Virginia Department of Planning and Budget
Economic Impact Analysis

18 VAC 50-22 Board for Contractors Regulations
Department of Professional and Occupational Regulation
Town Hall Action/Stage: 5793 / 9595
June 3, 2022

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with § 2.2-4007.04 of the Code of Virginia (Code) and Executive Order 14 (as amended, July 16, 2018). The analysis presented below represents DPB's best estimate of these economic impacts.[1]

Summary of the Proposed Amendments to Regulation

The Board for Contractors (Board) proposes to amend 18 VAC 50-22 *Board for Contractors Regulations* (regulation) to allow time and material contracts as well as cost-plus contracts.[2]

Background

The current regulation lists "statement of the total cost of the contract" as one of the minimum requirements for contracts in residential contracting.[3] Up until June 2021, the Board had responded to accurate complaints[4] concerning contracts that did not contain a statement of

[1] Code § 2.2-4007.04 requires that such economic impact analyses determine the public benefits and costs of the proposed amendments. Further the analysis should include but not be limited to: (1) the projected number of businesses or other entities to whom the proposed regulatory action would apply, (2) the identity of any localities and types of businesses or other entities particularly affected, (3) the projected number of persons and employment positions to be affected, (4) the projected costs to affected businesses or entities to implement or comply with the regulation, and (5) the impact on the use and value of private property.
[2] With a cost-plus contract, the contractor gets paid for all expenses of a project plus either an agreed-upon profit, which is usually defined as a percentage of the contract's total costs, or a fixed fee.
[3] More specifically, failure to have a "statement of the total cost of the contract" in the written contract is listed as a prohibited act.
[4] An accurate complaint is when the Board agrees that the contract did not contain a statement of the total cost of the contract. If someone made such a complaint, but the Board thought the wording was such that it did contain a statement of the total cost, no fine would be assessed.

the total cost of the contract by assessing fines.[5] The average fine for contract violations is $450.[6] It was brought to the Board's attention that cost plus contracts and time and materials contracts were becoming more commonly used in residential contracting (for the reasons discussed below).[7] For those two types of contracts, the total cost cannot be precisely known ahead of time. Once this was brought to the Board's attention, it stopped assessing fines for cost plus contracts and time and materials contracts that did not contain a statement of the total cost of the contract.[8]

Instead of requiring a "statement of the total cost of the contract," the proposed regulation would require a:

> "statement regarding total cost of the project with regards to the type of contract being specified:
>
> (1) Standard total value project: a statement of the total cost of the contract
>
> (2) Cost Plus: a statement identifying the type of cost plus contract, fee or percentage, and a cap at which the total dollar amount cannot exceed
>
> (3) Time and Materials: A fixed price for labor that includes wages, overhead, general and administrative costs and mark-up for profit and the cost of materials."

Estimated Benefits and Costs

According to DPOR, as the construction industry has evolved more contractors are moving away from the fixed price contract concept (standard total value project). A significant number of new home builders have shifted to cost-plus contracts and an equally significant number of trade-related and repair contractors have moved to time and materials contracts.[9] This has been exacerbated by the volatility in costs of construction materials, particularly copper and lumber.

If a contractor signs a standard total value contract and the prices of construction materials increase substantially before he can purchase the materials, he may be committed to a project where he would lose money or it would not be worth his time and effort if he knew the profit would be so small. On the other hand, if he quotes a very high price for a standard total

[5] Source: Department of Professional and Occupational Regulation
[6] Ibid
[7] Ibid
[8] Ibid
[9] Ibid

value contract to take account for the possibility of big increases in the cost of construction materials, he risks losing business. The cost plus and time and materials contracts largely eliminate the possibility of losing money on the projects since the customer is charged more than the cost of the materials in both of these type of contracts. Thus, allowing these types of contracts is beneficial for contractors.

By amending the language to include provisions for the two additional types of contracts, contractor licensees would legally be able to utilize all types of contracts largely available within the industry nationally.[10] Consumers would not be required to sign any particular type of contract, though. It would be up to the contractor and the consumer to agree. One of the requirements of the licensee when using cost-plus and time and material contracts would be to include certain information within their contract to educate the consumer on the type of contract being presented to them. This would allow the consumer to make an informed decision if they want to enter into that type of contract or not. Thus, the proposed amendments do not in practice introduce costs.

To the extent that the addition in allowable types of contracts increases the likelihood that licensees and consumers can find contracts that both are willing to sign, consumers may benefit as well. For example, as described above, licensees may only be willing to quote a very high price if they are restricted to only using a standard total value contract. With the cost plus contract, the licensee could include the very high price as the cap at which the total dollar amount cannot exceed. The consumer may be more agreeable to the latter contract because, even though it eliminates risk for the licensee, the resulting cost for the consumer may be lower.

Businesses and Other Entities Affected

The proposed amendments potentially affect the 54,179 licensed contractors[11] in the Commonwealth, as well as their potential customers. According to DPOR, a significant number of new home builders have shifted to cost-plus contracts and an equally significant number of trade-related and repair contractors have moved to time and materials contracts. Thus, these types of contractors would likely be particularly affected.

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[10] In practice, despite the current language in the regulation, contractors in the Commonwealth have already been using the two additional types of contracts.
[11] Data source: Department of Professional and Occupational Regulation

The Code of Virginia requires DPB to assess whether an adverse impact may result from the proposed regulation.[12] An adverse impact is indicated if there is any increase in net cost or reduction in net revenue for any entity, even if the benefits exceed the costs for all entities combined. The proposed amendments do not introduce cost. Thus, an adverse impact is not indicated.

Small Businesses[13] Affected:[14]

The proposed amendments do not appear to adversely affect small businesses.

Localities[15] Affected[16]

The proposed amendments neither disproportionally affect any particular locality, nor introduce costs for local governments.

Projected Impact on Employment

The proposed amendments do not appear to substantively affect total employment.

Effects on the Use and Value of Private Property

The proposed amendments may increase the use of time and material contracts as well as cost-plus contracts in the Commonwealth. This may in turn increase net profits for these firms, increasing their value. The proposed amendments do not increase costs for real estate development.

[12] Pursuant to Code § 2.2-4007.04(D): In the event this economic impact analysis reveals that the proposed regulation would have an adverse economic impact on businesses or would impose a significant adverse economic impact on a locality, business, or entity particularly affected, the Department of Planning and Budget shall advise the Joint Commission on Administrative Rules, the House Committee on Appropriations, and the Senate Committee on Finance. Statute does not define "adverse impact," state whether only Virginia entities should be considered, nor indicate whether an adverse impact results from regulatory requirements mandated by legislation.
[13] Pursuant to § 2.2-4007.04 of the Code of Virginia, small business is defined as "a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than $6 million."
[14] If the proposed regulatory action may have an adverse effect on small businesses, Code § 2.2-4007.04 requires that such economic impact analyses include: (1) an identification and estimate of the number of small businesses subject to the proposed regulation, (2) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the proposed regulation, including the type of professional skills necessary for preparing required reports and other documents, (3) a statement of the probable effect of the proposed regulation on affected small businesses, and (4) a description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed regulation. Additionally, pursuant to Code § 2.2-4007.1, if there is a finding that a proposed regulation may have an adverse impact on small business, the Joint Commission on Administrative Rules shall be notified.
[15] "Locality" can refer to either local governments or the locations in the Commonwealth where the activities relevant to the regulatory change are most likely to occur.
[16] § 2.2-4007.04 defines "particularly affected" as bearing disproportionate material impact.