

Professional Practice Corner

Developing Realistic Budgets at Master Planning/Programming Stages of Design

By Ian Parr, President, Owner Services Group, Inc.

“We are over budget” may be the most unpopular phrase in the construction industry and yet it is one that we hear time and time again. Over the past years Owner Services Group, as cost manager and owner representative, has been brought into hundreds, perhaps thousands, of projects to pick up the pieces after a project has gone “over budget” due to poor initial budgeting.

In most cases the root cause of the problem is a poorly considered and unrealistic budget. General capital projects represent major investments to the project owner. Any organization, public or private, undertaking a capital project does so in support of its core business or mission and it places a maximum value/cost on the project at which it is viable and worthwhile. It is incumbent upon project owners to recognize, and invest adequately in, initial project budget development.

At first glance “why do we budget?” seems like a trivial question with an obvious answer, but if it is so obvious why is it that so little attention is paid to initial budgets? Initial budgets are the litmus test for all major project concerns.

Project budgets are set up to strategically test and validate bottom line issues such as:

- Does this project or venture make business sense (can we afford it)?
- Does it support our mission (will our bottom line investment continue to meet the organization’s objectives)?
- Does it make sense as a project (have realistic goals for ROI, IRR, scope, quality, schedule and cost balance)?
- Are the stakeholders or investors aware of all the risks associated with this endeavor (do we have contingency planning)?
- Can we stay in control of the project (do we have enough information to monitor project development and deliver to expectations)?
- Will traditional funding alternatives support the organization’s or individual’s pursuit of this venture (will it hold up to scrutiny)?

Given the current economic climate it is to be expected that owners will look more closely than ever at budgets, risk, and the ability to control them. In the public sector, with the advent of the American Recovery and Reinvestment Act, much is being touted about transparency and accountability. In the private sector lenders are looking more closely at loans, while equity investors are requiring assurance that their investments will be well-managed.

The detail contained in a well-prepared budget should convey the thought and consideration given to its preparation. The framework and format of the budget should enable decision makers to reach consensus objectively on scope and risk issues. In combination the detail and framework will provide a basis for the ongoing monitoring and management needed to stay within project budget and net goals. Transparency, accountability, and the objectivity of the decision making process are thus assured for the project owner. Credibility of the budgeting process is further enhanced if the process is led by an independent third party organization with no subjective interest in design or construction.

“Given the current economic climate it is to be expected that owners will look more closely than ever at budgets, risk, and the ability to control them.”

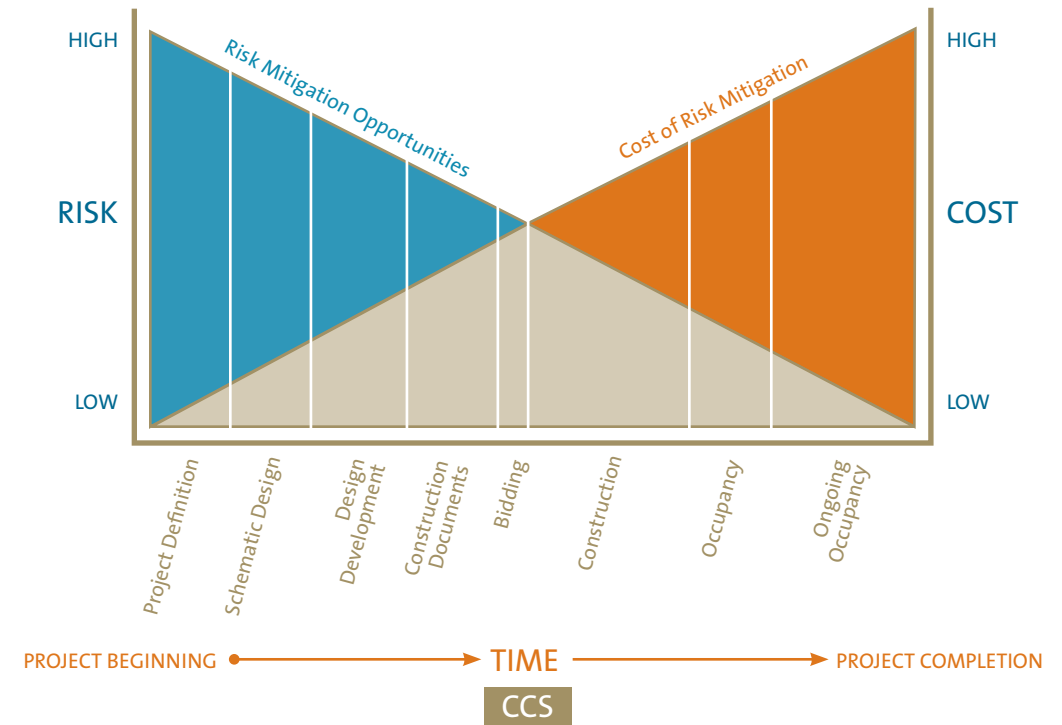
With the tools available today owners should be able to feel that they are in control of their budget before launching a major capital project. Utilizing a parametric modeling tool that quantifies building systems based on the building program and then prices the quantities based on a system of material selection is ideal. It is important that the system/material be reflective of a palette of material that will be appropriate to the owner and allow the design team flexibility to assure best value. Finally, the model should allow the owner to review options, alternatives and perform high level value engineering quickly and reliably.

This project-specific approach is a significant improvement over square foot estimates, even if the square foot budgeting is done at the program component level (by department for example). It is equally important that the budget review construction complexities and logistics (e.g. access, staging, hidden conditions) together with the owner’s operational constraints (e.g. noise, dust, work hours) both of which may have significant impact on budget accuracy. The construction cost component of the budget prepared in this manner will withstand the scrutiny and receive the “buy in” of project internal stakeholders, funding authorities, and the design and construction team. We have found this to be a key issue in building successful project teams.

Project budgets typically focus on the physical scope and quality of construction, the so called “bricks and mortar,” and fail to capture other key capital investment costs. In addition to construction costs, it is important that a total project budget must incorporate a range of soft costs. While many of the soft costs (such as professional fees, fixtures, furnishings, and equipment) are common to most projects, many are more “intangible” and project-specific (e.g. valet parking requirements, community and political issues).

Project Risk & Cost

©Owner Services Group, Inc.



It is in the grey areas such as constructability, operational constraints, soft costs as a whole, and project intangibles in particular that initial budgets often stumble. This is where projects tend to face cost overruns and /or project scope is compromised. In the worst cases projects fail. We have found that by placing as much effort on these less tangible areas as we do upon “bricks and mortar,” the risk of budget compromise is greatly diminished. How often do we value engineer the building in late design or construction because of an overrun in IT, furnishing budgets, or an intangible issue not even identified during the budgeting process?

Identifying and discussing all of the intangibles that may come into play and how to deal with them is beyond the scope of this article. However, it should be said that the exercise requires a disciplined approach, experience and solid cost management skills.

Over the years we have kept track of the intangibles we have encountered. It is a list that continues to grow. If an intangible issue involves significant risk we have, when needed, reached out to a qualified specialist at the initial budgeting stage where their expertise can bring the highest value. This may involve a little expense but if the expertise is that critical it will be needed sooner or later.

The question for the owner is, Do you want bad news now while options are open or later when there may be no acceptable option? Figure A demonstrates the impact of delaying the risk evaluation process.

An often forgotten but very valuable benefit of an objective well-prepared budget is that it will speed up the decision making process and overall project duration. Initial project definition is usually quicker, and subsequent design and construction proceed without the interruption that invariably occurs when the project goes “over budget”.

“It is in the grey areas such as constructability, operational constraints, soft costs as a whole, and project intangibles in particular that initial budgets often stumble.”

If escalation is at four percent, savings on a \$10 million dollar project due to a three month improvement in project schedule as a result of good initial project definition is \$100,000 – not a bad return on investment. This alone is more than enough to pay for a reliable budgeting exercise.

Savvy construction owners understand the value of the process and will spend a little more time and money up front when all options are open to avoid big costs later in the project when options are diminished. **CM**

Ian Parr is president of Owner Services Group, Inc. He can be reached at iparr@ccsos.com.