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PRIME COST SUMS AND PROVISIONAL SUMS

Prime cost sums (**PC**) and provisional sums (**PS**) can often be a point of dispute between a home owner and their builder in domestic building contracts. Often the cause of this dispute is because owners (and often builders) simply don't understand what PC and PS are and the allowances in the contract are not sufficient to cover the cost of the item or work.

In this article, we touch on what these two terms mean, how PC and PS are addressed in the *Queensland Building and Construction Commission Act 1991* (Qld) (**QBCC Act**) and provide some practical tips on how builders can ensure these costs are effectively communicated to owners to avoid any disputes down the track.

What are prime costs and provisional sums?

A "prime cost item" is defined under the QBCC Act for a domestic building contract as "...an item, including, for example, a fixture or fitting -

- a) that has not been selected, or the price of which is not known, when the contract is entered into; and
- b) for the cost of supply and delivery of which a reasonable allowance is, or is to be, made in the contract by the building contractor." ¹

For example, PC are used in contracts where a particular fixture or fitting (such as tiles or the basin) is required as part of the works in a contract, but the exact specification (brand/model/style) and cost is yet to be confirmed at the date of the contract. The PC allows the builder to allocate a "budget" in the contract for the item, rather than specifying the exact cost.

A "provisional sum" is defined under the QBCC Act for a domestic building contract as "...an amount that is an estimate of the cost of providing particular contracted services", where a "...building contractor after making all reasonable enquiries cannot state a definite amount when the contract is entered into". This includes a reference to the cost of supplying materials needed for the subject work. ²

A PS may be used where certain items of work are required as part of a contract (for example excavation for

a pool), however the builder is unable to provide an exact cost at the date of the contract. The provisional sum may be for both material and labour.

For PC and PS, the owner is responsible for bearing the cost of the prime cost item or provisional sum item. Generally:

1. If the actual cost is below the PC or PS allowance in the contract, the builder must deduct this amount from the contract price when submitting its next progress claim.
2. If the actual cost is above the PC or PS allowance in the contract, the builder would include this additional cost in its next progress claim, which the owner would be liable for.

Any adjustment required takes place at the time of issuing the progress claim which the amount for that item is included. In providing the progress claim, the builder must evidence the cost of the prime cost item and provisional sum item (such as providing invoices, or providing a breakdown of the labour).

Builder's Margin

If the actual cost is above the PC or PS allowance in the contract, certain contracts may also allow for the builder to charge an additional percentage (usually up to 20%, however percentage will vary from contract to contract) on top of the difference.

This is commonly referred to as a "builder's margin" (in Housing Industry Association and Master Builders Queensland contracts) or "contractor's margin" (in Queensland Building and Construction Commission contracts).

The builder's margin is also applied prior to any GST is added. Builders often apply the margin after GST which is not permitted.

For example, if a PC in the contract was set at \$1,000, however the actual cost was \$2,000, the owner would need to pay the difference of \$1,000 plus the builder's margin on the difference (which in this case, applying a 20% margin, would be \$200) plus GST, bringing the additional expense to \$1,320.

¹ See schedule 1B QBCC Act.

² See section 10 QBCC Act.

If not properly understood by the owner, this additional cost can come as a surprise and significantly raise the final cost of a project, resulting in disputes and ultimately the contract price would be adjusted and would delay the builders being paid.

Implied Warranty under the QBCC Act

For regulated contracts (which includes domestic building contracts for domestic building work over \$3,300) providing a “provisional sum” or “prime cost item”, the QBCC Act states the following warranty is given by the building contractor:

“The building contractor warrants the provisional sum or prime cost item has been calculated with reasonable care and skill, having regard to all the information reasonably available when the contract is entered into (including information about the nature and location of the building site).”³

Breaching this implied warranty, that is, failing to calculate the PC or PS with “...reasonable care and skill and having regard to all information reasonably available when the contract is entered into”, may result in the owners successfully disputing payment of the PC/PS.

Avoiding Disputes

Despite the implied warranty and a building contractor’s best efforts to provide accurate PC and PS, actual costs can inevitably exceed these estimates which results in disputes with progress claims, (often after the works have been performed and the building contractor is personally out of pocket). These disputes are costly, can delay works and damage the relationship between the building contractor the owner.

So, how can you avoid this? We have put together a few practical tips:

³ See section 26 QBCC Act.

1. Where an industry recognised standard form contract is available (for example QBCC, HIA, SPASA), use it. These contracts often contain ‘plain-English’ clauses clearly explaining the effect of PC and PS and setting out these separate components in the contract price.
2. Comply with your requirement to use reasonable care in skill in giving the PS and PC – for example get a quote for the work or material prior to giving the estimate
3. Document and provide as much information in the PS and PC to the client, which itemises (as best as possible) each prime cost item (for PC) or the estimated material component and labour component (for PS).
4. If variations are required which affect the PC and PS, ensure these are clearly itemised. Don’t hide them and expect the owner to simply accept the variation.
5. Make it clear to the owners the margin that will be payable (if any) on any increase to the PC or PS item.
6. Communicate in writing regularly. Provide the owner with regular updates on the costs for the PC and PS throughout the works, not just when you are submitting your progress claim. Address any concerns the owner may have early on.

If you would like us to review your building contract, assist in a claim dispute or just require further advice on provisional sums and prime cost sums, contact our experienced team of building and construction lawyers today on (07) 3139 1874.

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