



THE COMMERCIAL OBSERVER

February 15, 2011

THE WEEKLY NEWSPAPER

FOR THE COMMERCIAL REAL ESTATE INDUSTRY

\$7.00



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SPECIAL REPORT

CONSTRUCTION 2011

WHAT THE TOP FIRMS ARE BUILDING NOW—AND DOWN THE ROAD

The Biggest Challenge Facing Ground-Up Projects

Surprise!—or maybe not—it's the construction industry

When the bottom fell out on the real estate market in 2008, it seemingly happened overnight. As we all now recognize, there will be no corresponding recovery that will sharply match new projects with available funding from lenders ready to return to the market. The process will be a "slog," as capital slowly becomes available only to the best of borrowers and leaves the many distressed properties around the country to struggle for rehabilitation funding. Stable, income-producing properties will always find lenders. Speculative projects lacking steady cash flow to meet loan payments will have little or no chance of meeting a lender.

Yet any owner who wishes to be ready with a new project—be it a hospital, a hotel or a mixed-use facility—knows that to hit the market by 2013, it must start designing the project now. Foreign investors—and we are seeing them actively pursuing a wide range of real estate investments—are flush with cash and looking downstream for new opportunities. Still, there remains, according to many astute investors, one major fly in the ointment of developing a new ground-up project: the vagaries of dealing with the highly inefficient and unreliable construction industry.

The construction industry has suffered 20 percent unemployment, and each month brings more bad news. As a result, contractors of all sizes are prepared to bid well below the cost of a project's true price in order to win a job, secure some cash flow and find every means at their disposal to make claims against the owner, its architects and engineers in an effort to eke out a profit—even if it means driving up the project's total construction costs and causing completion delays as much as one year.

This unacceptable behavior became the norm during the building boom, when cash to pay off contractor claims was readily available. Those profligate days are gone. No owner has any capital flexibility to pay more than a project's true value. And there are no mezzanine lenders to fund payouts for large delay claims to contractors.

But with tomorrow's project in mind, what is an owner to do?

For owners who are serious about containing construction costs, the answer is to utilize a con-

struction contract that ensures against cost overruns and incentivizes each member of the construction team to complete its work on time and on budget.

How is this done? Simply put, by ensuring tight oversight of the project's design documents prepared by the architect and engineers; using sophisticated software that identifies and avoids clashes that cause otherwise costly interferences between the architectural, mechanical and structural designs; providing an owner with proven independent cost estimates before the complete and coordinated designs are put out for pricing by the prospective contractors; and negotiating all anticipatable contingencies into fixed-price line items.

With all of the above—which are not only attainable but essential—an owner can regain control over a project.

Properly drawn construction contracts have the power to ensure proper cost management, and the availability of such contracts now gives an owner a true choice. Right now, the familiar choice is gener-



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ally for the owner to turn over the project with incomplete design documents to the construction industry for a "fast track" commencement—an option that will ensure dozens of change orders and countless claims and delays costing 20 to 50 percent or more above the so-called "guaranteed maximum price" contract.

The new, preferred choice—a choice now available to the owner and developer community through the TruFixedPrice contract recently introduced by our firm under our C3 Method—empowers owners to execute contracts that ensure the true fixed cost of a project. Moreover, by ensuring fair pricing of the work, contractors also reap the benefit of earning a fair profit for the efficient performance of all the work the drawings call for.

Choice. Something that owners

have not previously had in dealing with the construction industry. Choice. What a wonderful opportunity for owners to finally regain control over their projects, their costs, their schedules and the chance to assure their lenders that the project will be built on time and on budget.

Choice. What a nice thing.

Barry B. LePatner, founding principal of LePatner & Associates LLP, is a corporate construction counsel to owners and the author of Broken Buildings, Busted Budgets: How to Fix America's Trillion Dollar Construction Industry (University of Chicago Press, 2007). His most recent book, Too Big to Fail: America's Falling Infrastructure and the Way Forward, is out from the University Press of New England.