



How to classify costs in construction tenders and projects

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Construction projects typically require a multi-disciplinary approach for managing project costs. A logical, common-sense approach is required, which involves managing costs at the outset, during the tender stage and right through the project life cycle to project completion. Understanding construction project costs in detail is essential for stakeholders to ensure that the project is delivered on time and on budget while maintaining the desired quality standards.

In this blog, using examples, we provide a simple way to categorise costs for a typical construction tender project by classifying them as either:

- visible costs (direct costs); or
- hidden costs (indirect costs).

We will also look at 5 key benefits of classifying costs in a construction project:

- Enhanced financial planning and budgeting;
- Improved risk management;
- Appropriate allocation of resources;
- Enhanced transparency and accountability; and
- Improved decision-making.

5 common “visible costs” in construction projects

Visible costs are the direct, easily identifiable expenses incurred during the project lifecycle. Examples of visible costs include the following:

Material costs

These include procurement of raw materials like steel, concrete, and piping. Prices for raw materials can fluctuate based on market conditions, impacting overall project cost.

Material costs can also include the purchase of specialised equipment needed for specific project tasks. These are usually high-value items with significant impact on the budget.

Labour costs

Typical examples of labour costs are salaries and wages for skilled and unskilled labour. The project location and market demand can impact the labour rates and increase project costs.

Labour costs also include overtime payments or extra payments for work done beyond regular hours. This type of cost is typically incurred when a contractor needs to meet tight schedules or recover from delays.

Equipment costs

These types of costs can include rent paid for leasing equipment for the duration of the project. Equipment costs can be significant depending on the length and complexity of the project.

Maintenance and operating costs are another type of equipment cost that is incurred due to the regular upkeep costs for equipment used on-site. These costs can add up over time.

Subcontractor costs

A common example of subcontractor costs is the contractual payments based on the progress and milestones achieved.

Subcontractor costs can also include the cost of hiring subcontractors for specialised tasks such as electrical work, plumbing, or HVAC installations.

Administrative costs

These are typically costs associated with project management activities, including planning, coordination, and supervision. They may also include office overheads which are day-to-day administrative expenses like utilities, office supplies, and communication costs.

3 common “hidden costs” in construction projects

Hidden costs are typically less visible and can emerge unexpectedly. Hidden construction project costs can significantly impact the project budget if not managed effectively. Examples of hidden costs include:

Rework and defects

These can include costs associated with a failure in quality, which are the costs associated with correcting defects or redoing work that does not meet quality standards. Rework costs can be incurred due to design errors, construction mistakes, or material failures.

A related example is the additional costs for repeating quality control tests and inspections where the original tests have failed.

Delays and disruptions

Schedule overruns: Financial penalties and additional costs due to project delays. These can arise from unforeseen circumstances, design changes, or resource unavailability.

Disruption costs: Costs resulting from interruptions in the workflow, such as equipment breakdowns or labour strikes.

Inefficiencies and wastage

During the course of a construction project, hidden costs can include the costs arising from inefficient use of resources, such as labour and materials. This can include idle time, unproductive hours, and material wastage.

Hidden costs can also include energy and utility wastage arising from the excessive use of utilities like electricity and water. Following completion of the project, it is also important to recognise that this wastage can lead to higher operational costs.

Examples of construction costs that can be both visible and hidden

Health and safety incidents

During the course of a construction project any workplace accident costs can be both direct (visible) and indirect (hidden); for example, costs such as medical expenses, legal fees, and compensation payments.

Following any findings of non-compliance, there may be fines and penalties as well.

Environmental costs

Environmental compliance costs are incurred when a project party is required to ensure compliance with environmental regulations, including pollution control measures and waste management.

There are also visible costs for remediation or environmental cleanup or due to accidental spills or non-compliance.

Benefits of categorising costs in a construction tender or project

Enhanced financial planning and budgeting

Categorising costs into visible and hidden categories allows for more precise financial planning and budgeting. By identifying both types of costs, it is easier to develop more accurate and comprehensive budgets early in the tender phase of the project. This approach helps ensure that sufficient funds are allocated for all aspects of the project, reducing the risk of cost overruns and financial shortfalls.

Improved risk management

Hidden costs can pose significant financial risks if not adequately identified and managed. By categorising costs, project managers can proactively address potential hidden costs through risk assessment and mitigation strategies. For example, recognising the potential for hidden environmental costs allows for the inclusion of appropriate contingency funds and the development of environmental management plans.

Appropriate allocation of resources

Understanding the full spectrum of construction project costs enables more effective resource allocation. A project manager can then prioritise spending on critical project components and allocate resources where they are most needed. This approach helps optimise resource use, ensuring that funds are not unnecessarily tied up in non-essential areas.

Enhanced transparency and accountability

Transparency and accountability are critical in construction project management as stakeholders usually demand a clear understanding of where project funds are being spent and understand areas that may require additional scrutiny. For the project manager, ensuring there is a clear understanding of all the project costs encourages trust and collaboration among project

stakeholders.

Improved decision-making

Categorising costs into visible and hidden categories supports better decision-making throughout the project lifecycle. It allows project managers to evaluate the financial implications of different project scenarios and make informed decisions based on a comprehensive understanding of all costs. For example, understanding the hidden costs of delaying a project can influence decisions regarding project timelines and resource allocation.

Get help from a construction lawyer

Seeking legal advice when necessary is crucial for ensuring that all contractual and regulatory obligations are met. This will further safeguard your project's financial health and overall success.

Wambeti Legal can help you to employ strategies to ensure your contractual and regulatory obligations are properly negotiated and documented within your contract.

Contacting Wambeti Legal

[0423 825 235](tel:0423825235)

hello@wambetilegal.com.au

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