

Construction Audit and Cost Control Institute

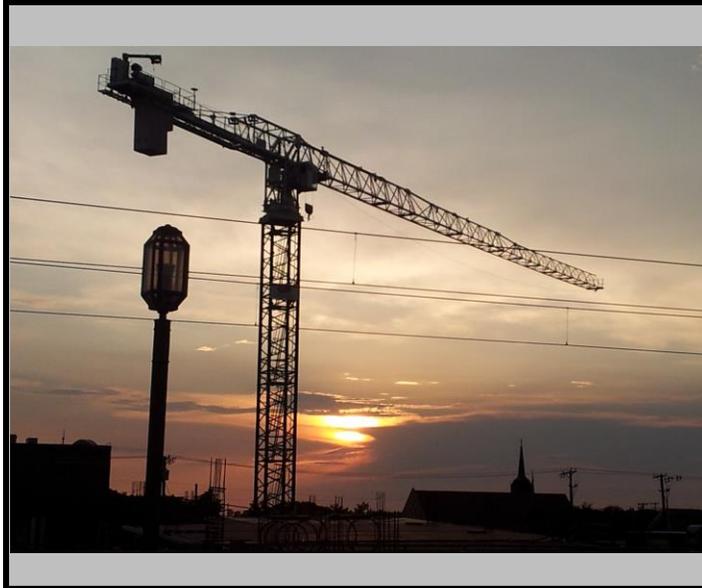
Should Owners allow CM/GC's to enter into lump sum (fixed price) subcontracts with themselves for self-performed work?

We have been watching a trend develop, mature and grow over the last several years related to self-performed work by construction managers/general contractors (CM/GC) on cost plus with Guaranteed Maximum Price (GMP) prime contracts. [Note: These GMP type contracts are commonly used for Construction Manager at Risk (CMAR) prime contracts.]

The trend is a predominant preference of many CM/GC's to perform self-performed work on a lump sum basis.

Self-Performed Work By Construction Managers





Self-Performed work by CM/GC's has been very prevalent for placing concrete and/or "general trades"

The lump sum value of the self-performed work is usually arrived at through the competitive bid process where the CM/GC solicits competitive bids for certain portions of work that they could perform with their own forces and/or sub-subcontract the work. Self-performed work by CM/GC's has been very prevalent for placing structural concrete and/or "general trades" miscellaneous project related work such as general clean-up, field engineering layout, hoisting, etc.

Many Owners also seem to favor this lump sum contract approach for self-performed work by the CM/GC because of the minimal amount of paperwork and the perceived advantage of competitive bidding to arrive at the lump sum amount for self-performed work.

If you do not already have an opinion on competitively bid lump sum subcontracts for self-performed work, you might be asking "what's wrong with this approach?"

We recommend that Owner organizations consider the following before allowing their CM/GC's to enter into lump sum subcontracts with themselves to self-perform work:

- Before this trend of CM/GC's performing self-performed work on a lump sum basis, the more typical scenario was for the CM/GC to estimate a budget for such work as part of their overall GMP estimate and if there were any savings under their GMP estimate, the savings would revert 100% to the Owner or the savings would be shared for example 75% to the Owner and 25% saving incentive bonus to the CM/GC.
- A variation of the actual cost of self-performed work within an overall GMP contract price was to establish a mini-GMP for the self-performed work. In those cases, where the CM/GC was self-performing the work against a mini-GMP for the scope of the self-performed work (in lieu of having the work performed by a subcontractor), some Owner's allowed the CM/GC a self-performed work fee (such as 5% or 10%).

Owners should consider the possibilities of potential manipulation of the competitive bidding process involving self-performed work such as the following:

- Minimizing effective competition by (1) limiting the potential bidders by limiting lead time to bid, (2) only obtaining bids from contractors who are not really interested in doing the work (resulting in high "complementary bids"), (3) obtaining bids from interested subcontractors, then manipulating the scope analysis and subsequent buy-out to award themselves the subcontract even though they were not the apparent low bidder.
- Entering into a subcontract for self-performed work (with effective competition), then without any further competition doubling or tripling the self-performed subcontract amount by awarding themselves change orders to add scope.



Consider the following example of a "competitively bid" subcontract that one CM/GC awarded themselves on a \$70 million GMP project.

- The CM/GC was the apparent low bidder to perform the structural concrete work. They entered into a lump sum subcontract with themselves for the "low bid amount" of \$3.3 million. (Note: Most Owners believe that a 10% FEE margin on self-performed work is reasonable. Therefore, their reasonable estimate of actual costs to be incurred would be \$3 million and the GM/GC would then receive \$300,000 as their FEE for performing the self-performed work.)
- However, in this real life self-performed work example, the GM/GC only incurred actual costs totaling \$2 million resulting in an effective FEE of \$1.3 million or an effective FEE that was more than 50% of their actual cost.
- Approximately \$300,000 of the "more than normal" profit margin in this self-performed work example was due to the CM/GC performing general conditions work related to the concrete self-performed contract work from the main job site office and charging the main project general conditions costs with the concrete related general conditions, personnel and expenses.
- The remaining \$700,000 of the "more than normal" profit margin in this self-performed work example can be attributed to other factors such as "ineffective results" of the competitive bidding, etc.



...the CM/GC's GMP amount for self-performed work subcontracts should be based on their competitive bid amount.

- In the above example, the Owner would have been better served by allowing the CM/GC to perform the work under a mini-GMP subcontract arrangement for the self-performed concrete work. If the mini-GMP subcontract for self-performed concrete had been to reimburse for actual cost plus 10% not to exceed the \$3.3 million bid, the Owner would have only have had to pay \$2 million in cost plus 10% FEE on the self-performed work or a total of \$2.2 million rather than the \$3.3 million they paid.
- The prime contract in the above example contained a right to audit clause which allowed the Owner to audit the records of all subcontracts including the records of the self-performed concrete work. However, the right to audit did not directly benefit the Owner on this project because the contract was a lump sum rather than a mini-GMP. The key cost control point to prevent this potential problem is to make it clear up-front to the CM/GC... while subcontracts for self-performed work will be allowed, they will only be allowed under cost plus % FEE mini-GMP subcontract arrangements.

We believe that the fiduciary responsibility of the CM/GC and the related partnership between the Owner and the CM/GC works fairly to both parties in most contract situations. Therefore, most CM/GC's are probably not benefiting from their self-performed lump sum subcontracts to the extent that was outlined in the above example. However, this is a situation where the best practice for the Owner would be to protect themselves from a scenario where for some unwarranted reason there is a potential for unreasonable profit margins to be unfairly realized by a CM/GC on lump sum self-performed work subcontracts.

We have been recommending that Owner organizations adopt procurement policies which address this issue and make it their organization's formal written policy that any self-performed work by CM/GC's be done on cost plus FEE with GMP subcontracts with no exceptions. Competitive bidding can still be used, but the CM/GC's GMP amount for self-performed work subcontracts should be based on their competitive bid amount.