



Dilemma of Construction Contractors with Rising Costs

By

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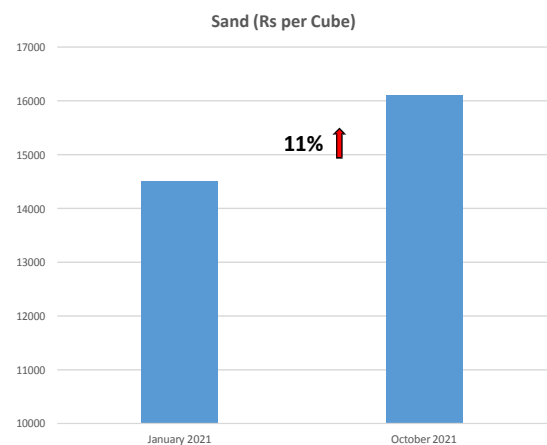
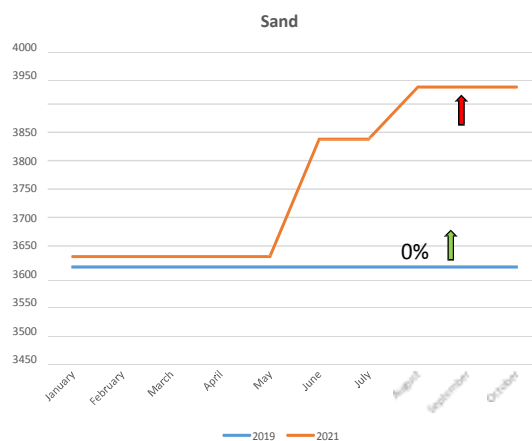
- A Glimpse of Recent Price Increases
- Impact to the Contractor
- Contractor's Dilemma
- Effects to the Industry
- Way Forward



Recent Increases in Material Prices

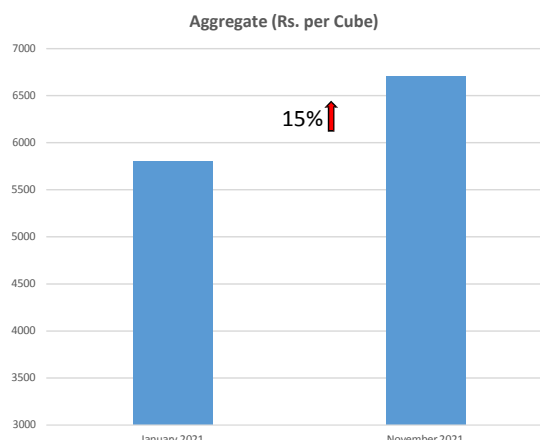
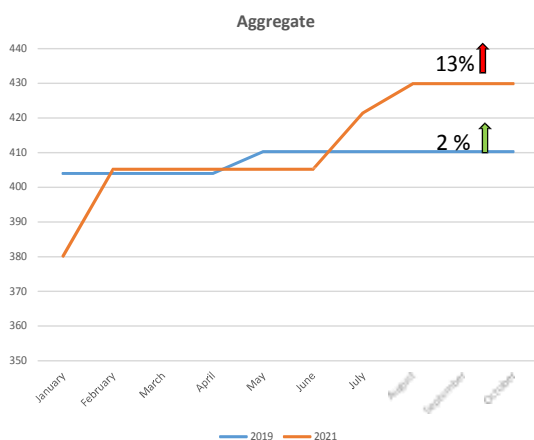


Price of Sand

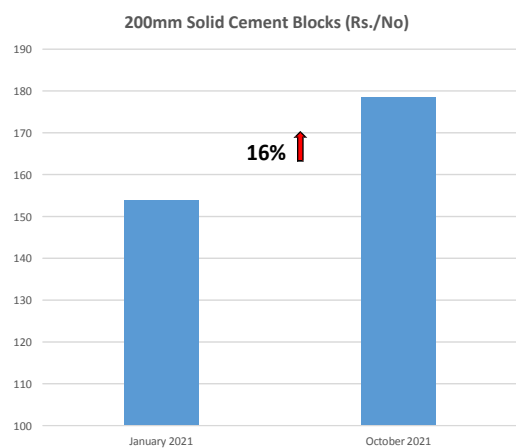
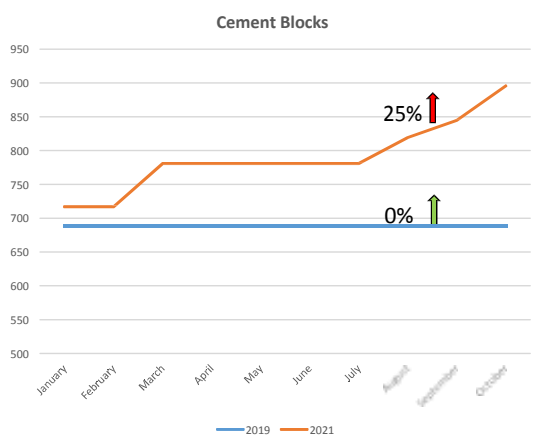




Price of Aggregate

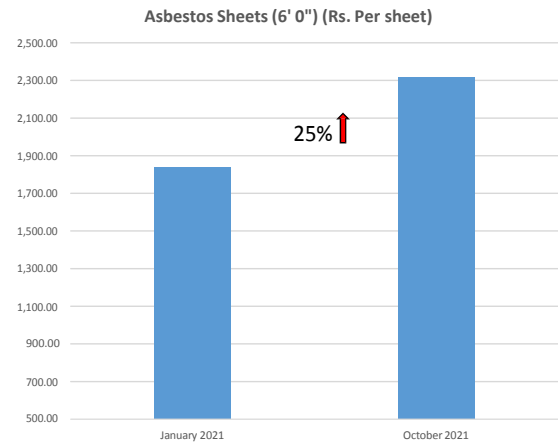
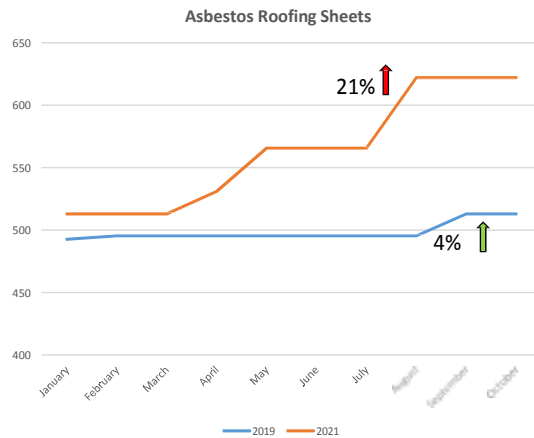


Price of Blocks

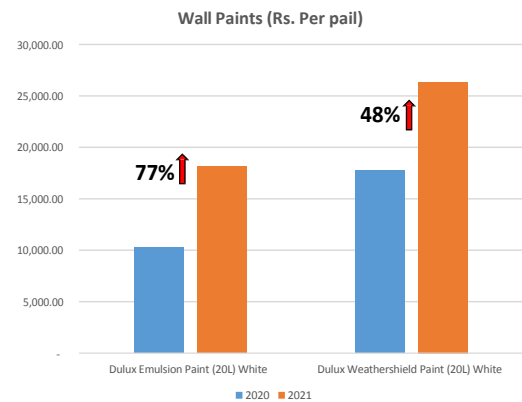
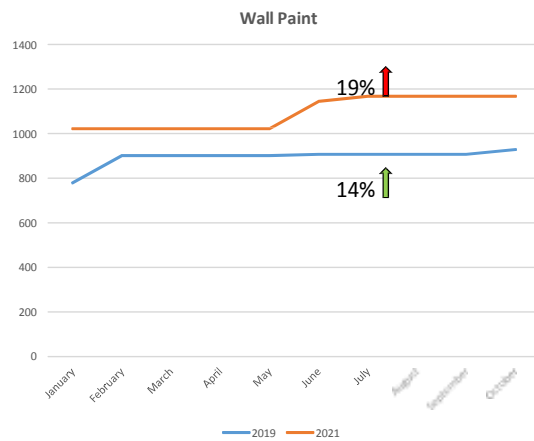




Price of Asbestos Sheets

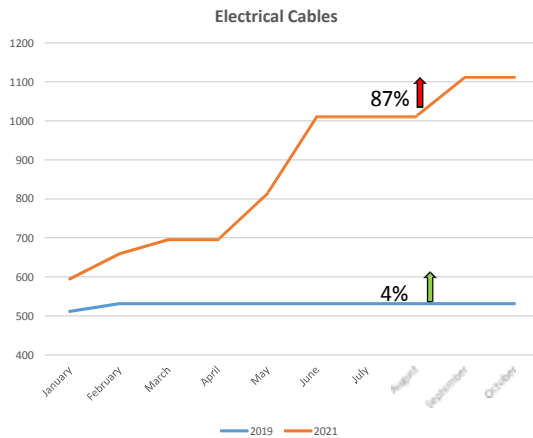


Price of Paints

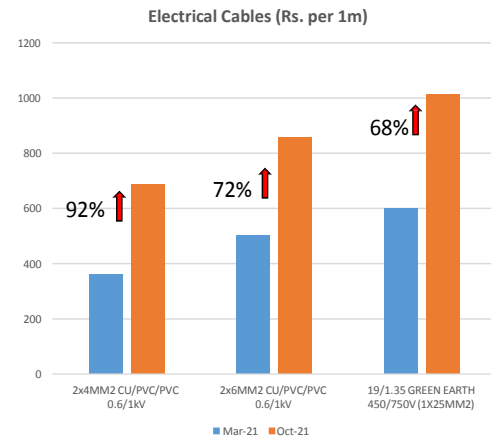




Price of Electrical Cables



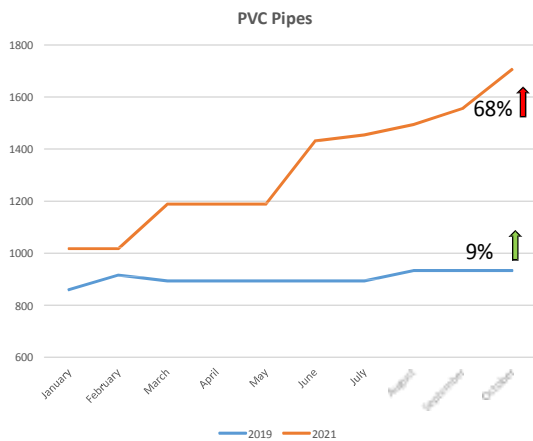
Source: CIDA Bulletin, October 2021



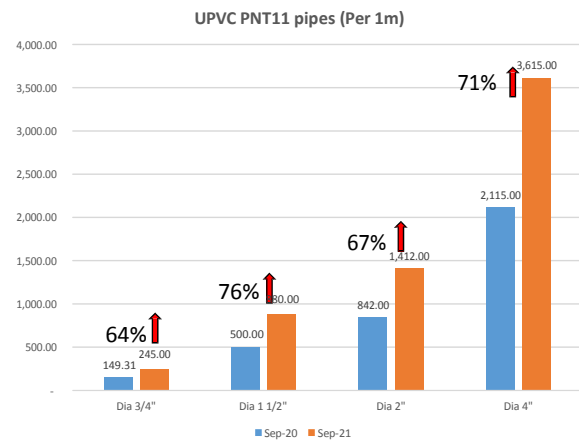
Source: Own



Price of PVC Pipes



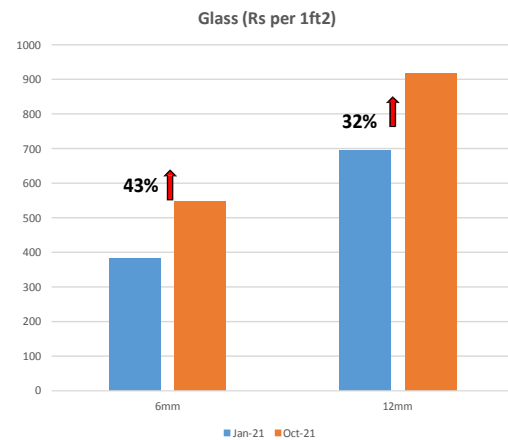
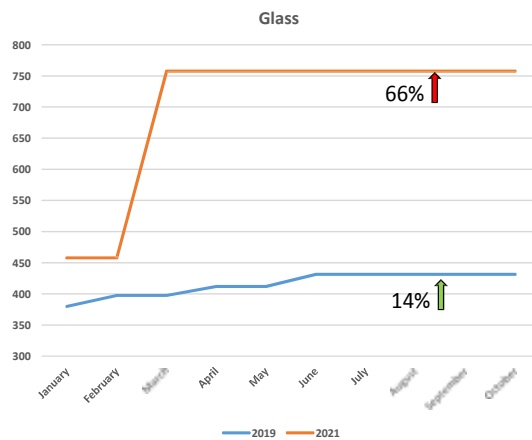
Source: CIDA Bulletin, October 2021



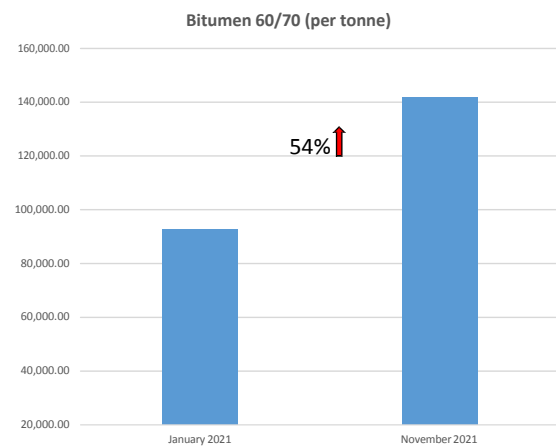
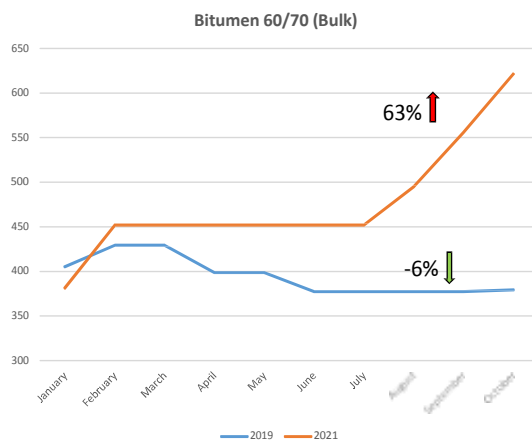
Source: Own



Price of Glass



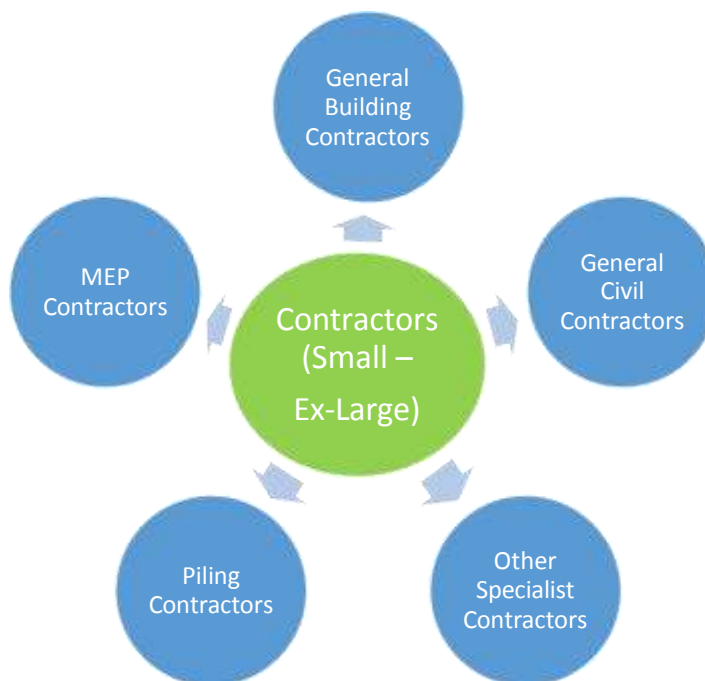
Price of Bitumen

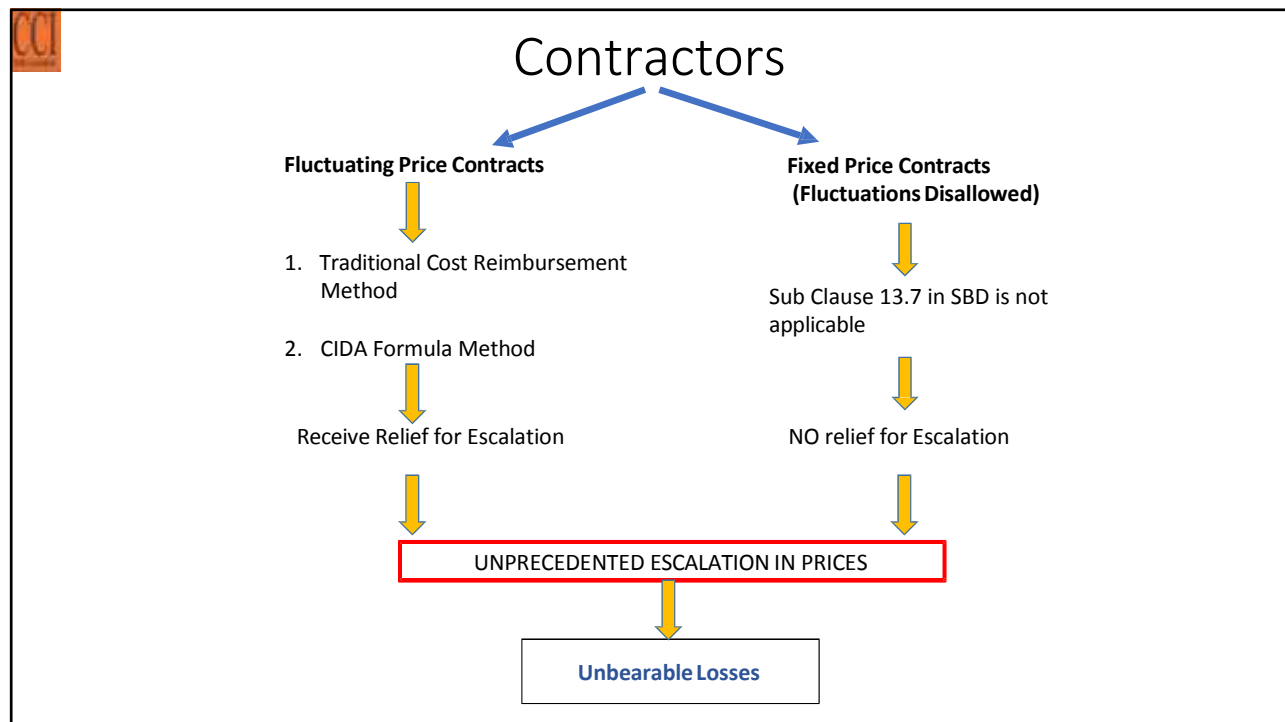




In Summary

- Usually, the escalation has been around 0% - 10%
- However, at present the escalation is 10% - 90% Or More
- Current escalation is beyond the imagination





1. Fluctuating Price Contracts

- Traditional Cost Reimbursement Method
 - Provides **actual reimbursement** of escalated cost
 - Generally, limited for **major materials** only
 - However, almost **ALL materials** have **skyrocketed**, especially due to Shipping Cost Increase
 - Considerable **losses due to fluctuation not-paid items**

World Container Index
assessed by Drewry®
 A weighted freight rate assessment of eight major east-west trades.

Source: Drewry Supply Chain Solutions

AL
Accessories
40%

Piping
Valves
20%

1. Fluctuating Price Contracts (Contd)

• CIDA Formula Method

$$F = \frac{0.966 (V - V_{na})}{100} \sum P_x \frac{(I_{xc} - I_{xb})}{I_{xb}}$$

- Provides **compensation** for escalation
- **Does NOT provide accurate relief** due to several reasons (Janardana et al., 2021; Jayalath C. and Wickramasinghe W.M.U., 2020) :
 - **Less Accuracy of Cost Indices**
 - Lack of regular updates
 - Less accuracy of costs taken (e.g. using CPC prices for bitumen)
 - Inconsistencies in sources of cost data
 - Non-availability of islandwide indices (e.g. bitumen purchased for roads countrywide are adjusted using same index)



1. Fluctuating Price Contracts (Contd)

• CIDA Formula Method (Contd)

- **Non-availability of indices for many materials**
 - E.g. Electrical switchgear (approx. 30-60% increase), Trunking, Conduits (20-30% increase)
 - Plumbing items (pumps), AC items, etc
- **Inherent assumptions in formula could provide less relief to contractors with lower profit %** (Samarakoon A.S. and Wijewardena, L.S.S., 2019)

0.966



Based on
15% OH &
Profit

1. Fluctuating Price Contracts (Contd)

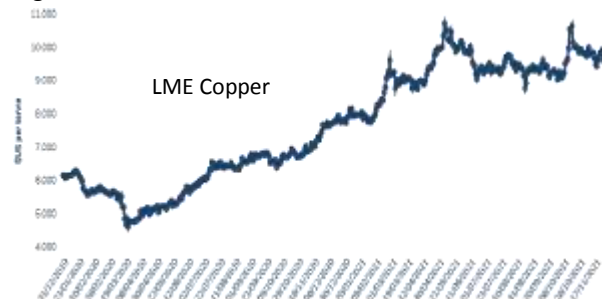
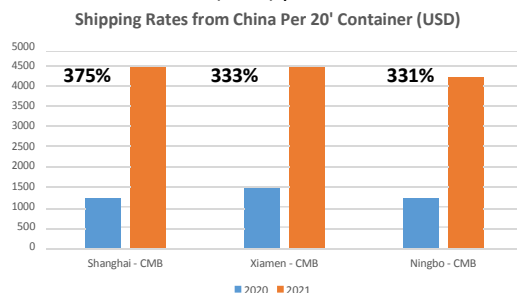
Adjustable items

- Some Preliminaries. E.g.
 - Temp. MEP work,
 - spare parts,
 - tools and machinery,
 - Safety items, etc
- Individual cost is less but cumulative cost is considerable due to excessive escalation



1. Fluctuating Price Contracts (Contd)

- Escalation is not paid for **Foreign Component**, but worldwide increase in market prices:
 - High escalation of Shipping Costs
 - Abnormal Increase in London Metal Exchange (LME) prices





1. Fluctuating Price Contracts (Contd)

- All these factors lead to **Unbearable Losses** even in Fluctuating Price Contracts!



2. Fixed Price Contracts

- Common in Private Sector Contracts
- Adjustments for Changes in Costs are not allowed
- Contractor allows a risk % based on past experience and **bears all risks** of Price Escalation

UNPRECEDENTED ESCALATION IN PRICES



**Unbearable
Losses**





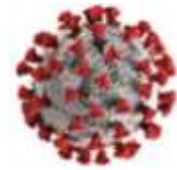
- Contractor is incurring this enormous **additional cost in the backdrop of Covid 19** where,

- Many **projects were extended**
- **Contractors were not paid additional cost** due to EOT

UNPRECEDENTED ESCALATION IN PRICES



Contractors fell from the **Frying Pan to the Fire**



Contractor's Dilemma



Contractor's Dilemma - Ongoing Projects

- Continue or Terminate?

- Due to the substantial escalation, Cost of continuation is greater than due income
- Especially Fixed Price Contracts

Cost Due to Escalation > Cost of termination / performance bond



Contractor's Dilemma - Ongoing Projects (Contd)

- How to Claim for the unforeseen Escalation Loss?

- No specific provision in SBD 2/ FIDIC 99
- Extra-contractual Claim
 - Unjust Enrichment
 - Beyond the parties' imagination at the time of contract
- Ex-gratia Claim





Contractor's Dilemma - Ongoing Projects (Contd)

- When to Procure Materials?

- Purchase in Advance?
- Delay Purchasing?
- Liquidated Damages



Contractor's Dilemma - Ongoing Projects (Contd)

- How to fund the Negative Cashflow?

- Excessive expenditure due to escalation
- Unplanned cash requirement due to advance procurement
- No Credit Terms by Suppliers. Payments to be in advance
- No Letter of Credits





Contractor's Dilemma - Future/Tendering Projects

- Bid or Not to Bid?

- Cost increases just 2-3 days after submission
- Suppliers provide price validity only for 3 – 7 days
Vs. Bid Validity of 60 – 90 Days
- Unable to forecast even the near future
- Better to be Safe than Sorry?



Contractor's Dilemma - Future/Tendering Projects (Contd)

- How to Price for the dynamic Escalation?

- Trend analysis using historical data is inaccurate
- 'Qualified' tenders may get rejected
- % of escalation in Fixed Price Contracts?



Contractor's Dilemma - Future/Tendering Projects (Contd)

- What Exchange Rate to be Used?

- A majority of materials are imported to SL. Especially MEP
- Serious Shortage of US Dollars
- Contractor's are compelled to buy from black market at varying rates from **Rs.230 – 250/USD**
- Exchange Rate in 02 months' time, Anyone??



Is this merely a Contractor's Problem?





Effects to the Industry

- Unrealistically high tender prices
 - Due to over estimated fluctuation costs
 - Lack of competition
- Half completed projects, leading to loss making investments
 - Losses to Clients as well as to financial sector



Effects to the Industry (Contd)

- Project delays, leading to issues in investment feasibility
- More Disputes
- Bankruptcy and Collapse of Local Contractors at all levels





Way Forward



• Contractors

- Forward contracts for material purchasing
- Advance procurement
- Request more advance or Client to supply materials
- Renegotiate terms of contract
- Provide CIDA with necessary regular cost updates and information



Way Forward (Contd)



• Clients/ Consultants

- Accept shorter bid validity and flexible decision making
- Allow better sharing of escalation risks
 - Actual cost reimbursement (Traditional Method) where possible for as much materials as possible
 - Fixed Price Contracts – Avoid or Atleast Pay for Escalation over 10% from base price
- Agree on a base exchange rate for all imports and pay fluctuations fully/partially
- Agree on fluctuation payments for USD component
- Value engineering or phasing out the investments
- Allow reasonable rate revisions in projects extended due to Covid19



Way Forward (Contd)

- CIDA/ Regulatory Authorities

- CIDA to take more [energetic and hands-on](#) approach to intervene
 - Directive on 29th November 2021 is welcome
- Take steps to improve accuracy of indices ([e.g. Improve data collection methods, more resources](#))
- [Regular updates](#) are critical in a dynamic market
- Vary indices based on [location](#)
- Consider [indices for new](#) items
- Provide indices separately for [different skill categories](#) (e.g. electrician, plumber)
- [Initiate future changes](#) to conditions of contract on abnormal price fluctuations



In Summary



- Current fluctuations in the market are [unprecedented](#) and [unpredictable](#)
- Contractors at all levels are incurring enormous losses due to the excessive fluctuation in prices
- Contractor's present dilemmas will severely affect the entire construction industry
- Providing [fair relief to the Contractors will help all](#) stakeholders and the future of the Construction Industry



Thank You