

gleeds

# Working in a Cold Climate

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Preparing the construction industry  
for business post COVID-19







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*Note: As a construction and property consultancy, Gleeds is supporting clients in the real estate sector to manage the unprecedented risks their developments and businesses face that this time. This document suggests possible considerations and reflects observations made at the time of writing, during a situation evolving daily.*

## Executive Summary



“Amidst a challenging period, we are working hard with our clients and supply chain to prepare for the time when development re-emerges and thrives.”

DOUGLAS MCCORMICK  
EXECUTIVE CHAIRMAN, UK

As a property and construction consultancy, we have witnessed the various stages of the effects of COVID-19 on a country’s workforce through the eyes of our local teams, as well as the impact to the global economy.

From the lessons we have learnt, the self-isolation and welfare of our staff are the most important aspects, followed by the ability to work remotely. I am extremely proud of the way our systems and processes have responded to the challenge, allowing us to continue to deliver high quality services.

As we navigate uncharted waters, like all other countries affected, the real estate industry in the UK faces the immediate need to address the impact to those projects which were on site when COVID-19 reached us.

Amidst challenging times, we are however, working hard with our clients and supply chain behind the scenes to prepare for the time when development re-emerges and thrives.

Pre-design or design stage work, procurement and contracts matters are just some of the many activities that can continue virtually, helping to reduce risk and position each project for a positive return to the market.

*Working in a Cold Climate* provides guidance through the situation we are facing, advising on key factors which could support each stage of a project, from addressing shutdowns to risk mitigation and legal considerations.

Whilst the current events are unprecedented and are causing a significant shock to the economy, Gleeds is using its global knowledge, network and over 135 years of experience in dealing with the effects of COVID-19 on construction projects, as well as being fully operational to continue to support our clients.

Our teams across the UK are poised to support you during this challenging period, and we hope you find *Working in a Cold Climate* a helpful touchpoint.

A handwritten signature in black ink, appearing to read 'Douglas McCormick'. The signature is stylized and fluid, with a large loop at the end.

**Douglas McCormick**  
Executive Chairman, UK





**Navigating uncharted waters**

Like all other countries affected, the real estate industry in the UK faces the immediate need to address the impact to those projects which were on site when COVID-19 reached us.



# Introduction

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## Overview

The COVID-19 pandemic poses a significant risk of an adverse economic impact, which will undoubtedly affect the construction sector as much as any other industry. However, once the world emerges from the current turmoil, a new world economy awaits us.

*Working in a Cold Climate* aims to support UK real estate sector peers navigate construction project planning and management, during a challenging climate. We seek to support our industry to find value in the current construction market, reviewing the mechanisms available for the management of increased risk in construction projects during these uncertain times.

During this challenging time, the application of good practice and increased diligence can result in mutual benefits to the project, employer, consultant team and contractor, enabling access to competitively priced projects, whilst aiming to manage risk down to acceptable levels.

## Impact on the UK economy

The British Chambers of Commerce downgraded its UK GDP growth expectations for 2020 to 0.8% on 17<sup>th</sup> March 2020, from its previous forecast of 1.0% made in December 2019.

Outside of the 2008/09 financial crisis, this would already have been the weakest full-year growth out-turn since 1992 and down sharply from UK GDP growth of 1.4% in 2019.

However, the recent situation has thrown all predictions and expectations in the air with significant uncertainty now the only real forecast, until things hopefully settle down.

## Economic update in the UK

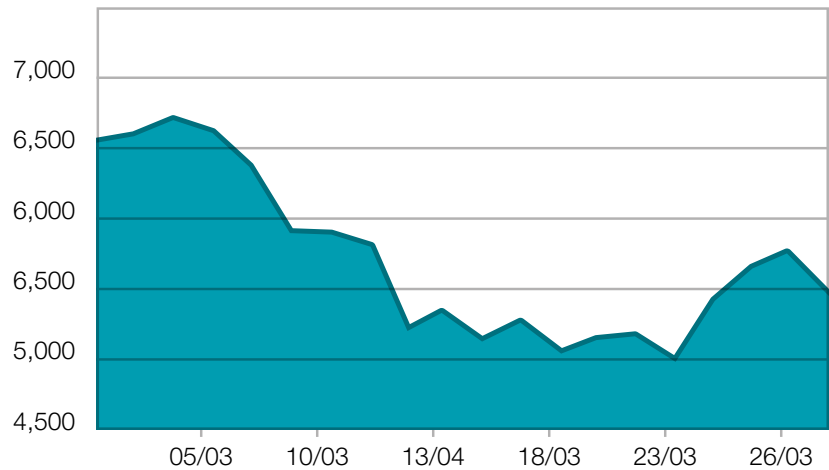
- Bank of England slashed rates to 0.1% from 0.5%, a record low in a bid to prop up the economy.
- Sterling fell 5% to \$1.15 USD on the 18<sup>th</sup> of March 2020, its worst exchange rate in 35 years.
- Sterling down by 0.2% to €1.06 EUR.
- The risk of a recession for UK and Europe.

**Our aim is to help real estate peers navigate construction project planning and management during a challenging time.**



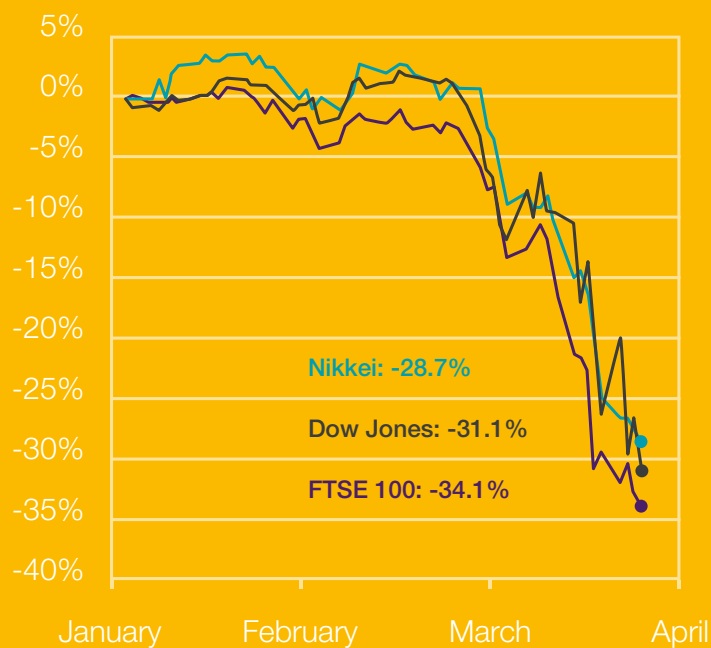


### FTSE 100 as of 27<sup>th</sup> March 2020



There has been a significant drop in the stock market due to the impact of COVID-19. However, this does not mean the construction industry should down tools and stop working in the background. In fact, we should all be considering the options available to us to prepare projects at pre-design or design stage for the new world economy.

### The impact of COVID-19 on stock markets since the outbreak





## Present situation

In response to the impact of COVID-19 on the construction industry, guidance notes for the UK have been prepared which are the result of a collaboration between the Association for Consultancy & Engineering, Build UK, Chartered Institute of Building, Construction Industry Training Board (CITB), Civil Engineering Contractors Association, Construction Products Association, Federation of Master Builders, and Institution of Civil Engineers.

In addition to regularly briefing the industry on recent changes, the guidance advises how to:

- Responsibly maintain site operations if sites are not closed or ordered to close.
- Manage employment issues including statutory and industry sick pay.
- Navigate commercial and contractual issues where work is suspended.

The Cabinet Office has confirmed that it is preparing guidance to public sector customers about how to deal with delay and disruption under public contracts, including force majeure claims. The construction industry is offering support to The Cabinet Office to take this work forward.

CITB has confirmed it will support the industry to protect skills for when the COVID-19 pandemic subsides, so that UK construction can play a full role in the country's economy working towards recovery from this crisis.

Visit the CITB website for information how they are doing this, with information including on grants and apprenticeships.

## UK government support

There has already been a lot of support from the Government in these uncertain times, encouraging a united approach to fight the outbreak.

The Chancellor of the Exchequer Rishi Sunak, has announced unprecedented support for business and workers, in an effort to mitigate catastrophic economic impacts. The measures include unlimited loans unlimited loans and guarantees to aid firms and help them manage cashflows through this period. The Chancellor will make available an initial £330bn of guarantees; equivalent to 15% of UK GDP.

To ensure that businesses have access to the funds they need, the Government is:

- Providing support for liquidity amongst large firms, with a major new scheme being launched by the Bank of England to help bridge COVID-19 disruption to cashflows through loans.
- Increasing the amount businesses can borrow through the COVID-19 Business Interruption Loan Scheme from £1.2m to £5m and ensuring businesses can access the first six months of that finance interest free, as the government will cover the first six months of interest payments.
- Including new legal powers in the COVID-19 stimulus bill, offering additional necessary financial support.

The action announced to date means that over £3.5bn in additional funding will be provided to the devolved administrations for support to businesses in Scotland, Wales and Northern Ireland.

**The Chancellor will make available an initial £330bn of guarantees; equivalent to 15% of UK GDP.**



“We have found a massive, massive development in performance; about a 13% improvement from people working at home.”

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**NICHOLAS BLOOM**  
PROFESSOR OF ECONOMICS\*

## The future workforce

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It has become almost immediately apparent that the government directive to work from home will result in a more agile workforce post COVID-19.

Technologies that could have taken years to be adopted have been enforced on people and businesses overnight.

Increased agility will help to reduce overheads both for consultants and for contractors looking to reduce preliminaries costs.

It is also an opportunity for companies to test new working patterns which may be a natural consequence of the change of culture in the aftermath of COVID-19.

The idea of work life integration will be a major topic once social distancing regulations have ceased, as the workforce will have found innovative and efficient ways of working whilst also managing their home life balance.

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\* Nicholas Bloom, Professor of Economics, School of Humanities and Sciences, Senior Fellow, Stanford Institute for Economic Policy Research, Ted X Stanford, April 2017



# Work has always adapted to the social, technological and economic influences; its reaction to COVID-19 will be no different.

## Meetings & remote working

Whilst most clients, consultants and site-based contract staff are being forced to work from home for the foreseeable future, there is no reason why planned meetings cannot go ahead utilising virtual conferencing technology such as Microsoft Teams, Zoom or Skype.

In fact, there are studies to suggest that once the relatively shallow learning curve is complete the meetings can be a lot more productive as illustrated previously in the document by Professor Bloom, especially when share screen technology, virtual whiteboards and recording functions are included. They also tend to produce a more focussed session.

## Commuting time

A side effect of not working from the office is not having to spend time travelling to the office. This can be the crucial strategic thinking time that alludes so many of us. There is also a feeling amongst some leaders that staff working from home may not be as productive as if they were in the office.

However, the reality is that poor performers will just as likely not work in the office. Performance issues will arise whether staff are office based or not. The crucial factor is tracking and analysing staff performance not by head count or time spent in the office but by output and deliverables and setting agreed goals.

## Business premises

Now is the time to carry out the theoretical study. How well could your organisation cope with true remote working? You could now retrieve some real time statistics to help inform your next office move or office development decision.

## Value development opportunities

The current uncertainty will no doubt trickle down to the acquisition of property and land with the result of lower demand for both, which will then reduce values. It is an important time for developers to keep their ear to the ground for bargains in the market.

## Pre-design

The above points may make some previously vetoed business plans now stack up or new opportunities available for review. Developers and clients should take the opportunity to carry out desktop feasibility reviews.

Assemble a virtual team and use technology such as Google Earth and Microsoft Teams to analyse those opportunities.



## Design

If a project is in the design phase, whether in pre-planning or post-planning, there will no doubt be a temptation to put the project on ice. However, that would be missing an opportunity to progress the design to a suitable stage using the project teams in a virtual capacity.

There is very little that cannot be done during the design phase by the virtual team that cannot be done traditionally and clients may find attractive rates from consultants, facing the same uncertainty as everyone else. This could also mean that the team is ready to get to site quicker once normality resumes.

## Tender stage

A very understandable reaction for the client who has a project ready to go to tender could be to pause the tender process. However, there is a good chance that the quality of tender returns will be greater as tender teams working from home potentially have greater focus. We would suggest getting legal advice to ensure you have a relevant COVID-19 clause included. It is likely that contractors and their suppliers will be looking for work so this could be a good time to test the market.

It is important to understand at tender stage where the materials are coming from and if they are likely to be coming from any areas significantly affected by the COVID-19 pandemic, ensuring an alternative specification is included where possible.

When analysing any tender returns, the quality aspect of the bid and the status of contractor will be of utmost importance, as there is a good chance that increased competition will drive costs down. Whilst good value is important so too is procuring a competent and secure contractor.

## Execution of contract

If you are in the tricky situation of execution of contract stage, then there will rightly be caution from both the client and contractor sides about whether to sign the contract and proceed.

Whilst a slight delay might be prudent idea, a total stop of the project could be a mistake. A slight delay could give your team the time to resolve some outstanding information or risks, such as firming up the provisional sums, reviewing the risk register, agreeing the gaps in design or settling those pre-start planning conditions. Additional fees paid to consultants during this period could reap huge benefits later with a more robust contract.







## Projects under construction

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### Valuations and site inspections

The present events have not yet qualified for a force majeure as there is no complete suspension of movement and government directive to shut sites, as at 6<sup>th</sup> March 2020.

However, if the government does call for a complete lockdown, it is inevitable that this might indeed qualify for a force majeure and could be prevented, hindered or delayed (or as otherwise determined by the contract) in performing its obligations under that contract.

In this constantly changing scenario, remote or desktop valuations and site inspections may well become the norm. It is advisable that legal advice is taken to understand contractual obligations regarding valuations, including off-site material valuations and works progress and quality inspections.

Looking ahead to contracts that have not already been placed, an amendment could be included to accommodate the use of technology to aid the valuation process. Construction progress can be monitored and managed using digital and BIM tools and can be correlated with photographs, giving less requirement to be present on site. This could even result in a more efficient process.

Documentation management software can be paired with 360° cameras to provide cloud-based documentation solutions, revolutionising the way photos are captured and managed on site.

Using mobile applications can create time efficiencies, tracking progress in real-time, through marking-up and comparing images taken at different times and live-streaming of 360° video content.



## Temporary shutdowns and reactivation of construction projects

The health and safety of each business' workforce is paramount, particularly during these challenging times.

Temporary shutdown of construction sites is occurring across the world as contractors gauge activity is no longer feasible in light of government rules and social responsibility in protecting the health and safety of their workforce. Shortage of materials is also inevitably an issue.

It is essential for clients, together with their professional advisers and contractors, to develop plans and procedures for temporarily shutting down and re-activating projects as a consequence of the COVID-19 outbreak.

## Disruption of construction projects

Given the inevitability that construction projects will be disrupted as a consequence of the COVID-19 outbreak, discussions around the likely impact of the likely impact of the COVID-19 outbreak on the project programme and the contractor's supply chain, as well as to talk through the contractual mechanisms for dealing with the situation.

The present impact on the construction workforce has not yet qualified for a force majeure as there is no complete suspension of movement. However, some contractors may look to rely on a force majeure event in the future. The important question is, therefore, what is "force majeure"; and the answer is that it's very far from clear, because it is a French law concept rather than an English law one and there are very few precedent cases.

It seems to be a question of fact and degree but requires something pretty serious and at this moment, it is uncertain whether or not the COVID-19 outbreak qualifies as force majeure. 10% of the contractor's staff off work with the virus would probably not, but with 90% of the workforce off, it may very well bring it into play.

Obtaining materials would also need to be substantially more difficult, should a force majeure be declared.

If the Government does call for a complete lockdown of construction sites, this may entitle contractors to an extension of time on the grounds that delay was caused by the government exercising its statutory powers.

Notwithstanding the above, it is recommended that clients wait for the contractor to make a claim and press for specific details, i.e. exactly what is it that is causing the delay, then apply the contract from there. However, if this involves anything other than enforcing the strict letter of the contract then this must be done carefully so as to avoid any unintentional waiving of any rights or unplanned deemed amendments to the contract.

It is also recommend that clients talk to their contractors as the situation evolves to try and reach agreement to try and avoid a difficult commercial situation. Many are waiting to see what the government are going to offer the construction industry as this may affect a commercial agreement.

In speaking to the contractors, it is important not to instruct them to take precautions or similar or do anything that may be seen to impede the works at this could lead to claims for both time and money. Any agreement should be formally recorded and incorporated into the contract.



## Managing risk

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**Contractors are particularly vulnerable to the impact of COVID-19 on the global supply chain. Thorough examination of procurement lines will minimise risk, here we outline a suggested approach.**

### **Business continuity protocols**

It is important to ask to see the contractors' business continuity protocols in light of COVID-19.

How can they maintain continuity of supply?

#### **Understand your contract**

If you are already under contract ensure you understand the contract and the mechanisms available to both the contractor and client to deal with potential delays caused by COVID-19. You should also check if any of the relevant clauses have been amended in anyway. It goes without saying that different forms will deal with events in slightly different ways.

Under a standard Joint Contracts Tribunal (JCT), a contractor may be entitled to an extension of time if it can be demonstrated that COVID-19 is a scenario listed under 'relevant events'.

There are two events that may currently apply:

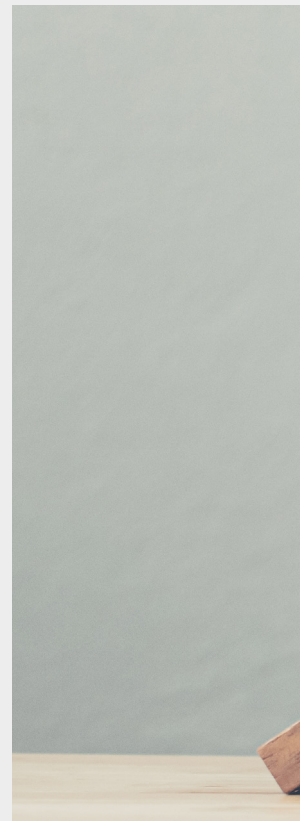
- The exercise of any statutory power by central or local government which affects the execution of the works
- Force majeure

#### **Supply chain due diligence**

Before entering into contract it is important to carry out a thorough audit of the proposed main contractor's supply chain, both sub-contractors and suppliers, to see whether any of them could be adversely effected by the COVID-19 pandemic. If there are any concerns then alternative suppliers and / or specifications should be considered.

#### **Review risk allowances/contingencies**

Most large contracts will now have a risk allowance included, which has been based on the residual risk from a project risk register. This risk register should be reviewed in light of the current circumstances and the risk allowance adjusted if required.





### **Credit checking and rating**

A close tab should be maintained on the contractor's cash assets, as it is not unreasonable to request to see bank balances in these uncertain times.

### **Health of accounts**

Check whether the contractor is a listed company and has published accounts audited by a trusted firm and with recent audited accounts available.

### **Annual turnover and project value**

Too great a proportion of a contractor's annual turnover resting on one project is a significant risk factor to their financial stability, both in terms of perceived risk in their supply line and in the ability to fund materials and works prior to valuation and certification.

### **Credit exposure**

Does the contractor carry a significant level of debt and if so, how secure are loans/overdrafts? Arrangements made in a more certain economic climate are by no means guaranteed to be renewed and hence borrowing should be viewed in conjunction with turnover.

### **Parent company backing**

Is the contractor able to offer a parent company guarantee for the project as an entity independent of the contractor?

### **Dun & Bradstreet**

Dun & Bradstreet can provide failure scores for most UK companies which represent an indication of the likelihood of collapse within the next twelve months. This is expressed as a score from 1-100 with the lowest scoring companies most likely to fail.

There are numerous other companies offering similar services, all will charge a small fee. However, it should be noted that most of these are retrospective and unlikely to have picked up the effects of COVID-19.

### **Future stability**

As liability for a project does not end with its practical completion, the employer should be confident of the potential contractor's continued stability (also see parent company backing). Access to their forward order book can provide a reasonable indication of medium-term prospects as can a review of past performance.

### **Spread of exposure**

As certain sectors of the industry are more volatile than others, contractors concentrating their workload in high risk sectors will be more vulnerable than those spread across various sectors. Public sector commissions may be of comfort to an employer.



**Business history**

A new company perhaps carries more attendant risk for the employer than one with a proven track record.

**Consistent profit margins**

Review of historic accounts may reveal how vulnerable a contractor has been in the past to fluctuations in profitability.

**Financial conservatism**

Has the contractor over extended? Excessive growth in more certain times may leave a company exposed as the market contracts.

**Stability of supply chain**

Major subcontractors and domestic relationships represent a significant risk to the main contractor and ultimately to the employer. Credit checking of subcontractors and an appraisal of their history is recommended.

**Ownership**

Publicly owned companies may be regarded as a lesser risk as private owners may unilaterally withdraw money at any time.

**Identity/role of directors**

A good relationship with senior management who are involved in the company and its projects is invaluable.

**Market position**

Market leaders tend to do better in recessions and at uncertain times and hence potentially offer less risk.

**Track record**

Contacting referees, particularly previous clients and consultants is invaluable in assessing actual past performance and employer satisfaction. Virtual visits via Google Earth of to completed projects with the client are an excellent way of doing this.

**Framework agreements**

Partnering and long-term projects, usually for larger clients may be viewed as reducing risk of the company failing.

**Construction contracts**

Willingness to work under the industry standard forms of contract (even if an alternate form is used) should be a prerequisite of any appointment.

**Discount and buying power**

Larger companies or those with established supply lines and good relationships may be able to negotiate more preferable rates for sourcing materials and labour or for finding alternative options for materials, which could be crucial in a post COVID-19 world.

**Quality assurance (QA)**

A formalised and or accredited commitment to the management of quality within a company indicates a reassuring approach to the process management of projects and services.

**Feedback**

Similarly to QA, a formalised feedback assessment procedure not only offers confidence to potential employers but allows review of previous performance on other projects.

**Commitment to programme**

While the contractual status of damages for non-completion within the programme are explored elsewhere, it is informative to enquire whether damages have been incurred on previous projects as part of the selection process.

**Commitment to cost plan**

Enquiries regarding final accounts in relation to initial cost plans on previous projects can give an invaluable insight into the risk attendant to an appointment. This may be particularly important where unusually low tenders are encountered.

*While the above is by no means exhaustive it may be regarded as an indication of the issues involved and methodologies available to the prospective employer in the risk management of selecting and appointing a contractor at any time but more than ever during the upcoming uncertain economic climate.*

## Importance of the contract

Equally important to the employer's risk management as the selection of the contractor is the selection and adaptation of a suitable and robust form of contract, appropriate to the nature, scale and context of the proposed works.

One unfortunate consequence of highly competitive tenders is an increased incidence of contractual claims for loss and expense by the contractor. This is either in an attempt to recoup lost profit or simply as reduced margins leave no option other than to incur further loss.

The choice and refinement of contract is now of more importance than ever. Employers and consultants, in addition to contractors and their sub-contractors will need to closely examine the contractual options and mechanisms available to deal with areas of potential problems as the risk associated both with the direct pressures of the current climate and the possible rise of associated adversarial culture increases.

It would be challenging for an owner to dispute that the virus outbreak's disruption to the supply chain was within the contractor's control. However, force majeure clauses are often revised from their native form, transferring the risks of the unknown to the contractor.

Whether negotiating a contract for a new project or in the middle of construction, it would be wise to consider who will bear the risks and costs associated with the still evolving COVID-19 crisis.

Another strategy for limiting delays may be to try and substitute materials or equipment manufactured overseas in areas heavily affected by the outbreak of the virus with products made in the UK.

Demand for these substituted materials has already driven up costs. Standard form construction contracts permit substitutions under certain circumstances where there is also a cost savings to the owner. Any increased costs for a substituted product are usually the sole responsibility of the contractor and can be investigated.

## Bonds

A bond provides financial security for the employer (up to the value of the bond which is usually 10% of the contract sum) in the event of a contractor's breach of the terms of the construction contract. It will not itself ensure that contracts are carried out efficiently and to time but it will be a commercial pressure on the contractor to perform well.

Bonds can be simplistically categorised as either 'conditional' or unconditional'. A conditional bond is often referred to as a 'performance bond' and can be called in only if/when the contractor is shown to be in breach of the contract. The Employer must therefore typically establish:

- i) that the contractor has breached the building contract
- ii) that the employer has suffered 'established and ascertained' damages as a result of the breach

With a conditional bond it is important to ensure that the employer is entitled to make an immediate call on the bond in the event of contractor insolvency (this is not necessarily classified as a breach of contract). If the breach of contract is disputed then the employer will have to prove its case.

This can be a lengthy procedure, if involving litigation it can take many years to resolve, long after the funds are needed by the employer to address the contractor's breach. Many conditional bonds include adjudication as a preliminary means of determining whether conditions have been satisfied to allow payment of funds. Such bonds are sometimes referred to as 'adjudication bonds.'

A retention bond is a form of conditional bond and allows a contractor to be paid without deducting retention. These bonds tend to increase in value as payments are made in accordance with the contract with the value reducing by 50% at practical completion and the bond expiring on the issue of the certificate of making good defects.



The use of retention bonds transfers financing costs from the contractor to the employer as the employer is required pay the contractor in full thereby passing cashflow benefits onto the contractor.

Generally a retention bond is only advantageous to the employer if the contractor reflects the benefits of improved cashflow in the tender sum for the works. Conditional bonds should have an expiry date, generally not related to a calendar date but to an event for example 'practical completion'.

This will mean the bond will not need amendment in the event of a delay to the contractual date of the practical completion event.

Conditional bonds are usually provided by an insurance company who will recover payment from the contractor's bank account under a counter-indemnity. They therefore do not impact on a contractor's loan facility but often require substantial premiums (which may be added to tender sums and are consequently financed by the employer).

An unconditional bond is often referred to as an 'on demand' bond and it can be called on regardless of the employer having to prove a breach of contract on the part of the contractor. An unconditional bond is in effect a letter of credit unless there is clear evidence of fraud on the part of the employer in calling in the bond (the commercial effectiveness of unconditional bonds is destroyed if contractors can stop payment merely by showing some form of arguable case). A variation on an unconditional bond is to attach some conditions relating to the procedure for calling in the bond ('conditional on-demand' bond).

Typically the conditions will cover:

- i) A mechanism for calling (so the bond may only be called in if certain procedures have been followed).
- ii) A requirement for the contractor to identify (but not to prove) the reason for calling in the bond.
- iii) A cooling off period during which the contractor may remedy the default.

An advance payment bond is a form of conditional on-demand bond which allows the employer to pay the contractor up to a specified limit in advance. The bond then covers recovery of that sum in the event of a breach by the contractor.

Advance payment bonds should reduce in value as interim / stage payments are made (often referred to as a 'conditional reducing bond' or a 'demand advance bond').

### Parent company guarantee (PCG)

A PCG is an alternative to a bond or can be used in conjunction with a bond.

It is given by a parent company or holding company to guarantee the proper performance of a contractor by one of its subsidiaries. A PCG can only be given if the contractor is owned by a parent company or is a subsidiary of a larger group.

The PCG is free of cost to the employer and can be more advantageous than a bond as rather than the employer recovering a fixed amount of compensation the parent / holding company is obliged to remedy the breach.

The parent / holding company in effect steps in to the contract and therefore performance and completion of the contract can be safeguarded.

A note of caution: a PCG will only be effective if the parent/holding company is financially sound and its financial resources are largely independent of those of its subsidiaries.

Bonds are not always necessary and should not replace considered judgement about the risks of a particular contract and the capabilities of the financial resources of the appointed contractor.

As a general principle, bonds should be drafted by solicitors and it is important to notify the bondsmen as soon as possible in the event of a potential call on the bond.

## Retention

Retention is the retaining of money by the employer from gross amounts due to the contractor. Under the standard form of building contract, the employer is entitled to retain these monies until the contractor has rectified all defects on the project. The defects liability period, which commences after the completion of the works, is stated in the contract and depending upon the nature of the project is normally either six or twelve months.

Since the publication of the Banwell Report in 1964, which recommended ending their use in building contracts, there have been discussions regarding the continued usage of retentions. The main view of those who are against change argue that by retaining monies it is good practice and gives the contractors the necessary motivation to return to site to remedy the defects.

The arguments levelled against the traditional system concentrates on the negative aspects this method inflicts on the cashflow of contractors and subcontractors in the construction industry.

Many believe that some employers exploit the system by withholding payments unfairly and using them as an “incentive” to achieve earlier completion dates, unjustifiable cost reductions, etc. These employers by withholding payments are damaging the contractor’s extremely fragile cashflows and especially in the current climate, adding to the mounting pressure on the contractor’s already meagre profit margins. An unpaid retention fund can substantially reduce a contractor’s profit or even cause a loss on a project.

In addition, opponents to retentions point out, employers are entitled to withhold payments from a contractor as long as the employer specifies the amounts and the reasons for the withholding (Housing Grants, Construction, and Regeneration Act 1996).

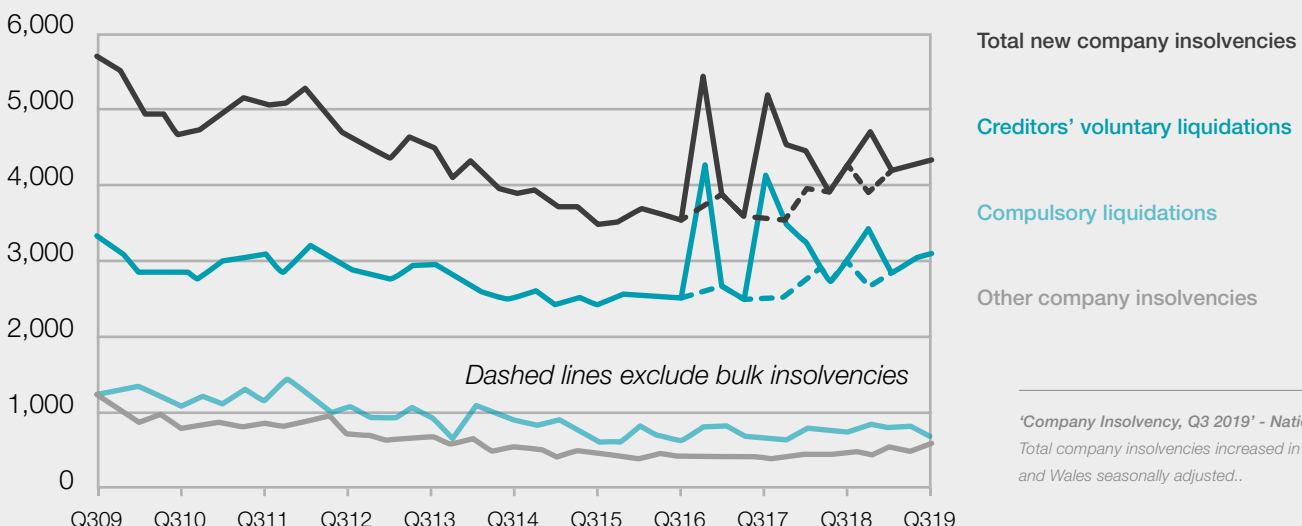
Retaining monies under the Construction Act, instead of the deduction of a random percentage from each payment during the contract period, is considered by many to be a greater incentive to the contractor to complete the remedial works during the contract period.

By deducting the actual value of the specific defective works and snagging items when they occur, the risk adverse cashflow, e.g. performance bonds, latent defects insurance, parent company guarantees, however, these result in an additional cost to the employer.

Recently a number of large private and public sector employers have abandoned the use of retentions, but it is highly unlikely that the construction industry as a whole will follow this change voluntarily.

## Insolvency

The latest statistics before the outbreak of COVID-19 listed 4,355 total company insolvencies in Q3 2019 in the UK; this is 0.4% higher than in Q2 2019 and had increased for the third successive quarter. Compared to the same quarter last year, this was an increase of 1.6%. This is the highest underlying level of company insolvencies in any quarter since Q1 2014. The highest number of new underlying company insolvencies was in the construction industry with 3,106 insolvencies.





As reported by Atradius, corporate insolvencies are expected to grow 2.4% in 2020, a pronounced acceleration from the 1.4% increase recorded in 2019, and this could increase even more as a result of the COVID 19 outbreak.

The outbreak of the COVID-19 is compounding the challenges to global trade and manufacturing, by weakening Chinese imports and tourism and causing disruption to global supply chains.

The mounting challenges have caused a downward revision of GDP growth forecasts around the world, especially in Asia, but also in Europe and North America. This downward revision in GDP growth may translate into a worse insolvency outlook than the one from last quarter.

The signs are reflective of previous economic downturns, although these are very unique circumstances:

1. As the market contracts, companies come under pressure to increase sales and maintain turnover. Monies are spent on increasing their marketing resources and providing clients with “added value” at no extra cost. This unbudgeted expenditure leads to losses.
2. To finance this sales drive and goodwill gestures, short term debts are arranged, this additional finance increases the companies’ overhead costs and applies even greater pressure to their profit margins.
3. As the market shows little sign of improvement, this unsecured loan at the bequest of the companies’ increasingly nervous bankers is switched to a long-term secured facility.
4. The rescheduling of the loan will reduce the companies’ repayment schedule and banks’ exposure to risk that will in turn improve the companies’ credit rating and thus resulting in an improvement in their ability to borrow. These additional borrowings are spent on chasing non-existing work and so the downward cycle of financial indebtedness commences again. As a result, these constantly increasing repayments to the bank bite deeper and deeper into the companies’ profits.
5. As the debt increases to an uncontrollable level, the banks yet again become nervous and demand repayment of the debt, if the company cannot comply, then the bank call in the administrators.

To survive any possible recession as a result of the COVID-19 crisis and avoid administration, companies at risk must be prepared to take action; there are three main choices:

Firstly, cut costs, the company should downsize so that it can trade profitably in the reduced construction market. This will mean incurring job losses, cutting out non-profitable parts of the company, reducing overheads, etc. to enable the business to survive the level of debt must be reduced.

Secondly, the company could be sold. There are many companies who could afford to finance a cash purchase. Yet again, this strategy will involve job losses as the new owner reduces the size of the company to improve performance.

Lastly, the riskiest option, companies at risk could attempt to trade their way out; this strategy is not likely to succeed. Most companies that are experiencing difficulties have fairly long-term problems, so if their current business approach is not competitive, their failure to act will not improve their trading prospects. Combine this with the inability to raise extra finance and time is not on the side of this approach.

The years ahead will be a testing time for the construction industry, even those contractors who are financially stable should be aware of the negative effect of reducing cashflows on major projects and in particular the risk of financial failure within their supply chain.

## Conclusion

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**The industry should use the opportunity to review methods of working to ensure we emerge from this crisis stronger, more resilient and more efficient than ever.**

**We are in uncharted territory in respect of the outbreak and repercussions of COVID-19 and nobody really knows how long this situation will continue for.**

It is undoubtedly a difficult time for projects that are currently onsite, with the situation changing almost daily.

In this scenario it is important to understand the contract, take legal advice where necessary and work closely with the consultant team and contractor to continue whatever work can be done on site or remotely.

Whilst work on site may be severely impacted or may have even stopped, design work, procurement, contract matters and other issues can continue remotely to ensure the project is in a good place for when work resumes.

If the project is in pre-design or design/procurement stage then there is no reason not to continue work on these elements and use the opportunity to de-risk projects as much as possible for when restrictions are lifted.

