

Bid and T&M Contracts: Pitfalls to Avoid

There are basically two types of construction contracts: "lump sum bid" and "time and material." Each one has its pros and cons. If you adhere to the following suggestions, you will have more "pros" regardless of which type of contract you use.

You have the right to collect your price only if your contract makes a full written disclosure

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Lump sum bid contracts

Under a lump sum bid contract, the contractor agrees to complete the project, as described in the contract documents, for a fixed price, which includes labor, materials, subcontractors, profit and overhead.

One problem that arises with a lump sum bid contract is that the contractor usually fails to specify which items *are not* included in the bid price, such as inspector and permit fees, appliances, etc. Make sure that you specify, in writing, all items that are "excluded" from the bid price. Or, if it's easier, state clearly in your contract "*any items not specifically included in the bid documents are excluded.*"

Lump sum bids usually include provisions for allowances, i.e. \$3,000 for appliances. You must indicate whether the allowance is for materials only or if it also includes installation, delivery, taxes, shipping, contractor discount, etc. Ambiguities are usually decided in favor of the homeowner.

On many projects the owners ask for a breakdown of the lump sum bid, especially if the bid is more than they wanted to spend. The owners review the various items to determine if there's something they can eliminate to lower the price. At the end of the

project the owner (usually a disgruntled one) asks for receipts for all materials, as well as time cards for employees. (Some contractors actually give these to the owner!) The owner then compares the amounts to the breakdown bid sheet and demands that the contractor credit him for excessive line items. Owners are not entitled to breakdowns on bid contracts and they should be informed of this at the beginning. Put a provision in your contract which states: "*This is a fixed price contract. The owner is not entitled to a cost breakdown, nor is the owner entitled to receipts for costs, unless related to allowance items.*"

If you absolutely *must* give a breakdown (which usually is required if a construction lender is involved), explain to the owner, in writing, that "*a breakdown of the bid does not entitle the owner to receipt review or to any adjustment in the price of the project upon completion.*"

Fixed price per unit

Similar to the lump sum bid is the fixed price per unit contract, which takes into consideration unknown quantities. For example, if an area needs to be excavated, the contractor can quote a fixed price per cubic yard of dirt. The unknown is the amount

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of dirt that will need to be removed. The quoted price includes cost, profit and overhead. Consider whether your price needs to be adjusted at certain threshold limits, either up or down, and whether you should require a minimum number of units.

Time and material contract

Under a time and material (T&M) contract, the contractor gets paid for all the time spent and costs incurred on the project, plus profit and overhead. Usually contractors like T&M contracts because there is virtually no down side, as there is with a poorly bid contract in which expensive items are missed or the time commitment is underestimated. T&M contracts are also useful for unusual or novel projects that don't permit a high degree of specificity in drawings and specifications, or for "fast track" projects in which construction commences before drawings and specifications are finished.

With a T&M contract it's imperative to define the terms "time," "material" and "profit and overhead."

For example:

Time: 1. Specify the rate at which different laborers will be billed. If you charge different rates depending on the employee (i.e. laborer, carpenter, roofer) or the task being performed on the project, specify the various rates.

2. If you're using subcontractors, specify whether they will also be on a time and material basis. If so, at what rate? If they're on a bid basis, will you pass the amount through to the customer with or without a markup?

3. Indicate if you are charging for administrative time, delivery time and other personnel.

4. The owner is entitled to see the time slips from your employees to verify the charges, so make sure your record keeping is accurate.

Material: 1. Many contractors receive documents from material suppliers. Are you going to pass the discount through to the owner or will you charge the owner retail?

2. Will you mark up materials or delivery charges?

3. Specify in the contract that "cost" includes phone calls, postage, mileage for pick up and deliveries, use of tools and equipment (on a per-hour basis). A very bold contractor may try to charge an additional overhead and profit on this amount as well.

Profit and overhead: These can be a fixed amount or a percentage of the project costs. If a percentage of the project costs, specify what costs are included in the calculation. Some owners may get upset if you charge for phone calls, postage and mileage and then charge a percentage for profit and overhead on that amount.

You have the right to charge the price you want for a project, but you only have the right to ultimately collect that price if your contract makes a full written disclosure to the owner. ♦

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accounting can have the greatest positive effect on your company, more so than any other skill.

Personally, I believe percentage of completion is the best method of accounting for any remodeling company that sells projects that last more than one month.

1 *The most challenging aspect of the remodeling business concerns fully realizing that all you have to sell is your time and expertise.*

As a result, you must sell your time and expertise for a price that is based solely on the quantity of time that any given project will take.

There is a fact about remodeling that is undeniable. Once this fact is identified and accepted, business strategies can be developed to overcome the obvious adversity. The fact is that a remodeling contractor will expend more time with a client per dollar spent by that client than any other form of construction.

What will you and your company be doing in the future? Change is a reality of life. The question is: Are you prepared for change? Can you affect change in your own favor? The time to think about change within a company is the day you start the business, not some distant year in the future

If you agree that this is true, how can it make sense to have a set mark-up procedure on every job, as advocated by many so-called experts in the remodeling field?

Consider this: Is Project A, with a \$10,000 contract, \$3,500 gross profit and 45-day production schedule, as profitable as Project B, with the same \$10,000 contract, \$3,000 gross profit and 10-day production schedule? Of course not! Project A contributed only \$77.78 per day, while Project B, at \$300 per day, contributed nearly four times more.

However, most remodelers typically use the same percentage of mark-up on every job. It's definitely something to think about! ♦