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# What Goes into a Quality Cost Review

Help clients understand risk by analyzing expenditures before funding

**F**or mortgage brokers helping their clients find funding for construction projects, it is essential to know and understand these projects' risk and exposure from the start. One way lenders will seek to mitigate risk is by requesting a project cost review. Brokers can prepare clients by suggesting they undergo a cost review before submitting a loan request.

A cost review allows analysis of your client's budget. This includes breaking down budgets and understanding what they mean, in addition to making sure all items are covered and that realistic costs are used.

A cost review will give you and your clients an opportunity to identify missing costs before construction begins. Further, by examining all budget components, you can protect your clients' projects and their bottom line.

When you are ready to order a cost review on your clients' behalf, it would be wise to find an unbiased, third-party company that uses construction professionals, experienced contractors, estimators and engineers to evaluate the budget. These professionals can find possible missing budget data, help establish market rates and understand project progression to foresee any potential risks to the project. This, in turn, will reduce opportunities for problems and improve the chances that the project will remain strong until completion.

Depending on your clients' needs, a cost review can occur on a variety of levels — from a good, cursory review to a better, detailed review to the best, extensive review. At any level, a cost review can help assure lenders that the contractor or property-owner has reviewed the budget

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for all actual construction costs and that all costs are included in the budget.

## **Good**

For any level of cost review, your client must provide a complete line-item budget and a set of approved plans to the consultant. The line-item budget should include everything necessary to complete the project. It is best to have an approved set of plans for conducting takeoffs to ensure you have accounted for all changes to the original plans.

The review will use industry subcontractors and construction-cost databases to verify and evaluate line-item costs. It also will examine comparable local or regional costs for the construction budget submitted. In addition, a cost review will consider whether the line items reflect the true costs of construction, as well as whether they provide enough detail to quantify the work necessary.

Additionally, a well-thought-out budget can help minimize change orders by ensuring everything is addressed from the outset.

Without the focus of a completed cost review, your clients risk taking cost-cutting measures at the end of the project, which could adversely affect the asset's value. For example, if the estimate of a concrete foundation's cost is inaccurate, it is

necessary to adjust proposed construction budget from other line items. If the quality of line-item selections such as plumbing or electrical fixtures, flooring, or appliances are adjusted, the impact could lower the asset's value.

## **Better**

In addition to the items needed for a cursory review, for a detailed review, your clients also must provide a project schedule, project specifications for commercial or high-end residential projects, a schedule of materials, and any available, fully executed contracts or sub-bids.

A detailed review also will attempt to answer the following questions:

- **Is the contractor licensed?**
- **Are the sub-bids realistic?**
- **How do the subcontractors want to be paid?**
- **Is the schedule realistic?**
- **Is the timeline for construction in line with loan time?**
- **Does the schedule account for weather and product availability?**
- **Have all decisions been made for items**

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such as plumbing and electrical fixtures, flooring, cabinets, etc.?

These items can greatly change the bottom line of any budget and can stall a project if not ordered in a timely manner.

If your clients gather and provide as much information as possible for the cost review, the third-party consultants can better assess the likelihood of the project being completed within the budget and on schedule. Product specifications are good for allocating resources, and they make it easier to monitor and manage the project.

### Best

An extensive cost review goes even further in its analysis than a cursory or detailed review. For an extensive review, your client also must provide a copy of the

appraisal, all soft costs (including permits, architectural and design fees, etc.), a soils report, a geotechnical report or any other fees that are part of the project.

Consultants also may evaluate whether contingencies and reserves are addressed in the budget and are sufficient, as well as whether all soft costs are addressed in the budget.

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With federal loan guidelines changing, cost reviews can help your clients' meet new requirements. A third-party assessment of construction projects can enhance the lender's and your client's confidence in a deal.

Regardless of the project size, a cost review can make managing the construction more effective and can keep all parties

working faster and more cost-efficiently. It also could help reduce risk by offering an unbiased, professional look at the project's viability and ensuring that a thorough budget is provided and in place before funding and at the start of each project. ●