



RHarper Consulting Group

RHarper Consulting Update

If it Seems Too Good to be True.....

**Contractors are Cutting Prices to Get Jobs—
Maybe Too Much!**

I have recently fielded several enquiries about projects that have been in limbo for several months and are now approaching a construction start. The primary reason for moving forward is the owners are seeing significant savings on construction contracts, (some approaching 40% from earlier estimates). However, many are wondering if this is really a windfall or is it just “fool’s gold.”



Roger Harper, Principal of [RHarper Consulting Group](#), provides development consulting services to the senior housing industry.

The economic recession has forced contractors and subcontractors to drastically reduce staffing and aggressively price the few new projects they are fortunate enough to bid, at zero profit (or even a loss), just to cover overhead and create cash flow. While this creates a tremendous opportunity for owners to achieve cost savings, it significantly raises the risk profile for the project. While there is no “free lunch,” by

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using the thoughts below, owners may better manage the increased risks and ultimately achieve a greater value for their projects.

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Contractor and Prime Subcontractor Financial Qualifications — The first line of defense is due diligence “on steroids” of the contractor’s financial qualification statement. A rigorous review of a contractor’s financials is essential. Really delve in depth into the **quality** of their receivables. If their receivables have more than sixty days of age, or are due from projects that are in trouble, they should be written off for purposes of evaluating the contractor’s ability to internally finance the project. Consider engaging an outside accountant with specific construction experience if you don’t have the financial expertise to evaluate the contractor’s financial statements internally. Of course, payment and performance bonds should be required for the general contractor and all major trade subcontractors.

Monitor Financial Status During Construction — Assuming the initial financial reviews are positive, the dynamics of the market and availability of credit may adversely affect the contractor or major subcontractors during the construction period. Reduced manpower, delayed material deliveries, spurious change orders, and inflated payment requests are some of the early warning signs of a contractor in trouble. Use of an experienced owner representative to actively monitor the project on a full time basis can yield tremendous benefits in early warning and proactively addressing issues as they arise.

Third Party Review of Construction Documents — The recession hit design and architectural firms early and hard. Many have reduced their staffs below functional levels. The result is deficient construction plans and specifications which creates change orders, costly rework, and numerous claims. Engaging a third party peer review to review and comment on construction documents is a critical step in due diligence and project planning.

Project Contingency — The most prudent step an owner can take to mitigate the increased risks is to provide a conservatively planned project contingency. Many owners erroneously consider a Guaranteed Maximum Price Contract an assurance of cost control. [This](#) explains some of the pitfalls associated with GMAX contracts. Now, contractors, are less capable and less likely to absorb unanticipated cost and schedule changes without submitting change orders. Plan your contingency accordingly. In all likelihood, your lender will no longer look favorably upon a loan increase request to fund overruns.

Today, the well informed and savvy owner certainly has an opportunity to proceed with a well planned project at a substantial savings. However, putting more time and effort into due diligence and maintaining a heightened awareness of any signs of contractor or subcontractor financial distress will make sure those savings remain secure. And, just be on guard, that your “free lunch” might end up with a bill after all.

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RHarper Consulting Group provides development consulting, program management, and owner representation services focused on the senior living and mixed use sectors. In addition, Mr. Harper is a listed mediator and arbitrator and provides dispute resolution services for the construction and real estate industries.

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