

The Dental Practice's Guide to

CONSTRUCTION CONTRACTS

WHAT IS A CONSTRUCTION CONTRACT?

The construction contract is an important part of your new office construction or remodel. A formal agreement executed between the owner and general contractor, the contract defines work to be done (called scope of work), the cost to do the work, the expected construction schedule and the terms under which the contract is to be administered.

Are you considering a new office construction or remodel?

Become informed about the different types of construction contracts you'll encounter along the way. Plus, learn the lingo that's used in construction contract clauses.



What are the types of construction contracts?

Lump Sum | The lump sum contract is very common in the construction industry. In it, the scope of work is clearly defined and the general contractor provides exact pricing for that work. If there are labor rate or material cost changes during construction, the contractor bears that cost. In a lump sum contract, the owner can be at risk for increased financial investment should they change the scope, or schedule, after signing the contract – referred to as a **change order**.

Cost Plus | A cost plus contract is also popular in the construction industry, and has many variations. These include guaranteed maximum price (GMP), percentage and incentive. In general, the cost plus

contract is structured so the owner pays straight cost for the defined **scope of work**, and also for any overhead or profit for the project as well.

Time and Materials (Unit) | Time and materials contracts are just as they sound: contracts that clearly define the cost of materials and labor needed to complete the project. These contracts are more typically used in the dental industry on smaller scope projects, as the risk for the owner can be high, and the **scope of work** not fully defined yet. Make sure to review the material and labor rates proposed by the general contractor, as many times they will add significant markup to both in this contract scenario.

Top 5 Construction Contract Clauses and Terms

1. Scope of Work

Most contracts will refer to the **scope of work (SOW)** as the defined set of requirements used as a basis for pricing and construction. In many cases the SOW is defined as the set of construction drawings the architect creates, and in some cases you may also see SOW defined through a line-item bid.

- ▶ *Tip: Make sure to review the SOW meticulously before executing the contract.*

2. Incentives

An **incentive**, in its simplest form, is an agreement to provide extra compensation outside of originally agreed-upon price if certain milestones are met. Construction contracts structure incentives in a variety of ways, but most are tied to schedule and cost milestones.

- ▶ *Tip: An incentive can be used to try to shorten the schedule in the case of an impending lease expiration.*

3. Liquidated Damages

Liquidated damages, or LDs, can be viewed as the opposite of incentives in a construction contract. With LDs, one party reimburses the other party if certain milestones are not met. LDs ensure you are reimbursed for any delays in your project that delay your opening. In the contract, you'll want to clearly define the delays so you can easily enforce this clause, and establish LDs as dollars per day or per week. The amount should reasonably reflect the amount of loss experienced by the contract date being missed, and

they are often capped to limit the overall damages that can be charged.

- ▶ *Tip: LDs can also be an amount agreed upon by both parties, but make sure to define what triggers an LD to take effect.*

4. Change Orders

Change orders typically have a negative reputation in the construction process, as they usually involve additional cost. Change orders are agreements between owners and contractors that define a deviation from the original scope of work, and the financial repercussions for it. Not all change orders will add to the construction cost – if the change order involves a simplification or reduction in scope of work, you may see a reduction in price.

- ▶ *Tip: Change orders can be avoided if you complete your due diligence during the design development phase with your Patterson designer and architect.*

5. Retainage

Retainage is the ability to hold final payment on a contract until all work is completed in a satisfactory manner, as determined by the owner. How much retainage is seen in a contract can vary, but most often it is between 5 and 10 percent of the total contract.

- ▶ *Tip: Retainage helps ensure the contractor completes all final items in the punch list, as they won't get paid the full contract amount until completed.*



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