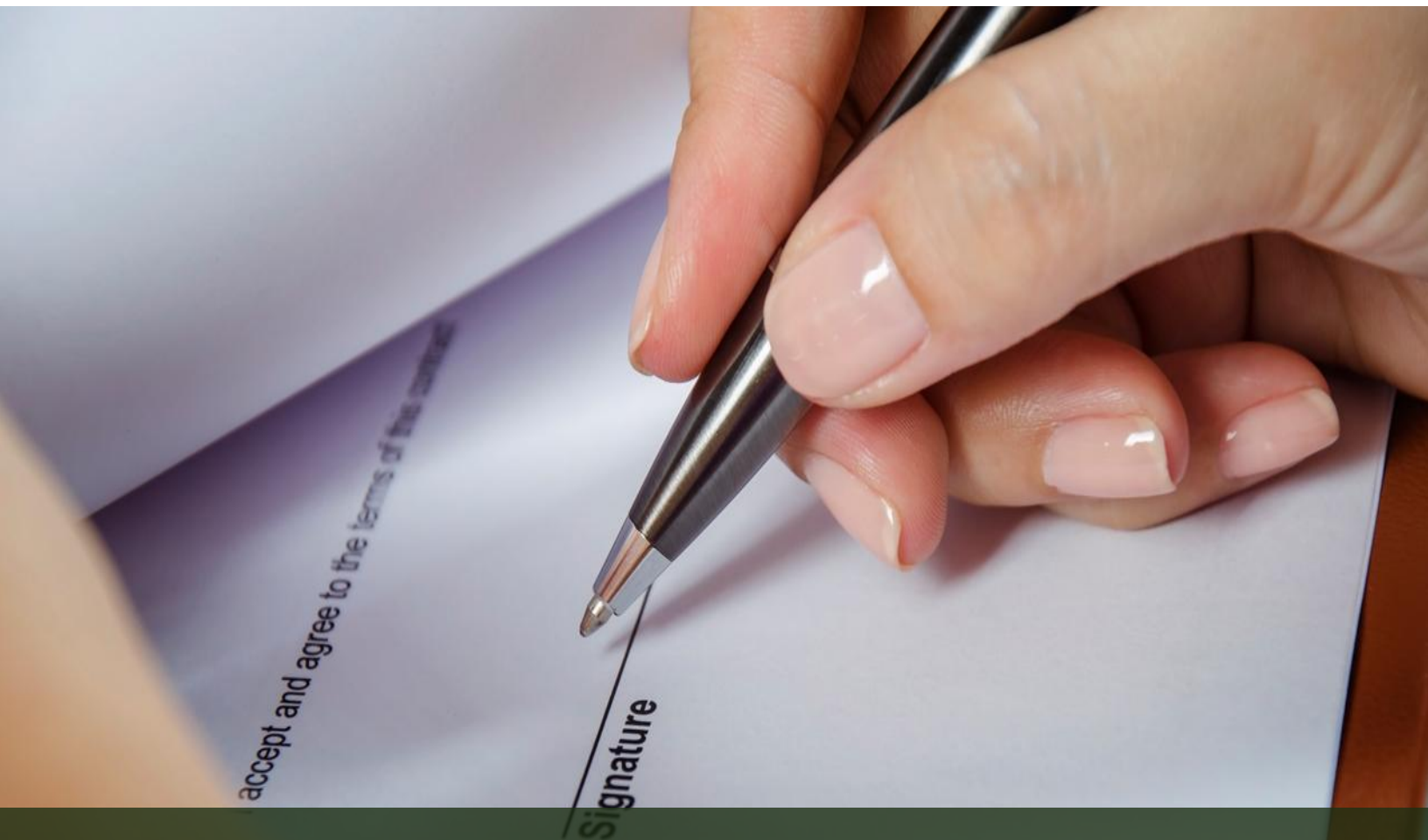


WHAT IS A GUARANTEED MAXIMUM PRICE CONSTRUCTION CONTRACT IN ARIZONA?

*Construction Contracts Take Different Forms,
Each with Certain Advantages and Disadvantages to the
Builder or General Contractor and to the Organization
Or Individual Who is Contracting for the Project*



Construction contracts must be drafted to protect the interests of all parties including the buyer/owner and the builder/general contractor. Construction contracts take different forms, each with certain advantages and disadvantages to the builder or general contractor and to the organization or individual who is contracting for the project.



An experienced real estate attorney can provide advice to clients in drafting construction contracts; determining the appropriate construction contract form; and negotiating the terms of the contract.

One of the first decisions an attorney can assist clients with making is the decision on whether the construction contract will be a fixed price contract; a time and materials contract; or a guaranteed maximum price (GMP) contract.

WHAT IS A GUARANTEED MAXIMUM PRICE CONTRACT?

A guaranteed maximum price contract is a type of construction agreement that combines the features of both a fixed price contract and a time and materials contract.

A fixed price contract establishes a set price for the completion of a construction project. The purchaser/owner of the finished property will pay the price outlined in the initial contract unless the purchaser makes substantial changes and signs a change order after the project has begun.





A fixed price contract puts the responsibility for cost overruns and unexpected expenses solely on the builder or general contractor, which is a significant buyer advantage. However, a fixed price contract can create incentive for builders to cut corners because every dollar of savings reduces the builder's costs and expands profits. Buyers receive no benefit from any cost savings.

A time and materials contract, also called a Cost Plus Contract, provides for a builder to be reimbursed a set price for labor and materials along with an additional cost for overhead as well as a fee for profit. With a time and materials contract, the builder is protected because materials, cost and profit are all built into the contract and because buyers pay for cost overruns. For buyers, however, there is uncertainty as to a final price of a project. There is also little incentive for a builder to work more quickly or efficiently or to consider cost-lowering alternatives with a Cost Plus Contract since the builder does not benefit from reducing the expenses associated with the project.

A guaranteed maximum price (GMP) contract is a hybrid of a fixed price contract and a time and materials contract. The builder is reimbursed for the work performed on a time and materials scale; however, there is a maximum price ceiling set in the contract. If cost overruns exceed this ceiling or if the project is more expensive than anticipated, the builder must complete the remaining work without additional payment.

There are different ways to structure a GMP contract. For example, the contract may provide that

the contractor's fee is based on a fixed fee or is based on a percentage of construction costs but that the contractor will be responsible for cost overruns once the price ceiling is reached. A GMP contract may also include a shared savings clause in which the parties agree

that savings will be split if the actual costs of the project are lower than the GMP agreed to.



Guaranteed maximum pricing provides the benefit of certainty to buyers and provides flexibility when it is difficult to estimate the total cost of completing work. GMP contracts also allow owners to benefit from any cost savings that occur. Buyers or owners benefit from the fact that their costs are capped and that they receive a percentage of savings, while contractors benefit because of the guarantee their costs will be paid, assuming that the guaranteed price maximum is not reached.

Risks to buyers include the potential for builders to overestimate the maximum



price to reduce risks of overruns, and the possibility that overstating the initial price makes it possible for the builder to increase profits due to the shared savings clause.

Builders, on the other hand, assume the risk of unexpected cost overruns

and profit margins can be adversely impacted if bringing the project to completion exceeds the set maximum price. Further, if the guaranteed maximum price is developed early in the design or preconstruction phase, there is a risk of disagreement regarding what is included in the scope of the project. This could result in the final costs exceeding the GMP.

Both buyers and builders need top-notch legal representation when a guaranteed maximum price contract or any type of construction contract is being drafted. Experienced real estate lawyers with a background in construction contracts can facilitate negotiations to help ensure a successful deal while protecting the interest of clients.

About the Author

Lotzar Law Firm, P.C. was founded in 2005, and serves clients throughout the U.S. We pride ourselves on the level of service we provide our clients and are determined to see each project through to positive results.

In addition to bringing a legal expertise to the table, we offer clients sound ideas and invaluable advice that enhances their business. One of our greatest attributes is our ability to approach projects from a business-owner perspective. Rather than narrowing in on the setbacks of a challenge and informing clients of what stands in the way, we prefer to seek innovative ways to transcend issues and create a better path for clients. With an unparalleled savvy in developing modern methods of financing, we can present you with viable and efficient options.

Our diversified portfolio of clients is comprised of entrepreneurs, real estate developers, contractors and property managers. We also do business with numerous nonprofit clients including Chicanos Por La Causa, Inc.; Tiempo, Inc.; and The Industrial Development Authority of the City of Tucson, Arizona.

We work in a team-based environment, supported by a skilled and caring staff, eager to answer your questions and provide you with consistent access to your team. Whether your needs are small or large in scope, we look forward to working with you.

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