



## Risk of Rise & Fall Clauses – Mitigation Strategies for Developers

### Rise & Fall Clauses – From a Developer’s Perspective

#### Introduction

Builders are increasingly insisting that developers agree to “rise and fall” clauses in construction contracts. Expertise in property and construction law is essential to mitigate increased costs.

This article looks at rise and fall clauses from the perspective of a developer and offers some helpful tips on how to negotiate and navigate through market constraints facing the construction industry to arrive at a “best for project” outcome.

#### 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 mean they explicitly **exclude price increases** - these are otherwise known as “rise and fall” provisions.

The application of fixed, lump sum contracts provides 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.

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## Solutions for developers

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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 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 some 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;
- Allow only 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 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.

## Need assistance to mitigate development risk?

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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 to provide practical and commercial contract drafting which mitigates developers' risks, which in turn gives greater confidence to finance partners. Conversely, Construction Legal also advises builders and contractors on how they can mitigate their risks.

Contact **Jessica Rippon** or **Oliver Sestakov** at Construction Legal for further assistance.

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