



An Advanced Discussion of the Risks and Rewards of GMP Contracting

Rick Burnham, Speaker

Meet your instructor

- 35 years in the industry
- 25 years “hands on” as a Contractor
- Expert in the identification and management of construction and contract risks
- Construction Company Executive, Analyst, Instructor, Expert Witness, Attorney



What will you learn today?



1. Potential Rewards and Risks of GMP Contracting
2. Components of a GMP
3. Addressing Increases/Decreases in the GMP
4. Administrative Capabilities Needed for a GMP Contract

What is a GMP Contract?



- Also Known as a Not-To-Exceed (NTE or NTX) Contract
- Is an Open-Book, Cost-Plus Contract Where the Construction Manager/General Contractor (CM/GC) Is Reimbursed for its Actual Costs Incurred, Plus an Agreed-Upon Fee
- **Subject to a Ceiling Price.**

What Do We Manage When We Manage Design/Construction



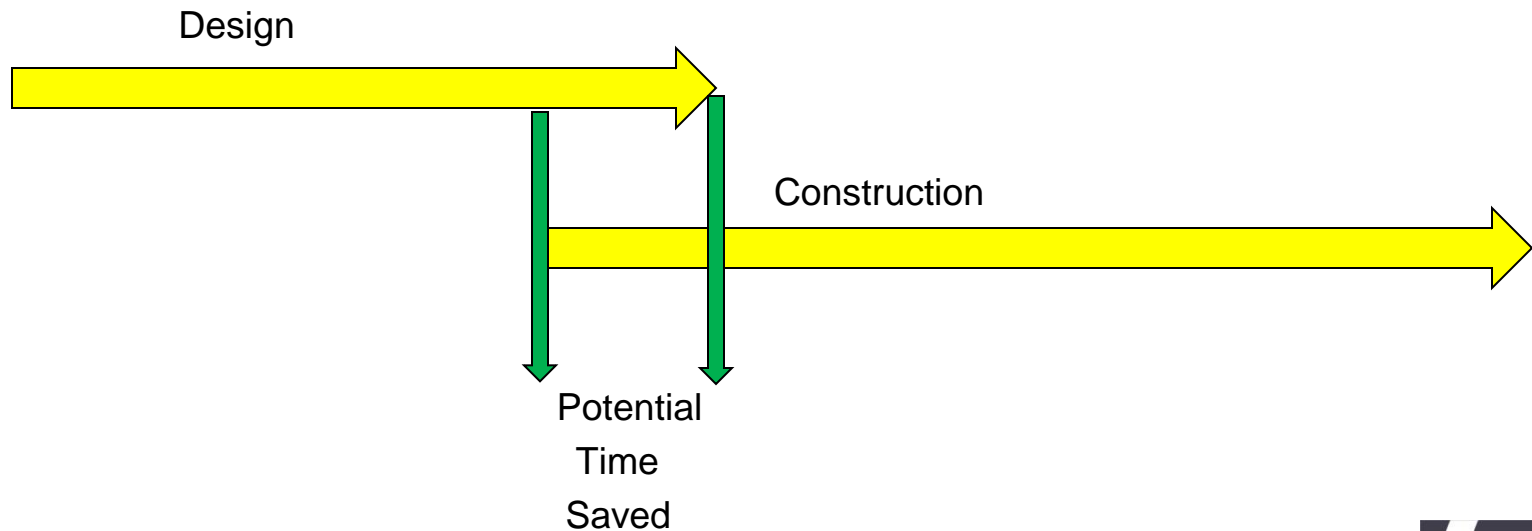
- **Time**
- **Money**
- **Quality**

1. Potential Rewards and Risks of GMP Contracts



■ Time – Reward

- GMP Contract Permits Construction to Begin Before Design is 100% Completed.



1. Potential Rewards and Risks of GMP Contracts



■ Time – Risk

- “Incompleteness” Of Plans and Specs When Setting the GMP May Cause CM/GC and its Trade Contractors to Be More Conservative in Their Time Estimation
- Designer Still Needs To Complete Its Incomplete Work in a Way That Is Consistent With the Accepted Value Engineering, Allowances, Assumptions, and Exceptions Set Forth in the GMP Proposal

1. Potential Rewards and Risks of GMP Contracts



- Time – Risk
 - Co-ordination Among the Trades Is at Least in Part Dependent upon Design Completion. Therefore, Design Must Be Completed ASAP.
 - Inability to Complete Co-ordination Can Result in Delays Down the Road

1. Potential Rewards and Risks of GMP Contracts



■ Time – Risk/Reward

- Can the Owner Do Things to Increase Its Confidence in Timely Completion? Consider Owner's Relative Bargaining Power to Negotiate an Acceleration –
 - Better to Accelerate Work Prior to Agreeing to a GMP Or After a Delay Has Occurred?
 - Cheaper and Easier to Accelerate When There is One or Two Trades Working (During Early Part of Schedule) or When There Are 10-15 Trades Working (During Latter Part of Schedule)?

1. Potential Rewards and Risks of GMP Contracts



■ Money – Rewards

■ Owner's Perspective

- Permits Owner to Begin Exercising Control Over Budget Earlier
- May Permit Owner to Close on Its Financing Sooner.
- Cost-Based Format and Open-Book Process Minimizes Risk of Contractor “Windfall”; Buy-Out Savings May Inure to Owner’s Benefit.

1. Potential Rewards and Risks of GMP Contracts



■ Money – Risks

■ Owner's Perspective

- GMP With Contingency May Initially Be Higher than Lump Sum Price If Waited for 100% Plans & Specs, But If the Contingency Is Not Used, Final Price Will Likely Be Lower Using GMP Format.
- Higher Initial Price Might Jeopardize Loan Closing.

1. Potential Rewards and Risks of GMP Contracts



■ Money – Risks (cont'd)

■ Owner's Perspective

- Competition at CM/GC Level Generally Limited to Fee and GCs Only (but, properly managed, there should be plenty of high quality competition at trade contract level, and that's where the bulk of the Costs are.)
- Engineer May Require Higher Fee Due to Increased Time Spent with GC

1. Potential Rewards and Risks of GMP Contracts



■ Money – Rewards

■ Contractor's Perspective

- CM/GC Has Enhanced Ability to Thoroughly De-scope Trades and Identify Gap and Conflict Issues Early
- De-scoping of Trades is Critical to Articulating Assumptions and Exclusions; and Fee Protection Comes from Contingency, PLUS the Ability to Clearly Articulate Exclusions and Assumptions.

1. Potential Rewards and Risks of GMP Contracts



■ Money – Rewards (Cont'd)

■ Contractor's Perspective

- Open Access to, and Communication With, Designer Can Enhance Confidence in Understanding of Scope.
- Potential “Shared-Savings”, If Applicable.

1. Potential Rewards and Risks of GMP Contracts



■ Money – Risks

■ Contractor's Perspective

- Fee and General Conditions Costs Exposed
- Sometimes GCs are “capped”
- Possibility of “Buy-out” profit lost (except to the extent of Shared Savings, if any)
- Subcontractor's claims may not “Pass-Through”
- All “standard” risks remain

1. Potential Rewards and Risks of GMP Contracts



■ Money – Rewards

■ Designer's Perspective

- If the Designer Truly Buys-In to The Process, Issues Related to Constructability and Co-Ordination Can be Solved With an Eraser, and Not a Jackhammer.
- Fee Due May Be Higher due to Increased Time and Involvement During Design Development with GC/CM and Trade Contractors.
- More Value Engineering Reviews

1. Potential Rewards and Risks of GMP Contracts



■ Money – Risks

■ Designer's Perspective

- As Field Work Begins Before Design Is Complete, Designer's Staff Capacity Can Be Challenged By the Need to Complete Design at the Same Time It Is Reviewing Submittals and Performing the Usual Array of Construction Phase Services.
- Some Designers Have Cultural Difficulty with the Fact that Design "Freedom" May Be Restrained by Assumptions, Exceptions, and Allowances.

1. Potential Rewards and Risks of GMP Contracts



■ Money – Risks (Cont'd)

■ Designer's Perspective

- Risk May Be Generated by the Reliance of Owner and GC on Implementation of Value Engineering by Designer.

1. Potential Rewards and Risks of GMP Contracts



■ Quality Rewards & Risks

- Overall, Constructability and Co-Ordination May Be Enhanced Due to Heightened Contractor and Trade Involvement Earlier in the Process.
- Designer's "Freedom of Choice" May Be Less, Due by Assumptions and Exceptions, But Ultimately Owner Can Choose to Pay for Quality Higher than that Which Is Specified.

1. Potential Rewards and Risks of GMP Contracts



■ Other Rewards & Risks

- Different Contract Format Requires a Different Mind-Set Among the Parties – Open Communication and Open Books Demand a Relationship of Trust.
- Administrative Challenges Require Different Skill Sets and Different Monthly Reporting.

1. Potential Rewards and Risks of GMP Contracts



Keep These Potential Risks and Rewards In Mind As We Proceed Through the Explanation of:

- Components of the GMP
- Changes to a GMP
- Administrative Capabilities Needed

Because the Better We Understand These Subjects, the Greater Will Be Our Ability to **Maximize the Rewards** and **Manage the Risks** We Have Just Identified.

2. Components of a GMP



CM/GC Fee

+ General Conditions Costs

+ Reimbursable Costs (COW)

+ Contingency

+ Allowances

GMP*

*With or Without Value Engineering?

*And Subject to Assumptions and Exceptions

2. Components of a GMP



Remember This:

- The Amount, Scope, Terms, and Conditions Related to Each of These Components Is Separately Negotiated, and the Precise Definition Typically Varies From One Contract to the Next.
- Similarly, the Conditions that Apply to the Payment of Each Component May Also Vary.

2. Components of a GMP



Fee

- Fixed Fee - Negotiated or Lump Sum
 - Most common for public sector contracts
 - Based on organization type, type/complexity of work, and risk factors/unknowns
 - May also vary based on construction contract value
- Variable Fee - Percentage of Contract Value
- Variations on the Above

2. Components of a GMP



Fee (Cont'd)

- How Is Payment Handled?
 - Pro-Rated Over Course of the Work (Fixed)
 - Balance Divided by Number of Months Remaining as Part of Monthly Progress Billing
 - Percentage Applied to Actual Costs Incurred (Variable)
 - Retainage? I/Ds for performance?

2. Components of a GMP



Fee (Cont'd)

- Risks That Affect Fee
 - Fixed Versus Cost-Plus-Fee
 - Relationship with Owner & Designer
 - When the CM/GC Is Retained
 - Level of Flexibility CM/GC Has With Subs

2. Components of a GMP



Fee (Cont'd)

- Risks that Affect Fee (Cont'd)
 - Level of Design Completion at GMP
 - Contingency
 - Assumptions and Exceptions
 - Allowances

2. Components of a GMP



General Conditions Costs

- Typical Indirect Costs Incurred in Performing the Work
 - Home Office, Field Office and Facilities, Supervision, and Administration
- To Avoid Disputes, GMP Contracts ***Must Be Specific*** about What Is Reimbursable and What Is Not Reimbursable Under This Cost Category

2. Components of a GMP



General Conditions Costs (Cont'd)

- Example - Home Office
 - Senior Level Executives Overseeing the Project May Not Be Reimbursable, But Part-Time or Full-Time Accounting Staff May Be Reimbursable
- Must Provide Details Such As:
 - Are Benefits Such As Paid Vacation Reimbursable?
 - What Categories of Expenses (phone, cleaning, bonuses, transportation, etc.) Are Allowable?

2. Components of a GMP



General Conditions Costs (Cont'd)

- Are Staff Costs Based on “Agreed Upon Hourly Billing Rates”, Or “Actual Costs”?
 - Example: If Employee Works 60 Hours in a Week:
 - If payment is based upon agreed-upon **hourly billing rate**, **Owner will likely be required to pay for 60 hours**, but,
 - If payment is based upon **actual cost**, and the employee is and “exempt employee” who is not paid overtime, **owner will only pay for 40 hours**.
 - Distinctions Need to Be Clear in Contract

2. Components of a GMP



General Conditions Costs (Cont'd)

- May Be Fixed Or Capped At Some Agreed Upon Amount
- Frequently Have a Provision that Requires Advance Consent of the Owner When Adding Staff to the Project

2. Components of a GMP



Reimbursable Costs (Cost of the Work - COW)

- Billings from Subs and Suppliers
- Cost of Materials
- Equipment
- Support Services
- May Also Include Costs of Self-Performed Work (CM/GC)

2. Components of a GMP



Reimbursable Costs (Cont'd)

- Contract Must Carefully Consider How Costs of Self-Performed Work are Segregated and Administered
 - For Example, If Owner Treats CM/GC Self-Performed Work As a Lump Sum Subcontract, Should Time of Superintendent Be Part of Lump Sum Price Or a Reimbursable Cost Charged to General Conditions?
 - Contract Must Be Clear

2. Components of a GMP



Contingency

- Not Always Clearly Identified
- To Minimize Misunderstanding, Clarify What May Be Billed Against the Contingency and what may not
- Some Contracts Have Separate Contractor and Owner Contingency

2. Components of a GMP



Contractor Contingency

- What Is Covered by the Contingency?
 - Buy-Out Gaps, Overruns, Underruns...Do They Flow Into and Out of the Contingency? When? How?
 - What About Overruns Due to Items Not Fully Detailed but Reasonably Inferred to Be Needed to Complete Work (Subcontract Change Orders)
 - Escalation? Remedial work? Punch list work?

2. Components of a GMP



Owner Contingency (NOT PART OF GMP)

- Owner Added Scope
- Design Errors and Omissions
- Changes in Specification Requirements Causing Increase in CM/GC's Cost
- Should Be Outside of the GMP, But Contract Language Does Not Always Make This Clear

2. Components of a GMP



Allowances

- Allowances Are Assigned to Items that Are Virtually Undefined at the Time the GMP Is Negotiated
- They are Just “Budgets” or “Plug Numbers” Included in the GMP Price With the Understanding that They Will Be Adjusted to Reflect Actual Cost When Defined

2. Components of a GMP



Allowances (Cont'd)

- Contract Language Will Determine How to Deal With Them, But Many Contracts Provide for Allowances to Be “Converted” When the Item Is Better Defined, and the GMP Is Adjusted Up Or Down Accordingly.
 - Therefore, It Is Important to Define What Is Covered By the Allowance When It Is Set (for example; freight, delivery, handling, mark-ups)
 - Does “One Size Fit All?”

3. Addressing Increases & Decreases to the GMP



What is a “Change”?

- Depends on Terms of Contract. . . .
 - What is Included in GMP/ What is Excluded?
 - Are the “Assumptions” or “Exceptions” Applicable?
 - Is It an Allowance Item?
- The Challenge in Identifying Changes Comes From the Fact that the “Baseline” Is Different Than in Design/Bid/Build Environment
 - Typically Not Well Defined in Standard Forms

3. Addressing Increases & Decreases to the GMP – What is a “Change”?



What Is a “Change”? (Cont’d)

- AIA A102 states:

- **5.2.5** *To the extent that the Drawings and Specifications are anticipated to require further development by the Architect, the Contractor has provided in the Guaranteed Maximum Price for such further development **consistent with the Contract Documents and reasonably inferable therefrom.** Such further development **does not include such things as changes in scope, systems, kinds and qualities of materials, all of which, if required, shall be incorporated by Change Order.***

3. Addressing Increases & Decreases to the GMP



What is a “Change”? (Cont’d)

- Use of Contingency (Either by Contract or by Conduct) May Influence Whether a “Change” is “Within the GMP” or “Outside the GMP”
 - If Contingency Is Used for Scope Issues that Should Have Increased GMP, a Precedent May Be Set
 - Delays
 - Should the Contractor’s Contingency Be Used for Differing Site Conditions?

4. Administrative Capabilities Needed for a GMP Contract

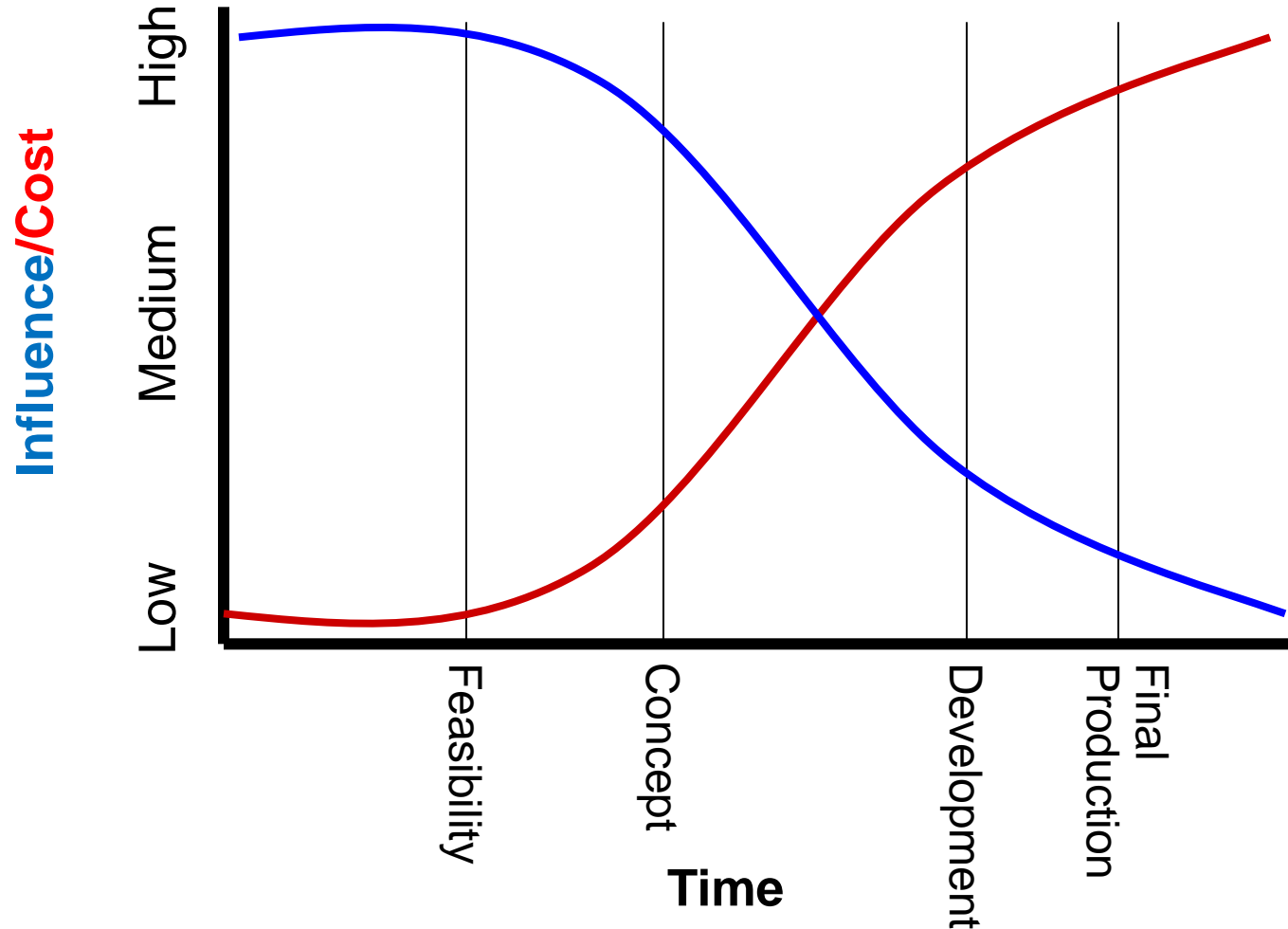


Phases in a GMP Contract

- Preconstruction
- Negotiation of GMP
- Construction
- Close-out

When to Hire a CM/GC?

Early Involvement provides best opportunity to influence costs.



4. Administrative Capabilities Needed for a GMP Contract



■ Preconstruction

- Totally Open Communication
 - Owner - Designer – CM/GC – Trades
 - Focused on Scope, Budget, & Constructability
 - Focus Needs to Be Not Only What **IS** Shown on Plans and Describes in Specs, But Also on What **IS NOT**
- Develop Trust Through Honest Exchange of Ideas and Understandings

4. Administrative Capabilities Needed for a GMP Contract



■ Preconstruction (Cont'd)

- Owner & Designer Need to Be Part of Trade De-Scoping Process (To Understand Not Only How the Trades Understand Contract Documents, But Also When is the Right Time to Finalize GMP)
- Focus on Foreseeable Co-ordination Issues

4. Administrative Capabilities Needed for a GMP Contract



GMP Negotiation Phase

- May Involve Several Iterations, Depending Upon Tolerance for Uncertainty.
- Should Include a Complete Reconciliation of Owner's Internal Estimate With GMP Estimate to Eliminate Duplication and Identify Gaps.
- Determine How to Deal With VE Alternatives

4. Administrative Capabilities Needed for a GMP Contract



GMP Negotiation Phase (Cont'd)

- Understand How To Use All “The Moving Parts” of a GMP to Address YOUR Specific Project
- Understand How to Use Assumptions, Exceptions, Allowances, and Contingency to Address “Soft” or Incomplete Aspects of the Scope.

4. Administrative Capabilities Needed for a GMP Contract



GMP Negotiation Phase (Cont'd)

- Understand That the Use of These Moving Parts Should Affect Negotiation of Fee.
- When Deciding When Is the Best Time to Set the GMP, Parties Need to Balance the Time Advantage of Setting GMP Early (start and finish work sooner) with Price Advantage of Setting GMP at Closer to 100% Design (reduced level of contingency).

3. Chronology of Performance



GMP Negotiation Phase (Cont'd)

- Progressive GMP
 - If Owner Seeks to “Fast-Track” Construction, May Negotiate the GMP in Stages to Start Construction Early
- Level of Communication and Trust Will Determine Success of GMP Negotiation

4. Administrative Capabilities Needed for a GMP Contract



Construction Phase

- Is the Designer “Geared-up” to Multi-Task? That is, Complete Design While Reviewing Submittals and Overseeing Construction?
- Is the GC Self-Performing Any Work?
 - If So – What Risks Do You See?

4. Administrative Capabilities Needed for a GMP Contract



Construction Phase (Cont'd)

- The Preparation and Review of Commitment Reports Can Do Much to Minimize Disputes By Identifying Potential Issues Early.
 - This Management Tool Needs to Update Buy-Outs, Identify Gaps, and Properly Assign Costs to COW, GCs, Allowances, Contingency, or Changes

4. Administrative Capabilities Needed for a GMP Contract



Construction Phase (Cont'd)

- The Preparation and Review of Progress Payments Can Be a Significant Burden on a GMP Contract:
 - Both Owner and CM Will Need Administrative Capacity that Is Far Greater than that Which Is Needed for a Lump Sum Or Unit Price Type of Contract.
 - Possibility: Agree to Use Estimated Progress Payments With the Understanding that Costs Will Be Verified By Audit at Completion

4. Administrative Capabilities Needed for a GMP Contract



Close-out Phase

- Shared Savings?
- Will Owner Choose to Exercise Its Audit Rights?
 - *Please Only Use Experienced GMP Auditors!*
(GAAP is NOT the issue!)
 - Are Subs Subject to Same Audit Provisions as the CM/GC?
 - If Subcontracts Are Lump Sum, Owner Should Not Require Same Audit Requirements

Summary of Risks Specific to GMP Contracts



- What Does the GMP Actually Mean?
 - What Is “Reasonably Inferable” from the Bidding Documents?
 - Who Has Responsibility for Scope Gaps?
 - What Is the Liability of Trade Subcontractors Who Are “Hard Bidding” the Documents?

- Each GMP Component Has Its Own Set of Risks (Fee, GCs, COW, Allowances, Contingency...)

Summary of Risks Specific to GMP Contracts



- Unresolved Value Engineering Proposals and Incomplete Incorporation of VE into Plans and Specs

- Timing of GMP affects the level of risk held by the CM/GC or retained by the Owner
 - Start Construction before 100% Drawings

Summary of Risks Specific to GMP Contracts



- Misunderstanding Regarding Roles of the Stakeholders
 - Design Contract Should Address Differences in Designer's Role in GMP Context.
 - Maladministration Can Lend Unintended Meaning to Contract (E.g., Poor Precedents Set in Early Progress Billings)

- Subcontractors ARE NOT “Bound to CM/GC as CM/GC Is Bound to Owner”

Keys to Success



- Understand that a GMP Contract is Different
- Clear, Concise Contract Language
 - Contingency
 - Self performed work
 - Overruns and under runs
- Early, Continuous GC and Trade Contractor Input
- Owner Participation In Bid Review
- Establish GMP at the Right Time
- Open Communication

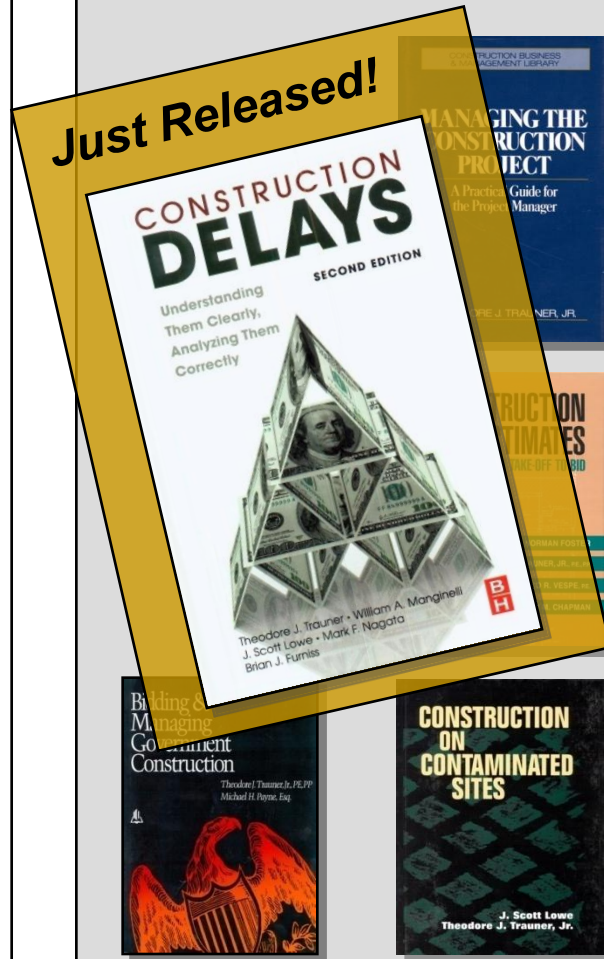
Further Information:



Rick Burnham
Director

5337 MILLENIA LAKES BLVD.
STE. 200
ORLANDO, FL 32839
Phone: (407) 345-0366
Fax: (407) 248-9535

rick.burnham@traunerconsulting.com
orlando@traunerconsulting.com
www.traunerconsulting.com



Trauner Consulting Services, Inc.

www.constructionnetcast.com