



Investing in UK Real Estate?

Construction procurement

June 2010

Construction procurement

Procurement options

A developer commissioning a new build or refurbishment project in the UK has a range of procurement options to choose from. The decision will be informed by a number of factors, including: the developer's expertise and resources and whether he wishes to be actively involved or "hands off"; the developer's appetite for risk; and the relative importance of early completion, cost certainty, lowest outturn cost and the quality of the finished product.

The main procurement options are:

- **Traditional (build only)** - the developer engages a professional team (architect, engineer, quantity surveyor etc) to design and specify the works in detail, and separately appoints the Contractor to construct the works as designed for a lump sum price. This route gives the developer control over design quality, but it is slow (sequential) and can lead to co-ordination problems and issues of split responsibility for defects.
- **Design and build** - the Contractor assumes single point responsibility for design and construction in accordance with the developer's requirements. This route is potentially faster and avoids issues of co-ordination and split responsibility. However, in return the developer loses control of design quality. Changes to the brief are also expensive.
- **Construction management (CM)** - under which the developer engages the package contractors direct, with the CM engaged as an adviser on a fee basis. This route is fast and flexible, but offers no initial cost certainty. It also imposes a significant burden of risk and administration on the developer.

Design and build is currently the most popular procurement route for commercial projects. However, all the options have their place, although CM is mainly used by experienced clients for major buildings and complex fit-out/refurbishment projects.

Forms of building contract

Building contracts are complex documents, reflecting the large number of risks and issues that can arise on a building project. Aside from the basic obligations to carry out and make payment for the

works, a typical contract will include (amongst other things) provisions relating to design development, the obtaining of approvals, variations, time for completion and delays, insurance, price adjustments, completion/rectification of defects and so on.

The most commonly used standard forms are those published by the Joint Contracts Tribunal (JCT). The JCT comprises representatives of all sides of the industry (clients, consultants, contractors and sub-contractors), so its forms are compromise documents and most developers seek to amend them to shift the balance of risk in their favour. The degree of amendment will reflect the developer's appetite for risk, recognising that the Contractor will expect to be paid a premium for risk transfer.

Other construction concepts

- Under **turnkey construction**, the developer engages the Contractor to provide a completely fitted out building ready for occupation. This approach is unusual in the UK commercial property market. Normally the developer will provide a shell and core only, with fitting out work carried out by tenants. This allows the tenant flexibility and control over the cost and timing of his fit-out, but can lead to co-ordination and access issues.
- The **CDM Regulations** apply to all construction projects, other than very minor works and contracts for residential occupiers. They impose statutory requirements in relation to the management of health and safety, including the appointment of a CDM co-ordinator to oversee the design process.
- **Collateral warranties** are an essential part of an investor's security package. They are designed to give third parties (investors, lenders and tenants) direct rights against the contractor and professional team in the event of defects in their work. They will also allow a lender or investor to step in and complete the project if the developer defaults. The Contracts (Rights of Third Parties) Act 1999 provides a more modern and efficient way of achieving the same result.
- **Professional indemnity (PI) insurance** provides cover against the risk of defects in design (but not work or materials). Usually maintained by

consultants and design/build contractors, it is seen as an important adjunct to the protection offered by collateral warranties.

- **Novation** allows the developer to appoint the design team in the first instance and transfer (“novate”) them to the Contractor when the building contract is entered into. It gives him the best of both worlds, allowing him to maintain control over the design while at the same time imposing design responsibility on the Contractor. Consultants do not like novation, because of the inherent conflict of interest which it creates. However, it is commonly used on design and build projects in the UK.
- The **Contract Administrator** (or Employer’s Agent) occupies a pivotal role in the process. His functions include the issuing of certificates of readiness for access and practical completion under the building contract, which will in turn trigger matters such as rent commencement and balancing payments. It is therefore critical that he is competent, reliable and independent.

Hints and tips

- Decide on your priorities at the outset and stick to them as far as possible.
- Choose your advisers carefully. Do not be tempted to select on price alone.
- Allow sufficient time for design, procurement and construction. Do not “rush in”.
- Understand that construction is a risky business and keep a sensible contingency for unforeseen risks.
- Avoid change if at all possible.
- Make sure contracts are actually signed!

Next steps

For more information on construction procurement or how we can help you navigate the issues, please contact:

John Hughes D’Aeth, Construction Partner

T +44 (0) 20 3400 4660

E john.hughes.daeth@blplaw.com