



RCI, PAL and Army Housing Training

Challenges with Design Build Contracts

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Agenda

- **Objective**

- Review lessons learned through Initial Development Period (IDP) process
- Explore strategies for out-year projects

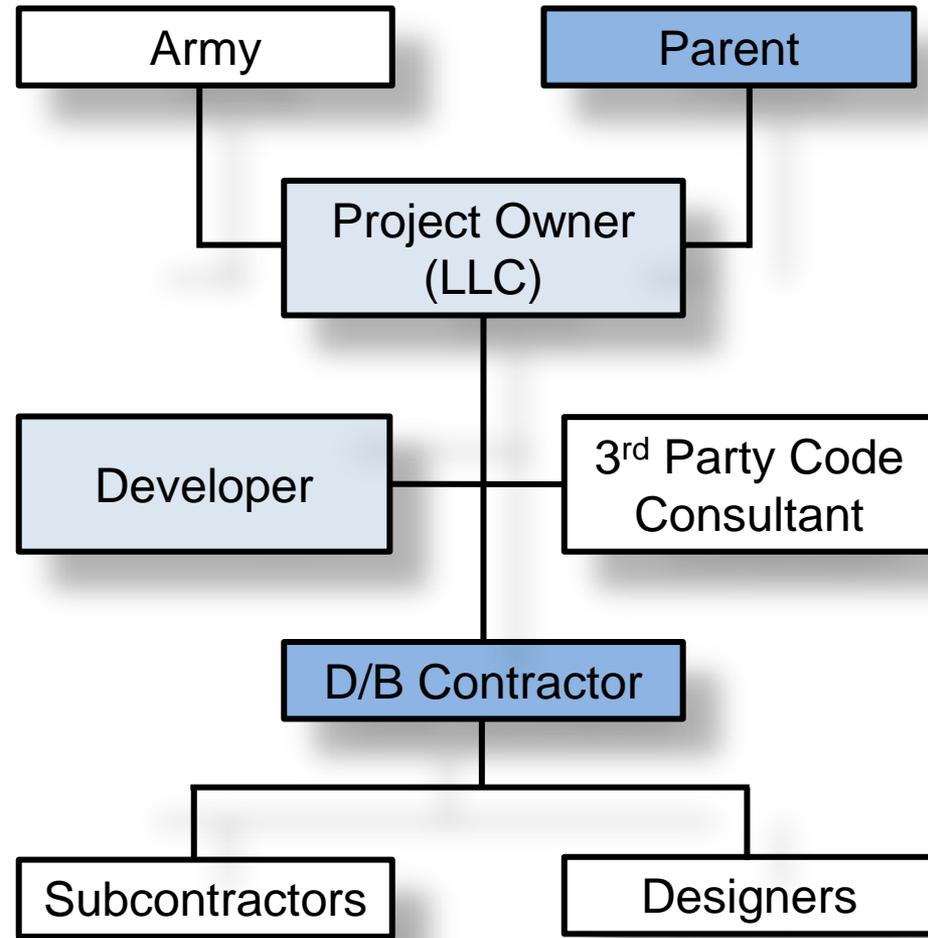
- **Discussion Topics**

- Provide basic definitions / contract types
- Review team structures
- Discuss IDP contracting priorities and strategies
- Explore out-year contracting priorities and strategies
- Understand transaction documents
- Develop implementation strategies



Development Team Structures

- **Project Owner is partnership**
- **Developer & D/B Contractor contracted by Owner**
 - Separate entities
 - Frequently affiliated
 - Roles defined by contracts
- **Developer**
 - Manages project for Owner
 - Assumes virtually no risk
- **D/B Contractor**
 - Assumes risk based on contract terms
 - Engages/manages design team
 - Engages/manages subcontractors





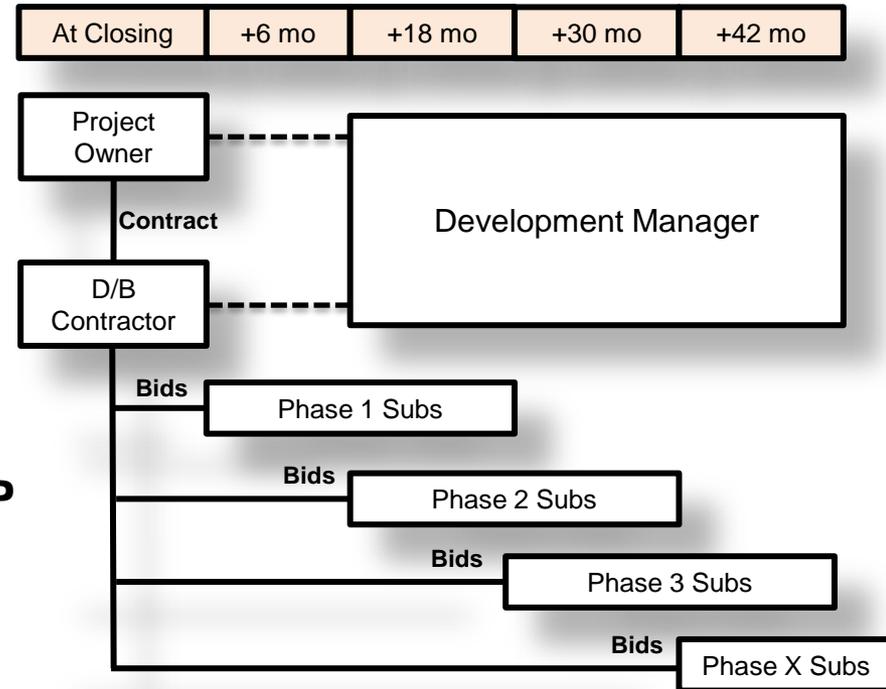
IDP Project Characteristics

- **Mega-projects**
 - \$300M to \$500M common
 - 5 to 7 years common
 - Negotiated so that each project has some type of guarantee to include scope, schedule, and budget
- **Risk transfer a critical factor**
 - Guarantees require significant financial capacity
 - Contractors provide most of the substantive guarantees
 - Large balance sheets
 - P&P bonds to back obligations
 - Engagement of subcontractors a phased activity in most cases



Understanding Incremental Risk Transfer

- Risk transfer has a cost
 - More uncertainty increases cost
 - Multiple contracting activities
 - Major time risk
 - Complex process for multiple bids
- Cost reflected in several ways
 - Significant contingencies in D/B GMP
 - Large staff to manage contracting
 - Larger entities have higher overhead
 - Multiple levels of markups for overhead and fee
 - Risk assumption commands premium fee levels
 - Change Orders for escalation, assumptions, allowances increase GMP
- Strategy driven by IDP project needs





Impact of IDP Mark-Ups

- **Total development budget \$368M**
 - Typical project budget
- **How much goes to actually build?**
 - About 53% to direct field costs
 - Varies with deal structure
- **Where does the rest go?**
 - Financing/closing costs
 - Soft costs
 - Fees
 - Overhead
 - General Conditions
 - Insurance & Bonds

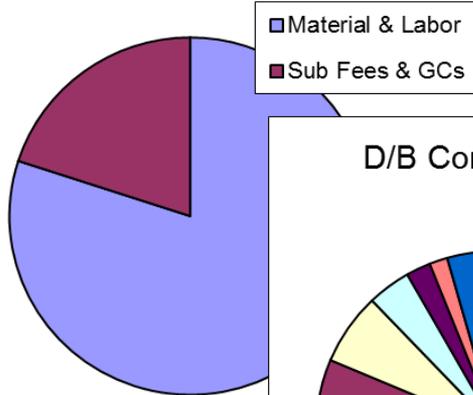
Hard Costs	Cost (\$)
Vertical Costs	116,517,835
Site Work Costs	45,302,810
Landscaping	1,962,000
Renovations/Conversions	39,812,236
Demolition	9,220,362
Utilities Infrastructure	4,844,812
Amenities	10,519,916
Inflation	18,306,341
Subtotal Hard Costs	246,486,312
Construction Soft Costs	
General Conditions	19,718,905
A&E Fees	11,792,674
D/B Contingency	6,700,055
D/B Overhead	4,929,726
D/B Fee	13,354,800
Subtotal Const Soft Costs	56,496,160
Subtotal GMP	302,982,473
Development Soft Costs	
Cost (\$)	
Developer Fee	12,858,880
Developer Staff	2,000,000
Development Contingency	9,089,474
Construction Consultant	4,905,000
Project Insurance & Bonds	6,659,542
Environmental Testing	5,000,000
Other	3,006,065
Subtotal Dev Soft Costs	43,518,961
Financing/Closing Costs	
Transition and Legal Costs	6,695,118
Financing Costs	5,958,567
Title Insurance	796,128
Reserves	4,310,453
Insurance	1,443,336
Subtotal Financing/Closing	19,203,602
Total Development Budget	368,748,648



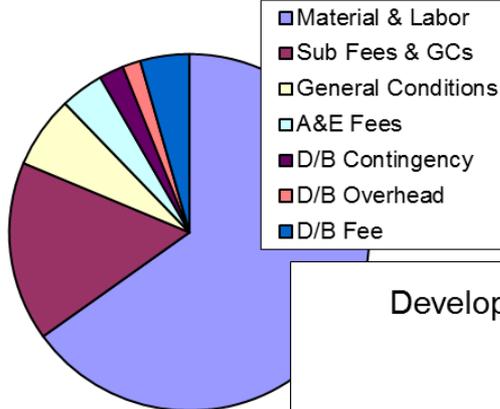
Result – The Incredible Shrinking Dollar

- **Subcontractor – 80% to build**
- **D/B Contractor (GMP) – 65%**
- **Development Budget – 53%**
- **Private Sector Project – 67%**
 - Financing accounts for 5%
 - Remaining 62% is 17% improvement beyond 53%

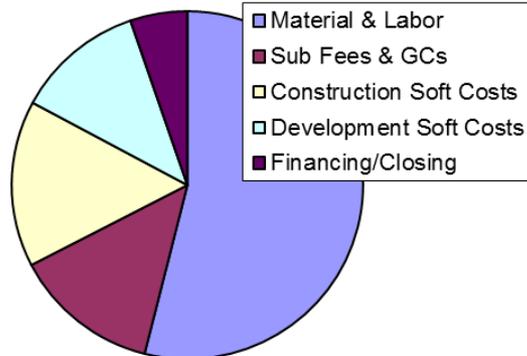
Subcontractor Level



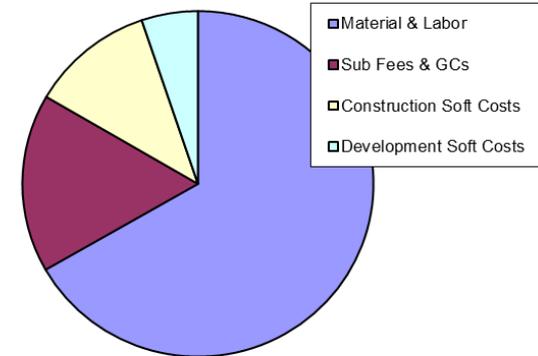
D/B Contractor Level (GMP)



Development Budget Level



Development Budget Dollar Spent Private Sector Project





What Changes for Out-Year Projects

- **Most projects will be much less complex**
 - Scope limited to a single phase over 1-2 years
 - Budgets more in the \$10M to \$50M range
 - Funded from reinvestment account vs. debt
- **Can implement with streamlined structure**
 - Go direct to subcontractors in single increment of bidding
 - Use local resources like major local homebuilders
 - Single procurement with no upfront risk transfer
 - Requires significantly less management effort
- **No water-skiing behind aircraft carriers**
 - Match contracting structure to the task
 - Retain the risk as Project Owner until it can be directly passed to subs
 - Drive more of the development dollars to the field



How Do You Improve Efficiency

- **Optimize use of the Project Team resources**
 - Review documents for potential constraints
- **Developer brings contracting strategy and resources**
 - Development Agreements typically for full 50 year duration
 - Compensation established as function of work managed
 - Has obligation to optimize Owner's interests (not contractor's)
 - Needs to provide skill set to examine alternative strategies
- **D/B Contractor typically hired for IDP services only**
 - Some operating agreements establish preferential role for out-years
 - Most do not mandate use of affiliated D/B
 - Terms of engagement are frequently not established for out-years
 - Compensation should be commensurate with risk assumed
 - Engagement should be evaluated on competitive basis



Actual Case Study

- **Development budget roughly \$300M**
 - 708 new homes, 700+ renovations of various types
 - 9 year IDP in 7 planned construction phases
- **By commitment of 4th phase escalation threatened scope**
 - Contract escalation provisions exceeded budget capacity to absorb
- **Owner creatively explored alternatives**
 - Adopted strategy that had worked effectively at other project
 - Broke the remaining phases into smaller increments
 - Enabled smaller local contractors and subcontractors to execute
 - Tapped the expertise and connections of local homebuilders
- **Results – delivering to original budget**
 - Nominally completing on original schedule



Actual Case Study (Cont.)

- **Exceptional product**
- **JNCO homes**
 - **Single family vs original duplex**
 - **Premium cabinets**
 - **Stainless appliances**
 - **Granite tops**
 - **Vinyl plank floors**
 - **Vaulted ceilings**
- **Creativity works**





Types of Contracts

- **Contract Structures**

- Developer (Owner advocate, specialized expertise, little/no risk)
- General Contractor - Design/Bid/Build (Owner hires design team)
- General Contractor - Design/Build (design team works for Contractor)
- Construction Manager (CM – hires/manages subs, could assume risk)

- **Contract Financial Structures**

- Lump Sum (Fixed Price – use when scope is clearly defined/simple)
- Guaranteed Maximum Price (Cost plus, GMP, Shared Savings)

- **Contract Protection Alternatives**

- Payment & Performance Bonds (ensure contract performance)
 - Subguard policies (protect Contractor from subcontractor defaults)
- Insurance programs (protect insurable events)
 - OCIP (Owner controlled, wrap-up policy, complicated to administer)
 - CCIP (Contractor controlled wrap-up, efficient from contractual perspective)
 - Conventional (each entity provides their own coverage, simple)



Out-Years – Match Strategy with Complexity

- **Simple out-year projects funded from Reinvestment**
 - Roof replacements, extended change of occupancy maintenance, etc.
 - Limited trades and complexity
 - Developer could facilitate procurement and contracting for Owner
 - Monitor progress of the work without a separate general contractor
- **More complex single phase projects**
 - Renovations of a neighborhood
 - Demo and rebuild a small neighborhood
 - Developer could develop and implement strategy
 - Hire design team on behalf of Owner
 - Competitively bid to local home-builders
 - Monitor the progress of the work
 - Potentially use affiliated Contractor in CM role to manage work
 - Structure fees commensurate with limited risk transfer



Out-Years – Match Strategy with Complexity

- **Major mid-term renovations & rebuilds**
 - Consider original IDP structure if multiple phases, complexity and/or debt funding
 - Limit risk transfer if funded from reserves
 - Owner has risk going into a midterm project
 - Do not pay risk transfer premiums unless there is value in doing so
 - Utilize Developer to examine strategies
 - Engage affiliated contractor if it adds value
 - Enhanced management capacity
 - Expedited design/construction process
 - Consider CM role without risk transfer to achieve objectives
- **Alternatives may require revised approval process**
 - Major decision approvals for project on conceptual budget & strategy
 - Update approvals based on actual bid costs



Summary

- **Recognize fundamental differences in projects**
- **Discuss opportunities with project owner**
- **Need to work within the confines of the current legal structure/agreements**
 - Complexity requires involvement of HQDA
 - May be opportunity for negotiation
 - Need to determine risk/reward relationship
- **Focus on driving as much budget as possible to scope**
 - Shift another 5% to field
 - Yields 10% increase in scope



Questions?

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