Smart contracts give clients several ways to pay

Practice Matters

By Elizabeth Harrison Kubany

A little creativity can go a long way in crafting a contract. Most architects use more than one compensation method, depending on the project, to improve profitability and manage risks, such as a fixed fee for one commission and a percentage of construction cost for another. But potential risks and rewards can vary, not just from project to project, but from phase to phase within a single project. "So, architects can apply this same principle of contract negotiation to individual agreements," suggests Michael Strogoff, AIA, a Mill Valley, Calif.-based negotiations consultant.

While architects currently have at least 11 ways to determine compensation (see sidebar) at their disposal, most practitioners opt for some variation of three tried-and-true methods. The *1997 AIA Firm Survey Report* found that, during 1996, most firms' contracts used some variation of either fixed-fee, hourly rate, or percentage-of-construction-cost methods.

Differing perspectives

Architects and clients often have different sets of criteria for evaluating contracts. Lump sum agreements, for instance, are simple from an accounting standpoint (for both the owner and the architect) but can be risky for the architect if the scope of work is not well defined at the outset of a project, as is frequently the case. Some architects prefer the percentage-of-construction-cost method because the fee usually reflects the final scope of work; others, however, are leery of tying their profit to a volatile bid market. Owners sometimes feel that it can be difficult, with the percentage-of-construction-cost method, to trust the architect's motivation for making certain decisions, such as specifying more expensive materials. Hourly fees allow for flexibility but are viewed by some clients as being too open-ended and prone to abuse. Another common complaint about hourly fees is that they don't let architects benefit from their expertise and efficiencies because the architect is not rewarded if the job is completed unusually quickly.

"Mixing compensation types can resolve these differences," says Strogoff. For phases where the scope of work is unknown or unclear—such as fund-raising presentations or the early phases of design with a new client—architects can ask for an hourly rate with a stipulated maximum. For tasks that are more easily quantifiable, the client and architect can choose a lump sum, percentage of construction cost, or unit cost. "Converting compensation methods at a predetermined milestone can align objectives and mitigate risk for both parties," says Strogoff.

Protecting the bottom line

William S. Harris, AIA, of Signer Harris Architects in Boston gives an example: "We were once asked to do a portion of a project in a wetland. We thought we might have to jump through hoops to get the necessary approvals but weren't exactly sure what the process would involve. So we used an hourly rate with a predetermined maximum for this part of the project. If we hadn't done this, we would have lost money."

Strogoff, who was recently involved in a negotiation for a series of large school projects in northern California, cites another example. In this case, he says, "mixing compensation methods provided the client with tremendous flexibility while eliminating much of the A/E team's risk."

A sample contract

The contract was structured as follows: The programming phase, where the scope was easily defined, was based on a fixed fee with lump sum adjustments for additional presentations to the school's oversight committee. Here, the A/E team benefited from its efficiencies while the school district was able to budget specific funds for a known scope. More open-ended predesign services, such as investigating existing conditions, were paid on an hourly basis. Design services were primarily based on a percentage of construction cost. To reduce the risk associated with a volatile bidding market for both the client and the architect, however, the percentage of construction cost was transformed to a lump sum at the end of the design development phase based on the adjusted construction budget. This predetermined fee let the client and the architect work closely during the construction documents phase to look for ways to reduce construction costs without diminishing the architect's fee. The construction administration phase, during which architects often lose money because of differences in contractors' methods and skills, was assessed based on a lump sum per site visit and on an hourly basis for other CA services.

This example may seem dauntingly complex, but according to Strogoff, it took only the time needed to go through the different tasks with the client and discuss the issues.

Choosing the correct combination of compensation methods can maximize the architect's profit and lower costs while balancing risk for both parties. It is often left to the architect to explain to the client how mixing methods can benefit the client, but the result is worth the effort. As Strogoff says, "Architects lose valuable opportunities when they base project fees on only one compensation method." ■

AN ARRAY OF CHOICES

The 11 compensation methods that architects can use today follow: predetermined measures such as lump sum, percentage of construction costs, and unit costs; time- and cost-based methods such as hourly or daily, multiple of costs, multiple of costs plus profit, multiple of subconsultants' billings, and retainer; and incentive-based methods such as royalty, equity position, and incentive bonuses and/or penalties.