CLIFFORD CHANCE

IS CONSTRUCTION MANAGEMENT RIGHT FOR YOUR PROJECT?

Developers often ask for our opinion as to whether construction management is right for their project.

By construction management we mean the direct appointment by the developer of multiple trade contracts, a construction manager and professional team (no design team novations).

We have advised on a number of construction management (CM) developments over the years and the route is currently having a renaissance due, in part, to the challenges of obtaining a fixed lump-sum design and build price of a palatable nature.

In some cases, two stage design and build arrangements are running into problems where the pre-construction services agreement (PCSA) fails to convert to a design and build contract. Programme pressure (perhaps from pre-let tenants with the ability to charge the developer hefty penalties for late delivery) mean that the client will be desperate to start works on site, but will also wish to avoid the many legal and commercial pitfalls of allowing the contractor on site under a PCSA which is often not designed to cater for more than minimal site set up. Clients facing this situation are considering CM as an alternative to design and build procurement.

It is worth noting that many of the so-called CM deals we see in the market are actually hybrids with either:

- an SPV contractor (typically a developer/contractor JV vehicle) sitting above the true CM arrangement but with limited long-term responsibility for defects post-completion; or
- only a handful of trade contract packages, each one being large enough to effectively be a main contract in its own right.

Before deciding on any procurement route, clients should consider their priorities in terms of time, cost and quality. Most clients want to "have it all", but in our view CM is most appropriate where time is at a premium, or on complex refurbishments where specialist trades are required (also avoiding the problems of traditional "nomination").

Success when using "true" CM procurement tends to be linked to:

- an experienced and professional construction manager with access to a well-established supply chain of trade contractors. Beware the main contractor who suddenly develops a passion for CM to reflect market conditions but without the change of approach that is required genuinely to be on the "client side" of the table as a good construction manager should be;
- a well-resourced client team – do not underestimate the client resource required to manage multiple trade packages, even with a good construction manager;
- a comprehensive latent defects insurance policy to take the pressure off the collateral warranty package negotiations with pre-let tenants – this is less of a concern on residential projects or commercial office projects with multiple small/medium lettings rather than projects with a large commercial anchor tenant;
- keeping it simple in terms of any possible "flip" from CM to a design and build route – it may be sensible from a commercial perspective in some circumstances for developers to have this at the back of their mind, but attempts to draft for it in the legal CM documents are usually no more than an "agreement-to-agree" (i.e. unenforceable) and it can encourage the wrong behaviour in contract negotiations.

Most clients will be concerned to ensure that their lenders are willing to finance CM, i.e. that it is bankable. In our view, the alleged reluctance of lenders to fund CM-based projects is sometimes over-exaggerated within the UK real estate development market, particularly where there is robust underlying property asset security. That said, lenders will take a cold hard look at the construction package before funding. As on other procurement routes, they will be interested in a clear line of step-in rights (i.e. rights allowing the lenders, their chosen replacement developer or their appointed insolvency practitioner) to build out the development in a developer insolvency scenario. Given, however, that step-in is inherently more complex with CM than with other procurement routes (because of the number of contracts into which step-in would be required), lenders will also focus on the level of contingency built into the development budget, and the size and robustness of the completion/overrun guarantee.

The complexity of making step-in arrangements workable for multiple contracts, lack of a single contractor responsible for programme (usually no LADs), budget or defects, and limited overall cost control (although individual trade contracts are usually lump-sums so there is control package-by-package), means that we tend to see banks scrutinising the experience and quality of the developer and its construction manager to a greater degree than say with, design and build, and requiring the following:

- the letting of larger trade packages where possible, rather than multiple small packages;
- latent defects insurance, not so much for the bank *per se* but as a marketing tool to attract tenants/purchasers (given the collateral warranty package will be of very limited value due to the disaggregated procurement route), which in turn gives the bank comfort that the project will be let/sold;
- strict requirements regarding programme and budget controls in the loan agreement, seeing as the construction manager typically only has very limited responsibility for such things and the trade contractors are only responsible for their packages; and
- comprehensive on-site and off-site monitoring requirements (which come at a cost).

The hybrid CM arrangements mentioned above may be more appealing to banks than "true" CM (i.e. namely multiple trade contracts entered into by the client and managed by the construction manager).

Another Way?

It is worth noting that failure to agree a fixed price for the whole of a development should not, in our view, automatically lead to a move to CM. Before moving from a fully wrapped design and build arrangement to fully disaggregated CM, developers should at least be aware of possible alternatives, e.g. proceeding with a single design and build contract but with lump sum pricing only applying to agreed portions of the works and cost plus pricing (potentially subject to a target cost or guaranteed maximum price mechanism) applying to the remainder.

Conclusion

CM is having a renaissance at the moment and, where "speed and specialism" are the client's main drivers, can offer genuine solutions to performance and budget challenges in the hands of an experienced client team and professional construction manager. However, there are risks for the unwary in terms of cost escalation and administrative burden. Success can be achieved with CM, but it requires clients to take a leap of faith away from the more commonly seen design and build lump sum "wrap" to a more hands-on approach with greater risk being retained on the client side.

CLIFFORD CHANCE LLP

Clifford Chance Construction Group

The Clifford Chance Construction Group provides specialist support to clients in the development of procurement strategies and in the analysis and allocation of construction risk. The Group is unique among the leading law firms in its size and specialist focus and is consistently recognised as a market leader.

The Group is involved in all sectors of the construction industry, including infrastructure, energy, oil and gas and real estate, allowing a seamless sharing of ideas and resources across those sectors.

We operate at the leading edge of the technological, policy and legal trends which shape the construction industry. For example, we are deeply involved in renewable and new nuclear energy and in carbon reduction technology, and are constantly developing new contracting concepts and structures to meet the changing needs of our clients.

Our clients include public and private sector developers, funders, contractors, end-users and service and technology providers. While acting for one participant in the construction process, we can therefore understand the perspective of the others.

We operate globally and can make available specialist teams on demand in any location. Our network of offices and relationship law firms enables us to blend our specialist skills with the legal and business cultures of the project's location. Our global reach also enables us to bring a market-wide commercial perspective to each individual transaction.

We work frequently as part of a team of specialists drawn from across the firm's industry and practice groups and understand how the construction element fits into the wider context of a complex transaction. We maintain especially close links with the firm's Energy and Infrastructure, PPP, International Arbitration and Real Estate groups.

The Group maintains a wide and frequently updated range of briefing and workshop materials which are available to clients and contacts free of charge on request.

If you would like to know more about Clifford Chance's Construction Group in London or across our network, please contact Marianne Toghill (marianne.toghill@cliffordchance.com), David Metzger (david.metzger@cliffordchance.com), Tim Steadman (tim.steadman@cliffordchance.com), Sandy Hall (sandy.hall@cliffordchance.com), or your usual Clifford Chance contact.

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