28th Weekly Crisis-era Message to Contractors from: Dr Tom Schleifer
Reader Questions and Answers

Reader's Question: *COVID job-site protocols are costing us and slowing our productivity. A number of trade associations have studies that indicate costs may be as much as 30%. If project owners pay for these unforeseen conditions, we will make a profit on the existing work. Do you think we can count on change orders for these costs?*

Answer: I don't think anyone disagrees that there are costs associated with the required COVID job-site protocols or that they were unforeseen. Whether contractors will be compensated for them is a legal question and I am not an attorney. I do have some concerns. Over the many years my former firm represented sureties in the completion of bonded projects, we were exposed to thousands of claims against project owners and few turned out as initially anticipated. We collected information from the contractors and their attorneys on their evaluation of the likelihood of success, the amounts they expected to collect, and when they expected to be paid. Our experience was that many of the claims that were considered solid lost and as many that were considered weak won. Those that succeeded were seldom in the amounts claimed, and most took twice as long as initially expected.

No one hopes more than I do that 100% of contractors involved receive change orders in the full amount of their costs plus the associated overhead and profit. Some have suggested that if a few win then all will win, but I have not heard anyone say that if a few lose then all will lose. My speculation is that collecting for these unforeseen costs is not a sure thing, that results will vary from project to project, and when you will collect is also an issue. Unfortunately, I have also seen claims that were won long after the firm failed for lack of cash flow.

I suggest that you strictly adhere to the letter of, and intent of, the COVID job-site protocols and requirements and that you make every effort to minimize the costs of these requirements as you would any other project activity. I recommend that you manage and plan the financial aspects of your business assuming you will not be compensated for these costs and assume that if you are compensated you may collect long after you have a critical need for the cashflow. Scrupulously manage all costs on all projects and consider reducing the cost of doing business because cashflow will likely be tight unless or until you have strong indication that you will be compensated in a timely manner. To do this will require downsizing which, while distasteful, is better than the alternative. If you do collect in the future, great. However, business must be managed in the present. Borrowing to cover the cashflow is not an option, because if you do not collect, or do not collect enough, or do not collect for a long time it magnifies the problem by digging a deeper hole. *(Please no questions asking if I think this situation "fair". If project owners have to pay, they may ask the same question.)*

Reader's Question: *You say the construction market follows the [US] economy which, if it continues at the current pace, appears to be doing fine and the stock market seems to agree. Why are you so pessimistic about a construction rebound?*

Answer: The pandemic resulted in a serious setback to the US economy and the fundamental drivers of the economy (full employment, consumer spending, etc.) will not improve overnight. That the stock market has done as well as it has is fortunate but when the economic fundamentals don't respond as vigorously and as quickly, the stock market may (will likely) undergo another correction.

In the ninth crisis message I explained that: *Two things are required to support the construction market: The need for something to be built and the ability and willingness to pay for it. A decline in the US economy slows expansion in the private sector which reduces the "need" for new construction. In the public sector the "need" for construction such as infrastructure continues through an economic decline, but reductions in taxes and fees stall the funding of public construction.*

When the economy slows, funding and borrowing capacity in the private sector suffer from reduced sales and profits. Funding sources that remain available go unused by a reluctance to spend and caution to conserve cash. One of the first things to be cut is capital spending, which results in the loss of construction funding.

In the 24th message I added some specifics: *A combination of unemployment and business news indicates certain worsening economic conditions that will affect both the need for and funding of construction projects in the short and long-term future.*

The need for new hotels, movie theaters or amusement parks may take years to revive. The need for airport expansion, office space, shopping malls and cruise ship terminals will not be needed for some time with the potential that the need may be permanently altered. There is no telling what will happen with sports venues, public transportation, and convention facilities in the near and long-term future. The list goes on, but you get the point.

I know that my messages from the first might sound pessimistic, but they were projections using a construction market decline model that, as has become obvious now, was accurate; or may be described as realistic. Construction work will continue throughout the downturn. Just not enough to satisfy the industry's appetite which drives profits down. The construction market will rebound when the need for and the ability/willingness to fund coincide.

It is possible and logical for the industry to profit during the market decline, but it would require adjustments to our way of conducting business which few are interested in.

This crisis has become routine so in the near future I will be adjusting these messages to every two weeks and eventually monthly.

Next week: Reader's Questions and Comments. **Send questions/comments to** tom@schleifer.com.

To receive the free weekly Crisis Message send your email address to tom@schleifer.com.

Note: Overhead management *information is found on* ***letstalkbusiness.net*** *click on "Manual", then Managing Overhead in the table of contents.*

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