

THE RISK ILLUMINATOR

A Quarterly publication for our clients by **Lender's Quality Assurance**, a Critical Edge Company

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Construction Risk Management Services vs. Performance Bonds

We have been asked by several of our clients - "What are the benefits of engaging Construction Risk Management Services vs. Performance Bonds?" It almost always costs more to fix a problem than to prevent it from the outset. LQA's Construction Risk Management Services have been specifically developed to help keep your project on track – uncovering issues before they become problems. A Performance Bond is designed to only fix a problem, but it will not prevent a problem. Construction Risk Management services can prevent a problem from occurring. A Performance Bond is much more costly (typically 1.5-4% of the total Project Budget) than the cost of Construction Risk Management Services (typically less than 1% of the Project Budget). At first glance, it may seem more expedient to secure a Performance Bond – there is the sense that as a lender, your "insuring yourself against risk".

But – how can you be sure of what the risks are? And, do you want to insure against risk after the fact...or wouldn't you rather avoid the risks to begin with? Another way to look at it is...does it make more sense to do change the oil in your car (preventative) or just replace the engine when it dies (reactive). When you look at avoiding risk, the cost comparison of Performance Bonds vs. Construction Risk Management Services look more like this:

Construction Risk Management Services – Up-front costs include:

- Pre-construction Review (PCA) - identifies risk & offers recommendation for mitigation.
- Monthly Cost for draw request inspections, lien waiver tracking & funds control.

Performance Bond – Up-front costs include:

- Bond Premium

And...Costs to collect on bond (not covered by premium).

- Cost to qualify and secure new General Contractor if initial GC fails to perform.
- Demobilization Costs
- Additional Administrative costs incurred during problem resolution.
- Opportunity costs arising from your staff spending time fixing problems instead of dealing with new, profitable business.

The "costs" associated with choosing a Performance Bond over Construction Risk Management Services don't end there. When you choose a Performance bond:

- Who confirms whether the General Contractor, Subcontractor and Supplier Invoices are accurate? How do you avoid double billings, or overcharges?
- Who reviews lien releases? Who processes payments to the General Contractor, Subcontractors & Suppliers?
- How do you confirm that the General Contractor has paid his subcontractors? How do you avoid liens resulting from the General Contractor failing to disburse payments?
- Insurers often dispute the bond claim amount or refuse payment until litigation forces a settlement, resulting in a potentially costly and protracted process.

And, don't just take our word for it. The U.S. Small Business Administration (SBA) - approves lender's use of Construction Risk Management firms for their Government-Guaranteed Loans. The SBA has issued a policy for its construction loans accepting a funds control service as an alternative to a surety bond. SBA SOP 50-10(4) Section 1c:

SBA can consider waiving its requirements for a performance bond when SBA proceeds are authorized to construct and/or renovate real property that is more than \$125,000, if proper documentation and tight control of the disbursement of the proceeds can avoid undue construction related risks.

So....you decide what makes more sense. Covering risk....or, stopping it before it happens.

Topics In This Issue

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Coming Soon!

IN OUR NEXT ISSUE...

Information on our
upcoming new product
- LQA's Detailed
Contractor's Analysis
(DCA).

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Hard Hat University

Pop Quiz # 13

- | | |
|------------|--|
| A. Plinth | 1. True vertical; to be, or cause to be, vertically aligned |
| B. Plough | 2. The overhand of a roof on the gable end of a building |
| C. Plumb | 3. Cutting a groove, such as a dado, with the grain of the board |
| D. Purlin | 4. To demolish or tear down to the ground |
| E. Quarrel | 5. A slot or groove used to hold or guide a panel, or to receive receive roofing or flashing - also called a raggle |
| F. Rake | 6.. A horizontal structural member used to support rafters between rafter end points - running at right angles to the rafters. |
| G. Raze | 7. Square base of a pedestal or column |
| H. Reglet | 8. A diamond-shaped pane of glass used in a leaded window |

Answers: A



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