# Construction sector is critical to SA's post-COVID economic recovery

Traditionally, the development of risk management plans is tailored to address assessed and quantified risks. There is however always the 'the unknown factor'. Enter the COVID-19 pandemic. Of course, we have faced localised pandemics before, but never one on such a globally synchronous scale, thanks to global travel and trade. It propelled the entire world into unchartered territory as mass economic and travel lockdowns were implemented, and contingency plans were hurriedly rolled out. For many industry sectors and businesses already teetering on the brink, it has been a crisis of unprecedented scale - a black swan event that simply cannot be quantified or dealt with, without the benefit of hindsight.

According to Michael Viterenwa, Senior Broker in Aon South Africa's Construction & Engineering Broking Centre, Government is the biggest spender on infrastructure in SA's construction industry. "With the onset of our national lockdown, government diverted infrastructure spending to alleviate the economic and social crisis facing the country, cutting traditional expenditure by 80%. This brought a large portion of the country's economy, including the construction industry, to a grinding halt. At the same time, restrictions on construction activity under lockdown regulations added further pain. Projects were left standing, deadlines were missed – the consequences of which are enormous."

Viterenwa goes on to detail some of the emerging and concerning trends impacting the construction industry – and while many existed prior to Covid-19 - they are now exponentially amplified:

- **Community Forums** – Better known in the industry as the 'construction mafia', local 'community forums' have been springing up around virtually every construction project – from a commercial project to the roll-out of fibre in the suburbs. Members demand their cut of the 'work' pie by applying pressure to contractors to employ local 'community' members, many who do not have the experience or skills required to perform the job. If contractors don't comply, they are typically threatened with disruptions and even the safety of their employees and projects – some of these disruptions and threats are so severe that contractors are either forced to comply at huge cost, or in some instances, abandon the projects entirely as the situation becomes untenable and not worth the risk. It's a serious and growing threat to the construction industry and the much-needed infrastructure development in SA – law enforcement, local authorities and construction bodies need to find common ground to resolve this issue and regulate the practice – the practice is likely to worsen as South Africa shed a further two million jobs in the last quarter alone.
- **Pricing** – With work and projects in short supply, pricing wars are leaving contractors exposed to the risk of unexpected costs or delays, that are often met with penalties that contractors will simply not be able to meet. Cutting corners and costs inevitably means cutting skills, quality and safety.
- **Currency** – The Rand's declining value against the US Dollar (26% in the last five years) has severe financial implications for an industry that relies on the import of machinery and specialised materials.
- **Supply Chain -** Given the global nature of this crisis, supply chains across all geographies have been disrupted with extended and costly delays on key components and materials, not to mention skills.
- **Credit Risk -** The failure of businesses across the spectrum is bringing capital availability problems into sharp focus. Accounts receivable is often the largest uninsured

asset on a company's balance sheet, constraining cash flows and having huge implications for creditors when debtors go into business rescue or liquidation.
- **Skills Shortages** – Uncertainty and volatility around politics and economics are likely to widen SA's growing skills shortage as an exodus of skilled people takes place. Companies are under pressure to afford and retain top talent. Increasing crime rates and growing social unrest as a direct result of the Covid-19 fallout are likely to further push skilled people into the arms of emigration to seemingly safer shores and better social structures.
- **Property Portfolios –** During lockdown, many companies gave up their office space in a bid to cut costs as the work-from-home trend took hold. As a result, many companies are not spending on building new offices or renovating existing office space. It's likely to be a long-term trend as many corporates realise that staff can successfully work from home, and that prime floorspace might not be as necessary as once thought. Shopping centres and malls are also under severe pressure with many large retailers having to cull stores and jobs as a result of the lockdown and depressed consumer spending.

To say that times are incredibly tough and uncertain would be a gross understatement. In a bid to cope, many construction companies have cut capex by 50% – 60%, jobs have been cut, work hours have been reduced and property rentals in industrial and commercial properties are likely to never return to pre-COVID levels as remote working becomes part of the new normal.

"Construction companies, landlords, developers and contractors will need to explore ways of managing the impact and complexity of a radically changed environment. It is vital to engage with all relevant parties to renegotiate contracts and clauses. These may include authorities, owners, lenders, contractors, subcontractors, suppliers, clients, and so on. Aon Global Risk Consulting (AGRC) has been working with organisations to identify, assess and quantify the short- and long-term impact of Covid19 on construction projects which can then be used as a basis for negotiation with external stakeholders and help communicate the situation internally," Michael explains.

To this extent, the approach consists of:
- Identifying construction project components which can generate high financial impacts, from a cost and delay perspective.
- Preparing a register listing and justifying each high financial impact and grouped by generating component.
- Quantify the overall financial losses associated with each impact and creating multiple impact scenarios from a cost and delay perspective.
- Comparing the results of impacts quantification to the contingency plans in place and existing insurance policies.

Insurance matters related to projects that are still on the go remains a concern. "Many companies are opting not to renew their insurance policies due to cost-cutting, which could be detrimental to their operations on projects that are still in progress. Companies have a legal obligation to ensure that cover is maintained up to the conclusion of a project, as the financial and liability repercussions could be catastrophic if anything should go wrong," Viterenwa urges.

"The industry will pick up in the coming months and we are already seeing a commitment from Government to infrastructure spending, and positive signs on the energy front with a determination by mineral resources & energy minister Gwede Mantashe to procure 11.8GW of additional electricity in the coming years from Independent Power Producers. Government has also committed to expedite the implementation of at least 50 infrastructure projects with a total investment value of more than R340 billion in the coming months as part of South Africa's economic recovery plan.

"It is crucial that construction companies maintain their covers and conditions of cover as far as possible. As reinsurers and insurers prepare for their major renewal season in January 2021, they may find that they will not have access to the same type of cover, pricing and terms and conditions from insurers that they have now. A conversation with a professional broker that specialises in construction risk is crucial in order to anticipate any changes in policy wording, terms and conditions, pricing and potential exclusions to maintain a workable and affordable level of cover during these trying times, and to avoid the potential for costly and potentially uninsurable liabilities," says Michael.

As a key driver of South Africa's economy, and a key pivot in the country's post-COVID recovery, more than ever the industry sector needs to maintain and grow its resilience and embrace change to emerge leaner, focused, having mastered new technologies and a new world of work in a very different new normal. Suitably scoped insurance and risk management practices remain fundamental to being able to embrace risks for the opportunities they present in the coming months.

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