



AMERICAN DEVELOPMENT CORP

EXQUISITE HOME CONSTRUCTION AND PREMIUM CARPENTRY

A Construction Contract Primer

Often in the bidding and decision process of a project, the homeowner will bring up the issue of what type of contract to use. It has been our experience that most clients are uninformed as to what they want, or what will serve them and their project the best.

To help with that, we have made this primer to help answer some typical questions.

Stipulated Sum – this type of contract is very simple. The bidding contractor submits a legal contractual price for the work based on the plans and specifications submitted. This is the type used in competitive bid scenarios.

- This benefits the Owner because if the contractor made a mistake in estimating then he still has to do the work for the same amount.
- This benefits the Contractor because if he can build the project for less than he estimated then his profit margin is raised.
- This type of contract is best used when the plans are complete.
- This type of contract can sometimes cause adversarial relationships between Owner and Contractor.
 - The Owner can sometimes distrust the Contractor if he thinks that the Contractor is not using the proper material and is cheating on the specifications to save money. This is difficult on a residential project because of the small size and common Owner influence on finishes and the like. This mistrust usually occurs on commercial projects.
 - An adversarial relationship can also develop if the scope of work changes. Very often the Contractor will bill extra for anything that is not originally on the plans, even if it would be necessary for construction. The argument here being that in a competitive bid the Contractor priced only the things on the plans so as not to falsely inflate their price.

Cost Plus or Construction Management – this type of contract is often used in large sized and developing projects. Basically, the Owner pays for the direct costs of the project plus a fee to the Contractor.

- There are two types of contracts:
 - Cost Plus a Percentage – this type is when the cost of construction is billed plus a percentage of the costs. Typically the amount of percentage varies with the size of the project. A small project could be 20%, and a large project (*over ten million*) could be as little as 10%. Most residential projects are around 15%.
 - Cost Plus a Fixed Fee – this is when the fee for a project is a set number. This number is usually billed evenly over the length of the project and is obtained by negotiating between the Owner and Contractor. The fee can be increased if there is a great deal of extra work (*called a cardinal change*) on the project.
- There is also a term associated with Cost Plus contracts called a Guaranteed Maximum Price (GMP). This is a contractual ceiling that limits how high the combined price of cost and fee may reach. Any costs over the GMP become the responsibility of the Contractor. This type of contract is very similar to a Stipulated Sum. Like a Stipulated Sum, any additional work requested by the Owner will increase the GMP.
- Cost Plus type contracts are used when the drawings for a project are not 100% complete at the start of construction. This allows the design team to continue working while construction on things like the foundation and framing starts. A project that uses an Owner's designer or decorator during the latter stages would be best served by a Cost Plus contract because of the changes that are common with that scenario.

Changes – very simply, anything that is not on the plans and specifications when bid by the Contractor is extra work. When extra work arises, a change to the contract is necessary. The best way to avoid Changes is to either have complete plans at the time of bid, or not add any new work to the project during its construction. Quite honestly, this never happens. On a renovation project, conditions that are hidden by old walls or bad pipes and the like are honest changes. Also, any changes made by the Owner or design team throughout the duration of the project may constitute a change. Contractors, contrary to popular belief, do not look forward to change orders. They usually involve a great deal of paperwork; delays schedules and can often cause strife between Owner and Contractor.

In summary, a Stipulated Sum contract is simple but is subject to even the smallest change orders while a Cost Plus contract is most like billing time and material. Also, anything not on the plans is an extra.

We are always open to use any type of contract depending on the circumstance, and will always be happy to provide you with examples for your legal team and would help explain the types further in person.

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