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Change orders are a way of life in construction. During the course of a project, owners change their mind about products, equipment and finishes, unforeseen conditions are discovered, work is deleted, work is added and so on. Negotiating change orders is a substantial administrative burden for owners, FMs and contractors. In addition, contractors are understandably hesitant to start significant changed or extra work without an agreed-upon price. Waiting for a change order to be negotiated can delay the project.

The problems with change orders

Negotiating change orders takes time and consumes administrative resources. In addition, resolving change orders can cause project delays, which cost money. Not only do project delays increase job site overhead and management costs, but they extend the date by which the project can be put to use. Whether it's a renovated bridge, a new public school or a revenue-generating enterprise such as a hotel, delays increase costs and decrease realized benefits.

On public construction projects, given the requirements for competitive bidding, and on private projects, given the difficulty of injecting a new contractor into an ongoing project, owners have limited options in for completing changed work with someone other than the existing contractor.

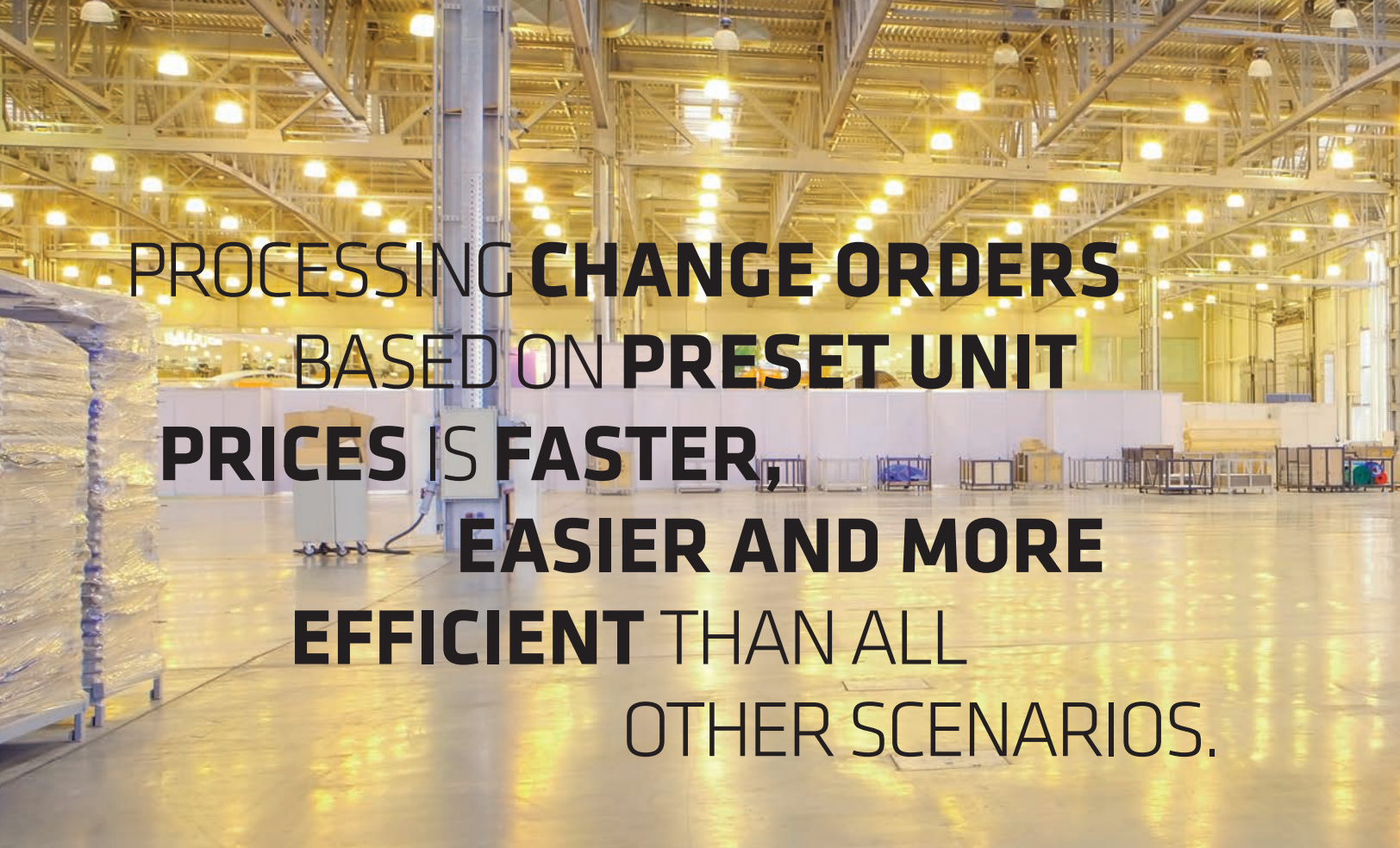
For the most part, the project and facility managers are stuck dealing with the existing contractor. As a result, they are generally in a weakened position when negotiating change orders. Their main goal is to get to a reasonable price and move on. Easier said than done. Owners and FMs are seldom confident that they negotiated a good price for change orders. In some cases, they know that they overpaid.

A recent audit by Washington State¹ identified many of these problems. The audit summarized the change order pricing issues as follows: "Change orders usually are negotiated after the contracts have been awarded, so contractors...are better positioned to obtain more generous pricing for labor, materials and equipment, and markups for overhead and profit."

Current change order pricing systems

Most construction contracts include a provision that permits the facility manager to make changes to the scope of work and includes basic language setting forth how changes are to be priced. Some clauses include a fixed markup for labor, equipment, material and subcontractor costs, or may require that all equipment for change orders be priced by referencing a standard equipment pricing guide. For public projects, labor rates are generally fixed at the current prevailing wage rates, so agreeing on the labor rates is easy. The hurdles presented by change order costs tend to be negotiating how many hours are appropriate for the task performed (i.e. productivity) and whether the contractor got the best available price for materials.

THE FUTURE OF CHANGE ORDER MANAGEMENT



PROCESSING CHANGE ORDERS BASED ON PRESET UNIT PRICES IS FASTER, EASIER AND MORE EFFICIENT THAN ALL OTHER SCENARIOS.

For some projects, where there are preset unit prices for most tasks, the change order process is relatively straightforward. This is true for many civil construction projects such as road work, large excavation projects or something as simple as a concrete sidewalk replacement where contractors bid unit prices multiplied by estimated quantities.

For these projects, the cost of changes will be based on the preset unit prices and the change order process moves quickly and efficiently with minimal room for arguments or negotiation. Also, the likelihood of project delays resulting from drawn-out change order negotiations is eliminated. The contractor knows payment will be based on unit prices, so the work progresses. Processing change orders based on preset unit prices is faster, easier and more efficient than all other scenarios.

Expanding the solution

The ability to establish preset unit prices has proven to be more difficult for general building construction work

because there are thousands of tasks that may be associated with a typical building project. But, if this can be done, the benefits will outweigh the costs.

The leading recommendation from the Washington State audit was to contractually “establish the basis for reasonable and typical prices and rates for labor, materials, equipment and markups.” Developing preset unit prices goes one step further. So, how do we get there?

FMs can start small. A school system can develop preset unit prices for commonly completed construction projects such as classroom doors, locksets, exit devices, ceiling tiles, VCT and other similar tasks. In the construction contract, the school system can require that all change orders involving tasks for which a preset unit price exists will be priced using those unit prices. A local department of public works can develop preset unit prices for standard tasks such as installing concrete and asphalt curbs, delivering imported aggregates, replacing inlet grates, etc. Over time, owners and project/facility

managers can build a substantial library of unit prices.

Unit prices should be updated periodically as labor rates increase and material prices fluctuate. The unit prices should also account for variations in quantities. The unit price to paint 500 square feet of drywall should be more than the unit price to paint 10,000 square feet of drywall.

If the database will be used for pricing changes in renovation, alteration and upgrade projects, it is best to include unit prices for removals and demolition work. For example, if a unit price is included for installing lay-in ceiling tiles, there should also be a unit price for removing those ceiling tiles. The same is true for windows, roofing, lavatories, VCT, doors, bathroom accessories, etc. Without removal and demolition unit prices, those tasks will have to be negotiated in the traditional manner.

As the unit price database increases in size and complexity, it will become



more difficult to keep the prices up to date. It will also become more difficult for contractors to prepare price proposals using the expanding database. However, there have been significant advancements in preparing construction unit price calculations using only local labor, material and equipment prices and in providing Web-based applications which can be used to generate price proposals from unit price databases.

Although there are published estimating guides available from different sources, they are not appropriate for establishing contractually preset unit prices. Unit prices are not locally priced, so the labor, material and equipment costs will not line up with the contractors' actual costs. Also, the task descriptions are generic. They do not include unit prices for most removal or demolition tasks and do not include quantity discounts for most tasks.

As a result, using a nationally priced general estimating guide will cause

more problems than it will solve. It is difficult to get local contractors to agree to be paid at national prices unless they are higher than local rates.

The keys to establishing a usable unit price database for pricing change order work include:

- Task descriptions must be specific and accurate (“3/4-inch native crushed stone” instead of “gravel;” “grade 1, F05 Function mortised lockset” instead of “classroom lockset”);
- Unit prices must be based on local labor, material and equipment pricing;
- Unit prices must include removal and demolition tasks and
- Unit prices must take into account varying quantities.

Establishing preset unit prices for change order work simplifies the negotiation process, reduces administrative effort and can avoid delays. To date, the variety of construction tasks associated with a

typical construction project has made it difficult to establish unit prices up front. However, recent advances in localized unit pricing data and integrated Web-based applications have brought this solution within reach. **FMJ**

REFERENCE

1. “Local Government Performance Audit Construction Change Order Pricing,” Jan. 10, 2012, Report No. 1007057, Washington State Auditor’s Office.



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