Contracts, Specifications and Quantity Surveying

ENCE421:

Contract Incentives

BIRZEIT UNIVERSITY

Today's Presentation Outline

- Revisit previous lecture
- Contract Incentives

Revisit previous lecture

✓Tendering procedures

Introduction

- Contracts can be considered as having the following functions:

1- Work transfer

2- Risk transfer

Why needed?

- Relationships in the construction industry are often adversarial with the parties resorting to contractual claims, which lengthen time scales and increase costs. The acknowledgement of the important role of motivation and its influence on project success has led to the increased use of incentive schemes.

Categories of Contractual Incentives

- Contractual incentives in construction are categorized into the following three areas :

1- Schedule and Delivery Incentives

2- Performance or Technical Incentives

3- Cost Incentives

Principles of Target Cost Incentive Fee Contracts (TCIF)

The client and the contractor negotiate and agree a target cost for the contract before the work commences and agree to share, in prescribed proportions, any variance (up or down) between the target cost and the eventual actual costs which are ascertained after the work is finished.

Why do it?

Q1 :Why would the contractor wish to share cost savings, which he earns and which under a firm price scheme would all be his to keep, with the client?

Q2: Why would the client be willing to sign up to a scheme that allows the price to vary and in which the final bill is not known until after the contract is finished?

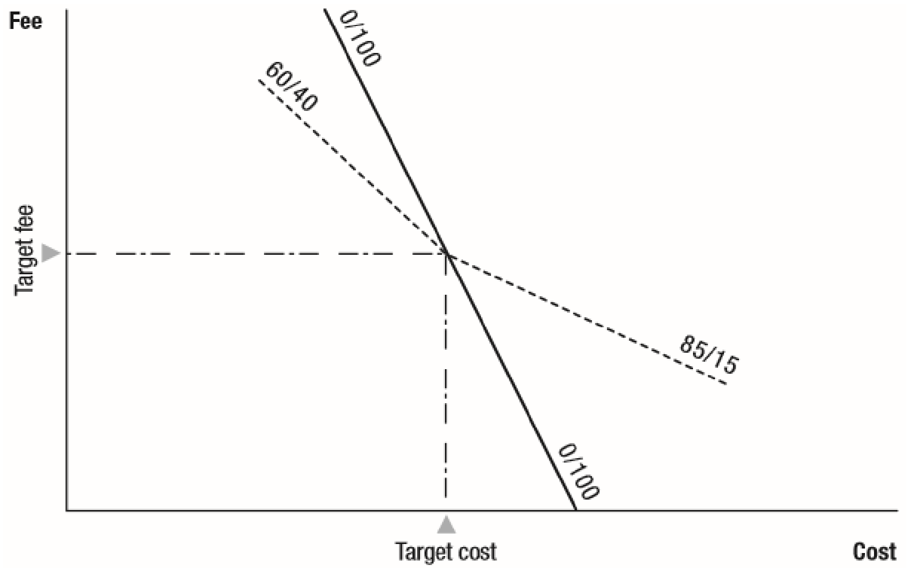

Fig. 1: TCIF vs. Firm Price

Why do it? (cont'd)

Contractors disliked the cost-plus era because of its low profit rates as costs fall, and the clients disliked the cost-plus era because of the absence of genuine incentives on the contractor to control costs.

Fig. 2 : Cost Plus Arrangement

Typical TCIF Arrangement

The essential elements of a TCIF are:
1- A target cost , which should be the best estimate mutually agreed by both contracting parties of what costs will be when the work is done
2- A target fee, which is the amount of profit payable if the actual costs equal the target cost
3- The share formula , which describes the way in which any differences between the actual cost and the target cost are to be distributed between the contracting parties

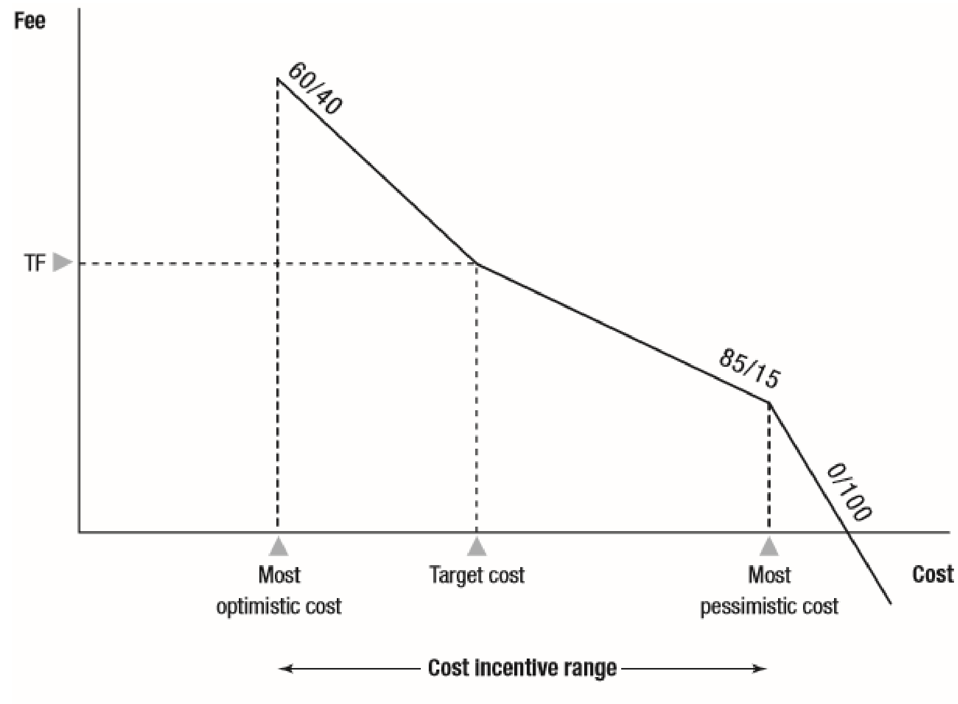

Fig. 3: Typical TCIF Arrangement

Smart TCIF

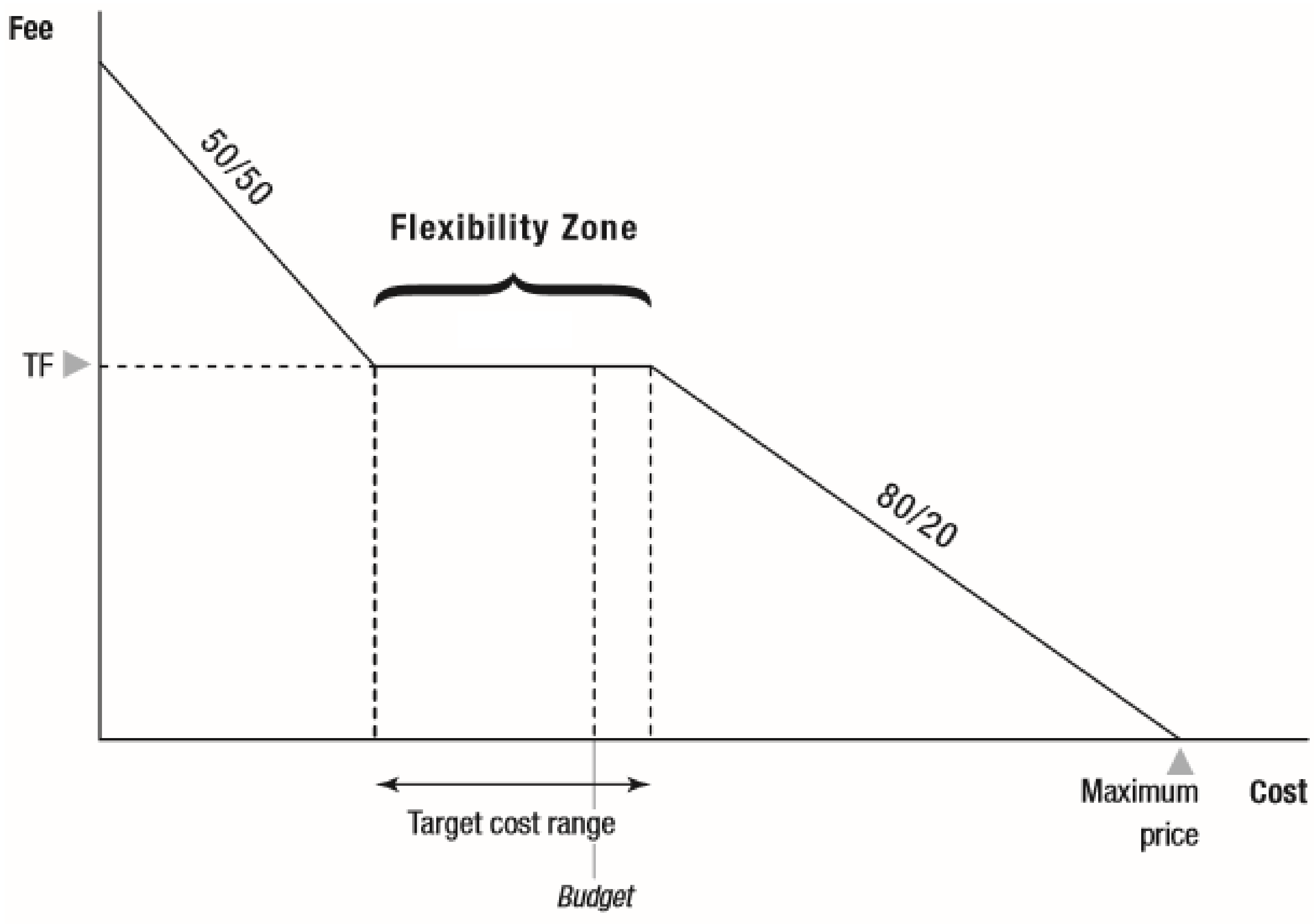

Fig. 4: Smart TCIF

Example

A target cost incentive fee has the following characteristics:

Target cost = $ 300 M , target cost range starts at $ 280 M and ends at $ 320 M, Target fee = $ 40 M, Cost saving share = 70 / 30 (70% by the client) , cost increase share = 40/60 (60% by the contractor) , contractor minimum fees is $ 10 M, the ceiling price = $ 420 M and the minimum expected project cost = $ 200 M

Draw the relation between project cost and contractor fee

If the cost of the project is $220 M , calculate the contractor's fee

Achieved Benefits ?

Summary

- ✓Contractual Incentives
- ✓Target cost Incentive Fee
- ✓Smart Target Cost Incentive Fee
- ✓Example
- ✓Achieved benefits

Any Questions??