Construction Contracts 100,000 Feet

The Basics of the Different Types of Construction Contracts

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Learning Objectives

1. Gain familiarity with the different types of construction contracts commonly utilized in the industry, including lump-sum, cost-plus, unit-price, and design-build contracts.
2. Understand the inherent advantages and disadvantages associated with each type of construction contract, enabling informed decision-making in contract selection.
3. Identify key considerations and factors to weigh when determining the most suitable contract type for specific construction projects, ensuring alignment with project goals and objectives.
4. Enhance proficiency in assessing and negotiating construction contracts by learning practical dos and don'ts from a legal perspective, empowering participants to safeguard their interests effectively.

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First Thing First

AIA

- American Institute of Architects
- Often architect focused
- Forms and contract portions that fit together like a puzzle to form the contract

ConsensusDocs

- Form contracts put together by organizations that represent contractors and others in the construction industry, not architects

EJCDC

- Engineers Joint Contract Documents Committee
- Form contracts put together by The American Council of Engineering Companies, The National Society of Professional Engineers, and The American Society of Civil Engineers – Construction Institute
- Intended for infrastructure projects

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Lump-Sum Contracts

What is it?

- Also called “Fixed Price” of “Stipulated Sum” Contract
- Established a fixed price for all of the materials and labor to complete the project.
- “Closed Book”

“The Owner shall pay the Contractor the Contract Sum in current funds for the Contractor’s performance of the Contract. The Contract Sum shall be $XXXXX, subject to additions and deductions as provided in the Contract Documents.” Example AIA A101-2017

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Lump-Sum Contracts

Pro:

- Easier to compare bids – apples to apples
- Contractor *should* make an accurate bid
- Owners know what the cost of the project is (non-inclusive of change orders) upfront

Con:

- If contractor “cuts corners” they get a higher profit margin
- Conversely, if costs raise (i.e. a triple the bid amount tariff is applied to steal), it cuts into profit margins for the contract
- Changes to scope can be more difficult

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Lump-Sum Contracts

When do I use?

- Do you know what the scope of the project is? Works best when you have a well defined scope. The contractors know exactly what is needed for the project – amount of time, materials, etc. No surprises.
- Note – may want to hire a construction manager to make sure that contractors are not cutting corners.

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Guaranteed Maximum Price Contracts

What is it?

- Also called "GMP" Contract
- Establishes a maximum price for the Project
- Owner pays costs and a fee up to a certain amount
- Anything above is the responsibility of contractor
- Audit ability for owner (open book)
- Different from lump-sum because owner is paying the actual cost instead of a lump sum for the entire project no matter what

Guaranteed Maximum Price Contracts

"Owner shall pay the Contractor the Contract Sum in current funds for the Contractor's performance of the Contract. The Contract Sum is the Cost of the Work as defined in Article 7 plus the Contractor's Fee." AIA A102-2017.

However, includes a cap – maximum price:

"The Contract Sum is guaranteed by the Contractor not to exceed $XXXX, subject to additions and deductions by Change Order as provided in the Contract Documents. The maximum sum is referred to in the Contract Documents as the Guaranteed Maximum Price. Costs which would cause the Guaranteed Maximum Price to be exceeded shall be paid by the Contractor without reimbursement by the Owner." AIA A102-2017.

Guaranteed Maximum Price Contracts

Pro:

- Somewhat easier to compare bids – apples to apples – since the maximum price is capped
- Owners know what the maximum cost of the project is (non-inclusive of change orders) upfront

Con:

- If contractor "cuts corners" they get a higher profit margin
- Conversely, if costs raise, it cuts into profit margins for the contract and the contractor may ask for a change order
- Requires cost tracing as the owner typically retains the ability to audit – "open book"

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Guaranteed Maximum Price Contracts

When do I use?

- When you have accurate details of what is needed
  - Reduces the risk of change orders
- When you have the ability to review the open book

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Time and Materials Contracts

What is it?

- Also called "TM" Contract
- Pay contractor's material costs
- Pay contractor's a fixed daily/hourly wage for labor costs
- Contractor markup rate added to costs

"The Owner shall pay the Contractor the Contract Sum in current funds for the Contractor's performance of the Contract. The Contract Sum is the Cost of the Work as defined in Article 7 plus the Contractor's Fee." AIA A103-2017

- No cap as to the amount of contract unless specifically added.

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Time and Materials Contracts

Pro:

- Contractors like it more – more protection for rising costs
  - Material costs generally include cost of materials, freight, and markup
  - Labor costs generally include base pay, overhead, admin costs and markup (profit margin)
- Profit margin predictable
- More favorable to contractors – markup for labor/materials built in

Con:

- Uncapped contract amount
  - Can be risky for Owners since total contract amount unknown
  - Work around – include a “not to exceed”/GMP contract amount
- Tracking costs

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Time and Materials Contracts

When do I use?

- Project scope unclear
- Changes in the project are likely
  - Allows more flexibility
- Advisable to use a construction manager (see AIA A134-2019)

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Cost-Plus Contracts

What is it?

- Contractor gets paid for labor, materials, equipment and a predetermined price markup (typically a percentage)
  - Key difference between a TM Contract
  - Cost-Plus bills for actual costs and a separate amount for profit
  - Time & Materials has the markup rate included in costs
- Administrative costs can be included on percentage basis
- Advisable to use a construction manager

"The Owner shall pay the Construction Manager the Contract Sum in current funds for the Construction Manager's performance of the Contract after approval of the Control Estimate. The Contract Sum is the Cost of the Work as defined in Article 7 plus the Construction Manager's Fee." AIA A134-2019.

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Cost-Plus Contracts

Pro:

- Contractors like the lower risk
- Owner and contractor incentives to manage risk

Con:

- Contractor can bill for costs potentially without justification
  - Want to make sure that there are audit provisions within the contract
- Estimate provided prior to beginning construction
- Total cost of project is unknown

Cost-Plus Contracts

When do I Use?

- Difficult to estimate projects
- Projects where the scope is potentially unclear

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Unit-Price Contracts

What is it?

- Fixed price for a unit/distance or “repeatable” part of a project.
  - Contractor charging $xx per 100 sq ft to 1,000 sq ft and $xxx per 1,0001 sq ft and above
- Should include all costs (labor, materials, admin, markup, etc.)

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Unit-Price Contracts

Pro:

- Can be more flexible
- Can simplify tracking of units/work performed

Con:

- Contractors can be on the hook for their pricing
- Total cost not known in advance
- Owners need to be cognizant of the total amount needed

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Unit-Price Contracts

When do I Use?

- When you don’t know how many units you will need? For example, I am not sure how much dirt I need removed, but it is $xxx per ton, yard, etc.
- When you know what type of materials will be used. For example, I know I will be building a road, I am just not sure the layout/length at the time of bidding

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Design Build Project Delivery Method

What is it?

- Construction project delivery method where owner has a single point of contact with the design/build entity.
- Design/build entity has subcontractors covers design (architect design services) to construction of project
- Single point of contact for owner
- Should describe the owner’s role in design, approvals, QA, etc. to avoid misunderstandings as the process can move fast

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Design Build Project Delivery Method

Pro:

- Communication is key
  - Can lead to collaboration and a stronger business relationship
  - Information sharing is necessary
- Flexibility
  - Having a distinct change order process is key
- Can be cost-effective
  - Reduce risk of delay

Con:

- Communication is key
- Want to make sure that the design also comes with a trusted builder

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Design Build Project Delivery Method

When do I Use?

- Time limitations. Potential to design as building.
- Larger projects
- Complex projects

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Integrated Project Delivery (IPD)

What is it?

- Construction method were all of the key parties are bound by a single contract
    - Design, fabrication, and construction under one agreement
- Can be GMP

“For the Contractor’s performance of services set forth in A295-2008 prior to the establishment of the Guaranteed Maximum Price (Pre-GMP Services), the Owner shall pay the Contract as follows: [amount of compensation or basis of compensation is added to contract].” AIA A295-2008.

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Integrated Project Delivery (IPD)

Pro:

- Requires a large amount of collaboration and communication
- Can reduce waste/increase efficiency
  - Personal assignment issues, material waste, communication wait time
- Tries to eliminate confusion because everyone is involved from the get go

Con:

- Requires a large amount of collaboration and communication

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Integrated Project Delivery (IPD)

When do I use?

- When all of the aspects of a project can be brought together. Goal is to "integrate" the project teams in order to have everyone work together to complete the project.
- When everyone knows that they need to be open and communicate

General Thoughts/Tips

- Not limited to use the same type of contract in different phases
- You can "OVERLAP"
  - Include a price not to exceed in time and material contracts to cap costs
- Document changes
  - Whether that is a change in scope of work, timing, additional payment, alternative payment, insurance, or even a waiver of some of the work to be preformed
  - May seem daunting, but it will save money in the long run. Especially true if there is a breakdown in the relationship or litigation
- Communicate. Even if not contractually required. Communication in any project is key

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