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## Where contractors are most likely to exceed the budget

Budget overruns can pop up in any part of a project's budget — specifically, these four major areas.

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Budget structures vary by the type of construction a contractor performs. For example, subcontractors typically have a significant amount of their costs allocated to direct labor and materials while general contractors' budgets are likely to have more subcontracted work on their books.

However, despite the differences in where the budget is weighted, every contractor, no matter its specialty, is vulnerable to cost overruns.

### Weather delays

When serious rain, snow or other weather events keep contractors from making progress on their jobs, it's not uncommon that both subs and GCs have those lost days tacked onto their schedules. But what about the extra costs?

“If we get a rain day, it's not like we can send the superintendent home and not pay him,” said Chuck Taylor, director of operations for Englewood Construction in Illinois. “If we have a construction trailer, it's not like we can tell the rental company, 'Hey, it rained today, so we're not going to pay for the rental on the trailer.' It doesn't work that way.”

Additional costs, which also include items like water remediation, wrapping an exposed building in protective material or bringing in expensive heaters, are often compounded by having to spend even more money on extra labor to make up lost time. That could mean paying for additional crews or paying workers overtime.

This is an area of contract or subcontract negotiations that deserves attention, and it never hurts to ask the owner or GC for reimbursement beyond just adding time to the schedule.

Joe McLaughlin, chief financial officer of Austin Industries in Dallas, said contractors need to take into consideration where they're building and factor in potential weather issues. But, he said, it all goes back to what's in the contract, so it benefits contractors to try to make the terms as flexible as possible.

## **Indirect costs**

Indirect costs include items that are not directly attributable to a project like labor, materials and equipment, but are necessary nonetheless. Insurance and fleet maintenance are two things that fall under this category.

When preparing a bid, estimators typically allocate a percentage of the total cost for these items. A portion of the total dollar amount of a general liability policy, for example, must be assigned to each job. If the estimating team doesn't have updated estimates for these things, the job will likely go over budget in these areas, said James Miller, partner and member of Marcum LLP's national construction industry group.

Often indirect costs, also referred to as burden or markup, are loaded into the company's estimating system and then forgotten. Often no one makes sure they are updated for inflation or otherwise adjusted to reflect what the company can expect to pay for these items, so bids will never cover costs.

"They didn't adjust it during the takeoff and estimation phases of the contract, so they are already going in with a profit fade built into the contract," Miller said.

## **Extra labor charges**

Labor is another area where contractors see cost overruns. Sometimes it's just a matter of getting that line item wrong, Miller said, by underestimating the hours it will take to complete a project and, in those cases, there's not much to be done outside of trying to save in other areas of the budget to compensate.

General contractors that do not self-perform work often push this risk to their subcontractors, McLaughlin said. "You really want to make sure you're protecting yourself," he added.

As for subcontractors, it's incumbent upon them to check their numbers because labor makes up such a significant portion of their expenses.

But in the era of labor shortages, companies are sometimes willing to take on budget overruns to get superintendents, project managers or skilled trade workers to stick around, even when they don't have projects for them.

Owners, Miller said, have to make a business decision as to whether they'll take the financial hit, keep these workers "on the bench" and allocate their time to projects or charge them to some internal project code. Either way, these extra costs can push those budget line items into the red.

And this strategy is not unheard of. When work on the \$7 billion Atlantic Coast pipeline was stopped because of permit issues, pipeline officials decided to keep welders on the payroll until work restarted because there was too much competition for their services. Those workers did everything from small maintenance tasks to volunteer work. Taylor said Englewood, in the past, has put superintendents to work in the office helping out with estimates while waiting for their next assignments.

## **Unexpected direct project costs**

Many overruns involve direct project costs and are a result of design errors, omissions or just a general lack of communication about expectations.

One way to head off unexpected direct project costs, McLaughlin said, is with a robust preconstruction process that gives “a line of sight” as to exactly what the owner wants and has envisioned for the project.

Understanding the contract, determining where there’s flexibility and how approvals and other processes will be handled while working toward a budget with the owner, he said, increases the odds that the budget is correct before work starts.

Any deviations to that budget via change orders must be priced and negotiated, Taylor said, so the extra work doesn’t bust the budget.

Design errors and omissions are also a threat to the budget.

“More and more clients,” Taylor said, “are giving us conceptual — or design development — drawings.” This set of documents will be worked into a version for permitting purposes and then into the final construction documents.

However, clients, he added, will direct general contractors to bid the project using the preliminary drawings and then award the contract to a construction company that, soon after, has to start signing up subcontractors.

Taylor said that many owners are under time constraints to get projects like hotels and restaurants built and operational so that they can start earning revenue.

“The clients have to keep in mind that they run the risk for cost overruns when they do that,” he said. And, of course, that means more change orders to be processed.

But even when Austin receives what is supposed to be a complete set of documents, McLaughlin said, it usually shows up incomplete and/or with inaccuracies.

To tackle this problem, Austin formed a team devoted to double-checking the design documents and identifying potential RFIs at a time when solutions can be identified in a more collaborative environment. A recent review of 16 projects containing more than 8,000 sheets, McLaughlin said, revealed 3,406 valid issues.

Dedicating individuals to this purpose has reduced the cost of dealing with errors and omissions, and linking potential budget concerns earlier in the design development has led to stronger estimates.

“It is interesting how it all ties together,” he said.