CONTROLLING COSTS WITH ALLOWANCES

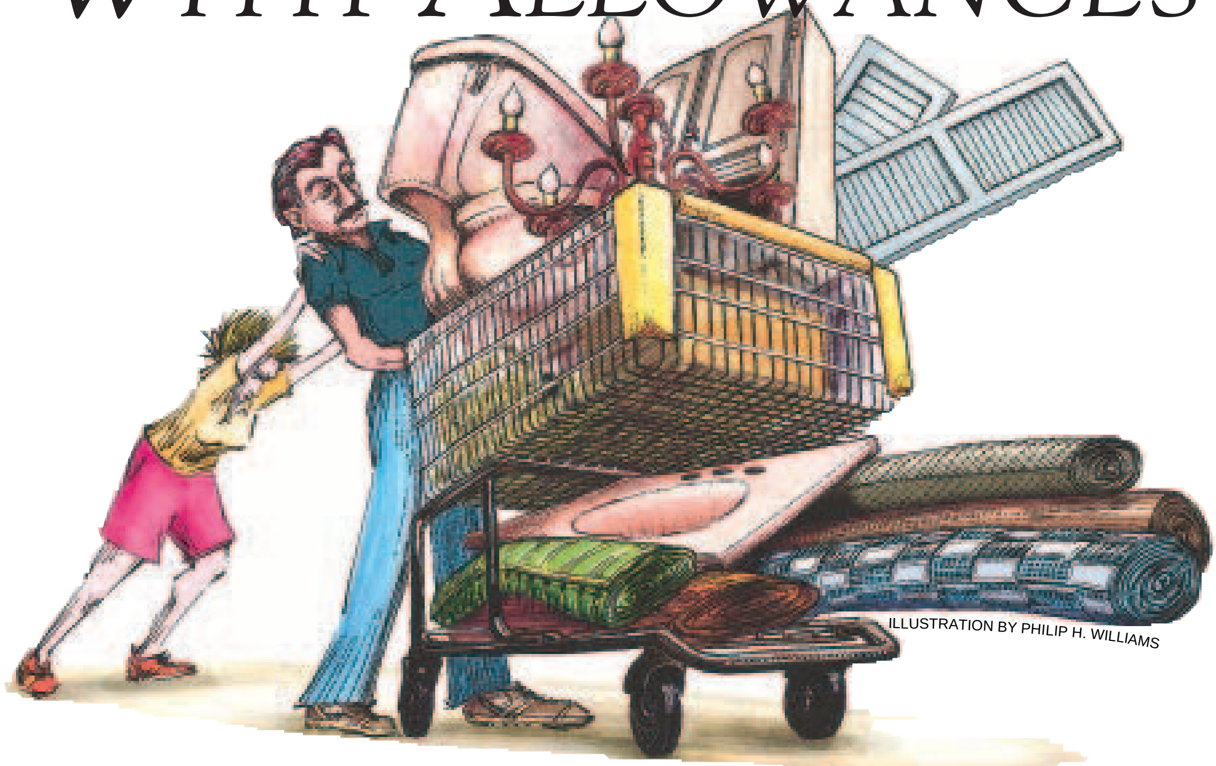

ILLUSTRATION BY PHILIP H. WILLIAMS

Have you ever signed a contract for what feels like a good price, then watched helplessly during the job as your costs rose far above what you projected? Your early optimism turned to frustration and despair as profits drifted uncontrollably away.

This familiar, disheartening scenario points up the fact that every job includes some unpredictable costs that can easily grow out of control. Like a puzzle, some parts of the jobs can be fitted into place easily, while others remain a mystery until work has progressed. Reducing risk and gaining control in the game of contracting often depends on being able to identify and separate out from the whole as many pieces of the puzzle as possible.

Don't guess at the price of incomplete product specs or unknown site conditions: Put them on allowance.

One of the most powerful control tools for builders is the allowance price. Like other parts of construction contracts — sections covering change orders, hidden conditions, and exclusions — allowances provide for a high degree of control over seemingly uncontrollable aspects of a project.

An allowance is an approximate or "best guess" amount that covers the cost of a designated item of work. Allowances are included in the cost of the job provisionally; after completion of construction, the total price for the job is adjusted to reflect any difference

BY DEVON HARTMAN

Contract Sum and Allowances

3.1 The Owner shall pay Hartman-Baldwin in current funds for the performance of the Work, subject to additions and deletions by Change Order as provided in the Contract Documents, the lump sum of:

Four Hundred Forty-Five Thousand Six Hundred Eighty-Three and 00/100 dollars ($445,683.00)

3.2 Quotations herein, unless otherwise stated, are for immediate acceptance and subject to change.

3.3 The Contract Sum includes the following Allowances:

Category	Amount
Plumbing Fixtures	$1,500
Ceramic Tile	3,300
Carpet	5,000
Resilient Flooring	900
Light Fixtures (chosen by Owner)	6,000

Figure 1. *Include a list of allowances and prices in your contract, and explain to clients how the actual cost to construct allowance items will affect the total price of the work.*

between the allowance price and the actual cost of all allowance items. The beauty of the allowance is that it partially releases the contractor from the pressure of having to predict the future and guess at unknowns.

Identify Allowance Items

Every time you bid a job, you should make a special effort to identify possible allowance items. The extreme case is a time-and-materials contract; even on jobs worth hundreds of thousands of dollars, T&M work is nothing more than an allowance for the whole job. While this may be unpalatable to most clients, there are usually a few items or portions of work in every job that are either not clearly specified or about which some information is unknown. The key is to identify these issues in the contract stage, before the job begins, not during the job or after it's finished.

Using allowances as a part of a fixed-price contract gives both parties the benefit of T&M pricing for some items. The client is assured of cost containment for most of the work; the contractor, while pinning down all known costs, is able to isolate questionable work into an allowance.

Only the politics of your relationship with your client limits the number of allowances on a job, and almost any item is a candidate. We tend to have some standard ones, such as hardware, lighting, and carpet choices. Often, the client has not made these and other material choices before the job starts. Instead of trying to guess the cost of their eventual selection — or including an unrealistically high number to cover every possible choice — we put those items into an allowance.

Remodeling jobs are especially notorious for incomplete or unclear work specifications that can't be resolved before construction begins. Sometimes, for instance, the framing is standard except for one area, such as where new joists must meet old in an existing attic, or where reframing an existing floor may require dealing with concealed rot. An allowance is usually the best way to handle these kinds of problems.

Setting the price. How we decide on what price to use depends on the nature of the allowance. Tile, for example, is almost always put on allowance in our contracts: We usually know the extent of the tile work, but the client rarely chooses a particular tile before work starts. Since tile costs can vary from less than $2 per square foot to more than $20, we use a price for a middle-of-the-road product that matches the quality expectations for the rest of the job. For tile, this is usually $8 to $10 per square foot; for carpet, we usually allow $25 per square yard installed. We follow the same rule for appliances: We price good-quality equipment, but not the most expensive.

It's a little harder to arrive at an accurate allowance price when more than a product selection is at stake. If we're pricing the remodel of an old office building, for example, the existing acoustic ceiling and wall paneling may obscure the condition of the drywall and plaster behind. The walls may require extensive patching and possibly a skim coat, both of which would raise the cost. In this case, our solution would be to use an allowance for the drywall work, setting the allowance price as close as possible to what the actual costs might be. This means either closely estimating the drywall work we're sure of, then adding a cushion for the unknowns, or including a fixed price for standard drywall work in the base bid and using the allowance only for any required patching and skim work.

What's included? The allowance prices we show to the owner typically do not include overhead and profit, which are part of the base price for the job. This reduces confusion when clients are shopping for products, like tile or carpet, for which they have an allowance: The vendor's quote is the price they will pay.

Unfortunately, if the owner decides to spend more than the allowance price, we're stuck with the margin we've included in the base price. For instance, if we allow $2,000 for light fixtures, our base price includes our margin based on that price. But if the client decides to buy a couple of expensive chandeliers and ends up spending $4,000, we don't double our margin.

We're currently trying to include contract language to provide for a 10-and-10 margin — 10% overhead plus 10% profit — on all allowances. In the case of the light fixtures, we would then receive $400 on $2,000 worth of lighting, and twice as much on $4,000 worth. Unfortunately, this type of pricing scheme is sometimes difficult for owners to swallow. If we can't convince the owner that the higher margin is necessary to cover our increased liability, we forgo the additional charges in favor of preserving the relationship.

Be accurate. We use middle-of-the-road pricing for most allowances. Low-balling allowances sometimes helps to win the job, but only when you know your client has more money to spend (and won't mind spending it). On the other hand, an allowance that's too high to begin with may cause you to lose the job, or may require you to make other types of cuts to get the price down. With product allowances, the fairest approach is to choose an allowance price that will cover what the client is likely to buy.

When the allowance covers framing or finishes or other types of work, it's relatively easy to explain that while you could give a fixed bid for everything, the price would have to be very high to cover every contingency. Most clients understand the fairness of the allowance approach: I can't remember a single time when a client has argued to have a fixed price placed on an item that we recommended should be an allowance.

Contract language. To link allowance prices to the cost of the work, and to avoid misunderstandings later, we include a list of allowances in the section of our contract that deals with the total cost of the job (see Figure 1, previous). This also gives us an opportunity while reviewing the contract with the client to answer questions about

Daily Field Report

Job Name MCFARLAND # ______ Day WED Date JULY 5

Weather: norm rain windy hot smog Safety Meeting: Y N subject ______

LABOR

name	work performed	hours	cost code	w/c code	total
SWEENEY	ALLOWANCE	1.5	1000.02		
		8.5	6100.01		10.0
HUDSON		1.5	1000.04		
		8.5	6100.01		10.0
LOWERY	Allowance	1.0	1000.04		
		2.0	1000.05		
		7.0	6100.01		10.0

subcontractors	man-hours	subcontractors	man-hours
JONES ELECTRIC	10.0		
ALLOWANCE	3.5		

MATERIALS

chg	cash	chk #	supplier	$ amount	invoice #	cost code	del/PU	remarks
✓			POWELL'S	14.79	22596	5700.02	✓	
			CLARK	114.96	95533	6100.02	✓	

MISC

deliveries; rubbish bins, special dump; inspections; owners; visitors; accidents; shop

Figure 2. *To track allowances in the field, the author uses a time sheet that breaks out allowance work into separate categories. The job foreman fills out the form every day, noting the amount of labor, material, and subcontractor time devoted to allowance items.*

Shopping List

Item	Room	Allowance	Selection
Plumbing Fixtures			
Basin Fittings	Bath #1	$150	
	Bath #2	$150	
	Bath #2	$150	
Shower Fittings	Bath #2	$200	
Finishes			
Carpet – 1st Floor	Living Room	$25/sq. yd.	
	Bathrooms	$20/sq. yd.	
Carpet – 2nd Floor	All Rooms Except Baths	$20/sq. yd.	
Ceramic Tile	Bath #1	$8/sq. ft.	
	Entry	$10/sq. ft.	
Resilient Flooring	Laundry	$16/sq. yd.	
	Bath #2	$20/sq. yd.	

Figure 3. *A shopping list given to clients at the start of the job serves both as a budget and as a reminder for decisions that need to be made about allowance items.*

Change Order

☐ Owner — Change Order #: 6
☐ Contractor
☐ Architect — Project: Alcott Residence
☐ Field
☐ Other — Contract For: Alcott Residence

The following are changes to the contract:

Breakdown of Net Allowances from Statement #8

Description	Allowance	Over/(Under)
Plumbing Fixtures	$1,500	$(616.25)
Ceramic Tile	3,300	(700.00)
Carpet	5,000	(284.79)
Resilient Flooring	900	49.52
Light Fixtures	6,000	881.00
Net Total of Allowances		$(670.52)
Total This Change Order		$(670.52)

Original contract sum $445,683.00
Net change by previous change orders.................... 14,532.81
Contract sum prior to this change order 460,215.81
Contract sum will be decreased by this change order ......(670.52)
New contract sum including this change order $459,545.29
Contract time will be increased by (0) days
New date of substantial completion is: unchanged

Owner — Hartman-Baldwin

Date — Date

Figure 4. *At the end of the job, material receipts, subcontractor invoices, and other supporting documentation are attached to a single change order that summarizes all allowance costs. In the sample above, the change order reduced the total contract price, since several allowance items were completed under budget.*

what the allowances are for and how the costs will be tracked.

Keeping Track

It's important to have a good way to track the costs of each allowance. Product allowances are easiest to document: With an allowance for appliances, for example, simply compare the total cost of the selected appliances with the allowance amount. For other types of allowances, however, labor and subcontractors will need to be tracked as well. We use a time sheet filled out daily by each job foreman (Figure 2). The sheet contains a cost category for each individual allowance in that job's contract, including subcontractors, who are also asked to break out costs for allowance items. We use this information to keep a running total for each allowance in the contract. This helps us keep tabs on expenses as the job progresses and also provides a paper trail for each allowance at the end of the job.

We also help the owner track allowances by preparing a detailed "shopping list" at the beginning of the job (Figure 3). If electrical fixtures are on allowance, for example, we include the total allowance price, plus a breakdown of the specific fixtures needed — two dining room wall sconces, one exterior entry lamp, and so on. The shopping list not only reminds owners which items need to be selected, but keeps the budget in front of them. If they exceed the allowance price, it comes as no surprise.

Billing for allowances. Since the original allowance price list is included in the total price for the job, we get paid for allowances as a part of each scheduled draw. At the end of the job, we present to the client a single change order that summarizes allowance activity (Figure 4). We list all allowances, showing both the original allowance price and the difference in what was actually spent, as well as the net total change to the contract. We include all supporting documentation, such as receipts, labor charges, and any profit and overhead charges. ■

Devon Hartman is a partner in Hartman-Baldwin, a design-build firm in Claremont, Calif.