

BUILDING BLOCKS

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Contingency Funds in the Design Professions & the Construction Industry

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In the design professions and the construction industry unexpected costs in a project seem inevitable. A certain level of ambiguity, defects and errors or omissions should be anticipated, and in fact, are normal. This is true in every project, be it new construction but especially in renovation projects. Renovation, rebuilding and remodeling buildings is changing with unknown and concealed conditions. Some would agree that it is an “art” and not a “science.” See DesignPro’s risk management article titled “Renovating, Remodeling or Rebuilding - Risk Management for Design Professionals,” July 2022:

<https://www.designproins.com/blog/2022/07/renovating-remodeling-or-rebuilding-risk-management-for-design-professional>.

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A STANDARD OF CARE DISPELS IMPERFECTION

Both in “the common law” and in agreements between design professionals with their clients, they ordinarily include a standard care statement. Consider this as an example.

The standard of care for professional design services performed or furnished by Design Professional under this Agreement will be the skill and care used by members of Design Professional's profession practicing under similar circumstances at the same time and in the same locality. Design Professional makes no warranties, express or implied, under this Agreement or otherwise, in connection with Design Professional 's services. This Standard of Care under this Agreement shall not be modified notwithstanding any provisions elsewhere in this Agreement. Furthermore, Design Professional is an independent contractor at all times during the performance of its services, and any provisions in this Agreement, either expressed or implied, shall not create an agency or fiduciary relationship with its client.

Likewise, it is a good idea that a design professional should educate their client, especially if that client is inexperienced in design and construction. Proactively addressing expenses involving ambiguities, defects and errors or omissions in advance of when a problem occurs is good risk management for all parties to a project.

WHY A CONTINGENCY FUND IN A PROJECT

A contingency fund is a dedicated reserve of money set aside to handle unexpected expenses and emergencies, ensuring financial stability when life takes a surprise turn. Think of it as a monetary safety net, ready to catch you when unforeseen costs arise. A contingency fund covers all types of unexpected expenses. *Cambridge Dictionary - Cambridge University Press*

CONTINGENCIES FIND THEMSELVES IN AGREEMENTS

This is the place where the parties to an agreement spell out the understanding of a contingency's terms and conditions. An example of such clause is in the American Institute of Architects' (AIA) Standard Form of Agreement Between Owner & Architect for a Complex Project, B103, Article § 5.3.1

The Owner acknowledges that accelerated, phased or fast-track scheduling provides a benefit, but also carries with it associated risks. Such risks include the Owner incurring costs for the Architect to coordinate and redesign portions of the Project affected by procuring or installing elements of the Project prior to the completion of all relevant Construction Documents, and costs for the Contractor to remove and replace previously installed Work. If the Owner selects accelerated, phased or fast-track scheduling, the Owner agrees to include in the budget for the Project sufficient **contingencies** to cover such costs.

TYPES OF CONSTRUCTION CONTINGENCY FUNDS

For the construction industry, there are two main types of construction contingency funds.

Contractor contingency

A contractor contingency is an amount built into the contractor's anticipated price for the project to account for various risk factors that cannot otherwise be accounted for in a **schedule of values**.

This money is set aside to account for any errors that occur on behalf of the contractor. Accordingly, contractors consider these funds *spent money*. Building this extra funding into an estimate is the contractor accepting the fact that unpredictable costs are all part of the construction process.

Owner contingency

A project owner's reserve is an amount set aside for additions or modifications of the scope of the work. These types of contingencies are used mainly in guaranteed maximum price (GMP) contracts.

Any changes not included in the initial bid will have to be paid by the owner-funded contingency. Incomplete plans or owner-directed changes are the leading causes of dipping into an owner contingency fund.

<https://www.procore.com/library/construction-contingency> by Alex Bernarroche, June 13, 2024

ESTABLISHING THE AMOUNT OF A CONTINGENCY FUND

There is a lot of latitude in establishing the amount. Factors include but are not limited to the scope, size, schedule, limitations, complexity, quality of the work, risk levels, environmental factors, unusual features of the project, and even the character and professionalism of the parties involved. It could be negotiated and set with a lump sum of money or a percentage of the project budget.

IN CONCLUSION

Contingency funds are good risk management for unforeseen incomplete designs, errors or omission in construction documents, construction project delays, substitute subcontractors, price increases, and any other number of unexpected costs. The project owner should discuss establishing a contingency fund when engaging design professionals and construction contractors.

About the Author of this Risk Management Building Block Article

As a risk manager for the last 18 years for the design profession, Eric has experience in professional liability insurance and claims, architecture, engineering, land use, law, and a unique background in the construction industry. Prior to risk management, he has 25 years of experience in the practice of architecture/engineering, and as an adjunct professor teaching professional practice courses at the undergraduate and graduate levels for the last 35 years at Kent State University's College of Architecture & Environmental Design.

As a Fellow of the American Institute of Architects and AIA National Ethics Council 2021 Chair, he has demonstrated his impact on architectural profession. He has presented numerous loss prevention and continuing educational programs to design professionals since 2000 on topics of ethics, contracts, and professional practice in various venues across the United States and Canada. He is a former member and chair of his city's Board of Zoning & Building Appeals for 24 years, and is a licensed architect, attorney, and property & casualty insurance professional.

His educational background includes a JD from Southwestern University School of Law, Los Angeles; Master of Science in Architecture from University of Cincinnati; and BA in psychology/architecture from Miami University, Oxford, Ohio.

The above comments are based upon DesignPro Insurance Group's experience with Risk Management Loss Prevention activities and should not be construed to represent a determination of legal issues but are offered for general guidance with respect to your own risk management and loss prevention. The above comments do not replace your need for you to rely on your counsel for advice and a legal review, since every project and circumstance differs from every other set of facts.

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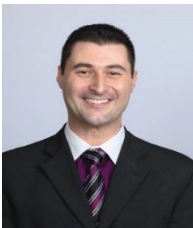
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