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# Construction Risk Management

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# Construction Risk Issues

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Construction financing is one of the riskiest, most complicated, and most sophisticated forms of lending.



# Construction Risk Issues

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To minimize these risks, lenders must control and monitor the process of construction lending, including:

- ✓ Budget
- ✓ Completion
- ✓ Take-out Failure
- ✓ Document Compliance

# Risk Mitigation

Risk is mitigated through

- Proper underwriting
- Highly diligent loan administration



# Risk Mitigation

To manage these tasks, a lender will typically retain the following:

- ✓ Attorney
- ✓ Appraiser
- ✓ Construction Consultant
- ✓ Environmental Consultant
- ✓ Insurance Consultant





## Goal of Construction Review:

To verify that the developer has thoroughly built the project on paper before it is initiated on-site.



# The role of the construction consultant

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Part I: Pre-Construction Phase  
Part II: Construction Phase

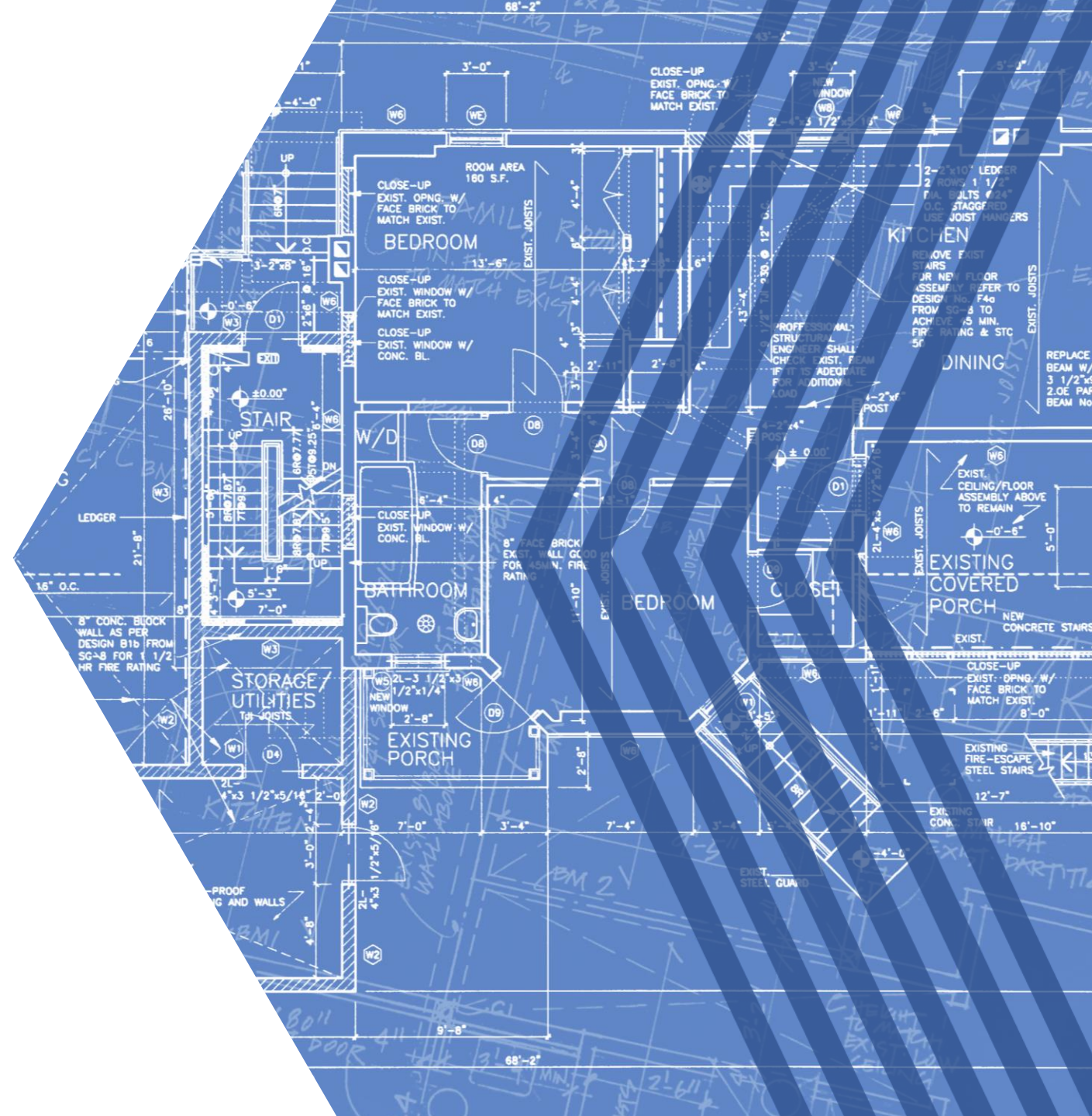


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# Part I: Pre-Construction Phase

Consultant will review the construction documents, as well as provide underwriting assistance.



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# Part I: Pre-Construction Phase

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## Consultant Responsibilities

- Review of Drawings and Specifications
- Analysis of the Developer's Team
- Review of Contracts, Agreements, and Risk Mitigation
- Review of Permits and Approvals
- Review of Construction and Disbursement Schedule
- Review of Construction Related Documentation
- Direct Cost Budget Analysis
- Preparation of a Document and Cost Review
- Release of Final DCR

# Review of Drawings / Specifications

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## Pre-Construction Phase

- Stage of development:
  - Schematic Design
  - Design Development
  - Construction Documents
- Same set of drawings for lender and contractor
- Coordinated to mitigate change orders and delays
- General compliance with commonly accepted practices and difficult details to field execute
- Acceptance by end-user



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# Developer's Team Analysis

## Pre-Construction Phase

- Developer experience with product
- Designer experience with product
- Team experience with developer, designers, contractor, subs, etc.
- Developer's in-house team
- Review of architect and contractor qualification statements
- Workforce to be utilized (union, non-union, or open shop)



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# Contracts, Agreements, Risk Mitigation

## Pre-Construction Phase

- Prime Construction Agreement
  - Lump Sum/Stipulated Sum
  - Construction Management as agent
  - Construction Management with GMP
  - Design/Build
  - Owner/Builder
- Subcontracts
- Bonding
  - Performance Bond
  - Labor and Material Payment Bond
  - Additional obligee riders



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# Contracts, Agreements, Risk Mitigation Pre-Construction Phase

- Subcontractor Default Insurance (SDI)
  - Project Attaching
  - Subcontractor Attaching
- Design agreements and professional liability insurance
- Project labor agreements
- Municipal agreements
- Building loan agreements
- Lease agreements
- Take-out lender/end-user agreement



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# Permits and Approvals

## Pre-Construction Phase

- Zoning and planning approvals
- Utility approvals
  - Existing
  - New
- Building department approvals
  - Sheeting/shoring
  - Foundation
  - Building
- Historical commission approvals
- Offsite work approvals



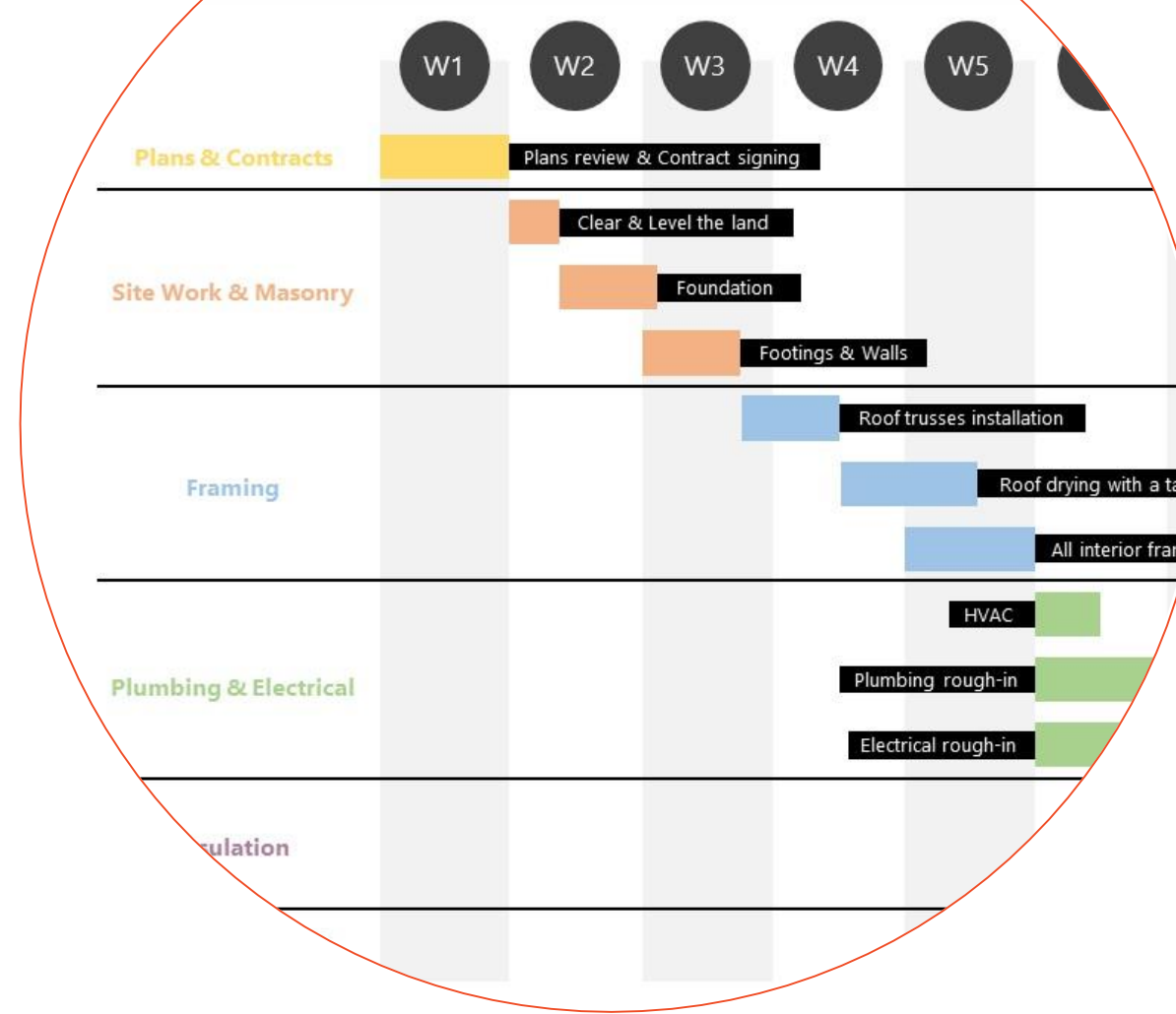
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# Schedules

## Pre-Construction Phase

- Developer project schedule
- Contractor schedule
- Disbursement schedule
- Stored material and deposit schedules







# Construction Documentation

## Pre-Construction Phase

- Surveys
- Geotechnical reports
- Accessibility reports
- Phase I ESA report
- Green Rating System (LEED, NGSB, WELL, etc.)





# Hard Cost Budget Analysis

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- Review of developer and contractor budget
- Third-party/independent cost estimates
- Status of contract documents
- Status of trade subcontractor and material supplier “buy-outs”
- Use of bonding/SDI
- Review of agreements, proposals, and letters of intent
- Hard cost contingency budget adequacy

Pre-Construction Phase



## Pre-Construction Phase

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# Contingency Budgets

### Owner

#### Expect

New ground up 3 - 5%

Renovation 8 - 12%

Increase % when project lacks permits, documents incomplete, historic / old project, occupied and/or complex project

### Contractor

#### Expect

Lump Sum - Not disclosed, carried in trade line items

Cost-Plus – None

Cost-Plus with GMP - Disclosed but should not be higher than 2 to 3%



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# Document and Cost Review

Pre-Construction Phase

- Project Budget and Schedule Review (PBR)
- Document and Cost Review (DCR)



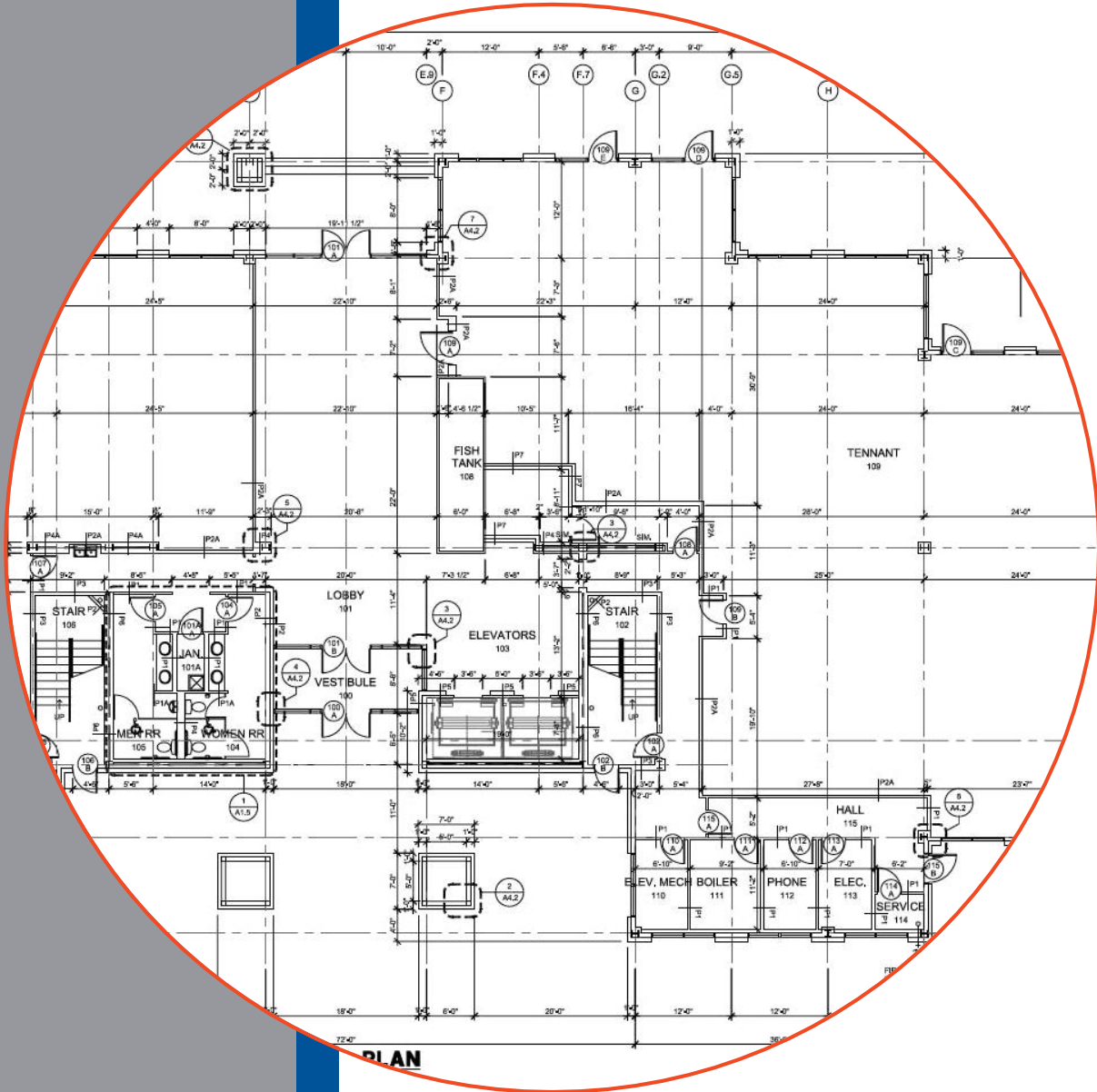
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# Release of Final DCR

## Pre-Construction Phase

- Executive Summary
- Project Description
- Opinion of Drawings and Specifications
- Opinion of Project Agreements
- Opinion of Project Budgets
- Opinion of Project Schedules
- Status of Permits/Approvals
- Items of Concern





## Contact Bob

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