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# Pitfalls in Cost-Plus Contracts

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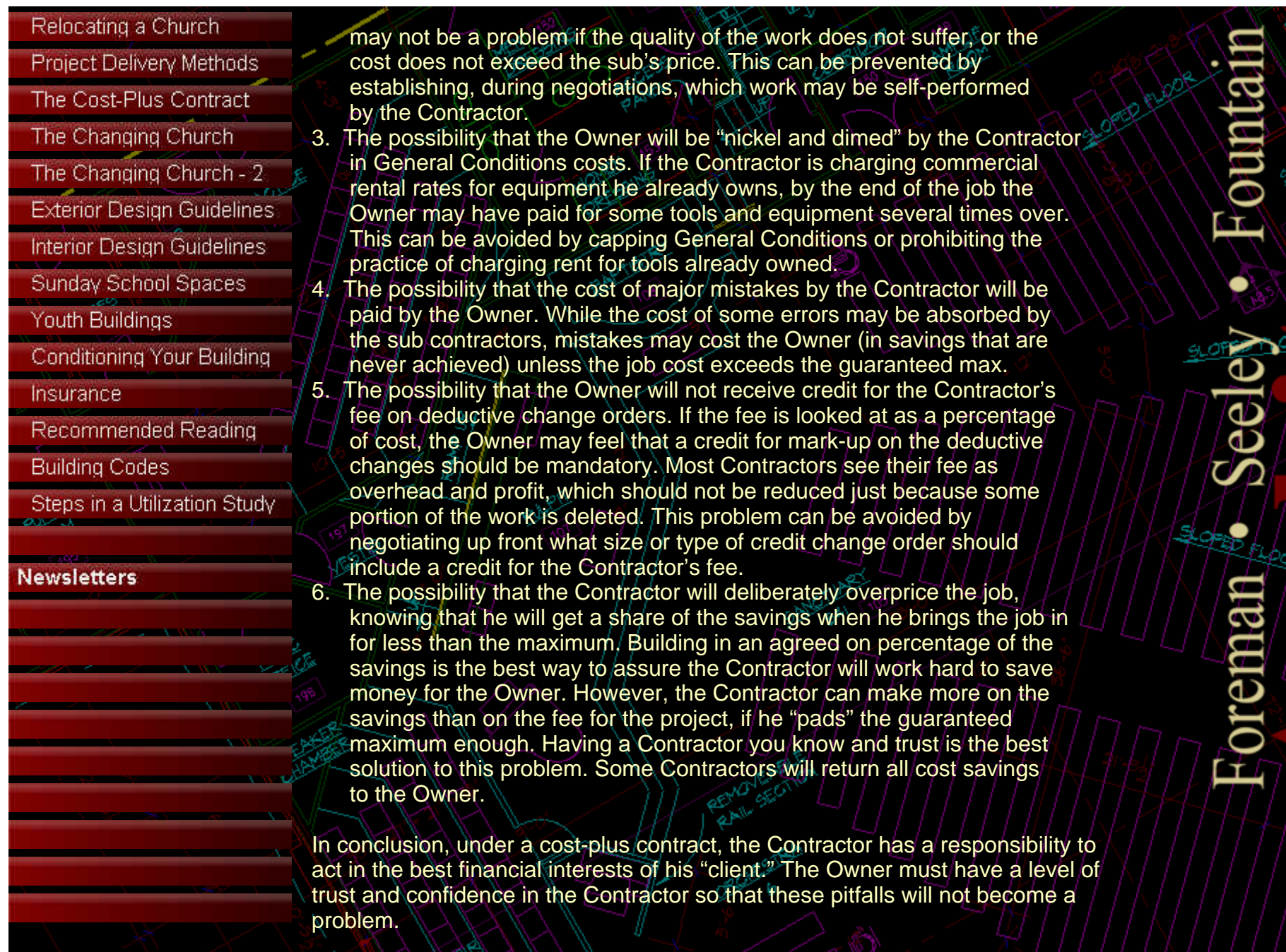
Traditional bidding is giving way to other means of pricing and project delivery. More clients are using negotiated cost-plus contracts, many with a guaranteed maximum price and some with a savings split. In separate articles we have examined and compared the advantages and disadvantages of the various construction delivery methods including the traditional design-bid-build, design-build and "partnering" where the A111, Cost-Plus Agreement is used. The cost-plus contract can be the best choice for many of our clients when one or more of the following conditions exist:

1. Where the construction market is "hot" and most good Contractors are too busy to have any interest in a traditional bid.
2. Where the Owner has an established relationship with a reputable Contractor and there is already a level of trust and confidence between them.
3. Where the Architect has had a positive history with the Contractor.
4. Where there is an ambitious schedule or a tight budget.
5. Where the Owner desires to handle a significant segment of the work on a project separate from the general contract; use volunteer labor, donated materials or use their own sub contractors or suppliers.

However, the following may present difficulties for some Owners who are not familiar with Cost Plus Agreements:

1. The possibility that the Contractor will use cost savings (which should accrue to the Owner) to cover cost overruns in General Conditions or field overhead. This can be prevented by capping General Conditions.
2. The possibility that the Contractor will self perform some of the work originally priced out by sub contractors. This potential conflict of interest

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may not be a problem if the quality of the work does not suffer, or the cost does not exceed the sub's price. This can be prevented by establishing, during negotiations, which work may be self-performed by the Contractor.

3. The possibility that the Owner will be "nickel and dimed" by the Contractor in General Conditions costs. If the Contractor is charging commercial rental rates for equipment he already owns, by the end of the job the Owner may have paid for some tools and equipment several times over. This can be avoided by capping General Conditions or prohibiting the practice of charging rent for tools already owned.
4. The possibility that the cost of major mistakes by the Contractor will be paid by the Owner. While the cost of some errors may be absorbed by the sub contractors, mistakes may cost the Owner (in savings that are never achieved) unless the job cost exceeds the guaranteed max.
5. The possibility that the Owner will not receive credit for the Contractor's fee on deductive change orders. If the fee is looked at as a percentage of cost, the Owner may feel that a credit for mark-up on the deductive changes should be mandatory. Most Contractors see their fee as overhead and profit, which should not be reduced just because some portion of the work is deleted. This problem can be avoided by negotiating up front what size or type of credit change order should include a credit for the Contractor's fee.
6. The possibility that the Contractor will deliberately overprice the job, knowing that he will get a share of the savings when he brings the job in for less than the maximum. Building in an agreed on percentage of the savings is the best way to assure the Contractor will work hard to save money for the Owner. However, the Contractor can make more on the savings than on the fee for the project, if he "pads" the guaranteed maximum enough. Having a Contractor you know and trust is the best solution to this problem. Some Contractors will return all cost savings to the Owner.

In conclusion, under a cost-plus contract, the Contractor has a responsibility to act in the best financial interests of his "client." The Owner must have a level of trust and confidence in the Contractor so that these pitfalls will not become a problem.

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