



IS A GMP CONTRACT RIGHT FOR YOU?

Guaranteed maximum price contracts require a true team effort and an open-book policy

By Jim Murphy

Perhaps you've considered using a guaranteed maximum price (GMP) contract instead of a cost-plus contract but were hesitant about opening the books to clients and the other members of the project team. To be sure, GMPs require transparency as well as tight teamwork, but don't discount this contract type until you've learned about its benefits.

A few years ago we were chosen to build an estate home south of St. Helena, Calif., in Napa County. The client, VP of a major development/construction company in Orange County, Calif., was apprehensive about our standard contract—a GMP contract, which we've been using for 30 years—because he didn't have any previous experience using one. The client came from a "hard-bid" world, where subcontractors compete for the lowest bid on fully completed construction documents. But it's my belief that, as a general contractor (also known as a Construction Manager at Risk in this situation), it's your responsibility to make the case for using a GMP contract whenever it's in the client's best interests.

It should be said that if pure profit is the driving force behind your company, a GMP is not the contract for you. It's a cooperative endeavor that requires discipline in managing the job, shaving time off the project schedule, and having a team that makes quick, resolute decisions. But in my experience, the successful execution of a GMP contract results in happy clients, repeat business, and solid referrals.

The main difference between a GMP and a cost-plus contract is that the GMP informs clients up front what their risk is going to be: the amount of the contingency, which is typically 3 to 5 percent of the total contract value. If the project takes more time or if materials cost more than expected, once the contingency is spent, the builder is responsible for additional costs. With a cost-plus contract, costs could continue to escalate and the client would have no control over them. Competently execute a GMP contract and you'll have a satisfied, loyal client for many years to come.

From a custom builder's perspective, you need three key elements to ensure a successful GMP project:

1. Excellent bookkeeping, clear communication, and trust. Both you and the client must be comfortable with a team atmosphere and an open-book policy. We believe this has the best chance of happening when we're involved from the birth of the project or brought onto the team shortly thereafter.

2. Early-phase budget estimates. During that early phase, assemble estimates to ensure the project will stay within the client's budget goals. Be ready to repeat the exercise: It may take several iterations before the design team produces drawings that meet the target.

3. Detailed Instructions to Bidders (ITBs). Once you have the estimates, send instructions to multiple prequalified subcontractors. Select the lowest thorough and accurate

subcontract bids to incorporate into the final GMP. The willingness to be open-book is key at this stage if your client wants to be involved in the bid-evaluation process.

After determining the final subcontract values, we add our General Conditions (the labor, materials, and equipment it takes to run a job), the fee we want to charge, the cost of liability insurance, and the 3 to 5 percent contingency, which is the client's money. However, our contract stipulates that the contingency sum is to be used at our discretion to cover any items that may have been missed in the bid process, subcontractor defaults, corrections to the work, or other related items. The total of all this becomes the GMP.

At the end of the project, any unused contingency is returned to the client. If we are able to return 100 percent of the contingency, our firm splits any additional savings with the client. On the wine country estate project mentioned above, we were able to return 100 percent of the contingency to the client and split an additional small savings upon completion.

The client was bowled over by our ability to use the GMP to control costs and finish the project for less than the contract value. The experience was satisfying for the whole team, and now our client is a solid advocate for the GMP contract, too.

Jim Murphy is president of Jim Murphy & Associates, in Santa Rosa, Calif. Founded in 1968, JMA is involved in residential construction and remodeling as well as commercial projects.