



Rural Development

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TO: State Directors
Rural Development

ATTN: Multi-Family Housing Program Directors, Coordinators,
Specialists and Field Architects

FROM: Joel C. Baxley /s/ *Curtis M. Anderson*
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SUBJECT: Contracts and Methods Required for Multiple Property
Rehabilitation Proposals for Multi-Family Housing
Projects

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance to Rural Development staff and to define the process of obtaining professional resources for large portfolio deals and the use of the contract method when performing construction and/or renovation on new or existing MFH properties/assets. This AN clarifies the requirements in RD Instruction 1924-A, sections 1924.6 and 1924.13.

COMPARISON WITH PREVIOUS AN:

This is an original AN. This AN issues guidance for the MFH properties and real property assets regardless of the funding source for the projects.

BACKGROUND:

Several procurement methods are available for use when large portfolio deals are anticipated. Options available include, design/bid/build, design/build and construction management. When contracts, other than Design-Bid-Build are submitted, National Office prior concurrence must be obtained for projects with costs that exceed \$250,000. Critical to the success of these projects, regardless of the funding source, is the need to place the risk with the appropriate entity.

EXPIRATION DATE:
November 30, 2019

FILING INSTRUCTIONS:
Preceding RD Instruction 1924-A

Multi-Family Housing is designed to assure rural America has decent, safe and sanitary housing for their citizens. Multiple standards, rules and laws may govern any particular project. RD rules for construction and development may be different depending on if new RD funds are in play or the property is a current RD asset. Difficulties can arise whether there is the potential for Agency funding, at any level, or no Agency funding at all. Regardless, the agency should not step away from design and construction “oversight”, which includes the 1924.5 and beyond. When the property remains a Rural Development asset, RD’s involvement is critical for the support of the project. It provides the best opportunity in achieving quality assurance in construction and the most cost-effective design for the project. Only the Agency will fully stand behind the best interest of the Agency customers. The following are tenets of success for all parties involved:

General

Free and Open solicitations and selection processes for project services. Advertising the solicitation to an appropriate geographic area to garner adequate interest in a project.

Appropriate contracts for the selected services.

Accurate and complete construction documents.

Appropriate government oversight and independent inspections are required regardless of the funding source or the contract method. Independent inspections cannot have an IOI with any other party involved with the project. The owner can fund the inspections or in rare critical cases, the Agency can procure the contract. In either case the action should be appropriate and timely so as not to negatively impact the progress of the project(s).

Capital Needs Assessments (CNA)

For the As-Is Assessment on large portfolio deals, the CNA Provider should submit all CNAs simultaneously. The CNA technical Reviewer will review the full submittal in a cursory manner to ascertain the quality of the information provided. If the work is deemed acceptable, then the Reviewer can focus on one report for a full analysis and comments that can be applied to all reports submitted. Any errors in the scope of work that need to be addressed in the rehabilitation will be identified when the Scope of Work is submitted for the RD Architect to review. When a major renovation is anticipated, the estimated repair and replacement costs will be provided in the “Post Rehab” report to assist the Underwriter with establishing the reserve account numbers. The CNA technical analysis will focus on review of the rehabilitation scope of work and Post Rehab assessment list of items and components with significant cost implications, accessibility issues and life safety concerns. Most repair and replacement cost estimates offered by the Provider can be verified by the MFH Underwriter and can be based on and compared to historical data.

Design

The process to select design services for a project are not required by regulation to be a competition based on cost, but rather based on qualifications. There is no regulatory statement that says the applicant, anticipating a construction project, needs to compete firms to make a selection, although it is strongly recommended. “Comparison shopping” will be beneficial to the outcome.

Design Bid Build

Design Bid Build is the most frequent contract method submitted to the Agency, in anticipation of construction or renovation. The design is completed and bid independent of a construction firm or individual that could potentially bid on the project. Inspections are provided by the designer or an

independent agency or individual. There should be no overlap or gaps of contact services without clear statements defining the terms. The level of inspections should be appropriate for the size and scope of the project. Those organizations contracted to perform inspections should provide personnel that have skills and experience with all applicable codes and the extent of the effort as to scope should match the scope and complexity of the project. The Agency will not dictate the scope of the third-party inspections, but expects that all code requirements and workmanship is monitored and reported adequately.

Alternative Methods

The Design/Build (DB) method of construction is one in which architectural and engineering services, normally provided by an independent consultant to the owner, are combined with those of the general contractor under a single source contract. These services are commonly provided by a DB firm, a joint venture between an architectural firm and a construction firm, or a company providing pre-engineered buildings and design services. The entity (company or individual) that is the DB firm, with whom the Owner has the contract, should have surety (typically bonding) (see 7 CFR §1924.6(a)(3) and RD Instruction 1924-A section 1924.6) and insurance in its own name, rather than in the name of other firms it hires to execute any part of the work of design or construction.

Selection for a design-build firm must be by an open and free competitive process with the cost of construction, a guaranteed maximum price (GMP), considered as a part of the bid proposal.

The solicitation must be advertised to an adequate geographic area that has the potential to draw a sufficient interest. The solicitation package may include independently prepared documentation concerning the project program and other criteria for an effective bid proposal to be developed. Samples of comparable projects, pre-prepared project development packages and owner budget parameters are solicitation package options for bidders to provide a reasonable construction cost proposal that falls within the owner established guaranteed maximum price. The important aspect is to make the selection for the contract with a full project cost proposed or a commitment to the owner's limit. This may not be the final contract price, but it should set the upper limit for the project cost. Bidders should be asked if they can commit to that limit prior to the selection of the service provider. Inspection services, that monitor and track performance of constructors during the construction phase, must be independent of the designer and builder when using this contract method. One value of this contract method is the reduction of change orders that affect the final loan. Owners can still make changes, but there should be clarity in the loan agreement that the owner should finance owner changes independent of loan funds.

The Integrated method of construction is one in which multiple disciplines, including architectural, engineering and constructor services may be formed together as a team, prior to any project work starting. The Integrated method is similar to Design-Build, but all entities involved may not be under one contract. Parameters of the Design Build process would also apply to the Integrated method. This method is often used when specialty work is required (LEED compliance or similar) that is not typically needed for most construction work. Selection of the design professionals by a competitive process is recommended. The construction entity selection must be by a competitive process with the cost of services considered as a major part of the proposal. The solicitation must be advertised to an adequate geographic area that has the potential to draw a sufficient interest. The solicitation package may include independently prepared documentation concerning the

project program and other criteria for an effective bid proposal to be developed. Samples of comparable projects, pre-prepared project development packages and owner budget parameters are options to establish a guaranteed maximum price for the request for proposal. The important aspect is to make the selection for the contract contingent upon an agreement of a guaranteed maximum price. This may not be the final contract price, but it should set the upper limit for the project cost. Bidders should be asked to commit to that limit prior to the selection of the service provider. Inspection services, that monitor and track performance of constructors during the construction phase, must be independent of the designer and builder when using this contract method. One value of this contract method is the reduction of change orders that affect the final loan. Owners can still make changes, but there should be clarity in the loan agreement that the owner should finance owner changes independent of loan funds.

There are two types of Construction Managers (CM): Construction Manager as Constructor (CMc) and Construction Manager as Advisor (CMa). A CMc acts in the capacity of a General Contractor and is financially and professionally responsible for the construction. This type of Construction Management is also referred to as Construction Manager "At Risk". The construction contract is between the owner and the CMc. The CMc in turn subcontracts for some or all of the work. The total cost of CMc services is stated in a firm-fixed price contract or guaranteed maximum price contract. The amount of either type of contract includes, but is not limited to, all direct (reimbursables, general conditions) and indirect costs, overhead and profit. Generally, fees (overhead and profit) for the CMc fall in the range of 2-7% of the cost of construction, depending on the scope of work and its complexity. The CMc will need to meet Rural Development's requirements for surety (see 7 CFR §1924.6(a)(3) and RD Instruction 1924-A section 1924.6) and insurance, typically required of any general contractor to a project. The most common contract available from the AIA for a CMc project is the A133. This contract is an agreement between the owner and the CMc and includes the clause for cost of the work plus a fee with a guaranteed maximum price (GMP). For RD projects we want to see all project costs stated as an itemized, fixed dollar amount. The overhead and profit can be stated as percentages of the construction cost.

Selection for a CMc must be by a competitive process with the cost of construction included as a proposal in the bid. This means the owner will need to prepare adequate documentation concerning the project program and other criteria for an effective bid proposal to be developed. Samples of comparable projects, pre-prepared project development packages and owner budget parameters are options for the request for proposal. The important aspect is to make the selection for the contract with a GMP established. This may not be the final contract price, but it should set the upper limit for the project cost. The owner can establish the GMP within the solicitation by stating to upper limit they are willing to pay for the project. (including contingencies). Bidders should be asked if they can commit to that limit prior to the selection of the service provider. Change orders can still arise and the CMc is not generally liable for design errors and omissions. The change order volume and process should be controlled by the CMc to the benefit of the applicant and agency. That's why this method is extensively used. For larger volume and high cost projects, it's necessary to have inspections performed by an independent third-party entity. These services should be financed by the owner/applicant or procured by the Agency.

Services provided by a Construction Management Advisor CMA are intended to be administrative only, including the requirements for inspection services required for a construction project. The CMA shall not be contracted for construction/building services. **Owners should be advised that a CMA/multiple prime contract method is not acceptable to the Agency.** Design-Bid-Build should be the contract method in states that require CMA over the CM at risk (aka; CMc, CM r and CM constructor) or any other contract method acceptable to the Agency, allowed by the state. A CMA contract is acceptable for inspection services when a bonded and insured General Contractor is anticipated to lead the construction effort.

Rural Development and owners should expect that an experienced CM can establish an estimated cost for reimbursables for purposes of the bid submittal. Rural Development and owners should also expect that the actual reimbursable costs may differ from the bid.

All projects using alternative contract methods, whether DB, CMc or Integrated must be submitted to National Office Appraisal and Architecture Division representative for review using the guidance outlined in this AN. No Identity of Interest, as defined in 7 CFR. Part 1924 section 1924.4(i) and 1924.13(e), is allowed with construction projects.

National Office recommends that all Design/Build or Construction Management contracts comply with 7 CFR part 1924, subpart A for “maximum open and free competition”, including cost as a primary selection factor. Capable and responsible entities shall have the opportunity to compete for the work based on fair, reasonable and equal criteria. Industry standard for bidding is to have a minimum of three bidders, where possible.

IMPLEMENTATION:

Reference the associated staff instructions pertaining to Alternative Contract Methods, Capital Needs Assessments and Rehabilitation for MFH properties. Please direct all questions pertaining to this AN to William Downs, Architect, for Program Support Staff at (202) 720-1499.