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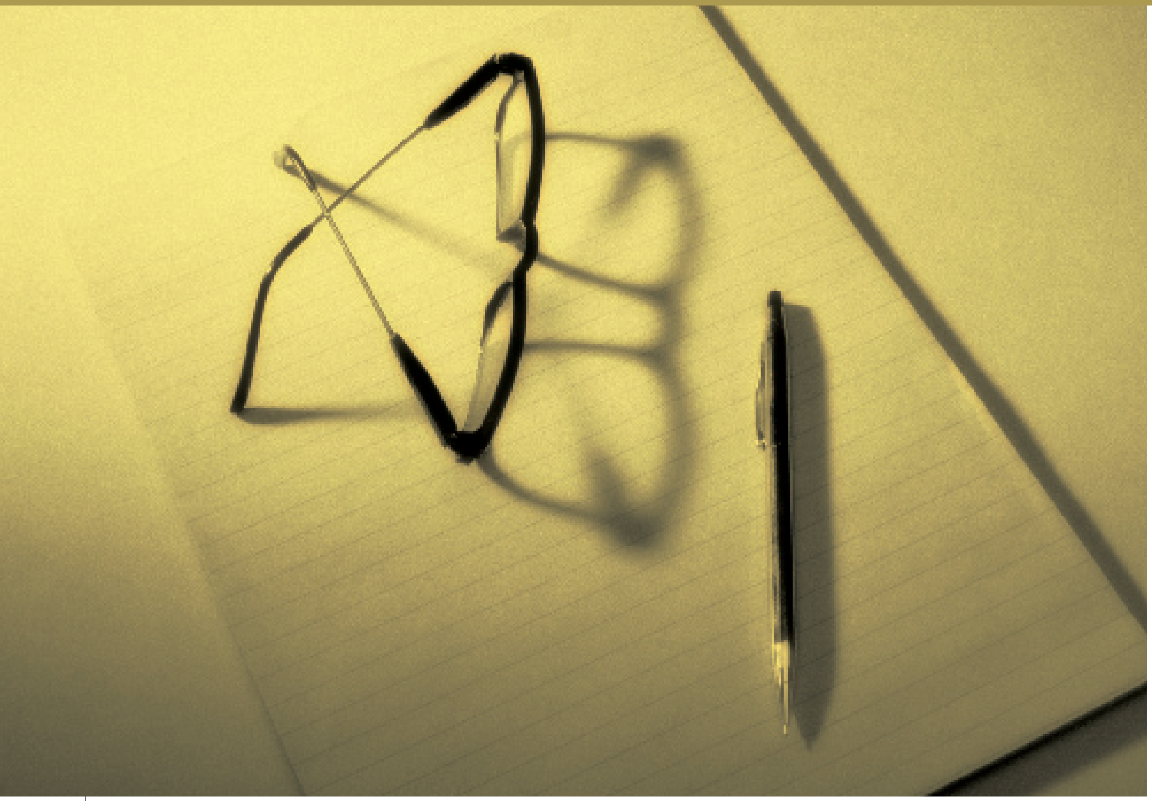

Smart contractors have PECs to protect them from rising fuel and materials costs so bids still pencil out in profit.

YOU MAY NEED TO WALK AWAY FROM SIGNING A CONTRACT WITHOUT A PEC BUT IT WILL MOST LIKELY BE THE BEST THING FOR YOU.

WRITE A BETTER CONTRACT

With proper contractor language, remodelers can save thousands

» PETER MERRILL

Most remodelers rely on their expertise and experience to earn them a good living as a remodeler. There is no question that an experienced and caring remodeler with in-depth construction knowledge can build up a reputation as a respected and sought-after remodeler. However, even the best remodelers can lose thousands of dollars if they do not have the many contract provisions in their construction contract that are designed to protect them from issues beyond their control.

These contract provisions won't cost the remodeler anything to place in his/her contract but they will almost virtually guarantee the remodeler that no unexpected issues that develop will cost him/her any of their expected profits on the remodeling job. Proper contract language not only protects your profits, but it also keeps the remodeler from having uncomfortable disputes with their clients and keeps the project moving and on schedule without having to wait for a court or other means to settle disputes. Let's examine some of those contract provisions.

PRICE INCREASE PROTECTION

One of the most common contract clauses that can help you to retain your profits is a "Price Escalation Clause" (PEC). Some remodelers are lucky to have their contracts based on a "cost-plus" basis where any increases in prices do not cause the remodeler to lose any profits as they can always take their costs and add the agreed-upon profit markup to those costs. As a matter of fact, contractors who work on a cost-plus basis usually welcome price increases as they usually can make even more profits due to the higher cost of materials. As an example, if we have a cost-plus 20 percent contract, an item that costs you $1,000 will yield you a $200 profit. If between the time that a project is quoted until the project is started (or the item is purchased), the cost of the item goes up from $1,000 to $1,500, the profit at 20 percent will go up from $200 to $300 based on the new $1,500 cost.

Unfortunately, the vast majority of remodeling projects are quoted at a fixed price. Unless a remodeler has a great reputation or is referred by a former client, it is usually the lowest price bid that is accepted by the project owner. The lowest price quote very often has a small amount of difference between making a profit or taking a loss on the job. If you had a PEC in your contract, you will at least keep your profit and most likely can add additional profits to your job. It is difficult in a short article to completely give you the suggested contract language for a PEC but I will give you an example of the simplest language contained in a PEC as follows:

"If the price of any item or service being utilized on this construction project is increased by more than ____%, that percentage increase shall be added to the cost of the job." Some price escalation clauses also contain a profit increase such as, "... more than ____%, that percentage increase shall be added to the cost of the job," which will also include a 20 percent additional profit. I must caution you to never add any language to your construction contract without running it by your attorney to make certain that it works with your contract and will not cause any conflicts within your contract.

BANKRUPTCY AVOIDANCE

I recently heard of a roofing contractor who basically had to declare bankruptcy to avoid having to do a major roofing project. The contractor had, several months prior to a shopping center project commencement, quoted a rather large "fixed price" roofing job. His quote was accepted and he became the contractor of record for the roofing aspect of the shopping center. We all know what has happened to the price of a barrel of oil. This job was a tar-and-stone flat roof project. Between the time he signed the contract and the commencement of the project, a barrel of roofing tar went up 72 percent. He had about a 25 percent profit margin in the job including the labor. The

72 percent increase in cost of the tar caused him to have to complete the job at about a 40 percent loss on the total job. Due to the magnitude of the project, he did not have the assets or the ability to complete the project with that large of a loss. The shopping center owner would not adjust the price of the job and the roofing contractor was forced to declare bankruptcy to avoid having to honor the contract.

As you know, most construction items are rising in price not due to the cost of the product but due in large part to the cost of delivering the product to market due to the cost of gas and overall transportation. Even the cost of getting raw materials to the manufacturer is adding to the overall cost in addition to the cost of distribution after the product has been made.

You should also know that it is not always easy to have a PEC in a construction contract. Many banks will not give Home Improvement Loans or First of Second Mortgages to homeowners who are looking for financing for their remodeling project when their construction contract includes a PEC. A client may qualify for a certain fixed maximum loan from a bank or lending institution. If the project escalates in price, the bank will not lend them any additional monies and the homeowners may not have the additional finances to handle any increase in the cost of the job. As a result, some banks will limit the loan to a much lesser amount up-front due to a PEC in the contract. However, this should allow the bank to lend the homeowners additional funds if the project experiences increase in costs.

A PEC is just one of the many contract clauses that can help you to retain your profits. Why not protect yourself with proper contract language? Especially since it will not cost you anything for this increased protection. You may need to walk away from signing a contract without a PEC but it will most likely be the best thing for you.

EDITOR'S NOTE: Stay tuned to future law columns in BUILDERnews *for more on contract provisions, such as hidden issues and dispute resolution, both of which can help you retain profits and minimize disputes with clients.*

PETER G. MERRILL
is president and CEO of Construction Dispute Resolution Services LLC, an NAHB Executive Board member and past president of the New Mexico Home Builders Association. He received Builder of the Year and Remodeler of the Year awards.

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