

Managing Material Escalation Claims

February 16, 2023

Presenters



Alex Koltsov, CCA and CFE

Managing Director, Advisory
Grant Thornton LLP

Alex.Koltsov@us.gt.com



Justin Levin, CCA

Manager, Advisory
Grant Thornton LLP

Justin.Levin@us.gt.com

Agenda

- Overview of construction material cost inputs
- Discuss the impact of volatile material prices for Owners and Contractors
- Proactive recommendations on how to mitigate material escalation risks
 - Currently working through a claim
 - Potential for a future claim on active project
 - Applying lessons learned to future projects

Poll #1

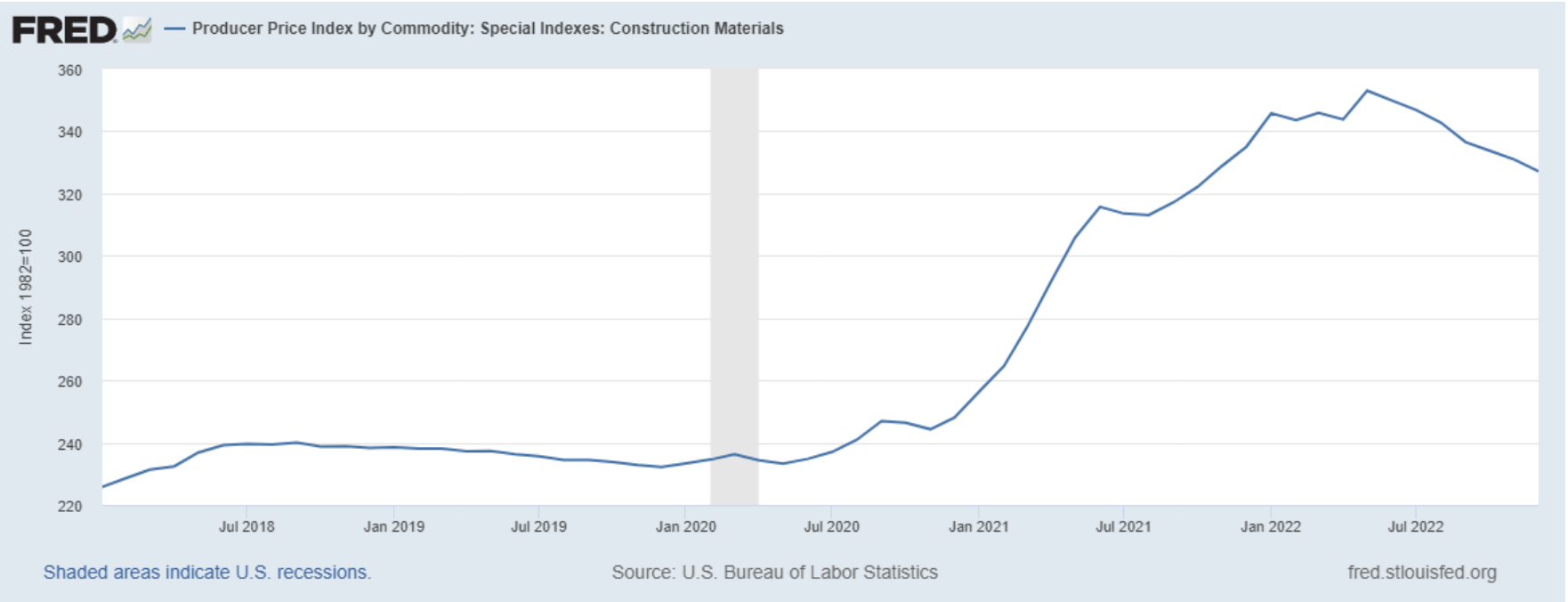


By how many percentage points did the Producer Price Index (PPI) of Iron and Steel increase between January 2020 and June 2021 (18 months)?

- A. <5%
- B. ~15%
- C. ~30%
- D. >50%

Source: Bureau of Labor and Statistics

Producer Price Index – Construction Materials (2018 – 2022)



Poll #2



Is the Owner always responsible for material escalation claims?

- A. Yes
- B. No
- C. It depends on the contract and what the contractor did to minimize those costs

Who Owns the Risk?

	Owner	Contractor
Contract Type	Cost Plus, No GMP	Cost Plus w/ GMP
	Design-Build	Lump Sum
Contract Clause	No Escalation in Contract T&C's	
	No Defined Process for Mapping Escalation	
	"High Level" Force Majeure that is Subject to Dispute	
Project Operational Factors	Undefined Contingency	Purchasing Behavior
	Significant Design Changes	Supply Chain Delays/Limitations

Managing an Escalation Claim Now

Scenario: CM submits a material escalation claim and contract does not include a material escalation clause.

Qualitative and Quantitative Elements

What mitigation efforts occurred?

- Use of **Buyout Savings** or **Contractor Contingency**
- Was an **alternate supplier/vendor** considered?

What support was provided w/in claim?

- Actual material costs that are limited to just materials and not productivity or other impacts.
- **Relevant pricing data** (e.g., invoices, audited internal rates)

What costs were not included?

- No additional Overhead & Profit
- No Change Orders

Managing an Escalation Claim Now

Qualitative and Quantitative Elements

Mapping Estimated to Actual Cost?

- Should only consider actual price increases against the initial estimate

Consideration of “Standard” Escalation?

- The escalation that was incorporated into the original bid – focus on the net impact.

Avoid Generalizations

- Escalation should be on as many direct items as possible. Any indirect cost claims should be vetted
- Use of specific indices not just “basket” (CPI) of consumer goods and services

Poll #3



These three factors are indicative of an effective claim:

- (1) It isolates the increased material prices against the bid estimates used during the award.
- (2) It is supported with detailed bid v. actual purchasing data.
- (3) It describes the proactive mitigation efforts undertaken by the contractor.

- A. True
- B. False

Potential Future Claim

Scenario: Construction is ongoing, material prices have been volatile, and escalation is likely.

How to proactively manage a material escalation claim

- Continuous monitoring of the original estimate verse actual costs by scope/sub
- Advance and/or bulk material purchases (may require offsite storage)
- Transition to more Owner-purchased, contractor installed model (i.e., OFCI)
- Proactive change order proposal submissions and discussion
- Value engineering proposals to offset material costs
- Regular reporting and communication b/t Owner and Contractor

Mitigating Risk on Future Project

Scenario: A contract has not been executed and material language can still be negotiated.

Select factors to include in a material escalation clause (prime/sub)

- Describes the triggering event(s) material escalation costs will be borne by the Owner and Contractor.
- Describes that a certain escalation percentage is built into the awards and no escalation will be sought if material index prices are within that range.
- Describes that certain awards include material allowances when prices are volatile and will be reconciled to actuals upon purchase.
- Describes the process for submitting and proving a material escalation change order or contingency drawdown.
- Describes the mitigation efforts that will be discussed and mutually-agreed by the parties once escalation is “reasonably known” by the Contractor.
- Describes the reporting requirements from Contractor to Owner related to ongoing material increases.

Sample Material Escalation Provisions

*“If, during the performance of the contract, the price of the material significantly increases, through no fault of the contractor, the price shall be equitably adjusted by an amount reasonably necessary to cover any such significant price increases. As used herein, a significant price increase shall mean any increase in price exceeding ____% experienced by contractor from the date of the contract signing. Such price **increases** shall be documented through quotes, invoices, or receipts. Where the delivery of material is delayed, through no fault of the contractor, as a result of the shortage or unavailability of _____, contractor shall not be liable for any additional costs or damages associated with such delay(s).”*

“...unanticipated price escalations in construction materials after the contract is executed have caused concern to owners and contractors. If the Owner and Architect are concerned about facing such price escalations in certain materials, they should identify those materials prior to the bid and provide for them in the bidding requirements as allowances.”

Sample Material Escalation Provisions

“Owner agrees to the amounts and to payment on the terms set forth above in the “Contract Price.” The Contract Price shall not change for the Term of this Agreement, except (a) in the event of changes authorized pursuant to other provisions in this Agreement; or (b) in instances where raw materials or component costs increase in an amount greater than ___ percent (%) of the Contract Price. In the latter situation, the Contractor shall be entitled to an escalation of raw material or component costs which shall be passed through to the Owner. No price change shall be effective unless the Contractor gives notice to the Owner of such a price change at least (___) days prior to the effective date of the price change. In the case of a ___ percent (%) or greater increase, the Contract Price shall be increased proportionately to reflect the entire increase in the cost of raw materials or component costs. The Owner agrees to pay these escalated costs consistent with the terms above. To qualify for such reimbursement, the Contractor will be required to maintain accurate records of costs and quantities of materials consumed and shall file a written claim presenting all required data for determining the amount of reimbursement.

Additional Resources



Article: Managing material escalation on construction projects

<https://www.grantthornton.com/insights/articles/real-estate/2022/managing-material-escalation-on-construction-projects>

Questions?



Alex Koltsov, CCA and CFE

Managing Director, Advisory
Grant Thornton LLP

Alex.Koltsov@us.gt.com



Justin Levin, CCA

Manager, Advisory
Grant Thornton LLP

Justin.Levin@us.gt.com