

RISK ALLOCATION

Construction costs too much! Construction purchasers hear these words every day from boards of directors, city councils and customers. Owners who do not want to reduce the quality of construction feel a tremendous push to reduce project costs. So what's the answer? Risk Allocation.

What is risk allocation? It is an attitude on the part of the owner to become an active participant in the construction process. Risk allocation is the process of identifying risk and determining how and to what extent they should be shared. Most owners understand that risk is an inherent part of the construction process and cannot be eliminated. What many owners may not know is that if risks are allocated to the appropriate members of the construction team - the contractor, designer, or owner - the cost of managing the risk and in turn the construction costs of the project, can be reduced.

The Associated General Contractors of America and the American Consulting Engineers Council formed a task several years ago to look at construction process risk and its impact on their clients, their member firms, and the public. The result of that effort is the "Owner's Guide to Saving Money by Risk Allocation." This publication will introduce you to a concept designed to improve the quality of engineering and construction and reduce costs to the owner through risk-sharing.

One of the first things the task force did was to identify examples of risks that may affect the cost or time of performance. Some of these risks clearly belong to the contractor or the designer. Other risks frequently cause delays, claims and disputes. For example, contract documents commonly developed by municipal attorneys are designed to reduce, as much as possible, the risk to the municipality or authority. Often times this is accomplished by transferring the risk to the contractor. Unfortunately, many cities require engineers to include clauses that will reduce liability to the owner

for unanticipated problems during the construction process. As a result, an increasing number of projects have been forced into excessive change orders, disputes, and litigation.

The careful allocation of risks can benefit all members of a construction team. The contractor benefits because there are fewer uncertainties during the competitive bid process. Engineers are likely to assume only those risks they are able to manage. Owners get quality projects with reduced delays, disputes and costs. Perhaps the best part is that everyone spends less time with their attorneys.

The allocation and management of risk should be clearly defined during the preparation of specifications and contract documents. Taking the time to research and assign risk at the outset of a project is a sound and effective method for managing costs. Owners who are practicing improved risk allocation have had fewer delays and disputes as well as improved relationships among the members of the construction teams. An added benefit is that owners have discovered that they themselves have done a better job of managing and administering contracts.

The basic underlying principal of risk is the possibility of economic loss. The potential for those losses can be best minimized through risk sharing, accurate risk identification and the assignment of risk to the party best able to evaluate, control, manage and bear it. The goals remain the same: to control costs, improve quality, reduce delays and resolve disputes efficiently and effectively.

How are owners achieving these goals? ACEC and AGC discovered that owners are doing the following:

- Using standard contract documents;
- reviewing and revising specifications and contract documents;

- providing substantial geotechnical information to minimize the "unknowns" regarding underground conditions;
- performing constructability reviews to see if design modifications are necessary;
- requiring a specific dispute resolution plan in contract documents, including:
 - 1) dispute review boards,
 - 2) regular legal review of documentation, and
 - 3) periodic review with the prime contractor of problems with subcontractors
- obtaining contractor advise and input on what is a realistic time to allow for construction;
- including specific procedures for providing the contractor with additional compensation when additional, unexpected work is performed;
- retaining the risk associated with permits and utilities relocation;
- establishing an adequate project budget;
- separating contracts between site preparation and construction;
- actively participating with the general contractor;
- participating at regularly scheduled construction meetings;
- instituting a communication and reporting system that identified problems early;
- keeping problems small and manageable through improved communications and;
- training inspectors and construction engineers to recognize potential problems and anticipate and reduce change orders.

Owners who have changed to a risk allocation system are realizing the benefits...in money, in time, and in human relationships. A University of Texas study includes the following quote: "Owners who routinely force maximum assumption of risk on the contractor are likely to incur higher project

costs. Contract preparation that allocates risk with a balanced input from all parties will be most cost effective." Teamwork is essential in the construction business. The sharing of risk is one of the best ways we know to pull together to achieve excellence in our industry.

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