

Advantages of GMP Contracts over Lump Sum

We believe that the Guaranteed Maximum Price (GMP; GMAX) contract structure is better suited for Owners to help them minimize their construction cost. Specifically, the Cost of Work plus Fee with a Guaranteed Maximum Price type contract provides the owner with a more favorable business arrangement than other forms of contract (in most situations). The contract maximum amount is capped by the GMP, yet the contractor is only entitled to bill for actual reimbursable costs incurred (which are defined in the contract). Therefore, the owner pays the lower of (1) the actual cost incurred plus the fixed fee or (2) the guaranteed maximum price. This provides the following two advantages: (1) the Guaranteed Maximum Price offers the same protection as does the lump sum contract - it limits the owner's risk and (2) unlike the lump sum contract, the owner has an opportunity to share in cost savings.

Another distinct advantage provided by the GMP contract is that it provides significantly more "accountability" than the lump sum contract. Payments made on lump sum contracts are based upon a predetermined schedule of values. The contractor is not required to provide any actual cost information. Such payments are a function of "perceived" compliance, since there is no other basis by which to measure. If the contractor "cuts any corners" in performing their work and the owner fails to "catch" it, the contractor will unfairly benefit. Under lump sum contracts, the contractor provides very little to the owner by way of accounting. They must only "convince" an owner that the work was performed in strict accordance with plans and specifications. Cost is essentially irrelevant, regardless of the work actually performed. At the completion of the project, the contractor will receive the entire lump sum amount, as adjusted by change order.

To effectively manage and control lump sum contracts, an owner must dedicate knowledgeable and experienced construction personnel to ensure that all contract requirements are complied with. This requires a significant amount of contract administration and includes all inspection, testing and other techniques to verify that specified quality, quantities and services are performed. However, under lump sum contracts, the owner usually does not have access to contractor records for the purpose of independently verifying strict compliance with all material aspects of the contract. This scenario places a greater burden on the Owner, who must then rely on their own controls and construction management to ensure compliance. This situation provides less "accountability" for the contractor.

Conversely, GMP contract payments made are merely a function of actual costs incurred, substantiated and submitted. This submission is in the form of detailed invoices and time sheets for labor, materials, equipment and subcontracts. The owner must still perform a compliance function. However, because GMP contracts provide more "accountability," this function can be streamlined to provide reasonable assurance that compliance is achieved. Additionally, the contractor cannot unfairly benefit if they "cut corners", because they are only entitled to bill for actual costs incurred that are defined as reimbursable in the contract. This reduces the incentive for them to make extra margin by cutting corners. Thus, an owner can still achieve its primary task objectives of cost and quality without prohibitive administrative costs or sacrificing schedule.



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GMP contracts have several common traits with lump sum contracts. Most importantly, the Guaranteed Maximum Price amount is intended to provide the same benefit to the owner as the lump sum amount – which is to "cap" the maximum amount payable to the contractor. In this manner, each contract transfers risk from the Owner to the contractor, though risk is often more often characterized as a "shared risk" on GMP contracts (for several reasons). Each value is also based on a specific scope of work (memorialized by a set of contract documents – Plans and Specifications). In this regard, the GMP and the Lump Sum are considered equivalents because each value is tied to a fixed scope of work at the time of contract execution. Furthermore, both contracts (GMP and Lump Sum) are subject to upwards and downwards adjustment for changes in scope.

Not coincidentally, a contractor will typically develop their detailed estimates in much the same manner for purposes of preparing a competitive bid, regardless of contract type (GMP or Lump Sum) and that a GMP value may be established through the competitive bid process in much the same manner as it would through a "Lump Sum" competitive bid process. Some contractors may suggest that GMP contracts are only suitable for negotiated procurements and only Lump Sum contracts should be used when competitive bidding is desired. However, we do not agree with that generalization. Rather, we believe that competitive bidding or negotiating is an acceptable procurement method for either contract.

For Owners, it is generally believed that GMP contracts offer the following significant advantages over lump sum contracts:

- (1) Contingency is normally included in both types of contracts; however, unspent contingency usually reverts back to owner on GMP contracts.
- (2) Owner participates in savings (usually a majority). Owner never participates in savings on lump sum contracts.
- (3) Can provide contractor with an incentive to control costs by including a "savings bonus" provision.
- (4) Owner retains more decision-making power.
- (5) Owner can still maintain a high degree of quality while providing a reasonable control of costs.
- (6) Allows owner to assess "actual costs" whereas lump sum does not.
- (7) Provides a better mechanism to manage and control change orders and related costs.
- (8) Suitable for both "conventional" and "fast-track" construction, whereas lump sum is generally inappropriate for fast-track.
- (9) Provides for greater control over all subcontractors.
- (10) Owner can more easily perform verifications or compliance audits, if desired.
- (11) Provides more "accountability" than the lump sum contract.
- (12) Reduces the likelihood and related risk that "front-end loading" will occur (contractors submitting payment applications that reflect a higher value of work than is actually performed).
- (13) Contractors are often willing to accept less Fee for less risk on GMP contracts.



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