved on commercial developments and the terms and conditions of finance will be contingent on proper payment accounting.

The only way to be able to determine the fair payment due is judge by experience, and this is often the way that claims are also prepared by the contractor. There is an inherent incentive for contractors to claim on the high side, in order to reduce their cost risk.

There is also the incentive for the developer to underpay on claims, effectively using the contractor as a financier, and this has given rise to the Construction Contracts Act, to enforce fair payment regimes.

Strict process must be followed if there is a payment dispute, and a reduced payment is to be negotiated, otherwise the amount claimed by the contractor becomes due after a set period, regardless of the fairness of the payment

If you fail to respond appropriately, within the time allowed, you only have the option to dispute that claim, after payment, which is not a good bargaining position. Responding appropriately means having a good reason, which must be stated, to hold back costs that have been claimed.

There are accepted accounting techniques that the industry follows and these have been developed in response to the Construction Contracts Act, to ensure that claims and responses to claims are easy to follow and comply with the legal requirements.

in summary

By sharing our knowledge gained after thirty years working as, professionals, in the construction industry, we aim to assist developers to avoid some of the common mistakes that are made in commercial development.

There is not a lot that we haven't seen or experienced, working alongside other architects, contractors and developers, in this space.

Looking back, we can chalk all this up to a learning experience, although at the time many of the mistakes created difficult circumstances that were; stressful, extremely costly to overcome, and would have been better to avoid.

Ask yourself:

Do I want to learn the hard way too, or do I work with someone who knows all the pitfalls?

Commercial development is exciting but can get intimidating at times, however choosing the right team can make it a rewarding process.

If you want to find out more about starting your commercial development, give us a call, or send us an email, so we can guide you, obligation free, to the next step.

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