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Types of Construction Contracts

Whether undertaking a simple tenant improvement, developing commercial land, or building your dream home, you will need to enter into a contract to get the project done. Knowing the types and choices of contracts before signing on the bottom line is the first best step towards protecting yourself. In this column we compare common forms of construction contracts. These are by no means the complete universe of contracts, and most of the below-described forms can be blended to create hybrids. So, regardless of what form you use, remember that not all contracts fit the same scenario. Whenever presented with any contract, it is best to have your lawyer review it BEFORE you sign.

LUMP-SUM aka Fixed Price aka Complete Plans and Specifications aka Stipulated Sum

This type of contract promises to build X project for Y dollars.

The Pros: For people on a budget, it is very predictable. Also, for consumers who are able to fully articulate the project specifications they want, this can be very equitable.

The Cons: This type of contract requires complete plans and specifications setting forth directions in enough detail to enable a contractor to carry them out. For consumers who are not able to fully articulate the desired project specifications, they should expect that the contractor will attempt to shake out as much profit as possible from their contract, meaning that if the consumer did not provide a specification for a certain aspect of construction, the contractor will most likely use the lowest suitable grade materials and workmanship to save costs.

Cost-Plus

Under this arrangement the contractor is reimbursed for the actual cost of labor and materials, plus charges a fee (typically an agreed-upon lump or percentage of the total costs) for overhead and profit. This arrangement seldom begins with a blank slate regarding

specifications and costs. Rather, the consumer and contractor will create a list of specifications and an estimated budget to match to those specifications. Although the contractor under this arrangement will have to keep copious records of its costs, most residential consumers in a cost-plus arrangement suffer from kid-in-a-candy-storeitis and overspend. One way to prevent breaking the budget is to set a guaranteed maximum price. However, even a maximum price will not alleviate problems.

The Pros: Where the consumer wants to have open reign to select materials and workmanship as the project proceeds, this arrangement can be extremely flexible and accommodating. Also, cost-plus typically requires the contractor to obtain competitive bids from subcontractors, translating (in theory) to lower construction cost.

The Cons: Because cost-plus contracts are usually used where the scope of work is uncertain, the costs can quickly get way out of control. Even under a maximum price, poor control in material selection and on-the-fly design modification can quickly consume a budget, leaving line items on the project starved for capital. This, in turn, requires either a diminution in quality in certain aspects of the project and/or total elimination of aspects of the project and/or the need for an additive change order to increase project funding. As one might imagine, the cost-plus contract tends to cause construction lenders fits. However, it is used frequently to great success.

Design and Build aka Design Build aka Turnkey

In a design-and-build contract, the consumer contracts with a single party that both designs and builds the project. Commonly this other party is either a joint venture between an architect and builder, or a lone builder that also wears the hat of design professional.

The Pros: possible substantial cash and time savings by using one party; predictable cost; and better execution of the project due to clearer understanding of the creative vision by the builder. Also, in the event of problems, the consumer may look to a single source for the responsibility for the finished product. In other words, whenever a problem arises in construction, the consumer will not be

stonewalled by a separate builder and design professional each blaming the other for whatever error occurs.

The Cons: the documents for the solicitation of bids under design-and-build require a lot of up front details furnished by the consumer including a program setting forth the project scope and the size, type, and desired design character of the building and site; project specifications covering type and quality of materials and workmanship.

Time and Materials

This is a rare contract and is typically only seen in maintenance arrangements and certain public works contracts. Under time and materials, the contractor charges an hourly or job rate plus the pass-through expense of its consumables.

The Pros: You only pay when your contractor works.

The Cons: Your contractor will tend to work

very slowly.

Other types of contracts include Construction Management; Project Management; Single versus Multiple Prime Contractor; Unit Price; Fast Track; Owner-Architect; Owner-Contractor; etc. Also, of these, most terms are negotiable from scope to price to timelines.

Locally, the predominant "canned" contract forms are from either the American Institute of Architects (AIA) or the Associated General Contractors (AGC). Both organizations copyright their forms (so don't steal them) and both have a fairly well-written and comprehensive portfolio from which to choose. Even so, there is no such thing as one-size-fits-all. So, before spending six to seven figures on your next project, spend a few hours with your lawyer to see whether your contract is what you think it is.®

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