For the Client: Understanding Rising Construction Costs in a Flat World

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The first 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.

The sad truth about construction cost overruns is that they have been a fact of life since Biblical times. Fortunately for today's engineers, construction cost overruns are no longer punishable by death, although some might say that litigation is a fate far worse than death.

Today, engineers do not have to face an angry Pharaoh or emperor when the low bid exceeds a project's budgeted cost or referendum amount. Still, one of the greatest challenges facing engineers today is the challenge that faced the first engineer: teaching a client that neither engineers nor clients (royal, divine, or otherwise) can totally control the rising cost of construction.

An owner's view of the world is quite simple. Public and private owners, alike, view their universes as very small universes, revolving around the needs of their constituencies. Thus, when events in the U.S. or other countries result in increasing construction costs, owners tend to blame their project designers, rather than those events. Often, the blame is accompanied by legal action aimed at making up the unanticipated difference between a static budget and rising construction costs created by a dynamic, global economy. Now, more than ever, attorneys for design professionals are being forced to defend such legal actions—actions which might have been avoided through simple education efforts and using contract clauses which limit the design professional's liability for unforeseen cost increases.

First, a little understanding of recent history is in order. In October 2004, rising violence in Iraq, combined with increased demand from China, caused crude oil futures to climb 60% to a then record of $55 per barrel. This price increase resulted in a spike in motor fuel costs and costs for petrochemical-based products, such as plastic pipe and roofing materials. Now, only two years later, crude oil prices reached over $75 a barrel. A simple threat from the world leader of your choice can cause the price of crude oil to spike as quickly as CNN, Fox News, or Al-Jazeera can send it out into the ether.

In late August 2005, Hurricane Katrina devastated the Gulf Coast. That devastation created demands for large amounts of plywood, drywall, and electrical generators. Simultaneously, the oil industry's Gulf-based refining capacity was crippled, causing overnight 60 to 70 cent per gallon increases in motor fuel costs. Meanwhile, China has awakened to the realities of the standards of living in industrialized nations that participate in a global economy and has begun to demand the lumber, steel, and oil required to achieve that standard of living. Supply and demand, a simple concept, right? Not so simple if you are an owner or a design professional who has to build a project within a budget set by a referendum or a bond ordinance and your world view ends at the project limit line.

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When the lowest responsible bid on a project exceeds the project budget, owners have three contractual choices: increase the budget, abandon the project, or work with the design professional to reduce the project's scope so that it can be built within the budget. None of these choices is very palatable to public owners.

A school board or governmental entity building a project within a referendum amount, a capital budget, or the limits of a bond ordinance cannot simply increase the budget. "Going to the well" again is not that simple. The attitude of an overtaxed electorate and the limits of public finance laws make that option an option in name only. Similarly, abandoning a project may not be possible when deteriorating infrastructure or court orders mandate improvements to prisons or schools. That leaves working with the design professionals to reduce the project scope as the most common solution; however, it's a solution that can leave a sour taste in the mouth of a public owner, especially during an election year, when bringing home a thinner strip of bacon may be the difference in a close contest.

Accordingly, design professionals must educate owners on the globally influenced realities of fluctuating construction costs and work with them in using simple procurement methods and contract provisions to limit construction cost overrun risk. Good, continuing two-way communication on this issue cannot be stressed enough. The time to sit down and *really* count the cost is at the project's inception. This risk needs to be discussed, explained, and provided for at the outset of a project lest, to paraphrase Luke 14: 28–29, after the foundation is laid, all that behold the cost overrun on a project begin to mock you.

Part II of this article will provide some concrete examples of risk allocation and limitation techniques for discussion between design professionals and their owners.

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