MATERIAL SHORTAGES AND COST ESCALATION IN THE BUILT ENVIRONMENT AND WHAT IT MEANS TO YOU – How to Identify & React

WASHINGTON BUILDING CONGRESS

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Preparing for the Unknowable Lessons Learned from the Construction Industry's Response to Significant Industry Disruptions

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Prepare for the unknown by studying how others in the past have coped with the unforeseeable and the unpredictable.

—General George S. Patton

What we'll cover…

I. DEFINING THE PROBLEM

II. HOW THE PROJECT'S DELIVERY METHOD/COST MODEL DICTATES THIS RISK

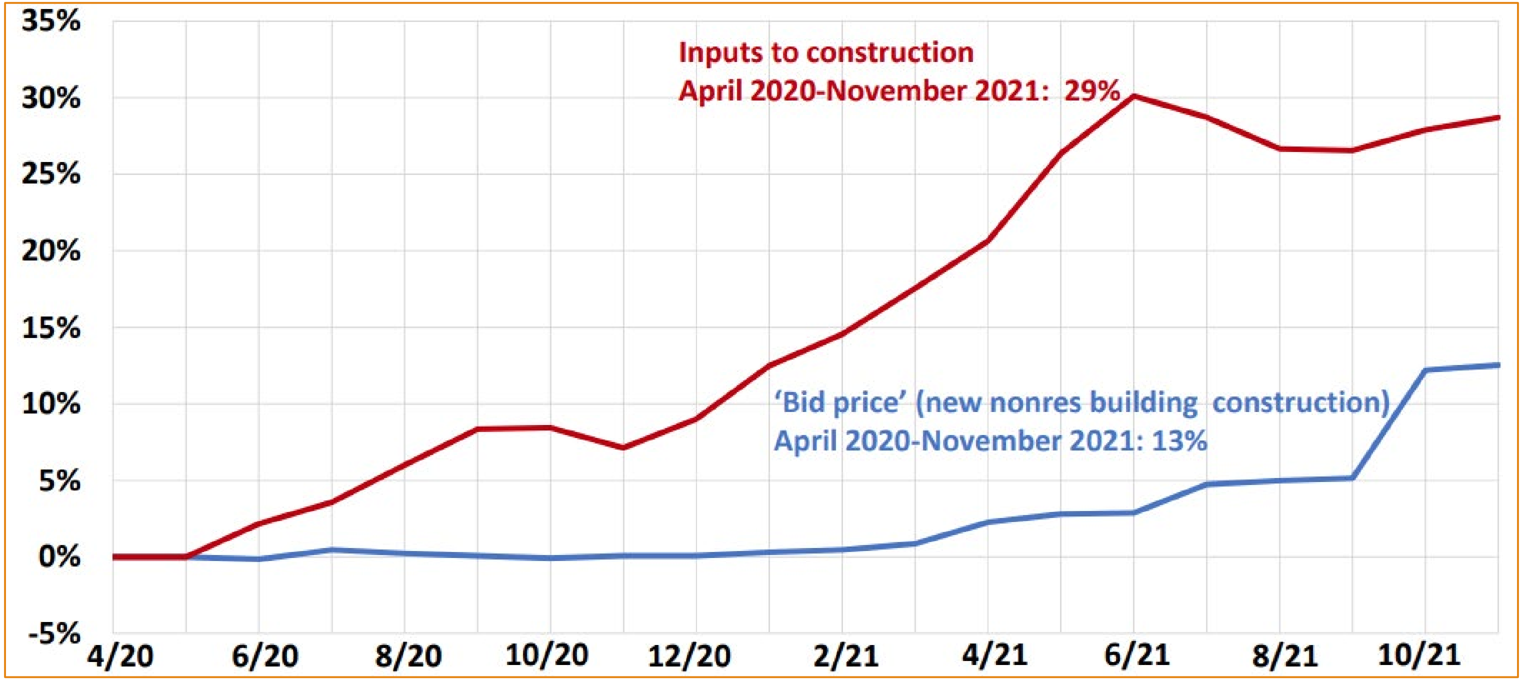
III. HOW CONTRACT LANGUAGE CAN BE USED TO ALLOCATE THIS RISK

IV. HOW THE PROJECT TEAM CAN MANAGE THIS RISK

Disruptions

- COVID-19 has reminded us that substantial industry disruptions can occur suddenly and unexpectedly.
  - Not just COVID – Supply shortages due to other events, adverse weather, etc.
- Limited value in planning for a specific event – better to manage risk by also focusing on the effects of disruptions and implementing less cause-specific measures.
- It is not over – on-going for the foreseeable future.

Construction Input vs 'Bid Price' PPI



Source: Bureau of Labor Statistics, producer price indexes, www.bls.gov/ppi

Recent Headlines

“Much of the increase in nonresidential construction spending is attributable to inflationary pressures, not actual increases in physical output,” said ABC Chief Economist Anirban Basu. “The fact that nonresidential spending was down in December despite rising labor costs and elevated materials prices does not bode well for near-term profitability.”

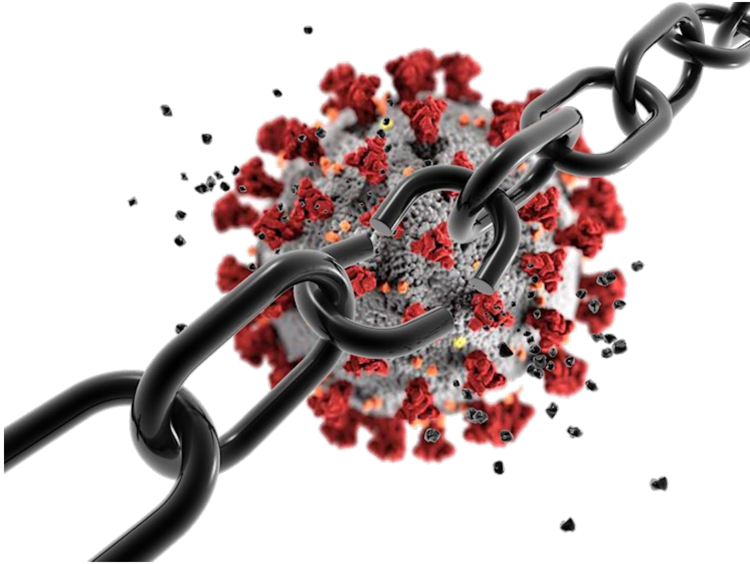
“A few segments continue to create a disproportionate share of contractor opportunities,” said Basu. “Among those are the commercial segment, which includes construction of fulfillment centers and manufacturing, a segment in which construction spending has expanded more than 30% during the past year. Residential construction also continues to be a hot spot in an environment characterized by scant inventory of unsold homes and rapidly rising rents, and the strength of multifamily construction is arguably one of the most surprising aspects of the economic recovery. Overall, contractors remain confident about the next six months, according to ABC’s Construction Confidence Index.

“Public construction was responsible for much of the weakness in December,” said Basu. “The expectation among many is that, as infrastructure monies begin to flow, the second half of the year will be better than the first. It is possible that infrastructure dollars will not begin to forcefully affect the marketplace until 2023. Time will tell.”

ABC February 1, 2022 News Release

Common areas of impact/risk from disruptive events

1. Supply Chain & Market Volatility
2. Project Delay/Disruption Costs
3. Payment/Liquidity Impacts
4. Legislative/Regulatory Compliance
5. Labor/Employment Impacts
6. Other Areas of Impact – Weather?



How Contract Language Can Be Used to <u>Allocate</u> this Risk

A. Design-Bid-Build (Stipulated Sum, GMP (allowances))

B. CM at Risk (with or w/o GMP)

  - Use of contingency?

C. Design-Build (Stipulated Sum/Cost Plus)

How Contract Language Can Be Used to Allocate this Risk

A. "Manuscript"/Form Material Escalation Clauses

- *Threshold* Escalation clause (Cost-Based)
  - Purchaser absorbs risk until a certain tipping point
    - Cost-based trigger
      - Over/Under (*i.e.:* price is fixed unless it exceeds/is less than 5% of bid price)
    - Index-based trigger
      - Price floats based upon indexed value – Commodity/Market Indices
      - Producer Price Index (U.S. Bureau of Labor Statistics)
    - *Assumes that you identify the base/as-bid prices*

How Contract Language Can Be Used to Allocate this Risk

- *Delay* Escalation clause (Time-Based)
  - Prices are held/fixed for a defined period of time
    - Clause expressly acknowledges uncertainty
    - Attempts to achieve equity
    - Adjustments apply reciprocally if price decreases (Owner gains the benefit of reductions in cost)

How Contract Language Can Be Used to Allocate this Risk

B. Standard Form Escalation Clauses

- FAR §16.203: Fixed Price Contracts with Economic Price Adjustment – 3-10% to Govt.
  - Need to be able to establish your as-bid pricing
- ConsensusDocs 200.1 Amendment
  - Identify key materials likely to be impacted
  - Establishes a baseline price (market, catalog, index, actual cost, etc.)
  - Equitable adjustments from baseline
- AIA Does Not Have Something "Baked In"

How Contract Language Can Be Used to Allocate this Risk

C. *Force Majeure* Clause

- Contract-based
- Beyond the control of the party seeking to enforce the clause
- Requires a nexus between the unforeseen event and the cost impact
- Usually limited to time extensions not cost increases
- COVID impacts are now less unforeseen
- Often makes delays and related recovery risk on neither party – meaning contractor “eats it”

How Contract Language Can Be Used to Allocate this Risk

D. Change in Law Clause

- Tariffs, Taxes, etc.
- Protectionist Legislation (Buy American, Buy America)
- Restrictions on purchases – Defense Priority, etc.

E. No Damage for Delay Clause

- Needs to be coordinated with other contract remedies
- Timing of NTP and project access take on increased significance

How Contract Language Can Be Used to Allocate this Risk

F. Suspension

- Give parties the right to suspend should costs spike – if written correctly!

G. Termination for Convenience Clauses

- Give parties the right to terminate w/o cause (but specifically for reasons related to spike in material costs/shortages) – if written correctly!

Project Delay/Disruption Costs

Shift this into a **non**-*force majeure* causation:

1. Identify the cause of the delay/disruption — some events may have multiple points of origin (some excusable/compensable)
   a. Access issues
   b. Transportation limits
   c. Supply chain impacts

2. Mitigation Strategies
   a. Equitable *force majeure* provisions
   b. Understand what is foreseeable under the circumstances
   c. Change in law provisions

3. Changes Clause/REA – Try to make it compensable.

How the Project Team Can Manage this Risk

A. **Early Communication, Coordination & Open-mindedness**

B. **Stored Materials**
   - Early Buy-Out
   - Additional handling/storage/insurance costs

C. **Use of contingencies/allowances/alternates**

D. **Risk Management Plan**

How the Project Team Can Manage this Risk

E. **Detailed Project Schedule – part of baseline?**

F. **Proper Backup**

G. **Use of substitutions**

H. **Owner's direct purchase**

I. **Benchmarking**

- Identify *up front* price assumptions for steel, lumber, gypsum, copper, pvc, stainless, insulation, etc.

How the Project Team Can Manage this Risk

J. **Timely Purchasing**
   - Negotiate price expiration dates from suppliers
   - Qualified bids could be a problem on public procurements

K. **Purchase in bulk**

L. **Invoice transparency**

M. **Manage Deposits**
   - Early funding

N. **Alternative/supplemental suppliers**
   - Ensure Contractors & Subcontractors have multiple suppliers

QUESTIONS?

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