

# GMP CONTRACTING ISSUES

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Guaranteed Maximum Price contracts, or GMP contracts, have attractive features for both employers and contractors. Employers do not have to worry about exceeding their budgets, and contractors get to work within a fixed job scope. Alternatively, employers could be stuck with a hefty price tag in exchange for inferior work, or contractors could be stuck with the GMP to which they first agreed even though they are finding that they have considerably higher expenses than they originally anticipated.



### **Components of a GMP Contract: The Contractor's Fee**

The contractor's fee in a GMP contract can be either fixed or variable. Fixed fees are most common for public sector contracts. Generally, a fixed fee is based on the type of organization for which the work is being done, the time required for the work, the complexity of the work and the associated risk factors. Variable fees, in contrast, are usually based on a percentage of the value of the contract.

Payment of fixed fees is usually pro-rated over the contract's duration. For instance, clients may pay a monthly progress fee based on the balance of the fee divided by the time remaining on the contract. For variable fees, payments may fluctuate based on the actual cost incurred. The specifics of the contract can outline whether the contractor should be paid according to a retainer model and whether performance factors into the amount and timing of payment.

### **General Conditions Costs**

General conditions costs are indirect costs associated with the performance of the work. Typical line items include home office, field office and facilities, administration and supervision. GMP contracting requires great specificity about what is reimbursable and what is not under general conditions costs. Staff costs, for instance, should be defined based on either actual costs or hourly costs. The contract should also specify which expenses, such as telephone, transportation and cleaning, are reimbursable.

### **Reimbursable Costs**

Reimbursable costs are the actual cost of the work and include bills from both suppliers and subcontractors as well as bills for materials, equipment and support services. Additionally, the contractor may ask to be reimbursed for self-performed work, although some contractors group these costs in with their fixed fees.

## **Contingency**

The contingency fund exists for unexpected costs. However, the GMP contract must still specify clearly which items are allowed to be billed to the contingency fund.

Acceptable line items may include buy-outs, gaps, overruns, subcontractor change orders, escalation or remedial work. Certain elements that come from the owner, however, should not be included as part of contingency funds. These situations include owner added scope, design errors and omissions, and changes in specifications requirements that increase the contractor's cost.

## **Allowances**

Allowances are items that are undefined at the time that the GMP contract is negotiated. Examples include freight, delivery, handling and mark-ups. According to the language of most GMP contracts, allowances are converted when the item is better defined within the context of the project, and the GMP is adjusted accordingly.

## **Potential GMP Contracting Issues: Time Risks**

On one hand, GMP contracts save time because work can begin before the design is completed. However, because contractors and subcontractors will not know the exact specifications of the finished design, they may be too conservative in the time estimates that they give to the employer. Additionally, the contractor is at risk because the designer may or may not

complete the specifications in a manner consistent with the allowances, value engineering principles, assumptions and exceptions laid out in the GMP contract.

Additionally, for a job to be finished on time, work between trade employees must be coordinated. Schedule coordination, however, depends on a finished design. If coordination cannot be completed far enough in advance, then trade employees may have scheduling conflicts that could result in job delays.



## **Money Risks**

If the employer does not wait for the completed design specifics before agreeing to a GMP, then the GMP with contingency may be higher than the actual lump sum price. Also, if the employer is financing the project, then the higher initial GMP may make obtaining a loan more difficult. For employers, competition at the level of general contractor may be limited based on fee. At the same time, if the employer manages trade competition well, then competition at that level will drive down costs.

From the contractor's perspective, fee and general conditions costs are exposed in a GMP contract, which could hurt future contract negotiations. Also, contractors may lose the flexibility to buy out their subcontractors if they can do the work at a lower cost on their own. Additionally, if subcontractors experience increases in cost, then their increases will not pass through to the employer.

GMP contracts carry financial risks for designers as well. On the positive side, because the design is a work-in-progress, problems encountered by builders can usually be resolved by changing the design instead of demolishing and rebuilding the work. At the same time, the assumptions, exceptions and allowances in the contract may interfere with design freedom. Also, designer staff capacity may be challenged by the prospect of completing the design at the same time that it is working on the construction phase of the project.

### **Quality Risks**

In some senses, because construction often begins before the completion of the design, constructability and trade coordination may be enhanced. Also, even though the design options may be constrained by the conditions of the contract, the employer can always choose to raise the GMP if higher quality materials or designs are desired. At the same time, monthly reporting and other administrative challenges unique to GMP contracting may require different skill sets from all parties. Additionally, while the

contractor naturally wants to manage costs, employers deserve some kind of protection regarding the quality standards of the construction.

### **Needed Elements for GMP Contracting: Preconstruction Phase**

For GMP contracting to be successful for all parties, totally open communication is required during the preconstruction phase. In addition to focusing on what is detailed in the plans, the parties have to discuss what is not mentioned in the plans and specifications. Discussions should focus on the constructability, scope and budget of the project. The contractor should also be able to anticipate potential coordination issues and should notify the owner and the designer. An honest exchange of ideas and frequent statements of understandings will ensure that communication problems do not cause disputes or delays during the project.

### **Negotiation Phase**

The GMP contract negotiation phase may involve several layers of discussions and agreements before the final contract is acceptable. The owner's internal estimate and the contractor's estimate should be completely reconciled so that any discrepancies, as well as gaps and duplications, are identified. All parties should discuss any potential value engineering alternatives before agreeing on the price.

Soft aspects of the contract are covered under the contingency and allowances sections and are spelled out in the assumptions and exceptions. Parties should decide the right time to set their GMP depending on their tolerance for these soft line items. For example, setting the GMP early means starting construction earlier. However, setting GMP later means setting a more accurate price because the design will be near 100 percent completion. GMP contracts may also be negotiated in phases so that construction can start earlier while still devoting attention to accuracy of price.

### **Construction Phase**

General contractors need to evaluate the risks associated with any of the work that they are self-performing as well as ensure that their designer is prepared to multitask. During construction, frequent review of commitment reports can minimize disputes because potential issues will be identified early. Providing constant updates of buy-outs and gaps as well as discussing proper assignment of costs throughout the process will keep the project on course.

Preparing and reviewing progress payments can place significant burdens on GMP contracts. One solution is to use estimated progress payments with the agreement that true costs will be verified during the audit process. Progress payments will require both the employer and the contractor to employ significantly more effort toward administration.

### **Close-out Phase**

Throughout the execution of a GMP contract, contractors should be aware that their subcontractors are not obligated to GMP terms in the same way. If subcontractors have agreed to lump sum payment, then auditing is less likely. However, if subcontractors do not agree to lump-sum compensation, then employers often want to audit the costs of the project to ensure compliance. The contractor has to decide whether or not to work with subcontractors who are unwilling to agree to lump-sum arrangements. The more flexibility given to subcontractors, the more likely that the employer will initiate an audit.

Any shared savings should be discussed during the closeout. If the employer does decide to audit the project, then make sure that experienced GMP contract auditors are chosen rather than choosing auditors who are simply skilled accountants. Auditors should understand construction quality in addition to having the ability to interpret financial documents.

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