



**Should Project Budgets
Be Based on Worth or on
Cost?**

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Calculating the Allowable Cost

Estimated Worth of the Asset to be Constructed



Willing to Spend



Able to Spend



Allowable Cost

Basic Commercial Model

Budget ▶

**Actual
Cost +
Fixed
Fees** ▶▶

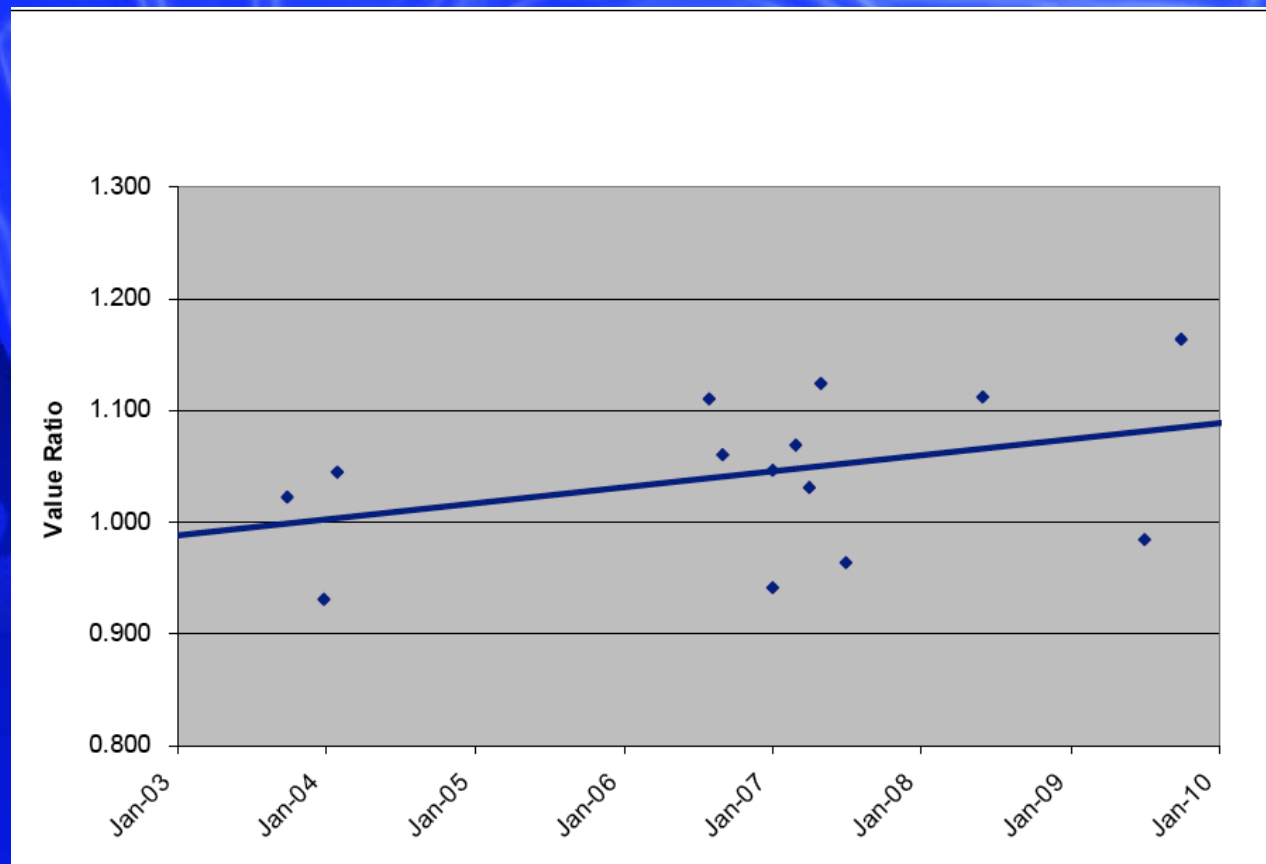
**Target
Cost**



Painsharing zone

Gainsharing
zone

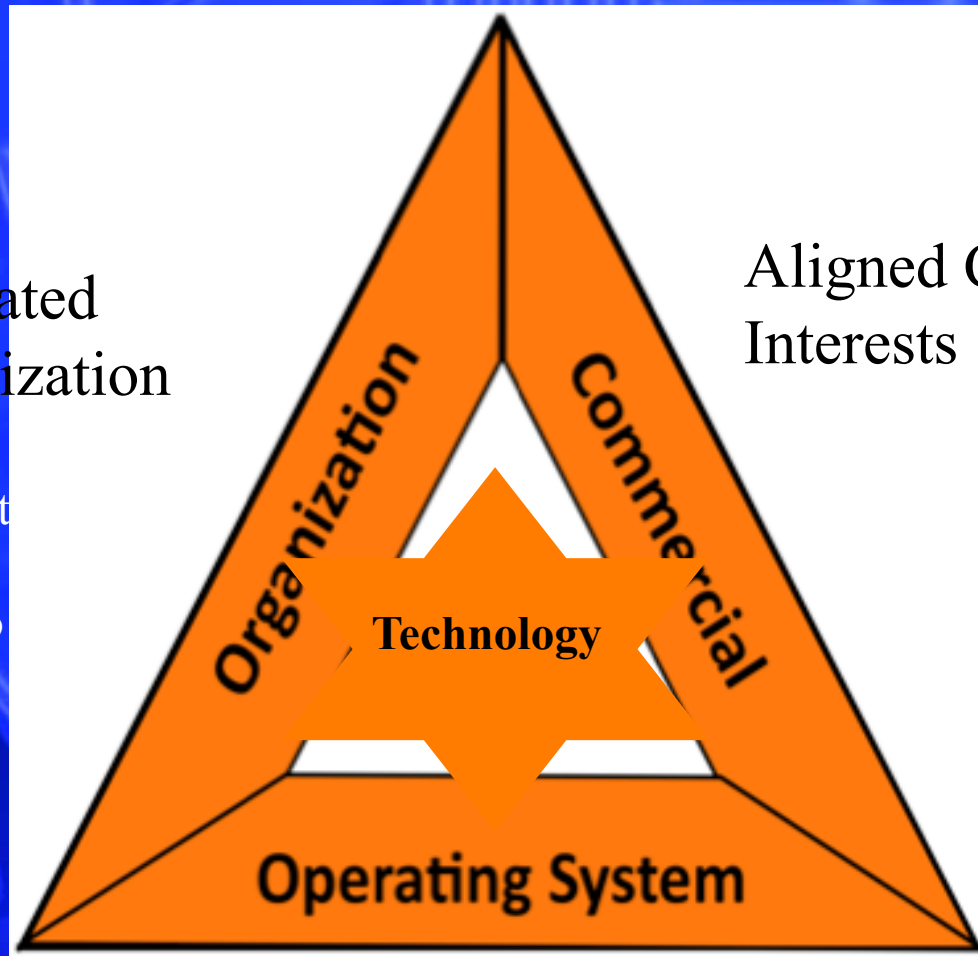
Project Cost Reduction Over Time



The Lean Construction Institute Triangle

Integrated
Organization

Apply all relevant
criteria
simultaneously to
the evaluation
and selection
from design
alternatives.



Aligned Commercial
Interests

Make money
able to move
across
organizational
and contractual
boundaries in
search of the
best project-
level
investments.

Lean Management

Target Value Design

Value Stream Mapping

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Last Planner System

Traditional Project Management Practices

- **Sequential processing**
- **Fixed price contracting**
- **Reductionist work breakdown**
- **Push scheduling & reactive project control**

Cost Performance on Completed Projects

Project	Location	Date Completed	Market Cost (M)	Cost at Completion (C)	% Savings $((M-C)/M)*100$
St. Olaf College's Tostrud Fieldhouse	Northfield, Minnesota	August 2002	\$13,533,179	\$11,716,836	13.4
Thedacare Shawano Clinic	Shawano, Wisconsin	2006	\$13,600,000	\$11,200,000	17.7
Sutter Fairfield Medical Office Bldg	Fairfield, California	Nov 2007	\$22,000,000	\$17,900,000	18.6
Will C. Wood High School Science Building	Vacaville, California	2008	\$16,908,251	\$13,375,000	20.9
UHS' Texoma Medical Center	Denison, Texas	Dec 2009	\$98,000,000	\$89,200,000	8.8
Sutter Mills Peninsula Hospital Expansion	San Mateo, California	Oct 2010	\$14,500,000	\$13,700,000	5.6

Conclusion

In order to reduce the risk that projects fail to achieve their purpose and to reduce the cost of projects over time, the traditional functions of project budgets should be performed by two different mechanisms, with budgets based on worth in order to secure value delivery, and costs driven down through gainsharing.