Allowances, Saving, Changes and Contingency

Design-Build and CM Construction

FOR THE EXPERIENCE

MOWERY

Allowances, Saving, Changes and Contingency

Overview

The “cost of the work plus a fee with a guaranteed maximum price (GMP)” construction delivery method has certainly matured over the last few decades and has become more widely used than ever. For certain projects, its advantages over the traditional “stipulated sum,” format is undeniable. As usage has increased, so has confusion over some of the key components that create the advantages of using this delivery method. The main purpose of this format is to create a collaborative team approach to the project allowing a win–win-win for the owner, design team and the contractor.

When a project owner decides to apply the “project team” concept early in the design process, a Design-Build contractor or construction manager at risk will often be hired. The main difference between the two is who the design team reports to: the construction manager or the owner. It is imperative in these contractual arrangements that all parties to the contract clearly understand the definitions, purpose, and differences between allowances, savings, changes, and contingencies and how they will be handled for the project. Misunderstandings of these items once construction is under way can hamper the trust that is necessary for a team oriented project to be both successful and mutually beneficial. The following sections discuss each item describing the most widely understood definition, and provide some examples. For the purposes of this article, the terms contractor, Design-Build contractor (DB), and construction manager (CM) can be interchanged.

Allowances

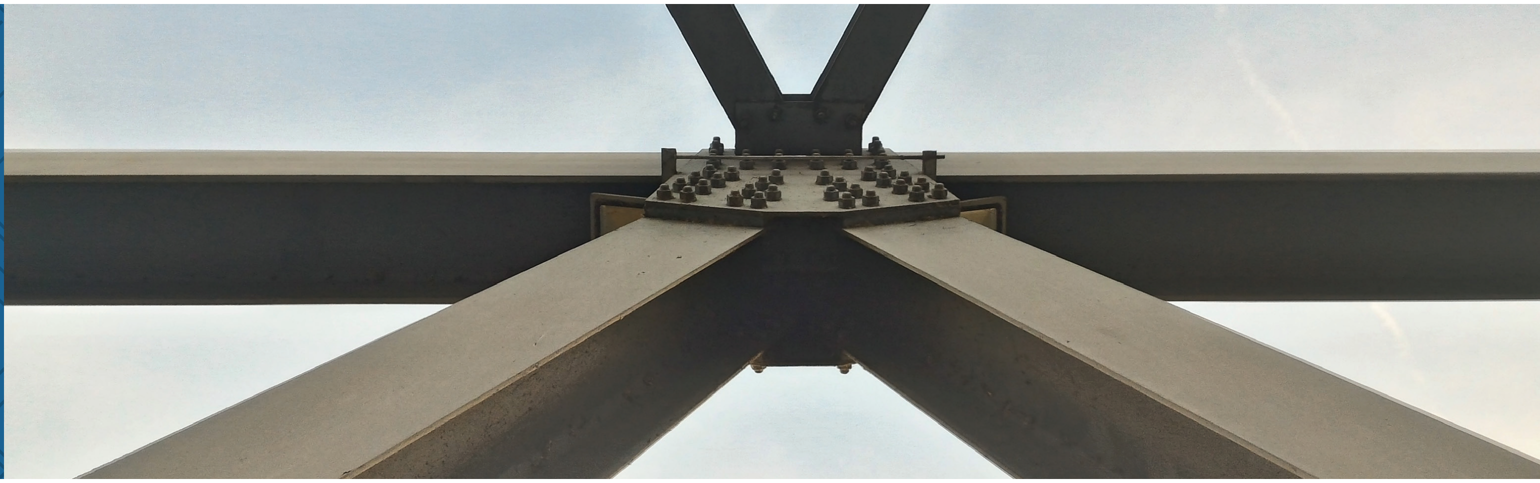
DEFINITION – An allowance is a dollar-value placeholder established in a construction budget and to account for a service or material whose scope is yet to be defined to a point where its value can be calculated with reasonable accuracy. Allowances are not a guaranteed maximum cost for a particular item.

PURPOSE – The purpose of creating allowances is to allow the project planning process, design, budgets, and contracts to move forward before all of the lower-priority decisions, such as floor finishes, have been made.

EXAMPLE #1 – If a geotechnical Investigation and report have not been prepared for a project, it might be reasonable to establish an allowance for rock breaking and removal. Let's say an allowance of $50,000 is established based on the quantity of earth to be moved and a general knowledge of the local geology by the construction manager. If during construction $45,000 is spent on rock removal, $5,000 would be credited to the owner, as leftover allowance dollars are not generally considered a savings item. Similarly, if $55,000 must be spent on rock removal, the owner would be charged an additional $5,000.

EXAMPLE #2 – Allowances may also be affected by owner decisions and selections. For example, if an allowance $30,000 is established for carpet tile based on the quantity required and the owner chooses carpet tile that only totals $28,000 then $2,000 would be credited to the owner. Similarly, if the owner chooses carpet tile totaling $32,000, the owner would be charged an additional $2,000.

As mentioned earlier, allowances are an order-of-magnitude placeholder to account for unknown information. In this case, 100% of cost risk is on the owner so rightfully 100% of any reward in the form of creditable allowance dollars accrues to the owner.



Savings

DEFINITION – Savings is the aggregate net difference between all budgeted (expected) cost values and actual costs experienced. Savings are realized through favorable purchasing or efficiencies found in labor, materials or project schedule. If realized, savings are generally shared between the owner and the construction manager. The purpose of this arrangement is to promote the efficient execution of the work by providing an incentive for the construction manager.

PURPOSE – As mentioned in the opening paragraph, trust is imperative in this type of relationship. An ethical construction manager will carefully estimate and assign appropriate cost values to the project budget allowing Savings to be fairly calculated.

EXAMPLE #1 – If there are two cost items on a project where neither are an allowance and there is $1,000 savings on one cost item but a $500 overrun on the second cost item, there is an aggregate savings of $500 to be shared between the owner and construction manager.

EXAMPLE #2 – If there are two cost items on a project where neither are an allowance and there is $500 savings on one cost item but a $1,000 overrun on the second cost item, there is an aggregate loss of $500. With a guaranteed maximum price, the total of all items other than allowances are guaranteed. The overrun is the responsibility of the construction manager and the owner sees no additional charges. The only exception to this is discussed in the following section, Changes.

Often, left over allowance and CM contingency monies are not eligible items to be considered in the savings calculation and are credited to the owner dollar-for-dollar at the end of the project.

In this case, assuming a guaranteed maximum price contract, the construction manager is taking 100% of the risk but because of the relationship and the construction manager's involvement throughout preconstruction, the owner can reap a reward that would not be realized in a stipulated sum contract.

Changes

DEFINITION – Changes are items which alter the scope of work of the project and affect cost. Changes will adjust the guaranteed maximum price either up or down as may be appropriate.

PURPOSE – The purpose of changes, sometimes referred to as change orders, is to allow the owner and construction manager to modify the scope of work and GMP in a manner that is equitable for all parties. The owner pays for what he or she is getting and the CM gets paid for the work they have done.

EXAMPLE #1 – The owner decides to add 1,000 square feet to an office fit-out project in an existing building and the additional work is worth $80,000 including any additional CM fee. This increases the cost of the work and therefore revises the guaranteed maximum price, increasing it by $80,000.

EXAMPLE #2 – The owner decides to change the exterior finish of a building project from brick to synthetic stucco and the credit is worth $75,000. This decreases the cost of the work and therefore revises the guaranteed maximum price, decreasing it by $75,000.

CM Contingency

DEFINITION – A construction manager's contingency is a dollar amount included in the cost of the work as a placeholder to cover unforeseen costs which are properly reimbursable as a cost of the work but not the basis for a change order.

PURPOSE – The purpose of the CM contingency is to cover cost shortfalls realized after the GMP is established that are attributable to unknown or overlooked conditions on the construction manager's part in the preparation of the GMP for items included in the GMP scope of work.

EXAMPLE #1 – The owner and construction manager agree to a guaranteed maximum price for a new office building but the design is only 75% complete. The CM has budgeted $50,000 for footings based on several assumptions and has not made footings an allowance. Upon receipt of the final structural designs, the CM discovers that footings are 10% or $5,000 larger and costlier than originally budgeted. The CM will reallocate $5,000 from contingency to make up for the overrun.

EXAMPLE #2 – The owner decides to add a folding partition to a project that is already underway. The owner and CM agree to adjust the scope of work and the guaranteed maximum price accordingly based upon a change estimate. However after ordering the partition, the CM is told by the manufacturer that the lead time for the partition is longer than originally expected and it will arrive onsite two weeks after the scheduled completion of the project. The CM did not include additional supervision costs in their estimate and are now facing an additional $5,000 in supervision costs that are rightfully reimbursable as a cost of the work. The CM will reallocate $5,000 from contingency to make up for the overrun.

Something that is important to remember when considering these concepts is that generally a guaranteed maximum price contract requires an open-book approach meaning that the owner has the right to hire an accountant to audit the accounting records for the project. All allowances, savings, changes and contingency records can be reviewed in detail.

If the details are handled properly and there is a clear understanding of the concepts, this type of delivery method can be rewarding for all parties involved.

About the Author

John Kottmyer, LEED AP, joined R. S. Mowery & Sons in 2011 as a Senior Estimator. With more than 25 years of experience in the construction industry, including field supervision, project management, and estimating, he has extensive knowledge of design techniques and principles as well as a strong familiarity with materials, methods, and tools. John is a graduate of the Pennsylvania College of Technology and resides in York with his wife and son.

Contact us today to learn more about our approach to Design-Build, and our promise to deliver an exceptional experience.

Perry Heath
Director of Business Development

R. S. Mowery & Sons, Inc.
1000 Bent Creek Blvd., Mechanicsburg, PA 17050

p 717.506.1000 | **rsmowery.com**

MOWERY

1000 Bent Creek Blvd., Mechanicsburg, PA 17050
p 717.506.1000 | rsmowery.com