

For the Client: Handling Unexpected Increases in Construction Costs

BY L. POWERS, ESQ.



The second of a two-part article.

"For which of you, intending to build a tower, sitteth not down first, and counteth the cost, whether he have sufficient to finish it?" Luke 14:28.

In Part I of this article, published in the December issue of *PE*, I reviewed the importance of educating owners on the causes of construction cost overruns. Education, however, is only one tool the design professional can use to limit liability for unexpected increases in construction costs. Contract clauses addressing cost overruns are equally important tools. Why are they important? First, the inclusion of such clauses in a contract proffered by a design professional forces the owner to contemplate the possibility that the owner might not have enough money to "finish its tower." Second, in the unfortunate event that circumstances beyond the control of the owner and the design professional cause a construction budget to be exceeded, a mechanism is in place to address that circumstance.

The contract clauses proffered by the design professional should address the

public projects you should assume that a referendum or bond amount is the budget. Forcing owners to put a number on paper and telling them that they have to live with it once the project program is established can be a sobering experience for the owner. Sometimes, in their joy over creating something new that will outlive the owner, owners need "sobering up."

3. Once a budget is fixed, and construction costs are estimated, the project must proceed within a fixed time limit, or the budget and cost estimates must be revised to reflect the cost escalation that occurs during any delay in starting a project. Many times, an owner will plan a project well before it can build a project. This clause will reduce the risk, for the design professional, that is attendant to volatility in labor and material costs.

4. If project bids exceed the project budget, the design professional's sole obligation is to work with the owner to redesign the project to fit the budget, one time, for no additional fee. Owners need to understand that design professionals cannot cram two pounds of programmatic sausage into a one pound budgetary casing, no matter how many times they try. Also, owners will have to pay for that effort if more than one

B-141. I have used that clause more than once to thwart an owner's attempt to obtain the return of a fee for a project that, while designed in strict accordance with the owner's expressed program, could not be built within the budget. In one instance, the reason for the budget busting was the post-referendum addition of "bells and whistles" by the owner. In the second instance, it was due to a long delay in starting the project during a time when construction costs in New Jersey were increasing by 5%–7% a month.

Last, when an owner balks at agreeing to limiting a design professional's liability for construction cost overruns to a one-time gratis redesign of the project to reduce the scope of the project to fit the budget, the design professional can use a "budget buster" clause. With this clause, the designer accepts the economic risk for redesign fees if the agreed upon budget is exceeded by more than an agreed upon percentage, often 7%–10%. Most owners will agree to this provision as an alternative to number 4, above.

By using such contract clauses, the design professional can educate an owner and reduce the design professional's risk for construction cost overruns. Dealing with risk allocation between contractors and owners for increased material costs, however, will have to be the subject of another article.

Due to many factors, the design professional cannot guarantee that a project can be built within the estimate.

following issues and limit the professional's liability for construction cost overruns:

1. There is a reason they call them estimates. Due to many factors, the design professional cannot guarantee that a project can be built within the estimate. Owners need to understand this unpleasant reality during a project's programmatic and budgeting phases while they can still do something about the scope before it becomes fixed and seen, in the eyes of the taxpayers, as a guaranteed entitlement.

2. There is no budget for the project unless the parties agree, in writing and in advance, that there is a budget. On most

try is required before reality sets in.

5. Then, there is the "reality clause." If the owner is unwilling to alter the project scope to fit the budget, the owner can either fund the cost overrun or abandon the project, and the design professional gets paid for all work done to the point that the project is abandoned. This is a clause that generally causes public owners to see the light, as neither of these options are generally available on public projects.

One good example of such a contract provision is the construction cost estimate clause in the American Institute of Architects' form Owner/Architect contract,

Lawrence Powers is co-partner in charge of the Construction Industry Practice Group of the New Brunswick, New Jersey-based law firm Hoagland, Longo, Moran, Dunst & Doukas LLC. He is counsel to the New Jersey Society of Professional Engineers.