

Home improvement and construction fraud

# NAILING FRAUDULENT CONTRACTORS

In many countries, new home construction and remodeling is booming. But so is home improvement and construction fraud. Fraud examiners can help stanch the flow of money into the pockets of fraudulent contractors by learning the latest tricks that plague unsuspecting homeowners.

**MARK WAS THE OWNER OF IKO CONSTRUCTION AND DESIGN. HE TOLD HOMEOWNERS THAT HE WAS A LICENSED CONTRACTOR BUT HE WASN'T QUALIFIED BY THE STATE TO PERFORM WORK.** Actually, he no longer had a contractor's license because it was revoked three years before in another state. But Mark was less expensive than others and had more business than he could handle. He received hefty deposits, knocked down walls, and stripped rooms, and either walked away with hefty deposits or did substandard work. All his customers had one thing in common: they were victims of home improvement and construction fraud.<sup>1</sup>

Fraud examiners can learn from the mistakes of unfortunate homeowners who trusted but didn't verify. A typical home repair construction fraud begins when a self-styled, unlicensed contractor makes an unsolicited call on a homeowner and offers to do some repair work such as building a deck or repairing a roof. He may claim to have leftover materials from a prior construction job or that he's repairing other homes in the neighborhood and can

offer a special deal. He requests a monetary advance for the repair work and says he'll return soon to begin work. That could be the last the homeowner ever sees of him. Or he may do some of the job but use substandard materials and/or shoddy workmanship.<sup>2</sup>

So, these frauds involve:

- unlicensed contractors;
- non-payment to a subcontractor and/or material supplier;
- stolen advance payment; and/or
- materials and equipment switches.

## Unlicensed contractors

A licensed contractor is someone who's authorized by the city, county, or state to perform contracting services. That person must take a test, prove financial responsibility, have insurance, take continuing education courses, and register with the city or county where he performs work. The local authority may require additional qualifications such as credit references, proof of address, and a local occupational license. All of this helps ensure the contrac-

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tor's work will meet all building code requirements and will be performed professionally. A licensed contractor must stay current with all building code changes and have insurance to cover accidental damage to the job site as well as to workers on the job.

A homeowner might not check the credentials of a contractor who shows up at the door. But sometimes a homeowner knowingly hires an unlicensed contractor because he thinks he will save money. If the homeowner would check with licensed contractors, he would discover that their prices aren't much different than the unlicensed contractors; in fact, they may be less.

### **The larcenous former town manager**

Jerry Benson was a licensed contractor and a former town manager. He would write construction contracts with homeowners and then hire subcontractors to complete the work. He collected all the payments from the homeowners but would never pay the subcontractors. After a two-year investigation by the sheriff, Benson was charged with six counts of fraud and two counts of obtaining money under false pretenses.

The majority of construction projects require building permits but the only way to obtain a building permit is by registering in the city or county of construction with proof of a valid contractor's license and insurance. If a project is completed without a building permit, the city or county can require that the construction be torn down at the expense of the homeowner. The city or county may also fine the homeowner if it determines that he was aware that the contractor was working without a permit or if he was unaware if a permit was obtained for the project.

Unlicensed contractors can, through either ignorance or

design, fail to follow standard building codes, which could lead to structural failures causing fires, collapses, and other unsafe conditions. Some of the problems might not be noticed for years. A poorly fastened roof could lead to leaks and roof damage during a storm. Poor wiring could cause an electrical fire. Poorly connected or inferior water pipes might have to be removed from under a home's concrete slab.

### **Subcontractor and/or material supplier payments**

A contractor, licensed or unlicensed, hires a subcontractor to perform some work on a project, which he completes as required by the contract. The contractor then tells the homeowner that the subcontractor was paid and that the homeowner must pay the contractor. However, the contractor might never pay the subcontractor. The subcontractor then might place a lien on the property and the homeowner ultimately will pay twice for the same service.

The homeowner should require a final notarized release or waiver of liens from all subcontractors before any checks are issued, which will help confirm that all subcontractors have been paid in full through the date on the release. A smart sub-

contractor commonly will file a notice of lien, which notifies a homeowner that he's working on a job. Of course, all is fine if the subcontractor is paid according to the contract with the contractor. However, if he isn't paid for his work, the lien can be enforced against the homeowner.

A homeowner should find out the names of the subcontractors, if any, and also check with the state or province to discover the number of days after a job has been completed that a subcontractor has to file a notice of lien. (A subcontractor can file a notice of lien even after the homeowner has paid the contractor.)

These suppliers also can put a lien on the homeowner for the cost of materials. The materials supplier can send the same notice of lien to a homeowner as the subcontractor and have the same rights. Therefore, the homeowner needs to require the same release before payment is made.

### **Payment in advance**

A homeowner should never pay a contractor in advance for a job not yet completed or give a deposit on a small, quick job. Larger jobs probably will require installment payments but should only be for the portion of the work completed.

Because a large job normally requires several inspections from the city or county, it's good practice for the homeowner to attach the installment payments to the passing of specific inspections. This

is an easy way to verify that the work has been completed. Lending companies typically require their own inspections before releasing progress payments.

### **Materials and equipment switches**

A fraudulent contractor might place high-quality materials on site and move them after an inspection to another site. The contractor actually uses inferior materials in the construction, which can cause serious weaknesses.

The homeowner should be wary if new materials are moved to the site and then disappear in a few days without being installed. An unscrupulous contractor also may install superior equipment but remove it and replace it with inferior equipment after an inspection. The contractor might install used equipment, simply change the metal cover, and tell the homeowner that it's new. Some have taken this a step further by removing the used materials from the homeowner's resi-

### **A poor work ethic**

Rose Construction started work on several large projects and collected progress payments but never intended to complete the jobs. The contractors tore down walls, removed equipment, and/or installed items that weren't according to code. The homeowners lost the money they paid the contractors and also the money it cost to complete the projects, which doubled or even tripled the actual costs of these projects. More than \$961,000 worth of fraudulent activities was identified.

### The third house was a lie

Stella Blue Construction (SBC) had a clever way of defrauding subcontractors. SBC's owner constructed three houses in a row. He hired subcontractors on all three jobs. He told his subcontractors that the third house wasn't for a customer but for himself. Because he was the contractor and owner of the project, the subcontractors weren't required to file a notice to the owner. After the house construction was completed and time had expired to file the notice to owner, the subcontractors learned that the house wasn't for SBC's owner but for another customer. It was too late for the subcontractors to file a notice and they had no way to collect their money.

renege (and making more money) if he installs 1/2-inch flooring. Normally, a reliable contractor will write in the construction contract an allowance for flooring and fixtures, which allows the homeowner to pick the desired items; if the final cost is over budget, the homeowner has the choice to either change the items or pay the difference. The homeowner should verify that the installed items are the ones that were chosen. Fixtures and flooring of differing quality might look similar.

A homeowner should obtain estimates from at least three contractors, verify their licenses and insurance coverage, require references, and check with the local department of professional regulation to discover possible unresolved conflicts.

If one estimate is significantly lower than the others, the homeowner should be wary and not make a quick decision. A legitimate contractor understands that a homeowner needs time. An estimate should state all work to be performed, price of the project, materials to be used, and the length of time it will take. Specifics such as brand, color, and style also should be stated in the contract.

The contractor's name and license number should be displayed on his vehicles (a requirement in some states and provinces). The homeowner should check the local governmental Web site to see if the contractor's license is issued to this per-

son or business and is active and whether they have any pending charges. The homeowner should ensure that a contractor's name and license number on the estimate and contract are identical to those on the Web site. Any discrepancies, including misspellings, could indicate a fraudulent contractor.

Call a contractor's insurance companies to verify he's in good standing. The contractor might provide proof of insurance but it could have been terminated. Contractors must carry workers' compensation, general liability, and auto insurance.

If a contractor doesn't have workers' compensation insurance and an employee gets injured on the homeowner's property, that employee may successfully sue the homeowner for injuries plus additional compensation. If the contractor doesn't have general liability insurance and an accident causes a house to burn down, the homeowner will be responsible for the cost of all damages. Or if the contractor cuts down a tree on the homeowner's property and it accidentally falls on a car parked on the street, the homeowner is liable for all damages. If the contractor doesn't have auto insurance and one of his vehicles causes any damages on the homeowner's property, the homeowner will be liable. The homeowner can sue the contractor but it's unlikely that he'll be successful.

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The homeowner should call the contractor's references and ask if he could come by and see the work performed. After examining the reference's work, the homeowner should ask: Was his experience working with the contractor favorable or unfavorable? Did the contractor complete the project on budget and on time? What kinds of problems, if any, did the reference experience during the project? Would the reference hire this contractor again?

The ultimate signed contract must be between the homeowner and the specific name of the contractor hired. An unlicensed contractor could provide a homeowner with information about another contractor (who's legitimately licensed), place his name on the contract, and state that he works with this other contractor under his license. All contracts and cash disbursement checks should be written in the name of the person or business that the homeowner verified.

In addition, the homeowner should also see a building permit issued by the city or county, which shows that a city or county inspector will check the contractor's work. Some small jobs don't require a building permit so the homeowner should check with the local city or county to review the regulations. Once the construction contract is awarded and work begins, the homeowner should be actively involved. If the homeowner monitors each step of construction and asks questions, the contractor will be on notice that he's being watched and will be less likely to try anything that violates the contract agreement. If possible, a friend of the homeowner who has some construction knowledge should visit the site periodically.

For larger construction projects, the homeowner can demand a bond for the project, which is insurance that the project will be completed. There's a difference between a bonded contractor and a project bond. A bonded contractor will hold a certain amount of insurance bond to cover all projects. For instance, a contractor with a \$10,000 bond is found guilty of fraud in the amount of \$200,000. In this case, the homeowner will only be able to collect the \$10,000. If two different persons own the property, each one will receive only \$5,000. A project bond, however, is in the amount of the entire project. If the contractor doesn't complete the project, the bonding company will step in and com-

plete it at the same cost to the homeowner as in the original contract.

A homeowner who suspects he has been a victim of construction fraud should report it immediately to the local authorities (such as the police department) and the department of professional regulations in his city, county, and/or state or province of residence. While this may or may not help in collecting damages from the fraudulent contractor, it could help another homeowner from experiencing a frustrating and demoralizing fraud. Many states and provinces have recovery funds established as places of last resort but a homeowner must first seek all other available avenues to recover damages.

A homeowner can best protect himself from an unscrupulous contractor by being a savvy and informed consumer. The clichés "let the buyer beware" and "you get what

you pay for" apply doubly for such large and often irreversible purchases. Quality is remembered long after cost is forgotten but a construction fraud is etched in the memory forever.

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\*The names and some case details have been changed.

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