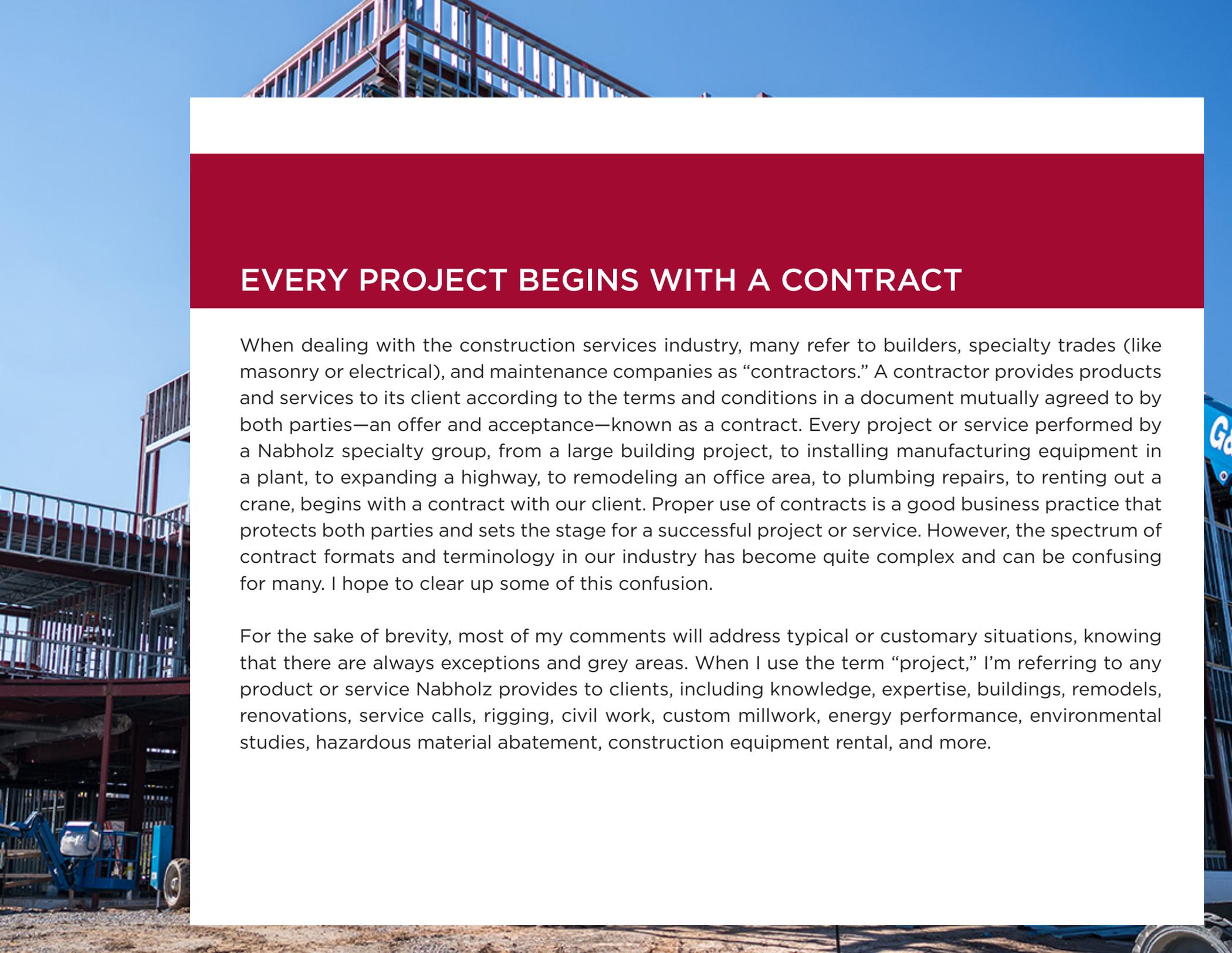




CONSTRUCTION CONTRACT BASICS

By Don Greenland, Nabholz COO



EVERY PROJECT BEGINS WITH A CONTRACT

When dealing with the construction services industry, many refer to builders, specialty trades (like masonry or electrical), and maintenance companies as “contractors.” A contractor provides products and services to its client according to the terms and conditions in a document mutually agreed to by both parties—an offer and acceptance—known as a contract. Every project or service performed by a Nabholz specialty group, from a large building project, to installing manufacturing equipment in a plant, to expanding a highway, to remodeling an office area, to plumbing repairs, to renting out a crane, begins with a contract with our client. Proper use of contracts is a good business practice that protects both parties and sets the stage for a successful project or service. However, the spectrum of contract formats and terminology in our industry has become quite complex and can be confusing for many. I hope to clear up some of this confusion.

For the sake of brevity, most of my comments will address typical or customary situations, knowing that there are always exceptions and grey areas. When I use the term “project,” I’m referring to any product or service Nabholz provides to clients, including knowledge, expertise, buildings, remodels, renovations, service calls, rigging, civil work, custom millwork, energy performance, environmental studies, hazardous material abatement, construction equipment rental, and more.

CONTRACT CHOICES

There are a variety of contract types to choose from for any given project. You may hear this menu of choices referred to as *project delivery methods* or *alternative delivery methods* or *project delivery formats*. Your primary goal should be to select the right contract from this “menu” for a specific project. The “right” contract should meet the needs of the client, while reducing risk to the contractor, which should lower costs to the client, thus delivering the best value.

There is no shortage of contract types, versions, and formats from which to choose. We tend to recommend the use of an industry-standard contract form because it’s usually a format familiar to the prime contractor, specialty subcontractors, and supply chain. This approach minimizes misunderstanding, speeds the contract negotiation process, and reduces risk to the parties. Certain industry associations maintain a family of standard contract formats; such as the American Institute of Architects (AIA), Design-Build Institute of America (DBIA), and Consensus Docs, just to name a few.

Many federal and state agencies also maintain standard contract formats. The parties often modify the terms and conditions in the selected industry-standard contract to meet the unique aspects of the project.

In some cases, the client may prefer to use their own “homemade” contract format in lieu of an industry-standard one. This is common for some large Fortune 500 companies that regularly procure projects and have a robust purchasing or legal staff. Many of these contract formats are fine. However, they may prolong the contract review and negotiation process and increase risk to some of the parties.

In other cases, it makes sense to use a “homemade” contract format proposed by the contractor, including smaller projects, maintenance work, or renting equipment.

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COMMON TERMS & CONDITIONS

Almost all contract formats, both industry-standard and “homemade” versions, address a set of common terms and conditions in some way. These sections typically include:

- Naming the parties (e.g., Owner or Client, and Contractor)
- General responsibilities of each party
- Defining the location and scope of the project to be performed
- Reference list of other contract documents (e.g., plans, specifications, and addenda)
- Duration of the project (i.e., start date & completion date, or number of days)
- Contract Sum (e.g., \$100,000) and/or Unit Prices (e.g., \$25/square foot)
- Payment process and terms
- Process for handling changes to the scope
- Resolution process for disputes between the parties
- Process for terminating or suspending the contract
- Insurance and bond requirements

Depending on the “basis” of the selected contract format, the wording of many of these common sections may be different (e.g., responsibilities of the parties, contract sum, and payment process), and some additional sections may be necessary to better define the contractual relationship.

CONTRACT BASIS

The primary “basis” of a contract format refers to how the contractor or service provider is paid.

- **Lump Sum**, also known as **Stipulated Sum** or **Fixed Price**, is a common basis. The client agrees to pay the contractor a specified dollar amount for the project scope.
- **Unit Price** basis is a variation of Lump Sum. The client agrees to pay the contractor a specified unit price amount for listed work activities (e.g., \$10/square yard of asphalt paving, \$100/window installed, \$60/hour of crane service, or \$500/inspection). Contract sections are necessary to address how units are measured, who measures them, and measurement records to maintain.
- **Cost-Plus**, also known as **Cost of the Work Plus a Fee**, **Cost +**, or **Time and Material**, is another common basis. The client agrees to pay the contractor for their actual costs to perform the project, plus a specified amount for their overhead and profit, often referred to as **Fee** or **Contractor’s Fee**. Contract sections are necessary to address allowable actual costs. It is common to address costs paid by the client, sometimes referred to as **Reimbursable Costs** or **Reimbursable Expenses**, and costs included in the Contractor’s Fee, sometimes referred to as Non-Reimbursable Costs or Non-Reimbursable Expenses. Additional contract sections are necessary to address how the Fee is calculated, accounting and records keeping requirements, and the right of the client to audit such records. We often refer to this arrangement as “open book.”
- **Guaranteed Maximum Price**, also known as **GMP** or **Price Not to Exceed**, is a component commonly incorporated in a Cost-Plus basis contract. In such cases, the GMP is established as the maximum total dollar amount the client will pay to the contractor for the project (i.e. the amount will not be exceeded) for actual costs and Contractor’s Fee. Additional contract sections are necessary to address any savings under the GMP. In some cases, the client may retain all savings. In other cases, the client may split savings with the contractor as added incentive (e.g. 50%/50%, 75%/25%).



PRIMARY CONTRACT BASIS REFERS
TO HOW A CONTRACTOR IS PAID.

SECONDARY BASIS

A secondary “basis” may be the role of the party under contract with the client (e.g., contractor, manager, advisor or consultant, designer, or a combination).

- **General Contractor**, or **GC**, implies a role where other parties have designed and defined the scope of the project and the GC prepares a proposal to execute the project, and the client contracts with the GC to perform the project. The GC has discretion over specialty contractors and suppliers they may employ to accomplish the project.
- **Construction Manager**, or **CM**, implies a role with more responsibility in managing the project planning process for the client. In most cases, the client employs the CM early in the design phase or before the design phase begins. The CM works with the client and/or the client’s design firm prior to the construction phase. We often refer to this approach as **Building Team**. The CM may assist or advise with designer selection, site selection and evaluation, schedule and construction phasing, feasibility of building components and systems (i.e. **Constructability**), conceptual budgeting and estimating, cost/payback studies (i.e. **Value Analysis, Value Engineering, Life Cycle Costing**), and input from certain specialty contractors and suppliers. We refer to this phase as Preconstruction Services. At some point during **Preconstruction Services**, the project scope is adequately defined. The CM will then solicit pricing from specialty contractors and suppliers, perform detailed estimating, and prepare a proposal to construct the project. The client and design firm is involved and informed as desired. Upon approval by the client, the CM may proceed with the construction phase of the project. Some refer to this role as **Construction Manager/General Contractor**, or **CM/GC**. Contract sections are necessary to address scope and fees for Preconstruction Services and termination should the client not proceed with the construction phase.

COMING UP NEXT:
CM AT-RISK
CM-AGENCY
CM-ADVISOR
DESIGN-BUILD

SECONDARY BASIS, cont'd

- The role of Construction Manager may be further refined by the level of project performance risk they assume. **Construction Manager at Risk**, or **CM at Risk**, implies that the CM is responsible by contract to perform the scope of the project. The CM is “at risk” for scope, price, schedule, quality, insurance, warranty, and in some cases, performance and payment bond. **Construction Manager as Agent**, also known as **CM Agency** or **Agency CM**, implies that the CM is providing a professional service (i.e. consultant) to the client for the project. Professional services may include Preconstruction Services, facilitating prime contracts between the client and other contractors to perform the project, and providing oversight of the project during the construction phase. In this case, the CM is not directly “at risk” for project performance, they are acting as the agent of the client. Going one-step further, **Construction Manager as Advisor**, also known as **CM Advisor** or **Construction Advisor**, implies that the CM is providing limited professional services (i.e. advisor) to the client for the project. In this case, the client has contracted with another General Contractor to perform the project. The client employs the CM to provide advice and counsel throughout the design and construction phases.
- **Design-Builder**, also known as **Design-Build** or **Design-Bid-Build** or **Engineer-Procure-Construct** or **EPC**, implies a role where the client contracts with one party to be both designer and General Contractor (or Construction Manager) of the project. The GC or CM may self-perform portions of the design if staffed appropriately, or subcontract with architectural and engineering firms for design services. Contract sections are necessary to address design responsibilities, and termination should the designed project not proceed to the construction phase.



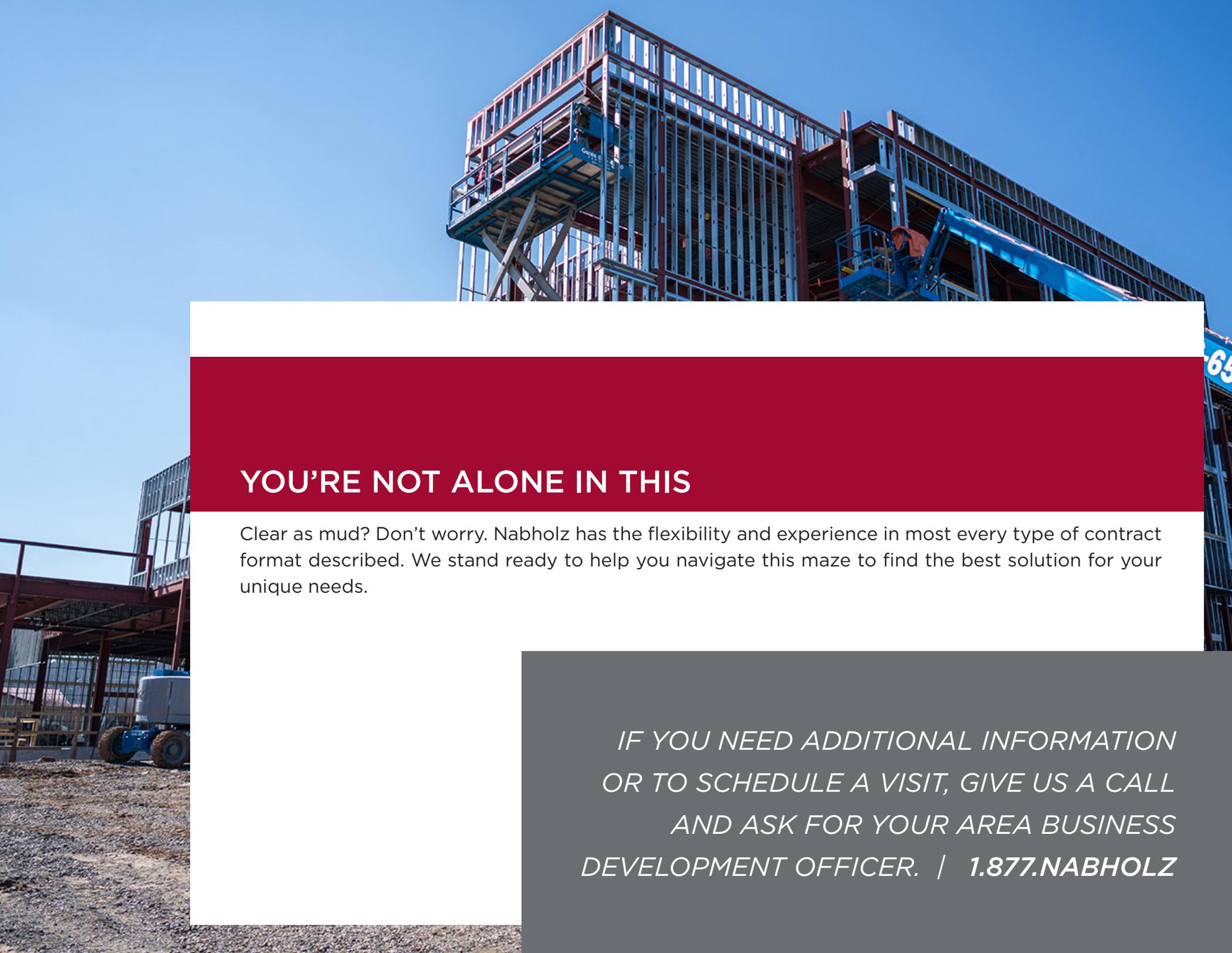
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HYBRID CONTRACT FORMATS

As with anything in business, there is a variety of hybrid contract formats and variations of traditional contract basis and roles as outlined above.

- **Program Management**, or **Program Manager** or **PM**, can incorporate a wide range of services on behalf of the client. A General Contractor or Construction Manager may be well suited to serve as a Program Manager. The PM serves as an out-source acting on the client's behalf. Scope could include everything a client might be responsible for: site selection, programming, hiring designers and contractors, procuring furniture, fixtures, building systems, and office equipment.
- **General Contractor-Operator**, **Construction Manager-Operator** or **Design-Build-Operate** takes the roles one step further, as they are responsible for the actual operations of the completed facility for the client.
- **Alliance Contractor**, or **Alliance Agreement**, is another hybrid. A client may use an Alliance contract format for a portfolio of projects or for services at multiple locations. An Alliance contract outlines the scope of services and contains a fee schedule for different types, sizes, and locations of the various projects.
- **Integrated Project Delivery**, or **IPD** or **Multi-Party Agreement**, is a wonderful emerging contract format. Under IPD, the parties under contract expand from just client and contractor. IPD parties include client, designer(s), Construction Manager, and in some cases, major specialty contractors (e.g., site work, mechanical, electrical). Under one contract, these stakeholders share risk and fees for successful achievement of the client's project goals.

WHY PICK A
CONTRACTOR AT
THE SAME TIME
OR BEFORE AN
ARCHITECT?
[MORE HERE](#)



YOU'RE NOT ALONE IN THIS

Clear as mud? Don't worry. Nabholz has the flexibility and experience in most every type of contract format described. We stand ready to help you navigate this maze to find the best solution for your unique needs.

*IF YOU NEED ADDITIONAL INFORMATION
OR TO SCHEDULE A VISIT, GIVE US A CALL
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