

Allowances: What to do When Your Client Exceeds Their Amount

By Nancy Chillag

When a contractor is asked to give a fixed price for construction work, many times all the decisions by the owner have not been made. To accommodate for this lack of information, a contractor will give the owner an "allowance" for certain items. Basically the contractor is using his experience and knowledge to estimate what he believes the owner will spend on a particular item. Typical allowance items include appliances, floor coverings, countertops, cabinets and light fixtures. All too often the contract provides for a dollar amount for each of these items

and calls them allowances, and that's it . . . no explanation as to what an allowance is or what is included. The contractor assumes the owner knows what "allowance" means. When billing adjustments need to be made, there are undoubtedly problems.

The biggest problem with allowances comes when the contractor includes his labor charges in the allowance amount without telling the owner. In other words, the contractor provides the owner with a tile allowance of \$10,000. The owner then chooses tile that costs a total of \$9,000. The owner thinks they are going to get a credit of \$1,000, but instead the contractor tells them they owe an additional \$3,000 because the labor to install the tile will cost \$4,000. The owner assumed the entire allowance item was for materials, but the contractor included the installation cost in the amount. Misunderstandings can be eliminated if you only include the material cost in the allowance amount for items that your employees will install and put the labor cost into your general bid. Items like carpeting where the installation is built into the square foot cost would include both material and labor.

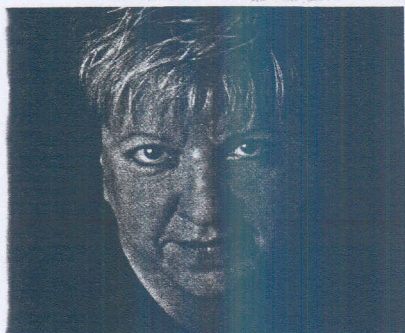
Each allowance line item should indicate whether it includes the labor for installation or whether it is only for material.

That having been said, what happens when the owner chooses something that is totally different to install than you anticipated and your labor costs, which are not included in the allowance amount, will increase dramatically? If your contract specifies what the allowance is for, then the problem does not arise. For example, if the owner tells you at the bidding stage that they want laminate countertops, then the allowance item should state that it is for laminate countertops only. Your contract should state that if the owner chooses granite or some other substantially different material, the allowance amount will be credited and a change order will be submitted for the new material cost, the additional labor to install it and profit and overhead on the difference. It is critical that you define what is allowed in the allowance!

Another problem connected with allowances are profit and overhead. You provide the owner with a tile allowance of \$10,000. They choose tile that costs \$15,000. They are expecting an invoice for an additional \$5,000,

but they receive an invoice of \$6,500. Why? Because you added 30 percent profit and overhead to the increased amount. Can you do this? Yes, IF your contract says you can. It should state that if the allowance amount is exceeded, profit and overhead at a certain rate will be added to the overage. (Some contractors allow a cushion so that profit and overhead are only added if the allowance is exceeded by 10 percent). If you are going to charge profit and overhead on an amount in excess of the allowance, be prepared to rebate profit and overhead if the cost of the items chosen by the owner is less than the allowance amount.

It is also critical that you give a realistic estimate for allowances. Too often I have seen contractors low-ball allowances to make the bottom line look better. When the owners start shopping for allowance items, they find that they cannot possibly buy anything within the allowance amount. Consequently, they are invoiced for the excess over the allowance plus profit and overhead. While you may be awarded the project, the owners won't be very happy with the final price and will feel misled. | QR



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