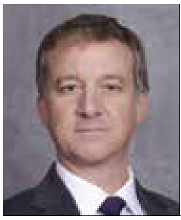

Recognize, Resolve and Repeat:
The Essential Elements of a Successful Risk Mitigation Plan

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Construction is inherently risky and there's never a time that's risk free and all is well. In addition to general risks inherent in contracting, there often exist heightened specific risks related to other economic issues, e.g., fewer available projects due to recessionary pressures, severely tightened lending standards, etc. While the overall economy and specifically the construction economy continue to be strong, we're living in a time where supply chain disruptions and labor shortages are causing substantial cost escalations and project delays which pose a serious risk not only to the bottom-line of individual projects, but the overall health and well-being of a contractor's company.

Exacerbating the already massive cost impact of high oil prices are challenges to the supply chain that would have not been considered pre-COVID-19; basics components in the overall "supply" of goods and materials which were previously taken for granted—mining and harvesting, packing and shipping, loading and unloading are all now more difficult, lengthier and costlier thanks to the pandemic.

It's important to be aware of these risks and to develop plans to mitigate them and, equally important, to proactively share those plans with your surety. Here are three steps to a successful surety bonding program in today's times.

1. Risk Recognition:

The exact same project that a contractor completed just three years ago likely costs much more and may require more time to complete. The industry hasn't faced severe inflationary pressure in a long time, or the kind of supply chain issues that have emerged since the start of the pandemic; add to that the massive increase in fuel prices and the worsening labor shortage.

Dealing with these issues should be an integral part of every contractor's business plan. Part of maintaining a bond program is communicating with the surety and to show that it is taking proactive steps to mitigate risks. While it may not be the contractor's intent to "grow" its surety program and expand surety capacity, the simple fact that the same projects are now materially more expensive often necessitates sureties extending larger individual bonds and aggregate programs to support the same number and type of projects typical of a contractor's historic backlog. Give sureties the confidence that you are properly recognizing and mitigating risks even in the case where the bonded project is the same jobs a contractor has successfully done for years.

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2. Methodical Mitigation Approach:

Have a proactive plan to reasonably deal with today's circumstances. Every approach will be different; it's not formulaic and it varies depending on the project. While there's no boilerplate contract language for mitigating the risk associated with scarcity in materials or labor, a contractor's counsel should require that contract language is added to mitigate the specific risks of each project.

One part of the plan might be to add cost escalation clauses that automatically increase the amount allowed to be claimed for critical material components. If formulaic escalation clauses aren't possible, a blanket increase in materials estimation should be strongly considered. Another possibility, one that recognizes both materials scarcity and labor shortage issues, is to negotiate for more time to completion on the project. If that is impossible, an elimination of or cap to delay penalties is a fair requirement.

3. Culture of Consistency:

Not every project requires a bond, but all sureties want to see a continuous emphasis on methods for mitigating risk even when projects are unbonded. Are the steps you're taking more for the benefit of the surety, or are they part of your company's risk management culture and a true recognition of the risks and steps to protect your company? Risk management should be a practice embedded in the culture of your company.

Bottom line, whether general contractor, trade contractor or supplier, if you aren't taking steps to protect yourself, then you're accepting too much risk—and your surety will see it. Take a proactive approach to mitigating risks, outline your approach and communicate these plans with your surety.

When it comes to what sureties look for, we all talk about "The three Cs": Capital, Capacity and Character. To this list we should add a fourth category, Communication. Among other things, specifically communicate plans to avoid or mitigate risk on individual projects and a contractor's work program as a whole. ◆