

## Guidance Statement – Confidential – For Internal Use Only



### Underpricing

Underpricing is where the contract price for the residential construction work is understated, and does not reflect the true value of the work to be performed.

Underpricing occurs where a contractor fails to appropriately cost the job. It may also occur where a contractor is in financial trouble and in order to generate cash flow the contractor intentionally underprices jobs to win contracts and acquire deposit money.

Underpriced jobs mean the contractor undertaking them will make a loss. Contractors who make continued losses will become insolvent or will be unable to finish jobs because they cannot pay subcontractors and suppliers. Underpricing is not uncommon in non-completion claims because of this.

### The Home Warranty Scheme

The Queensland Home Warranty Scheme (the Scheme) compensates the consumer for loss caused by the contractor defaulting on their obligation to complete the contract for residential construction work. The amount of compensation is the cost to complete, less the consumer's liability amount.

The Scheme aims to protect consumers who have entered into legitimate contracts for residential construction work with the intention of having the work done at the best reasonable market price.

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Created – June 2016	
Amended – August 2017, January 2018, November 2019; May 2021; September 2022	
Reviewed – March 2021; June 2022; December 2023	

What underpricing (and prepayment do) is place an obligation on the consumer to act reasonably to protect their own interests. A conscious decision has been made to place the risk on the consumer where they have failed to act reasonably by entering into a contract which clearly does not reflect the value of the work to be carried out.

This is considered necessary to ensure that the Scheme does not prop up “money for nothing” contracts that were entered into by recklessly indifferent consumers. If the Scheme were to do so, claims costs would rise, and as the Scheme must be managed in accordance with actuarially sustainable principles (i.e. not make a profit but not make a loss), premiums would also rise.

It should be noted that the QBCC recommends consumers obtain 3 quotes and that the cheapest option may not always be the best.

## The Legislation

The Queensland Building and Construction Commission Regulation 2018 (QBCC Regulation) Schedule 6 Terms of cover states:

### ***“Subdivision 2 Completion of work***

#### ***7 Assistance for completion of work***

*(1) The consumer is entitled to claim assistance for the reasonable cost of completing the residential construction work.*

*(5) The assistance mentioned in subsection (1) or (3) the consumer is entitled to claim in relation to the residential construction work must be reduced by—*

*(c) if the insurable value of the work exceeds the contract price for the work by more than 30%—the amount by which the insurable value of the work exceeds the contract price.”*

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## How Underpricing is Determined

Once the Non-Completion Assessment Report is received from the service provider, it first needs to be determined if the value to complete is more than 30% higher than the contract price.

All the relevant figures are to be entered into the **Underpricing Calculation** spreadsheet ensuring the defects (where relevant) are not included in the calculation.

If the calculator identifies underpricing needs to be investigated:

- Please escalate to your Senior Lead/Manager for review who may instruct you to request an Underpricing Report from the service provider.
- the Underpricing Report is then used to make a final decision as to whether underpricing should be applied and the value.
- The 'Service Provider Estimate' figure required for the calculation spreadsheet is highlighted in the below example (extract from a Service Provider Non-Completion Assessment Report).

### Estimate of Completion & Under-Pricing Assessment

Based on current building costs, I estimate that the current cost of completing the project, with establishment costs and associated inclusions to be **\$647,200.00**.

The project was quoted by the Builder in 2020, and I note that building costs have significantly increased since that time. A building cost increase of 12% (based on a recent quantity survey report) would equate to a reconciled cost of **\$645,113.83**, to complete the project (original contract price of **\$575,994.49 + 12%**). Therefore, I believe that the project was appropriately quoted at the time.

Given the extent of incomplete work noted above (99%), the proportionate cost to complete the project is estimated to be **\$570,234.55** based on the contracted amount.

Taking into account second Builder set up and mobilisation costs (30% on cost), the cost of completion could be realistically projected at **\$741,304.92**.

The Owner has a balance of payment due up to the completion stage of **\$515,977.76**. I estimate a shortfall of approximately **\$225,327.16** to the Owner to complete the remaining works.

1. All of the above figures include Builder's Margin and GST.
2. The above figures are based on estimated percentages of incomplete works only for reserving purposes; this is not a Quantity Surveying estimate. If a more precise figure is required we can engage our Quantity Surveying Department to undertake this task.

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**Note:** the Underpricing Report (QS Report) excerpts below, will always specify a % tolerance margin. The Assessment Officer should then **always** deduct this % from the Adjusted Total Service Provider Cost Assessment amount, taken from the Total Estimate Summary also in the Underpricing Report.

## 9. Estimated Cost

### Total Estimate Summary:

- Below is a summary of the total rectification cost, as estimated by Sedgwick Building Consultancy division. For a full cost breakdown refer to Appendix A.

Job	Cost (\$) (incl GST)
<b>Original Contract Builders Price</b> <i>Builders Contract date - June 2018 - Builders Margins Included</i>	<b>\$325,000.00</b>
<b>Sedgwick Building Consultancy</b> <i>Contracted Building Works (as at September 2019)</i>	<b>\$620,860.00</b>
<b>Depreciated to June 2018 (-3.51%)</b>	<b>\$21,792.19</b>
<b>Adjusted Total Sedgwick Cost Assessment</b> <i>(as at Contract date - June 2018)</i>	<b>\$599,067.81</b>
<b>Total Cost Variance</b> <i>(Difference between Original Contracted Builders Price and the Adjusted Total Sedgwick Cost Assessment)</i>	<b>\$274,067.81</b>
<b>Variance %</b>	<b>54.25%</b>

This amount is then to be reduced from the amount payable.