

March 16, 2020

IN-DEPTH UPDATE: The Impact of COVID-19 on Construction – Best Practices for Coping



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Construction

According to the Centers for Disease Control (CDC), the novel coronavirus virus (COVID-19) has been detected in more than 160 locations internationally, including in the United States. As anyone with a computer or television knows, the number of cases involving person-to-person transmission outside China has been increasing at such a steady rate that the World Health Organization has recently declared the outbreak a pandemic. Each day, the number of confirmed infections rises exponentially. Quite simply, all industries, including retail, hospitality, manufacturing, finance and professional services are suffering and will continue to suffer disruptions not seen in our lifetimes.

Not surprisingly, the construction industry will not be spared. The potential impact on construction is threefold:

- Possible labor shortages;
- Difficulty procuring certain construction materials and supply chain disruptions; and,
- A general financial downturn.

All of these factors are likely to impose undue financial stress on contractors, design professionals and owners alike.

We will briefly address these issues and offer some best practices for this new (and hopefully temporary) business paradigm.

Construction Industry Labor Issues

To prevent further spread of the virus, many employers are simply directing employees to work remotely or from home. While individuals in some industries can effectively work remotely, contractors and tradespeople, who must be onsite, cannot.

Prior to the outbreak, the industry had already been plagued by an aging and ever dwindling skilled labor pool. The probability of skilled laborers remaining at home to prevent further spread of the virus can significantly enhance the impacts of those existing labor shortages. This limited workforce can result in problems meeting project deadlines, putting further financial strain on a contractor's or subcontractor's business.

Having a small and potentially decreasing pool of skilled laborers available also raises safety and quality issues. In states where there are specific licensing requirements for specialty trades, it is even harder to replace trades who cannot get to jobsites or take new jobs. In an already tightening construction labor market, any further and widespread disruption will have a major impact.

Construction Industry Supply Chain and Materials Issues

In addition to labor shortages and financial burdens created by the virus here in the United States, the U.S. construction industry faces another potential hurdle involving difficulties procuring certain construction materials and supply chain disruption. China still remains ahead of every other country in total number of Coronavirus cases. As a result, many China-based factories and suppliers

have shut down or imposed government restrictions on where nationals can move for extended periods in an effort to curb further spread of the virus.

How does this affect the U.S. construction industry? On average, 30% of construction materials and components used in the United States come from China, including but not limited to timber, steel, plaster, drywall, insulation, lighting/electrical products and flooring materials. However, some construction companies get as much as 80% of their materials from China. This suggests there may be shortages of some building materials, supply chain issues and possible pricing increases.

While some factories have resumed operations, it is unknown whether their full workforce has returned or whether they are operating at some limited capacity and for how long. The alternative is to seek materials from American companies or companies located in countries not hit as hard, but it is not clear how available these alternative sources will be, especially with the crisis in America deepening.

General Financial Market Downturn

Obviously, you do not have to be an economist to understand that chaos in the financial markets may be the single most disruptive force facing the industry. These economic pressures will impede growth in both the residential and commercial construction markets.

A corporation planning on expanding or replacing existing facilities may decide it is either unwilling or unable to invest the capital in such a project. Developers may decide to hold off on office or residential construction. Lending sources may dry up. Homeowners will be less likely to build new houses or undertake the capital intensive remodels. Even public projects can be impacted by decreasing tax bases and increasing government costs during the crisis.

Economists for certain construction industry groups have pointed out that the commercial construction industry typically lags the overall economy by 12-18 months, which suggests that the major impact on the construction industry may be delayed a bit. Similarly, travel restrictions and governmental restrictions may also create impacts. On the other hand, many owners and developers will continue with projects to be in a good position when we come out the other side.

Best Practices

Although little can be done to eliminate the consequences of the spread of the virus, every owner, design professional, contractor and subcontractor should consider these best practices to limit project impact:

- **Good Communication**. Good communication between subcontractors, suppliers, general contractors and owners, is most important. Most problems can be avoided, or at least minimized, if there are candid discussions about which materials on a job are likely to be impacted and whether substitute materials can be used. If alternative materials are more expensive or aesthetically less pleasing, but readily available, and that alternative is raised early in the process, owners can make educated decisions as to whether completing the project faster, at a higher cost, or without some of the planned design features, is worth accepting.

Such discussions will also allow the owner to determine if it is better to put the entire project on hold for a period of time or delay a planned move. Accordingly, with good communication comes proper identification of issues when they arise. The parties should fully understand any notice procedures required by the operative contract. Not only does proper notice help with the prompt flow of information amongst all parties, depending on how your contract is drafted, you may also be waiving certain rights if your notice is improper.

- **Establish a Health Safety Plan**. Discuss implementing additional safety measures or sanitation procedures necessary to help in preventing further spread of the virus. Although this may seem minor, preventive measures such as increasing sanitation stations or limiting travel for certain employees reduce the likelihood of your workforce contracting the virus and can be an easy and cost-effective step in limiting potential delays caused by a sick workforce. This applies to the offices of owners and contractors alike, as well as to the actual construction sites.
- **Understand How the Contract Addresses Risk**. Ensure that responsibility for risk is spelled out in the agreement and understood by the parties. If you are the owner, consider what provisions may provide you with the most benefit while limiting

cost increases due to a potential delay. While we believe that it is likely that widespread disease would be considered an unforeseen condition or an event of force majeure (an act of God), even if not spelled out, it should be specifically addressed.

Likewise, owners may want to look at relevant suspension and termination provisions that may either delay a contractor's entitlement to cost increases for short suspension periods or, in the case of termination, limit the potential for future cost overruns with the hope of hiring a suitable replacement contractor.

- **Ask What Steps the Contractor Has Taken To Address Workforce Shortages**. Consider inquiring what plan, if any, a contractor has in place in the event laborers become ill and unable to work. Owners should also get a sense of how many employees the contractor has and how many current jobs on which those employees are currently involved. Incentives may be an option for meeting completion dates with a limited workforce as a contractor may be apt to re-allocate portions of his workforce to complete an incentivized project.
- **Insurance**. Talk with your insurance broker to discuss whether any insurance may protect you against project interruptions due to coronavirus situations. Business Interruption and Builder's Risk, to name a few, may provide coverage for a coronavirus outbreak on your project; however, coverage will likely be policy/project specific. Having an open discussion with your broker early in a project will help you best determine how you may be impacted if a situation arises. You should discuss the possibility of purchasing coverages that may be available in the market.
- **Maintain Detailed Project Delay Records**. Owners and contractors alike should maintain complete records of all costs and delays associated with a coronavirus outbreak on your project. To the extent there are disputes as to who is responsible for cost overruns and timing delays associated with an outbreak, having a full understanding, with backup, can be of great guidance when communicating with the other party.
- **Use Technology**. Reliance on technology can become an increasingly important tool. Not only can it help locate new sources for impacted materials, or alternative materials, but it can also serve as a tool to eliminate unnecessary site visits and/or meetings that may lessen the threat for infection. It will even enable better and more detailed communications between the parties.

In dealing with this unprecedented pandemic, owners and contractors must work together to minimize the potential impact on projects. Whether parties attempt to protect themselves through contractual provisions at the onset of a project or whether the parties engage in thoughtful discussions as a project progresses, open dialogue between the parties can help with identifying issues, preparing for problems in advance and otherwise protecting the current workforce. Most importantly, like in all other aspects of life during COVID-19, collaboration, understanding and patience are required.