

Rise & Fall Clause

Builders are seeking to cover rising construction costs and uncertainty right now, and are increasingly insisting that developers agree to “rise and fall” clauses in construction contracts.

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Against the environment of increasing costs in the construction industry, the majority of building construction contracts have historically been on a fixed, lump sum basis.

Developers are increasingly faced with contractors requiring, as a minimum, some type of rise and fall clause for an increase in the cost of material and labour during the project.

Should the developer find that the builder is insisting on protection against rising costs, there are a number of options that can be reviewed to mitigate risk.



BAXTER GAMBLE
Director

“We have worked closely with Jessica and her team at Construction Legal, on a number of substantial projects and have found their approach to be pragmatic and commercial, providing outstanding solutions for their and DFP’s clients.”

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The rise and fall clause provides some flexibility and padding on prices, which allows for a margin of cost fluctuation, with the risk shared between the financier, developer and builder.

The result of these clauses means developers and their respective financiers struggle to act with certainty. Working with the right finance partner, with expertise in property and construction law, is essential to mitigate risks and increased costs for your project. We have put together this month’s Property Development Insight with the assistance of our friends at Construction Legal.

THE SITUATION

The construction industry continues to see widespread impacts that seem to be never-ending, whether it is the ongoing effects of the COVID pandemic, flooding, or the war in Ukraine. These events, amongst other factors, have led to supply chain delays and increased costs, labour shortages, and a general escalation in construction materials costs, particularly with steel and timber.

The impact of these increased costs is felt not only during projects that are already underway but can also result in the need to reset estimated development costs during the planning phase.

Against this environment of increasing costs in the construction industry, the majority of building construction contracts have historically been on a fixed, lump sum basis, which means they explicitly exclude price increases, or otherwise known as “rise and fall” provisions.

The application of fixed, lump sum contracts provide greater cost certainty to the developer. However, in light of industry wide rising costs, developers are increasingly faced with contractors requiring, as a minimum, some type of rise and fall adjustment for an increase in the cost of materials and labour during the project.

SOLUTIONS FOR DEVELOPERS

The ideal position for developers is to hold their ground and insist that the contract is fixed, or in other words, for the contract not to have a rise and fall provision. This position is more likely to be accepted by larger builders that are proficient in assessing cost escalation risk and can withstand fluctuations in pricing.

However, it is not always feasible for large builders and contractors to work on certain developments, particularly smaller sites.

Should the developer find that its preferred builder is insisting on protection against rising costs, there are a number of options that can be reviewed to mitigate risk to the developer. Some of these strategies are outlined below:

- negotiate a cap on the total amount payable over and above the agreed cost for specific materials.
- link escalation costs to market indices to verify actual costs being claimed (such as iron ore, steel and timber);
- negotiate only a handful of key materials to which the rise and fall relates (rather than all materials used on the project);
- require certain mitigation measures that the contractor will be obligated to follow as a precondition of payment;
- require strict adherence to notification of cost escalation to allow developers to take steps to mitigate;
- require allocate of those costs that are a direct consequence of the change in economic or market conditions outside of the contractor's control;
- require three comparable quotes to allow you to undertake a due diligence exercise of the costs being claimed;
- ensure you have ultimate discretion (if you can) on costs being approved.

An added benefit of implementing strategies such as the above is that the developer's financing partner will have better comfort as to how cost risk is dealt with. With this in mind, costing for any anticipated increased costs should be reflective of the contingency available in project funding.

Development Finance Partners (DFP) are specialists in property development and construction finance and are well versed in working with developers to understand how risks are assessed and managed and partner with developers to negotiate the best property finance solution suitable.

Mr Gamble, Director at DFP, says "we have worked closely with Jessica and her team at Construction Legal, on a number of substantial projects and have found their approach to be pragmatic and commercial, providing outstanding solutions for their and DFP's clients".

NEED ASSISTANCE TO MITIGATE DEVELOPMENT RISK?

If you are a developer and require assistance in mitigating your project cost base, Construction Legal are experts in drafting construction contracts. Construction Legal works closely with developers and financiers to provide practical and commercial contract drafting which mitigates developers' risks, which in turn gives greater confidence to our finance partners such as Development Finance Partners.

Contact [Jessica Rippon](#) or [Oliver Sestakov](#) at [Construction Legal](#) for further assistance.

Development Finance Partners was established in 2011 as a specialist property development and construction financial advisory firm by development, banking and finance experts, Matt Royal and Baxter Gamble.

The firm has access to hundreds of bank and non-bank lenders, a number of which, do not take applications directly from borrowers. DFP has offices in Sydney, Brisbane and Melbourne and has written over \$3 billion in loans (as at 2022).

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