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Contractors Are All But Guaranteed To Balk At GMPs. Here's What Project Owners Can Do About It

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Supply chain delays and rising material costs have contractors looking for ways to limit their risk, including refusing to commit to true guaranteed maximum prices — or "GMPs" — on contracts. Fortunately, there are steps owners can take to keep projects on time and under budget.

“The incredible price escalations that we are seeing mean that contractors are reluctant, if not absolutely refusing, to lock into GMPs,” said attorney Rhian Cull, a director with law firm Goulston & Storrs who specializes in construction law. “They are unwilling to bear those risks.”

And it is no wonder why, she said. Prices for construction materials increased greatly during the pandemic and show no signs of slowing down soon.

Cull cited data from John Burns Real Estate Consulting showing that the cost of lumber increased by more than 30% in Q4 2021 while cost inflation for steel and aluminum was about 23%. Practically every type of material continued to become more expensive, with electrical and lighting, drywall and insulation prices all creeping up around 15% in the fourth quarter.

As a result, it has become more common for contractors to insert conditional clauses into contracts. Cull called this a contractor's version of the “get out of jail free card.”

“Even when the contract structure is called ‘GMP,’ we are seeing these clauses inserted,” she said. “They range from ‘we can't guarantee anything’ to ‘we will take a 5% cost escalation risk, but nothing further.’ We do still see some contracts where the GMPs are locked in, but conditional provisions have become much more common.”

Closely related to the problem of cost escalation is supply chain disruption. Not only do construction projects face higher prices, but there is often uncertainty about when the materials will actually arrive on-site and delays of many months — or longer — have become common.

This has made contractors take steps to protect themselves against liquidated damages — pre-negotiated costs that can be recovered by the owner if the contractor breaches the contract — such as delay damages. Many are requesting that an additional clause be inserted in contracts to account for the impact of supply chain disruption, Cull said, and for delays resulting from supply chain disruptions to be treated as both excusable and compensable.

“This is different from the situation pre-Covid, when third-party delays such as a supply chain risk were seen as excusable, but not necessarily compensable,” according to Cull. “We now see the contractors asking to be compensated for those delays.”

Contractors also are asking for grace periods before liquidated damages take effect, she said. Historically, the clock started ticking the day after a project was substantially completed, but some builders are asking for grace periods of up to 30 days after that milestone.

These trends could leave construction project owners in a bind, but Cull highlighted two steps owners can take to protect themselves and contain costs.

One is to try to source materials from closer to home. It is not always an easy solution, but it can lessen contractors' dependence on overseas cargo shipments that are stalled at U.S. ports.

“Starting as early as the design phase, people are being asked to think, ‘How can we source this locally?’ with ‘local’ being Canada, the United States and Mexico,” she said.

Cull also recommended specifying and purchasing materials — and looping in all project stakeholders — much sooner in the process. Making this work, she said, requires teamwork.

“You need to speak to the designers to see where they can source,” she said. “You also need to get the contractor on board earlier because you need a collaborative approach and they may be able to suggest alternative materials or sources.”

A design/build or similar project delivery method — where designers, developers and other project stakeholders work together on every aspect of a project from the the design phase through construction and up to final completion — can also help the team plan around supply chain shortages, which Cull said is yet another issue afflicting project teams in some regions.

In the Northeast, public-private partnerships are becoming more common. For all of its benefits, though, P3 does not shield project owners from cost and supply chain issues.

“Whatever mode of procurement you go with, you're going to have these supply chain disruptions, and a P3 contract typically calls for a GMP,” she said. “If you are forcing contractors to give you a GMP, your total cost is going to go up because they're going to price the risk and add it to the base cost of the work. There is additional risk for contractors under the P3 model, where if the project comes in late, there are additional financing costs.”

The bottom line, Cull said, is that the current supply and pricing environment requires a level of collaboration that might have been foreign to some stakeholders prior to the pandemic. They should also keep in mind that one party’s well-intentioned efforts to protect its interests might draw a strong reaction from their partners.

“If you force the contractor to give you a fixed price when they feel that they are facing uncertain price escalation, they're going to give you a much higher price because they price in the risk of fluctuations, which may or may not happen,” she said. “Instead, owners need to work closely with their partners to lock in prices early to not overpay later.”

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