



# Making the Most of Your Budget

*How to get the best FEC for your money.*

by Randy White

*This is the fourth installment in a series about starting a family entertainment center from the ground up. Part One ("Secret of FEC Success: Know Your Market," Fall 1992) covered how to analyze a trade area to better know your customer. Part Two ("Customer-izing for Success," 1st Quarter 1993) gave a general overview about how to determine what guests want and expect from your FEC. Part Three ("Design and Development: Creating a Profitable FEC," 2nd Quarter 1993) covered how to use an integrated team approach to design your FEC.*

**S**o you've picked the right site, finished the concept development and feasibility study, and got the funds lined up. You're on the home stretch—time to pat yourself on the back and take a breather, right? Don't even think about it. There are more challenges ahead as you work to bring your FEC in on budget and on time.

It takes a special set of skills to transform a great idea on paper to a three-dimensional winner. Development management techniques and tools reduce your risk because without them, the best-conceived

project can quickly get out of control. Before you know it, you've got a financial disaster on your hands.

Cost overruns can handicap an FEC's ability to generate the return projected in the feasibility phase or even cause a negative cash flow. For example, if overruns eat up funds that were earmarked for grand-opening advertising, or if you don't have the cash to buy the right redemption prize merchandise, you've got a problem.

Your household probably has a budget that you follow fairly closely. Yet some people, when they go into business, get pulled in a million different directions. They become a victim, managing their money in ways they never would on a smaller scale. The right budget process ensures that you won't become a victim.

Maintaining control of costs requires a budget process that includes four components:

1. Creating the budget.
2. Controlling costs.
3. Monitoring costs versus the budget.
4. Updating the budget.

## **CONCEPTUAL BUDGETS**

Beware of the conceptual budget. It's that first budget you

draw up during the concept development feasibility phase, and often it reflects more of what the owner thinks the FEC should cost than what it really will. An unrealistic budget can drive your FEC into financial trouble before it's even built.

Based on the conceptual budget, owners raise equity and capital and secure financing. But the conceptual budget rarely is based on detailed construction plans, detailed quantity takeoffs, or an itemized costing of each furniture, fixture, and equipment item (FF&E). Conceptual budgets are often unrealistically low for several reasons:

- The individuals who developed the budget are inexperienced in the complexities of all the components of an FEC and fail to provide for many important items. Big items like rides and kitchen equipment are obvious. It's the little things—office supplies, flyers, uniforms, spare parts, and training—that quickly add up to serious money.

Even at the concept stage, a properly prepared budget can have more than 100 line items in its cost estimates. For example, White Hutchinson, a consulting company based in Kansas City, Mo., recently prepared for

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insurance purposes an inventory list for a 30,000-sq-ft project. The list was over 620 lines long, with each line describing one type of item.

- Soft costs don't make it in the budget. Soft costs are those intangible items like real estate and finance closing costs, points and interest on loans, professional and design fees, permits and licenses, surveys, appraisals, equipment shipping and installation, and training for employees. Soft costs can easily add up to 15 percent or more of the total cost.

- Noncost items aren't included. It's going to take awhile before the FEC generates a positive cash flow, and the budget should reflect every cash outlay you must make before then. That includes start-up inventory, utility and insurance deposits, and operating capital. (You can't operate a business, even a cash one, without money in the bank.)

- The budget is prepared using an approximation of costs per square foot, rather than an estimate based on specific categories of items. Every FEC is unique in its mix, build-out finish costs, and most other factors, and that must be included in a realistic budget.

Depending on the FEC's geographic location, for example, construction costs, shipping, use taxes, and labor costs vary widely. And large FECs can cost less per square foot than small ones. Basing your budget on someone else's FEC or the industry average is a quick ride to trouble.

- The budget doesn't include contingency dollars. Estimates of cost at the concept design stage cannot be as accurate as estimates based on completed working drawings. The amount of contingency dollars that need to be included depends on where you are in the design process, and its associated detail.

Let's say you're at the concept stage. In that case, a contingency of 10 percent or more is reasonable. If the FEC includes renovation of an older building, you may need an even higher contingency. But contingencies can drop to as low as 2 percent once the project is bid and orders placed for most FF&E items.

Once you have a realistic budget, the entire FEC design team needs to stick to it. For some, that may require an attitude adjustment. Agree at the start that if various contingencies are exhausted, either the budget will be revised, the design altered, or the team will look for a creative alternative. This way, the conceptual budget becomes part of the total design process.

## STICKING TO THE BUDGET USING VALUE ENGINEERING

If you've been involved in a traditional design project, you know what happens after the bids are in: there's that delightful panic when everyone realizes the designers' specifications and the budget are about as close as Chuck and Diana.

At this point, it is too time consuming and costly to dump major building components. Instead, the owner is forced to compromise on quality and cosmetic and theming elements. This can damage attendance or long-term operating or maintenance costs. Sometimes, the owner has to drop a major component or ride even though it was essential to the FEC's concept, mix, and market appeal.


Value engineering can reduce bid panic, and it works best with concurrent design. (See part three.) Value engineering has been around since the 1960s, used mainly in the construction industry. Its goal is to find the best way to accomplish a task for the least possible cost. Applied to FEC design, it is an innovative approach to reduce cost and improve quality and performance.

Cost benefits of value engineering reach beyond budgetary and capital costs, including operations throughout an FEC's life cycle, like utilities, labor, maintenance, and marketing. Value engineering, combined with concurrent design, can reduce developmental costs by 5 to 25 percent over the traditional design approach, while improving quality, safety, reliability, and maintainability.

Value engineering is a problem-solving technique based on functional analysis. In functional analysis, each component is described with only two words—a verb and a noun. That puts the focus on what something does, not what it is. Examples include "create comfort," "speed loading," and "reduce noise." For an FEC, you'd have 100 or more functions applicable to the entire FEC or to specific sections.

The following steps are the core of the value engineering process:

- Identify the essential function to be performed.
- Stimulate creativity within the design team to develop alternatives that will perform the function.
- Evaluate how much each alternative costs and how well each performs.
- Select the best solution.



Value engineering ends bid panic because the general contractor, subcontractors, and suppliers are involved throughout the process. They have to be, because they have the most up-to-date experience and information on equipment, technologies, and construction techniques.

The general contractor, subcontractors, and suppliers should be brought in as part of the design team at the earliest stage. They'll help get you a more accurate concept budget, and not just because they give you a more accurate estimate. They also can identify design issues and costs you'd miss until later using a traditional design process.

Subcontractor involvement, in particular, is vital to value engineering. Subcontractors know about specific products and methods because they work with them every day. For example, the energy management design may call for every bell and whistle, but your electrical subcontractor may know of a system that's cheaper, simpler, and more user-friendly. Sometimes a simple thing like changing the kind of light fixture or the thickness of the pavement in the parking lot can keep down costs and meet functional needs. Only your subcontractors can give you this information.

### **UPDATING THE BUDGET REDUCES OVERRUNS**

Another way to avoid nasty surprises is to keep reviewing and updating the budget as you go along. At each design stage, the budget should be updated to match the level of design detail, and actual costs tracked in relation to planned costs. This is true even in the preconstruction phases as costs—especially soft costs—pile up. And monitoring cost versus budget is even more important once construction starts.

You can't do this using the traditional line-item method of monitoring a budget. In the traditional method, you compare the costs paid with the budgeted costs for each line item. If an item is budgeted for \$10,000 and you've spent \$4,000, the budget shows 40 percent completion. Problem is, the job may only be 20 percent complete, it's just costing more than you expected.

Traditional line-item budgeting fails to spot overruns until the end of the job because all it can do is tell you where you've been. It's as sensible as navigating your car using only the rear-view mirror.



Instead, your budget monitoring system should be based on accrual basis "flexible budgeting." For example, let's say the \$10,000 item really costs \$12,000, and the \$4,000 represents a deposit. The traditional budget still shows the cost as \$10,000, and you don't see the overrun until the item is delivered and the balance paid.

Accrual basis flexible budgeting would have identified the overrun immediately, and changed the budget to reflect it.

The soul of an accrual basis flexible budget is in the procedures. The budget must be updated based on the what an item costs when it is purchased. Using purchase orders allows you to do this, if the person responsible for monitoring the budget has access to enough information to determine the entire scope of each budget line item. It's not enough to carry a budget item for furniture unless you have a schedule of all the furniture items against which you can cross-check payments and purchase orders.

A budget is a cost goal; it isn't static. You can often achieve the overall cost goal even if you don't meet each line item cost goal. How? Through aggressive cost management and constant communication with all team members. This allows you to offset cost overruns by reducing costs for other items. Accrual-based flexible budgeting shows you problems in time to do something about them without compromising the quality of your FEC. And if there's an overall cost problem? Well, the sooner you know the sooner you can tackle it.

It's equally critical to know early on if you're coming in under budget, something that

happens more often than you might think. You can use the money you're saving to reduce financing costs or spend the excess on something that will give you the best return, if you know early enough to take advantage of the situation.

You can use your budget to improve your FEC, not count

the compromises you've made. The only way to do that is by making the budget an integral part of the design process. ●

*Randy White is a principal of White Hutchinson, Inc., a Kansas City, Mo.-based firm that assists FEC and recreation center owners with market and feasibility analyses, design and development management, and operations consulting.*



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