Self-Performing Developers and General Contractors Working Together

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One of the major goals for a general contractor during construction is to make a profit and for the owner, get the project built for the lowest amount possible. Just as general contractors have been opening self-performing divisions within their own company, owners are capable of self-performing certain aspects of a construction job as well. Owners have shown the capability to operate the project management aspect of construction in order to keep control of factors that are important to the owner and then form a joint venture or subcontract the entire construction management aspect of the project. The project management aspect includes bid leveling, project buyout, scheduling, procurement, submittal and document management and direct communication between the architect, engineers, and subcontractors. Using this owner-incorporated structure, the owner is in more control of operations and has more oversight throughout the project, but in return they take on more risk with the added responsibility in regard to financials and building out the project correctly. In this research, owners can be thought of as developers and are constantly in the market for acquiring land in order to build a new project in hopes of making a profit.

Key Words: Developer, Owner, Self-perform, Joint Venture

Introduction

A developer is someone who looks to acquire land and build a project on the property with the intentions of owning and operating the newly built property or to build the property and then sell it for a profit based on the original price the land was acquired for. Developers can be in the market for commercial construction such as malls, shopping centers, office buildings and medical centers. Residential construction is also a possibility in the form of housing complexes, residential towers, student living buildings, and multi family housing. Below is a graphic from levelset.com showing the general categories of projects that owners are building.

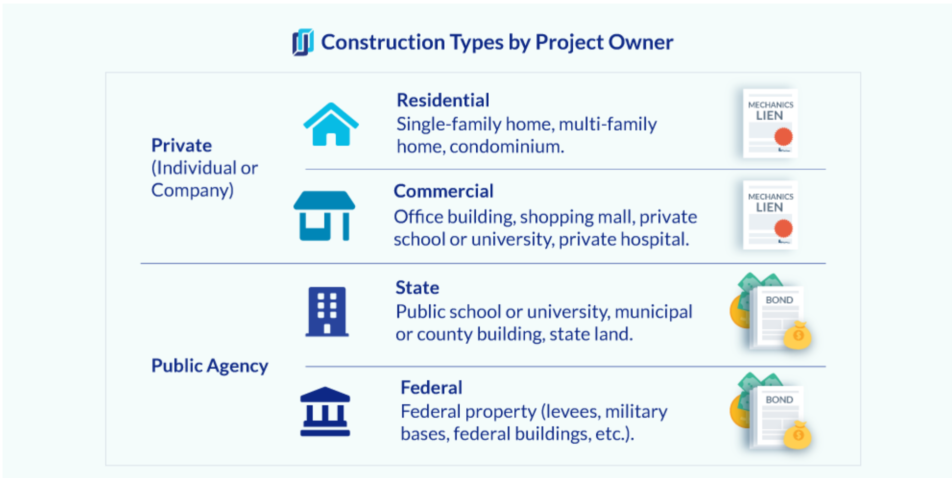

Figure 1: Construction Types by Project Owner

An overall broad schedule of developing property begins with purchasing land that could be an empty lot or could have an existing building, prepare the land by demolishing the existing building if present and then preparing the earth foundation by doing the necessary earthwork to support the project. Once the site is prepared, construction begins and carries on with its normal activities. Once the new project has been fully built, the product can be operated by the owner or be sold for a profit.

When it comes to developing the land, developers take on the responsibility of purchasing the land, filing for the necessary permits to develop the property, ensuring all codes and regulations are met with local and state requirements. Purchasing land is a process that can be done through local governments or within private negotiations amongst the current owner and the interested party, which is in this case, the developer. Developers must also evaluate the addition of things like powerlines, sewer systems, roads and sidewalks, and traffic systems when a piece of land has not been worked on. Necessary utilities require local officials and utility providers to be involved so that all parties are aware and agree of the new layout. If an existing building is present and is not being remodeled, it must be carefully demolished, and all waste needs to be sorted and delivered to the appropriate waste site (epa.gov).

Background

The construction industry does not frequently see joint venture contracts within the traditional contract delivery methods. The main contract delivery methods are design build, design bid build, construction manager at risk, construction manager agency, and integrated project design. These methods have the owner on the top of the chain of command with usually minimal involvement with the project other than design requests and supplying the funding for the project. Joint venture can take place in either of these contracting methods. It is more focused on the relationship between the two parties who wish to form the joint venture rather than a specific delivery method.

The influence and curiosity behind this topic are tied to my experience of four summers of interning with Related California Construction. I worked on two projects for two summers. Related California Construction was formed during the middle of my first internship in 2018 and was a branch off of a major developer called Related Companies. Both projects were mixed use residential and commercial buildings in San Francisco. My curiosity grew for this relationship once my education began at California Polytechnic State University San Luis Obispo (Cal Poly) because I feel that developer builders were not covered as much throughout the courses in the Construction Management major. The general contractor on both of these projects was GL Builders and they managed much of the on-site field activities while Related California Construction (RCC) was highly involved in the project management of both of these jobs as they had bought out material directly from suppliers, hired subcontractors directly, and managed the completion of these scopes they were involved in. I couldn't find many similar examples of a developer forming a construction sector and then working together with a general contractor to build a successful project so I wanted to evaluate if this was a construction method that could be replicated by other developers.

Joint Venture

There are a few reasons why a joint venture would be formed by two or more companies. A joint venture is a temporary partnership or team that can be formed through an agreement to work together for a specific project. The most common form of joint venture is a special-purpose partnership and is usually formed to build out a single project (Schaufelberger, 2009). Joint ventures "are formed to share risk, to acquire expertise, or to provide adequate resources to construct the project" (Schaufelberger, 2009). The purpose of this grouping is to utilize both of the individual companies resources and to take on work that can allow risk to be divided up rather than taken on by one party (Schaufelberger, 2009). Resources can include skilled labor, quantity of labor, materials, equipment and machinery, and services.

Both parties share the role of management of the joint venture which differs from having one single company take the lead on management in the form of a project manager, a construction manager at risk, or a construction management agency. With the split in management also comes with a divided profit that must be decided between both parties. This can be negotiated through the agreement of the joint venture and can be in the form of a lumpsum payout or a percentage of profits earned. The sharing of risk can also make joint ventures attractive due to being able to mitigate big costs that can come up from lawsuits, defects, or the chance of injury or death on a jobsite.

A joint venture contract will clearly breakdown the following details that define the agreement (Schaufelberger, 2009), which include the following topics.

- Objectives of the organization
- Obligations and rights of each party
- Percentage interest of each participant
- Amount of working capital contributed
- Responsibilities and procedures for managing the joint venture
- Limitations on liability.

Self-Perform Work

Self-performing work means to provide your own self-employed employees to complete a portion of construction (vipstructures.com). In construction, self-performing work is referenced to a general contractor that can be hired and not only manage construction but has established labor services that allow them to perform certain aspects of construction. In the big picture of things, a general contractor is hired by an owner and is responsible for the build out of the project whether it is their own construction services (self-perform) or also through the use of subcontractors that specialize in a trade that the general contractor cannot perform themselves. There is also a lot more analysis that takes place for a general contractor to determine whether or not they wish to self-perform a sector that they are capable of performing. In an article that analyzes the decision to self-perform work or to subcontract it out, Dr. Khaled Nassar states, “The general contractor’s own resources as well as profitability usually govern the decision on what items to subcontract. Often contractors would retain on their payroll permanent crews for performing specific types of operations, while others operations are subcontracted” (Nassar, 2003). If a certain scope of work is beyond a companies resources or they simply don’t have the labor, then they would need to look into subcontractors in order to get that scope gap filled.

Risks

Risks must be analyzed in order to preserve a company’s profit and reputation. An example of these damages is not meeting schedule milestones, which puts the general contractor at risk of facing liquidated damages at the end of the project. The reasons for this result could come from an understaffed office that cannot manage a certain scale of construction, leading to a scattered trade that can start to miss deadlines. Another would be insufficient skilled labor or access to materials. By not having enough skilled labor available in your area or not being able to train people enough to perform a job correctly, the quality of the product can be in jeopardy.

Another example of damages is the possibility of the general contractor’s reputation being tainted should they not be able to perform to the industry standards for that specific job. A common quote in the industry is “you are only as good as your last job”, thus stressing the importance of a contractors reputation. A company’s reputation can have a large impact on whether you earn a new contract, pull in repeat clients, and grow into new sectors of construction. The same can be said for developers who may or may not have a good reputation amongst general contractors due to the organization of the developer or their means and methods of construction. Some main reasons a reputation can be affected are job performance, quality of the work, and especially safety on a jobsite.

Another main risk contractors face performing the work is injury and worse case scenario, death. Both of these on a construction site can hike up a companies experience modifier rate (EMR), which is used by insurances to determine how likely a business is to have a worker’s comp claim filed against them (Higgins, 2018). This can be a major factor for both private and government contracts since there isn’t any other metric in the construction industry that is as reliable on tracking safety as of now. If your EMR is above 1, meaning you are above the industry average, then you are less likely to earn a contract even if you are the lowest responsive bidder. Developers and owners are able to ask for your EMR when analyzing a bid proposal, “Following the government model, more and more private contracts are also requiring a maximum EMR. Private contracts are even more likely than government contracts to give preferential treatment to those with lower EMRs” (Higgins, 2018).

In summary, when self-performing work, there are many risks that are taken on that can jeopardize your company quite rapidly. The construction industry is one of the riskiest industries when compared to other labor dependent industries. Statistics continue to prove that new business struggle to stay afloat due to the risks in addition to other costs and business management processes. A statistic from freshbooks.com, a financial service provider, claimed that in 2018, “The construction industry is expected to grow 13 percent but its business failure rate is a whopping 25 percent. The transportation industry suffers the same failure rate. In both industries, 35 percent fail in their second year and 60 percent fail by their fifth year.” (freshbooks.com, 2018). These statistics prove that it is tough for contractors to stay in business and evaluating the balance of risk between a developer and a contractor has a lot of factors that must be managed in order for both parties to have success and continue to pursue success.

Methodology

The knowledge and perspective to write this paper is coming from interviews with two men who have executive experience in the construction industry. Since there are not published statistics about success rates of joint venture relationships, the best way to analyze the topic is to hear from the perspectives of those who would be making the deal. I want to ask them open ended questions that allow them to speak freely on if they think this process can be achieved with success. This research is not to provide a series of steps on how to form this relationship, it is focused on analyzing if the methods of construction can be expanded and reworked in order to create a larger profit for the owner.

Case Review

The joint venture is being analyzed in this paper to look into the potential success between the developer's construction team and a primary contractor who may or may not self-perform work. The joint venture would be an agreement that there would be a sharing of resources in order to accomplish one common goal and that's to build out a project as smoothly as possible. The most common and powerful resource being shared in this joint venture would be the combination of employees from both sides. As previously discussed in this paper, the developer can form their own construction firm or team that is built of experienced office personnel. The team would be made up of senior project managers, assistant project managers, project engineers. They would also have a project superintendent that would be able to manage the subcontractors directly hired by the developer's construction team.

The contractor would supply personnel that were more field focused and field experienced. The staff would contain senior superintendents, assistant superintendents, site safety managers, and field engineers. They would also hold a construction manager manage the overall direction of the activities and keep the field staff on track and manage the budget. Both parties would have some type of crossover role, the office-oriented superintendent and the field-oriented construction manager, who both serve to keep the interests of their company at hand and make sure there is an even distribution of responsibility based on the actions occurring on the project. That does not take away from the true purpose of utilizing each other's resources, which is to work together in order to make sure both parties and all employees are aware of the construction taking place and any risks that need to be mitigated. Open communication is highly encouraged and crucial to the success of the duo building out the project per the drawings and per all of the owners requests. Below is a proposed staffing matrix based on my experience and research findings.

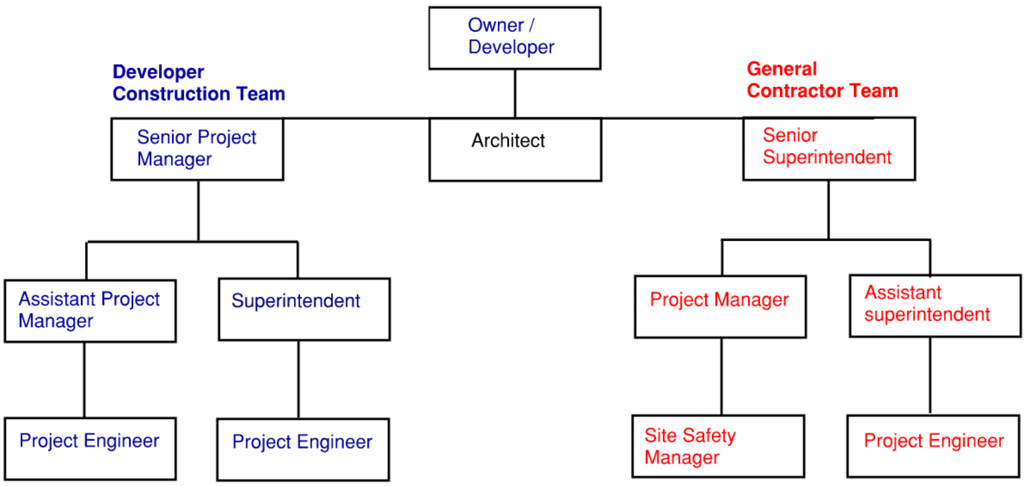

Figure 2 - Matrix chart proposed for a $100 million job

Interviews

There were sit-down interviews with Jeff Lucas, vice president of construction for Related California, and Mark Montoya, senior construction executive and former vice president & residential divisional manager of Morley Builders. The idea was proposed of a new joint venture / partnership style of project delivery to them and explained the process of how there could be success for both ends. The idea was pitched as if more developers should consider forming a construction branch in order to help save cost on fees and to have more control over the project. With both Jeff and Mark having a careers worth of experience at almost every position in the construction industry, they were highly valuable and could best analyze if they thought the concept was something that could be replicated throughout average developers across the country and not only build a project correctly and safely, but have both ends be satisfied with their profit and quality of work as well.

Mark Montoya

Mr. Montoya was interviewed first since there already had been some basic knowledge of the developer side of the construction due to my internships. The basic framework of the questions pertained to risk, contracts, and the pros and cons for a contractor to agree to this method of project delivery. The first question was asking him "Would big name general contractors be attracted to the developer running the project management aspect of a job while the general contractor gets paid to run the construction management side of the project" and then broke down the different roles and responsibilities of what project management and construction management entail. His response was not very jolly for the idea because he believed the general contractor would not be bringing in enough profit for the effort that would be put into the job. "The general contractor would want to be paid to oversee all work done by the subcontractors hired by the owner." He explained that the general contractor would end up putting in resources and time into the subcontractors hired directly by the developer's team, leading to work performed without a fee attached to it. This type of response was anticipated because the whole purpose of this delivery method is for the developer to save money by taking on work and not having to pay the contractors a fee for specific work. Building on to Mr. Montoya's point, he said, "It can be unattractive due to the extra management it would take on the general contractor". He explained that although the developer's subcontractors would be their responsibility, there would still need to be some responsibility to oversee the subcontractors not hired by the contractor when it comes to the company's policies such as safety and strategies such as phasing of construction.

The next question asked was, "can developers find a common success if they form their own construction team when they haven't had any experience doing something like this in the past?" and Mr. Montoya's response was, "yes they could, depending on the complexity of the project". He spoke on the importance of hiring experienced employees that have worked on projects that the developer wishes to build. He did not believe that this would be an easy process for a developer's construction team if the project was a very large and the team hadn't worked together before, as many thoughts and strategies might be brought up and it could be a struggle to work together with the established general contractor.

We wrapped up the interview with a discussion of what specifically would make the project delivery method to general contractors. Mr. Montoya spoke on defining the clear responsibilities of the two construction teams and keeping the general contractor from taking on more risk from the developer's team. In this joint venture relationship, we assumed it'd be the developer's team who'd have the 51/49 majority of the leadership when it came to contract agreements and overall direction of the project since the project client would be the developer. The responsibilities defined in the contract would have to be much more detailed than a regular contract to call out the many scenarios that could take place and assign would be liable for potential added costs. Mr. Montoya provided this hypothetical as an example, "if you get assigned 75 million worth of work out of a 100 million dollar project, the chances are you'll still have to oversee some of that 25 million so a general contractor will expect a fee on that work but can not charge it.". He followed this with, "a contract could say 'must coordinate with subcontractors of owner', so if you go over your agreed contract are you supposed to stop coordinating?". While Mr. Montoya had some optimism this project delivery method could have success with the right breakdown of responsibility and an equal division of risk between the two parties, it would be difficult on the general contractors end to manage all of the risks that can be put on them with this relationship while still trying to earn their profit on the project. His last comment on the overall idea was, "General contractors would not be totally attracted to this method but since there's general contractors starting every minute, you're going to find someone to agree to the work.".

Jeff Lucas

When Jeff Lucas was interviewed, there was now a good understanding of the point of view of an established general contractor. It was important to express these concerns to Mr. Lucas to hear if he agreed with those concerns and to hear more about how he has been able to make a similar project delivery method work successfully and satisfy both parties. First there had to be an understanding of just how the relationship was made between GL Builders (GLB) and Related so that there could be a better understanding of the origin of the model that influenced this research report.

Mr. Lucas explained that Related had originally hired a general contractor, not to be named, to manage the entire projects operations but this contractor was not performing sufficiently over a matter of time, and the decision was made to relieve them of their position. The founder of GLB had been doing entrepreneurial work for Related already and was looking to take over the role as the general contractor for the jobsite, Mason on Mariposa. Related had already been a very hands-on developer, and they decided to share the work with GLB and start Related California Construction. Mr. Lucas was asked why they would choose to go this route with a brand-new contractor and he said, “We said we were going to self-perform this work, GLB was insufficient in accounting systems, track record, reputation, and money. GLB was made up of field guys and had connections throughout the field and is aware and experienced in the process. Related is not that and does not have those contacts. If they do have the contacts and experience its in the management side.”. With Related already being a very involved developer, they felt this relationship could work if they worked together and Related was able to oversee the processes and lead the duo in the direction they wanted to move in. Mr. Lucas then went on to say, “With every joint venture somebody is bringing something to the table that the other is lacking or doesn’t have experience in. You are willing to give up a percentage of your fee in order to gain something”. This appeared to be the cheapest option that granted them the most control in order to get their project back on schedule.

The discussion then leaned towards the benefits both companies were getting by working together. Normally a brand-new general contractor wouldn’t win a 299 unit mixed-use project in San Francisco, but this so happened to be the right place and the right time for these companies to work together. Mr. Lucas was asked what the risks were that both he and GLB were taking on and responded with, “I felt that I was taking very little risk by hiring GLB because they didn’t really cost me anything.”. This partnership was formed by Related hiring GLB on a cost plus contract with a very small fee less than 1%. With a fee this small, this comment is very relevant to Mr. Montoya’s comments when he mentioned general contractors were forming everyday and someone would take on the work. Mr. Lucas explained that Related covered all costs for GLB to operate as a company and build the project. By granting GLB with such a large project for their first job, that they were gaining much more beyond the profit. Mr. Lucas then described the benefits for GLB taking the job, “GLB has a huge upside. If you want to become a big contractor its really hard to do. Most people start by taking on small jobs like building a food store or a commercial store but you don’t just start as a contractor and get big jobs. GLB is then allowed to project themselves to the market that they are an established contractor. They can then go on and talk to other developers and have a real chance of establishing themselves.”. He also added that GLB was able to promote their company all over the jobsite to help spread the company image amongst people passing by and subcontractors on the job, helping them form relationships. The same scenario occurred when GLB worked with Related to build the 2nd jobsite I worked on, which was a 14 story luxury senior living high-rise in San Francisco. Mr. Lucas saw the value of being able to add two projects of such caliber to a company’s brand new portfolio was worth so much that they would be willing to take a very small fee, which turned out to be true.

It then came down to seeing if Mr. Lucas thought of the idea of a joint venture between a developers construction team and a general contractor seems reasonable and realistic. He believes it definitely can happen but there are so many things that need to be defined within the contract in order to keep both parties protected. The experience between Related and GLB was not a joint venture, but it could have been if GLB was a little more established and if Related didn’t want so much control over the project. Mr. Lucas referred to Related as a very involved developer that is constantly trying to save time and money throughout the duration of the project, and since they are in a much more powerful position, they tend to play that game very well in this scenario. If another developer was just wanting to get started into the self-performing world, it is possible, but it would come down to how many people both parties have in order to make a sufficient team. He agreed that some well established general contractors would be hesitant to jump into a scenario like this when they can bid other jobs and take on the full scope and get a full fee, but that for a smaller general contractor that dreams of building higher level projects, a joint venture with a developers construction team could help them build projects that are beyond their portfolio.

Conclusion and Future Research

Working in a nonstandard project delivery method can be somewhat concerning and uncomfortable because it does not fit the normal established processes that have proven to be successful throughout the past and present of the construction industry. Working on a project that combines resources through a joint venture can help both parties make money, but it takes responsibility on both ends to keep their resources and subcontractors liable throughout the entire project. A developer takes on the responsibility of managing their subcontractors and overseeing their safety and quality practices in order to build a project up to the right standards. Staying on top of long procurement items, filing for the necessary permits and inspections are just some of the many responsibilities the developers construction team would be taking on but the more jobs they finish, the more their experience grows which grows the teams value over time. The general contractor must also be aware that their responsibilities on the job are just as valuable as they were before they signed up for the joint venture. Although they might be handling half of the usual scope then they are used to, they also need to coordinate their own subcontractors with the schedule, keep the jobsite safe, clean, and prepared for the next phase of construction.

I believe there still needs to be more research that can breakdown developers forming construction teams and just how well this system works. More research can help answer what types of projects does this method work best for, what general contractors best fit this delivery method, figuring out the right staffing matrix to ensure a successful project, and the capital both parties need in order to run a project. Research that would help best would be studies published that recap projects that were performed similar to the project delivery method discussed in this paper, more open statistics about joint ventures getting published, more published articles on developer builders who have been successful self-performing certain aspects of a project to see what has been accomplished in the past.

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