

## Cost Plus Building Contract

Cost Plus contracts are typically used where the exact cost of the building project cannot be foreseen or determined with certainty. Here's our guide to help you decide if this is the right contract for your NSW construction project.

### What is a Cost Plus Contract?

A Cost Plus contract is a construction contract where the homeowner or business owner agrees to reimburse the expenses of the contractor. Aside from the building expenses, there is also an additional amount for the contractor's profit margin, hence the term "plus" in its name. Although it appears like the amount can be flexible, some cost plus contracts include a limit on the amount that the contractor can only spend.

### What is the Purpose of a Cost Plus Contract?

One purpose that can be perceived in cost plus basis contracts is giving the construction company and the client the opportunity to talk over the estimated amount to spend during the building process. Of course, it still depends on the type of cost plus contract they agree to use. As opposed to fixed price contracts where both parties should just stick with the amount they had agreed upon in the beginning of the building project.

### What is the Difference Between Cost Plus and Fixed Price Contracts?

The [main difference between the Fixed Price and Cost Plus contract](#) is the method of calculating the contract price and payments for progress claims.

There are also practical differences between the two contract types.

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- For Cost Plus contract arrangements, there is significantly more administration. This is because the contractor must have supporting documents and information to value his work.
- Whereas, a Fixed Price contract simply requires the contractor to evidence that the works have been completed as per the contract. In residential contracts, that is to establish that a stage of works has been achieved.

COMPARATIVE TABLE	FIXED PRICE	COST PLUS
Pricing	Fixed price/lump sum	Calculated based on: Cost to carry out works + Builder's margin
Advantage to Homeowner	Budget	Administration
Effects	<ul style="list-style-type: none"> <li>• Scope of work is more rigid</li> <li>• Scope of work is known at the time of contract signing</li> <li>• Limited need for homeowner to provide instructions during construction</li> <li>• Builder is required to assess the works performed on site</li> </ul>	<ul style="list-style-type: none"> <li>• Scope of work is not complete</li> <li>• Advantage where there is renovation, or the work is being performed</li> <li>• More administration by homeowner</li> <li>• Ongoing homeowner responsibility</li> <li>• Homeowner may provide Builder timely instructions</li> <li>• Homeowner can ensure the Builder is only claiming for genuine Works performed</li> <li>• Builder is not required to assess the works performed on site</li> </ul>
Similar Clauses	Provisional Sum Prime Cost Items	
Guiding Law	Home Building Act of New South Wales 1989	

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## Contents of a Cost Plus Contract

- Project Details
- Contact Information
- Customer Details
- Project Site
- Terms and Conditions
- Scope of Works
- Special Conditions
- Insurance
- Estimated Contract Sum
- Employee Rates
- Plan or Equipment Costs
- Further Project Site Details
- Other Insurance

## Advantages and Disadvantages of a Cost Plus Contract

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## Cost Plus Contract

PROS	PROS
<ul style="list-style-type: none"> <li>✓ It reduces the builder's risks</li> <li>✓ The builder gets his margin</li> <li>✓ It encourages the builder to do quality work</li> <li>✓ It covers all related building expenses</li> </ul>	<ul style="list-style-type: none"> <li>✗ Uncertainty on the final amount for the building project</li> <li>✗ Due to uncertainty on the final cost, there can also be uncertainty on the time expected to finish the building project</li> <li>✗ Disputes may arise over building expenses The building project may require additional materials and could mean additional time and expenses</li> </ul>

## What are the types of Cost Plus contracts?

- 1. Cost Plus Incentive Fee** - This type of cost plus contract minimises the builder's risks and encourages the builder to do a job well done.
- 2. Cost Plus Award Fee** - The award fee for this type of contract is determined in the beginning or before the execution of the contract. This can either be a penalty fee or a gratitude fee and is usually based on the contractor's performance.
- 3. Cost Plus Fixed Fee** - The amount for this type of contract is agreed upon by both parties and is determined while forming the contract. It also covers direct and indirect costs. The downside of this cost plus contract is that the builder may not focus on quality work and would just finish his tasks as soon as possible.

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## When Should Cost Plus Contracts be Used?

Cost Plus contracts should be used when the **works are not possible to value**.

Examples of when works cannot be valued or are difficult to value include:



### Renovation works

typically, when you renovate a house or building, it is difficult to quote for the works involved because much of the existing structure is hidden. Until there is demolition work, it is difficult to know with certainty what lies behind the walls and floors.



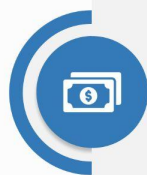
### Where parts of the work is hidden:

Examples of hidden work is where you are demolishing a building or excavating. There can be significant unknowns until you carry out works. Often owners intend to carry out renovation works regardless of what lies beneath the surface. In these circumstances, the owner may not require tests for asbestos or rocks. And the initial demolition and excavation works are performed on a Cost-Plus basis.



### Where the client wishes to update the scope of works during construction:

Often where the owners have deeper pockets or there is an architect and engineers involved, clients want to direct and make selections as the works progress throughout construction stages. A Cost Plus building contract helps provide the Builder with certainty with the risk of delay with obtaining instructions for the works and the flexible works required. On the flipside, this gives the owner the flexibility with making their decisions on the works.



### Where the value of the contract price exceeds \$1 Million:

Whilst there is no legal restriction on Cost Plus builds in NSW as to the value of the contract price, unlike Victoria, it is more common that owners are open to cost plus contracts when the contract price is likely to exceed \$1 Million and the duration of the works is likely to exceed 12 months. This allows the builder to be paid for the variables that arise with project and construction works that arise over time.

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However, it is also common that Builders and contractors are able to provide a fixed-price contract for the above works.

## What are the Essential Terms of the Cost Plus Contracts?

The essential terms of a cost plus contract are broken down into 2 categories.

- First, **statutory requirements**. That is, the terms and conditions mandated by the Government. In New South Wales, these terms are mandated by the Home Building Act 1989 (NSW).
- Second, are the **terms that contracting parties expect** from the agreement.

## What are the Warranties Under Cost Plus Contracts?

Similar to the essential terms of a cost plus contract, warranties are also broken down into the same 2 categories. First, those that are mandated by law, and second are those agreed to by the parties.

The warranties mandated by law arise from section 18B of the Home Building Act. The section is adopted here as follows.

### 18B Warranties as to residential building work

1. The following warranties by the holder of a contractor licence, or a person required to hold a contractor licence before entering into a contract, are implied in every contract to do residential building work—
  - (a) a warranty that the work will be done with due care and skill and in accordance with accordance with the plans and specifications set out in the contract,
  - (b) a warranty that all materials supplied by the holder or person will be good and suitable for the purpose for which they are used and that, unless otherwise stated in the contract in the contract, those materials will be new,

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(c) a warranty that the work will be done in accordance with, and will comply with, this or any other law,

(d) a warranty that the work will be done with due diligence and within the time stipulated in the contract, or if no time is stipulated, within a reasonable time,

(e) a warranty that, if the work consists of the construction of a dwelling, the making of alterations or additions to a dwelling or the repairing, renovation, decoration or protective treatment of a dwelling, the work will result, to the extent of the work conducted, in a dwelling that is reasonably fit for occupation as a dwelling,

(f) a warranty that the work and any materials used in doing the work will be reasonably fit for the specified purpose or result, if the person for whom the work is done expressly makes known to the holder of the contractor licence or person required to hold a contractor licence, or another person with express or apparent authority to enter into or vary contractual arrangements on behalf of the holder or person, the particular purpose for which the work is required or the result that the owner desires the work to achieve, so as to show that the owner relies on the holder's or person's skill and judgment.

These warranties are not limited to residential building works. These warranties also apply to specialist work. For example, the warranties may be implied to work done in connection with commercial or industrial work. For example, plumbing, drainage, mechanical services, gasfitting, and electrical wiring works are examples of specialist work.

The contractual warranties that you should expect to be in cost plus contracts includes warranties regarding the progress or diligence of the works and the cost of the works.

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## Warranties as to Residential Building Work

In every contract to do residential building work, there are implied warranties by builders and contractors that:

The works will be done with due care and skill

The work will be done with in accordance with the **plans and specifications**

All materials supplied will be **good and suitable** for the purpose

All materials supplied will be **new**  
*(unless stated otherwise in the contract)*

The work will be done in **compliance with the laws**

The work will be done with due diligence within the time **stipulated**, or within a **reasonable time**

Alterations/additions/repairs/renovations/decoration/protective treatment will result in a dwelling that is **reasonably fit for occupation as a dwelling**

The work and materials used will be reasonably **fit for the specified purpose or result**  
*(if the owner expressly makes the particular purpose/result known to the builder/contractor)*

And additionally, Cost Plus contracts have the following implied warranties:

progress or diligence of the works

the work and materials used will be **reasonably fit for the specified purpose or result**  
*(if the owner expressly makes the particular purpose/result known to the builder/contractor)*

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## How Do You Make Progress Payments Under a Cost Plus Contract?

For most home owners and clients, the contract price and amount to be paid under a cost-plus contract is very important. No one wants to over pay.

Owners should strictly follow the payment terms of contract.

Owners should require the Builder to provide supporting documentation to evidence the value of works performed.

Examples of supporting documentation for cost plus contracts includes:

- Tax invoices
- Timesheets
- Site diaries
- Photos of works performed
- Inspection Test Plans ITP's

There is a level of trust between contracting parties to a Cost Plus contract. The Cost Plus contract works best for both parties if both parties are genuine, honest and diligent.

### **Do I need to provide a Cost Plus Estimate?**

In New South Wales, it is mandatory to specify the contract price. This applies to Cost-Plus agreements where the Home Building Act applies.

Failing to specify the estimated contract price exposes the Builder to difficulty with enforcing their building contract.

### **What if the Owner insists on an Estimated Cost Price Contract?**

Owners are entitled to insist on an estimated contract price. Builder's Beware!

Owners should insist on a fixed-price Builder's margin of the contract.

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It is common that lending institutions and banks will not provide construction loan funding against a cost-plus contract. Often banks want certainty on the loan to value ratio. If a lender provides a loan facility on a cost plus arrangement then the lender often appoints a quantity surveyor to assist with managing the value of works claimed is consistent with the loan payments released to the Builder. Owners should have additional personal funds or other available funds in case the lender refuses to pay any part of a claim.

### **Who has the greatest risk in a Cost Plus type contract?**

The Owners bear significantly more risk with a cost plus arrangement. This is because the Builder is able to claim for the cost of construction works performed.

However the benefit to the Owner is that the Builder is more likely to make a profit on the project. This should improve the quality and productivity of the project.

The Owners also know the Builder's margin is an agreed amount without any extra padding for contingencies.

In New South Wales, construction Cost Plus contracts are subject to the Building and Construction Industry Security of Payment Act 1999 (NSW). Owners, developers and clients should be across their legal obligations to issue payment schedules and adjudication responses whenever they receive a cost plus progress payment claim. Otherwise a construction lawyer can assist with resisting a cost-plus progress payment claim made under the Security of Payment law.

### **What are your rights if you overpay on a Cost Plus contract?**

It is important to include in your cost plus contract a right to recover overpayments. It is common that Owners over pay on cost plus contracts so owners should include express contract to provision to recover over payments.

Typically the standard cost plus agreements from industry standards including the HIA, Master Builders and the Architects contracts do not have express provision for the Owners to recover overpayments.

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However if you overpay on a cost plus contract then Owners should consult with a construction lawyer. A construction lawyer is able to assess the information and determine if the Owner has a lawful entitlement to recover overpayments. It is possible to recover over payments despite the contract not having express provision for recovery

## Best Practices in Cost Plus Contracts

Cost plus contracts are high risk for clients and home owners. All principals, owners and clients should have their contracts reviewed by a construction lawyer prior to signing the contract. A specialist construction lawyer can assist with ensuring appropriate cost plus clauses are included to manage their risks.

## How Can Contracts Specialist Help with Cost Plus Contracts?

Contracts Specialist is led by a specialist construction lawyer whose expertise lies in Contract Review and Advice. We can go over your contract and advise you on how to administer your contract well, so that your risks to time, cost, and build quality are significantly minimised.

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