

Target Cost Contract

Construction Procurement Guidelines

October 2019

Overview

Target cost arrangements are designed to manage the cost risks associated with a cost reimbursable pricing mechanism. A target cost for the project is set early on and any savings or cost overruns made in the final project cost are shared between the client and contractor based on an agreed formula.

The main aim is to create a positive financial incentive to the contractor to encourage good cost control.

Contracting on a target cost basis can lead to good collaboration among the project team. Target cost pricing mechanisms tend to be a key feature of alliance delivery models.

The target cost can be set for the project, or for specific elements of it. Agreeing on the target cost requires the client to have expertise in accurate estimation of the cost of the works, and effective contractor negotiation skills to arrive at an agreed target cost.

There needs to be a balance between setting a target cost that is easily achievable, and therefore less of a motivator towards looking for further efficiencies, against one that is totally unrealistic and likely to result in significant financial loss for the contractor.

Target cost contracts require good cost management expertise and experience in managing this type of approach, to ensure that the target cost is reasonable, and that all costs claimed by the contractor are properly due under the contract.