Contracts

Building Business Briefs

Like projects and clients, no two contracts are alike. Given all the variables, it’s important to match your contract to your client, job, and the way you do business. Here’s a rundown on the most common types of residential construction contracts.

Fixed price. Under this type of agreement, the contractor charges a fixed amount for the entire job. With any contract, you’ve got to define the project’s scope and estimate carefully. That’s especially important for fixed-price contracts, which depend on absolutely accurate estimates. You’ve got to nail all job costs and factor in contingencies for jobsite theft, lost hardware, and other things you never expect to go wrong.

“I’ve never seen a job that didn’t have contingencies, says custom builder John Piazza, who runs Piazza Construction in Mount Vernon, WA. “We generally run 2 to 5 percent contingency per job.”

And don’t forget to pay yourself. “Draws shouldn’t only include job costs,” says Wayne Foley, a custom builder and president of W.M. Foley Construction in Great Falls, VA. “They should include part of the builder’s compensation, too, because he’s earning it as the project progresses.”

“I base [my fee] on time,” says Leon Sekunda, president of Seabreeze Construction in Gulf Breeze, FL, who uses fixed-price contracts for 80 percent of his projects. “You can manage most clients in about five hours a week.”

A fixed-fee contract places responsibility for unforeseen circumstances on the builder; the client pays for having that risk taken off his or her shoulders. If the client changes the scope or specs, the builder uses a change order to bill the client for each change. Fixed-fee contracts are good for projects in which the clients aren’t likely to make many changes. They’re also good for penny-pinching folks you don’t want poring over your books (we’ll get to them in a minute).

Sekunda, who does a mix of new construction and remodeling, won’t use a fixed-fee contract for a remodeling job. However, remodeler Robert Criner, president of Criner Construction Co. in Yorktown, VA, swears by them. “I don’t like to give the client any surprises,” he says. “My contracts give us an out for unexpected things encountered on a job. However, I rarely take that out because it’s worth large amounts of money to maintain the relationship with the client.”

Cost plus. Under this agreement, the client pays the job cost plus a certain percentage to cover the contractor's fee and markup.

Cost-plus contracts are useful for projects in which you can't fully nail down the scope before the job starts or the clients are likely to make a lot of changes midstream. They effectively shift responsibility to the client.

That said, you could still be in for a mess of trouble if you use a cost-plus contract. Most clients who demand them are used to getting what they want at any price. They're willing to shell out for umpteen change orders and increased job costs. But look out—all those changes could cost you big-time in scheduling headaches, increased management, and endless client negotiations.

Under a cost-plus agreement clients get to review every cost associated with their job. Many builders don't want that hassle. "As soon as you go cost-plus, you have someone in your books and in your business," Foley says.

Clients who are unfamiliar with the construction business don't understand why builders have to charge certain margins to remain profitable. And many don't understand the costs associated with each change.

"When a client makes a slight product change, they generally don't realize the work involves more than just swapping out a window, for instance," says Sekunda. "I have to meet with a manufacturer rep, meet with the framers to make sure the new window will fit, maybe redraw the plans, etc."

Construction management. Also known as a consulting contract, a builder uses this kind of agreement when the client acts as his own general contractor. Construction management contracts can be extremely risky for builders and clients alike; even with a tightly defined scope, clients generally don't know what they're getting into when they opt to G.C. their own job or a portion of it. "Most times, they're not doing it for the glory of building their own house," Sekunda says. "They're doing it to save money."

Tom Stephani, president of William Thomas Homes in Crystal Lake, IL, recommends doing construction management contracts on a fixed-price basis. That way, the fee for your services becomes a line item in the project's cost breakdown.

Design. This type of contract ensures that you get paid for design and spec work even if the client decides to use another contractor. After an initial consultation, Criner has clients sign agreements to pay his company a fee (usually 2 percent of the job cost) for working up designs and specs for each job. If the client signs a contract with Criner, the design fee is waived. "A design contract protects me from giving away work for free," says the remodeler. "It also prequalifies people willing to hire me for their job."

For examples of fixed-price and cost-plus contracts as well as 90 other forms, check out *Home Builder Contracts and Management Forms on Disk*, published by NAHB's Business Management Department. The book includes a CD containing contracts and business forms in Microsoft Word, making it easy for builders to download and customize them for their businesses. Available through BuilderBooks.com (www.builderbooks.com or call 800-223-2665). $49.95 for NAHB members; $62.50 for non-members.