

To build or not to build

What to consider before starting a new construction project

INTERVIEWED BY SUE OSTROWSKI

Labor and supply shortages, combined with rising interest rates, have many owners reconsidering the timeline for their construction projects — and in some cases, they are deciding not to proceed.

“Materials that used to be available in the normal course of business — concrete, steel, aggregate, light fixtures, lumber — that go into construction projects are now not as readily available,” says Matthew Moses, attorney at Babst Calland. “With interruptions in foreign trade, domestic supplies and transportation, things that used to be viewed as completely dependable now may not be available as needed. And the construction labor supply is smaller than it used to be before COVID, in both in the trades and in unskilled labor.”

Smart Business spoke with Moses about what to consider before deciding when — and if — to move forward with a construction project.

HOW ARE RISING INTEREST RATES IMPACTING CONSTRUCTION?

If owners have their own funds to spend on a project, that's great. But if they need financing, the cost of borrowing has increased and is widely expected to continue to rise. That could have a significant impact on the cost of a project, as a 1.5 percent interest rate increase on a \$5 million project could result in a six-figure cost increase.

There is some pressure to borrow now, before interest rates rise further. Ask your lender how long it can commit to a rate lock for a particular project. That has typically been a few months but is changing with interest rate volatility. And while that was not previously a major problem, it can be if the project is contingent on other actions that push out the closing date on the loan. If you are buying property, it may be difficult

Matthew Moses

Attorney
Babst Calland

mmoses@babstcalland.com
412.394.5624



WEBSITE: For more information about what to consider before starting a new construction project, contact Matthew or visit www.babstcalland.com.

INSIGHTS Legal is brought to you by **Babst Calland.**



to get the acquisition signed and closed in a shorter time frame. In addition, government permits can take months, and that initial interest rate commitment could expire by the time permits are received.

Projects are costing more than anticipated, and as material and labor costs continue to rise, some businesses are moving forward quickly before they go higher. However, many large projects have been put on hold as owners re-evaluate their capital priorities and decide not to proceed on noncritical projects. But delay also risks interest rates being even higher in six months to a year.

HOW DOES FORCE MAJEURE PLAY INTO THE CURRENT SITUATION?

Force majeure is a contract provision that affords a party temporary relief from liability if they can't perform because of circumstances outside their control, such as adverse weather or interruptions in supplies or labor. Contracts should specify how long of a delay a contractor is allowed before the contractor becomes liable for failing to perform. Shortages of materials and labor are a serious problem, and some contractors are shifting their available resources among multiple projects to keep the projects moving forward. That, in turn, lengthens the timeline for the project.

Owners should also attempt to secure a firm contract price, or at least limit the components subject to fluctuation. If you

don't have a firm price, an increase in the cost of materials could result in a project budgeted at \$10 million rising by several million dollars. However, contractors are impacted by circumstances they don't control, and they may not be able to agree to a firm contract price.

WHAT DO YOU SEE GOING FOR CONSTRUCTION GOING FORWARD?

Theoretically, higher interest rates will cool construction activity somewhat and help stabilize costs of materials. As inflation comes under control, theoretically, interest rates would stabilize. Construction costs — both of materials and labor and of borrowing — are expected to remain higher than they were pre-pandemic, but at least they would be more predictable.

Before proceeding with a construction project, evaluate how mission critical it really is and how much project delays would affect operations. If you knock out a factory wall to add floor space for a new production line, certain areas could be unusable until construction is complete — which could impact operations if it goes on longer than expected.

Ask if you really need to it right now, and if you do, understand the potential increased costs as a result of increasing interest rates and a shortage of materials and labor, and the detrimental impact it will have if the project continues longer than expected. ●