

COVID-19 and the Construction Industry - A Surety Perspective

The economic impact of COVID-19 on the construction industry is impossible to quantify, as circumstances are changing daily. Some Unions and construction workers are pressing for greater health and safety practices, others threatening temporary shut downs. The CCA has asked for Federal input and guidelines with respect to job site practices and expectations, and is lobbying for financial relief for businesses surely to be impacted in one way or another. Most provinces have deemed construction an essential service, Quebec has shut it down.

Over the last week, we have engaged a significant number of surety colleagues and underwriters, with a view to assessing the impact of COVID-19 on the world of contractors and their Sureties. What follows here are a series of questions and answers designed to help provide some insight as to the impact of COVID-19 on bonds and bonded contracts.

Are the performance bonds on our ongoing projects still in place and valid?

Once bonds have been issued, they cannot be cancelled – they are by nature non-cancellable. The surety's obligation ceases once all the terms and conditions of the contract have been fulfilled, including the warranty period. If the project is cancelled or terminated, this would have to be done in a manner that follows the conditions of the contract, in order to not compromise or impair the bond.

Can an Owner claim on a performance bond if the project is delayed as a result of COVID-19?

It is important to appreciate that a performance bond guarantees the underlying contract, so the question of whether a bond may be called depends on the underlying contract.

Owners and contractors will no doubt be reviewing the merits of the contractual rights and obligations associated with the resulting damages. Cost overruns, delays, liquidated damages and other scheduling conflicts will all be on the table.

The hot topic right now is the concept of Force Majeure ('FM'), and whether the COVID-19 pandemic qualifies; and if it does, what relief does it offer the contractor. The short answer is that it depends on the specific wording in each contract; but if there is an FM provision under the contract that can be invoked by the prevailing pandemic (which we believe there is in most contracts, even though they're not referred to specifically as 'Force Majeure' or 'Pandemic')

then your obligations under the contract—and the surety's obligations under the bond—are amended, as is the project schedule.

Usually contracts will have a procedural mechanism to be followed when invoking the force majeure clause, including providing the other party with notice within a specified time frame. Failure to notify the other party of a force majeure event within the requisite time frame may result in an exclusion of such event from force majeure relief, so it is particularly important to be mindful of any specified timelines and other requirements to claim force majeure relief.



What happens to the bonds if a Project gets cancelled?

This will be determined by the construction contract, not the bond. If the contract is cancelled, provided it follows the provisions of the contract, then likely the obligations have been met under the bond.

Is there any way to determine what financial impact of COVID-19 will have on private Owners, Contractors, Subcontractors, and Suppliers from a liquidity perspective? How do we manage our credit risk? How do we get paid?

This is a serious question that should generate much discussion.

Looking up the contractual chain, there may, or may not be any payment protection. A General Contractor working for a private owner will have very little remedy, aside from lien rights or breach of contract claims. A sub-trade, or supplier may have the benefit of a payment bond provided by their customer to the party with whom they have a contract.

Be proactive, and ask questions—Owners to Financing Partners, GCs to Owners, Subs to GCs, Suppliers to Subs and GC. What is their position? Ask the tough questions. Each party has the right and the responsibility to understand the current situation. Easy answers won't be quickly forthcoming, but start the dialogue.

As you bill for work performed, now more than ever it is critical to be sure that this is accurate, complete and documented in a form that will allow for quick verification and processing, so payments are not stalled or impeded.

What advice do you have for a General Contractors in dealing with private Owners, to ensure there is a steady flow of funds?

Payment waterfall generally begins at the Owner level, and GCs are in a position to secure key information from their Owners. Recommendation is to obtain this in a documented form – Bank Letters, Confirmation of Financing.

Most unamended contracts entitle the GC to be provided satisfactory proof of project financing, use it. That reference in the CCDC 2 is GC 5.1.

Push to get the information you need to make a decision on the Project and be prepared to share that with the other contractors on the Project.

What will this mean for my current Bond Facility, and my ability to get support going forward? Will surety 'tighten up'?

Prior to COVID-19, the surety market has been relatively soft, at least compared to historical trends. That said, the COVID-19 pandemic will undoubtedly have a financial effect on the entire construction community, locally, nationally and globally.

As a result, it is reasonable to predict a cascading effect on the surety community, since economic strain on contractors leads to contractor defaults, which leads to surety claims.

While it is too early to see any material behavioral change from surety underwriters, be prepared for a tougher surety market over time. Be prepared to answer a wide range of questions to help the underwriter assess the impact on your business, such as:

- Do you have a COVID-19 strategy / safety protocol in place for your office and job sites? Reach out to us for a good template, if you need one.
- Operating Line Utilization and Dependency
- Working Capital and Balance Sheet Resiliency
- Capital Replenishment Contingency Plans
- Work on Hand and Progress Reports
- Change Orders on Projects
- Business Planning for Getting Through 2020. How are you testing your path forward?

Other resources:

The NASBP (National Association of Surety Bond Producers) has a number of very insightful pieces surrounding the construction and surety business and COVID-19, including, "Navigating Business through a Global Pandemic: Advice for Contractors".

Please visit: <https://www.nasbp.org/informed/coronavirus-coverage> for that and other articles.

Contact your Mitchell & Abbott Advisor with questions or concerns. We are here to help.

LET US HELP YOU MANAGE YOUR RISK

2000 Garth Street, Suite 202,
Hamilton, ON L9B 0C1
1-800.463.5208

mitchellandabbott.com
navacord.com
mail@mitchellabbottgrp.com