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Construction Management Agreements: Pricing


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This will be the first in a series of articles dealing with construction management agreements (CMAs). In this series, we will cover pricing, project scheduling, defects and failures, and insurance and liability. Our topic for today is the pricing of CMAs, including the fee of the construction manager (CM), general conditions (GC) costs, subcontract costs, contingency, and insurance. Where appropriate we will make distinctions between "cost-plus" and guaranteed maximum price (GMP) CMAs.

CM Fee

Generally speaking, the CM's fee consists of two components: a preconstruction services fee and a construction phase fee. The preconstruction services fee covers the CM's services (if retained during the design phase of the project) for working with the owner and its design team on such items as constructability, site logistics, subcontract and general conditions costs budgeting, and scheduling. The fee for these services can be based on a monthly fee, a fixed fee for the anticipated duration of the preconstruction phase or actual personnel costs. Often, owners will request a cap on these fees, which would be a function of duration. Owners may also ask that the preconstruction services fee be credited against the construction phase fee once work begins.

During the preconstruction phase, the CM may also be requested to perform "early start work" (ESW), such as abatement, demolition and excavation. A separate fee for ESW would be negotiated and might be based on a percentage of the cost of the ESW, including related general conditions costs. The CM might also be requested to provide a lump sum for the cost of the ESW.

The second component of the fee covers the construction phase and is usually based on a negotiated percentage of subcontract costs and supervisory and other GC costs. The CM would also charge a fee on change orders at the same rate as first established; however, we usually request a "dead band," meaning that there is no additional fee on the first "X" dollars of change orders, on the theory that the owner should be given some grace amount before additional fee is due. Often, CMs ask that the fee also be based on liability and subcontract default insurance costs. We uniformly object to this and seek to limit the fee to subcontract and GC costs on the basis that insurance costs are merely pass-through costs; the CM is not at risk for these payments.

Under a GMP scenario, the CM may be entitled to additional compensation as a result of "shared savings" due to the expenditure of costs less than guaranteed by the CM. The owner would share these savings, on a negotiated ratio, with the CM.

Subcontract Costs

On a cost-plus form of CMA, all subcontract costs are fully reimbursed to the CM by the owner, whereas on a GMP form of CMA, the CM guarantees the total subcontract cost (but has access to a "contingency," discussed below). Regardless of the form of CMA, the owner must scrutinize the bids of the subcontractors and attempt to obtain a fixed price for the particular subcontractor's scope of work. Care should be taken to analyze all assumptions, clarifications and qualifications in order to eliminate the likelihood of change orders for additional costs. One particular area of concern is allowances,

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where the construction documents (particularly finishing details) are not complete. The use of allowances can be a blank check to increase subcontract costs and should be accepted only with care. Indeed, a GMP rampant with allowances is not a GMP at all.

General Conditions Costs

Generally speaking, GC costs consist of the CM's personnel and laborers and related expenses, supplies, small tools and field office costs. Also, under the term "general conditions" may be included "general requirements," consisting of site safety, security, scaffolding and snow removal. Under a cost-plus scenario, these costs are passed through to the owner, generally without a cap or limitation; under a GMP, the costs would also be passed through, but subject to, the overall GMP.

An alternative to this pricing would be a lump sum or "GC Cap," under either a cost-plus or GMP scenario. Under a lump sum, the CM would provide a fixed sum for GCs and general requirements and would charge the owner on a percentage of completion basis. A GC Cap is a separate limitation on these costs, which would be billed as incurred by the CM, subject only to the GC Cap. (GC costs are also charged on change orders and we try to limit them to actual costs incurred as a result of the change.)

Insurance Costs

Included within insurance costs are liability costs (general, automobile and excess) and, where applicable, subcontractor default insurance (SDI) costs, also known by the brand name "Subguard." Liability insurance can be provided through a "corporate" policy of the CM, by a project policy provided by the owner which covers both the owner and the CM or a "wrap-up" policy covering the owner, CM and substantially all the subcontractors. A wrap-up policy can either be an Owner Controlled Insurance Policy (OCIP) or a Contractor Controlled Insurance Policy (CCIP). In all cases the cost of insurance is borne by the owner and is paid either directly by the owner to the carrier or through the CM to the carrier based on a percentage of the cost of enrolled subcontracts and GC costs and, in certain cases, the CM fee.

SDI insurance is determined by a percentage markup of enrolled subcontractors. Under SDI, the CM bears initial responsibility for a defaulting subcontractor but may file a claim with the SDI carrier costs arising from the default. The CM is responsible for deductibles and co-payments, which are first funded by the owner through the SDI markup. Under both liability insurance and SDI, the initial premiums paid by the owner are estimates, and are subject to true ups on the completion of the project. Markups for insurance and SDI are also applied to change orders.

The foregoing represents our approach and that of our developer clients to pricing of CMAs. There are no hard and fast rules and each term is subject to negotiation based on the nature of the project and the bargaining power of the parties.

Contingency

Under a GMP form of CMA, an amount is established for the CM's exclusive use to provide funds in the event the CM finds itself responsible for subcontract or GC costs which may result in surpassing the GMP, a GC lump sum or a GC Cap, although there is usually a limitation on the amount of the contingency which can be used for GC cost overruns. The need for contingency funds could occur through missed trade buys, overtime or additional costs incurred because of delays for which the CM is responsible, subcontract defaults not covered by SDI, unanticipated market conditions or other costs for which the CM is responsible. The amount of the contingency is usually a percent of the subcontract and GC costs at the time the GMP is determined, plus savings from the finalization of the final subcontracts thereafter.

Closing Caveat

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