

**TOP-DOWN / BOTTOM-UP PROJECT FEE BUDGETING**

Budgeting, scheduling and coordinating are ways in which Project Managers plan for the most effective utilization of their prime resources: people, time, technology and money. The importance of budgeting depends to a certain degree on the type of contract used for the project. For contracts with a fixed, lump sum or guaranteed maximum fee, preparing a fee budget is critical, since the compensation is limited to a maximum amount and fee overruns are generally not recoverable.

Fee budgeting might be less important for those projects being done on an hourly basis without a maximum. Not many of us see these types of contracts anymore. Regardless, I believe the design professional still has a responsibility to provide their client with some idea of what their projected fee might be. As the scope expands, at the request of the client, the fee projected will also need to be expanded. Most clients will have some expectation of what they expect to pay for your services, even with an open-ended hourly fee.

The following are two (2) ways to approach the development of a project fee budget:

1. Top-Down Fee Budgeting:

This process is most applicable for public sector projects where the client sets the fee (e.g.: government agencies-fee as a percent of the construction budget). Since the fee is already established, your concern is to determine if the requested scope of services is feasible for this given fee. The best way to do this is to evaluate each component of the fee (refer to Page 5 of the handout for these components). Most importantly, this would entail determining each task to be done for each phase of the work and then estimating (hopefully using some previously completed, similar project) the number of hours to complete each task/phase. To establish the cost of those hours use the hourly-billing rate for each staff member to be assigned to the project. You could also use an average hourly billing rate. This process will provide a cost for the services requested. Your calculated cost may however exceed the fee established by the client. If so, it would be necessary to negotiate for a reduced scope of services (or a higher fee) to allow for some level of profitability. If this negotiation is unsuccessful, the decision to 'go, or not go', becomes one of risk/loss assessment. This method does not provide much opportunity for 'value-added' compensation.

2. Bottom-Up Fee Budgeting:

This process is the reverse of the Top-Down process. This is the most common approach for private sector projects, which allows you to determine the fee for a defined scope of services. Again, as with the Top-Down approach, the most important part of the process is determining each task to be done for each phase of the work and then estimating the number of hours and cost to complete each task/phase. The distinction here is to use the 'break-even' rate for those staff to be assigned to the project. Again, an average 'break-even' rate could also be used. Once all of the costs have been calculated, a 'value-added' percentage of profit can be added to establish the fixed fee to be negotiated.

An essential tool in establishing the respective hourly rate for calculating the fee for these two methods is knowledge of the current overhead rate for the firm. Without this key indicator, it is not possible to establish an appropriate 'break-even' or billing rate for each assigned staff member. The appropriate 'value-added' profit percentage is added to the 'break-even' rate to determine the hourly billing rate.

Using these approaches to define the scope and fee is not a guarantee that a profit will be realized at the end of the project. These budgeting tools will however provide a 'road map' to earning the targeted profit. If the fee analysis calculations are reasonably accurate and the client agrees to the scope and fee, the chances of completing the work and making a profit are better than if these fee/scope setting approaches were not used.

The goal is to create a win-win negotiation. However, with these methods you can maintain control of the negotiation process because you will know what your break-even cost is for the defined scope. Sometimes however, to 'win' the negotiation you may have to say "no thanks" to a client.