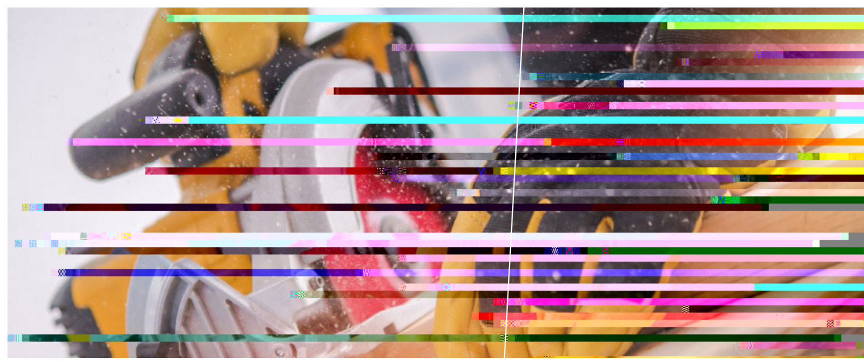
MCX



HOW TO MITIGATE RISK & STRUCTURE A PLAN TO COVER YOUR PROJECTS

All construction industry stakeholders are aware that material prices, especially lumber, have seen steep increases that are unprecedented in the United States. With the COVID threat rebounding, the demand for raw materials, including materials to construct buildings and other infrastructure only seems to be increasing. From April 2020 through April 2021, prices for plywood rose 86%, steel 67%, copper and brass mill shapes rose 49%, and aluminum mill shapes rose 20%.

Despite that reality, projects still need to be completed and most have already been financed based upon material prices that have quickly changed. Owners and developers need their projects built and contractors, subcontractors and suppliers need projects to build. The question is, how do these project stakeholders manage their risks?

Knowing Whn.ros[illegible]

Playing The Waiting Game

There are various tools available from a strategic perspective. One is simply to wait until material prices drop. This is akin to attempting to time the stock market and has its own risks. As people begin to return to their normal lives, ready to spend their hard-earned money, demand for materials and projects only seems to be increasing across the industry.

Relatedly, not all projects can wait. Many companies are facing a desperate need for additional workspace to increase capacity and output to meet increasing demand for products and services. These factors tend to indicate that waiting may not be a viable option for all projects.

Understanding Contract Terms

Another tool is to address material price increases is through contract terms. These are important tools and should not be ignored. For example, by setting a firm notice to proceed date instead of letting the commencement date be determined by the owner, contractors can be more confident in their material price quotes that are typically held open for only 30 days.

Contractors can also use allowances for different items of the project that may be sensitive to material prices increases, instead of quoting firm numbers for items of work. The amount that is spent in excess of the allowance is the owner's risk.

Relatedly, the owner and contractor can agree to set aside a contingency fund and could even earmark the contingency funds to address material price increases.

Another, more direct method, would be to include material price escalation clauses in the contract — this would shift the risk of material price increases above a certain level to the project owner.

While the contractual methods are certainly a necessary part of the risk management portfolio, each contract term proposed necessarily involves shifting the risk of material price increases to one party or another. And even if the risk is shifted contractually, the other party still bears the risk that the risk-bearing party will be able to perform, which may not be the case. Such a scenario would lead to an incomplete project where no one wins. How is this risk addressed?

Revisiting Insurance Options That Can Help

In response to the unprecedented material prices increases, some insurance providers are offering insurance to provide certainty in an uncertain market. The way the insurance generally works is that a contractor pays a monthly premium