Construction Contract Types

Lump Sum Contract

A lump sum contract, sometimes called stipulated sum, is the most basic form of agreement between a contractor and a customer.

A lump sum contract or a stipulated sum contract will require that the contractor agree to provide specified services for a stipulated or fixed price. In a lump sum contract, the owner has essentially assigned all the risk to the contractor, who in turn can be expected to ask for a higher markup in order to take care of unforeseen contingencies. A contractor under a lump sum agreement will be responsible for the proper job execution and will provide its own means and methods to complete the work. This type of contract usually is developed by estimating labor costs, material costs, and adding a specific amount that will cover contractor's overhead and profit margin. If the actual costs of labor and materials are higher than the estimate, the profit will be reduced. If the actual costs are lower, the contractor gets more profit. Either way, the cost to the owner is the same.

A lump sum contract is a suitable if the scope and schedule of the project are sufficiently defined to allow the contractor to fully estimate project costs.

Unit Price Contract

In a unit price contract, the work to be performed is broken into various parts, usually by construction trade. This contract type is based on anticipated quantities of items which are counted in the project in addition to their unit prices. The final price of the project depends upon the quantities required to carry out the work. For example, painting is typically done on a square foot basis. Unit price contracts are seldom used for an entire major construction project, but they are frequently used for agreements with subcontractors which involve accurate identification of different types of items, but not their numbers, in the contract documents. They are also often used for maintenance and repair work.

Cost Plus Contract

Cost plus contract – The cost plus contract is an agreement which involves the buyer's consent to pay the complete cost for material and labor in addition to the amount for contractor overhead and profit. This contract type is favored where the scope of work is highly uncertain or indeterminate in addition to the types of labor, material, and equipment being similarly uncertain in nature. Here, the contractor's profit is set at a fixed amount. If actual costs are lower than the estimate, the owner keeps the savings. If actual costs are higher than the estimate, the owner must pay the additional amount. The advantage of a cost plus contract is that, generally speaking, the project will result in the building that was envisioned, even if costs run high. The builder is less likely to cut corners or argue for less expensive materials because his profit is not in jeopardy.

Three key types of cost plus contracts are:

- *Cost + Fixed Percentage Contract* - Compensation is based on a percentage of the cost.
- *Cost + Fixed Fee Contract* - Compensation is based on a fixed sum independent the final project cost. The customer agrees to reimburse the contractor's actual costs, regardless of amount, and in addition pay a negotiated fee independent of the amount of the actual costs.
- *Cost + Fixed Fee with Guaranteed Maximum Price Contract* – Compensation is based on a fixed sum of money. The total project cost will not exceed an agreed upper limit.

Incentive Contracts

Compensation is based on the contracting performance according an agreed target - budget, schedule and/or quality.

The two basic categories of incentive contracts are

- Fixed Price Incentive Contracts
- Cost Reimbursement Incentive Contracts

Fixed Price Incentive Contracts are preferred when contract costs and performance requirements are reasonably certain.

Cost Reimbursement Contract provides the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This type of contract specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. After project performance, the fee payable to the contractor is determined in accordance with the formula.

Guaranteed Maximum Price Contract

A Guaranteed Maximum Price (also known as GMP, Not-To-Exceed Price, NTE, or NTX) contract is a cost-type contract where the contractor is compensated for actual costs incurred plus a fixed fee subject to a ceiling price. The contractor is responsible for cost overruns, unless the GMP has been increased via formal change order (only as a result of additional scope from the client, not price overruns, errors, or omissions). Savings resulting from cost underruns are returned to the owner. This is different from a lump-sum contract where cost savings are typically retained by the contractor and essentially become additional profits. Sometime, savings are shared between the owner and the contractor as an incentive to keep costs down.

Design-Build Contract

A design-build contract is appropriate when the project delivery method is design-build. Traditional contracts are awarded using a design-bid-build system, where the project owner starts by hiring an architect. Once the architect has finished the design phase, the project is put out for bid to general contracting companies. The contractor with the lowest bid is awarded the project and is responsible for completing the job according to the plans created by the architect.

With a design-build contract, the owner awards the entire project to a single company. It is typically awarded to a contractor, though architects or engineers may be awarded one in some specialized cases. Once the contract is signed, the contractor is responsible for all design and construction work required to complete the project. This system allows the owner to deal with a single source throughout the duration of the job, rather than coordinating between various parties.

When this type of contract is awarded to a contractor, he must hire all architects and engineers required to complete the design work. The owner is still given the right to approve or reject design options, but is no longer responsible for coordinating or managing the design team. Once the owner approves the design, the same contractor then oversees the construction process, hiring subcontractors as needed. Most of these contracts are awarded through negotiation rather than through a bid process.

Integrated Project Delivery Contract

Integrated Project Delivery (IPD) contracts represent the latest trend towards a more collaborative approach to delivering construction projects. IPD contracts are unique in that they require the involvement of owners, designers, contractors, and key stakeholders on a project as early as possible—sometimes even at the conceptual stage. This contract type results in more transparency among all the parties involved on a construction project. Additionally, both risk and reward are shared by the parties who enter into the IPD contract, resulting in greater integration of resources, processes, and expertise than would be possible under more traditional contract arrangements, as well as maximizing eefficiency through all phases of design, fabrication, and construction.