Australia’s construction sector: A Ticking Time Bomb?

Australia’s construction sector: A Ticking Time Bomb?

Demand for building works in Australia remains strong – but there are many challenges, and construction companies and subcontractors should recognise any warning signs and take early action if they are in financial distress, urges national business rescue/insolvency firm Jirsch Sutherland.

“The construction sector has traditionally accounted for a disproportionately high level of insolvency appointments – and it’s one that is of growing concern. Our fear is that these potentially terminal businesses may ‘infect’ their directors, owners, employees and stakeholders if action is not taken to address the financial imbalance. While the pandemic has been a big contributor to the issues the sector is facing, they were apparent even before COVID-19,” says Andrew Spring, Jirsch Sutherland Partner.

Spring adds that the pandemic introduced circumstances which many construction contracts did not anticipate, including issues relating to supply of materials, delay on construction sites as a result of site closures, and reduced capacity of workers as a result of legislative changes.

It’s a view echoed by Nelson Arias-Alvarez, Eakin McCaffrey Cox Special Counsel. “The COVID-19 pandemic caught out contractors and subcontractors who had accepted poorly negotiated contracts. Unable to meet contractual obligations, contractors and subcontractors have had to wear the costs of COVID-19 in terms of cost and time,” he says. “To make matters worse, in the aftermath of recent shutdowns, there has been an over-reaction to risk allocation with many post COVID-19 contracts. Contractors and subcontractors are asked to take on unrealistic risk and the financial pressures in the aftermath of COVID-19 means these requests are being adhered to.”

Infrastructure Australia has found that there has been a decline of 26 per cent of contractors meeting their contractual obligations*. Additionally, mandatory vaccinations for construction workers significantly contributed to delays, which has impacted construction programs and the potential liquidated damages being payable.

ATO debt

Spring said the issues are evidenced by the sector’s share of the Australian Tax Office’s debt attributed to SMEs, which was $21.4 billion as at FY20. One-third of the reported SME ATO tax debt at FY20 was housed in the construction industry. “Unfortunately, when it comes to the issue of non-payment, construction’s large-scale problems are very much prevalent,” he says. “Thousands of subcontractors have been forced into insolvency due to the ‘domino effect’ of bad debt down the line when building and construction companies fail to pay. By the end of 2021, employment in the construction industry is projected to fall by approximately 3.6 per cent*, and the fear is that the current climate is only exacerbating this.”

Arias-Alvarez says that coupled with the challenge of properly and fairly allocating risk, the construction sector, which is already one of the most heavily litigated sectors, is likely to see an increase in principals turning to onerous provisions in construction contracts to 'prevent' delay. "The result will be many projects likely to overrun, which may trigger contractual defaults at all levels of the contracting chain, adding pain to already squeezed bottom lines and working capital reserves," he says.

Spring and Arias-Alvarez point to five specific challenges facing the construction sector:

1. inflation, particularly following the rise in prices of raw materials due to a lack of supply;
2. labour shortages and unskilled labour as a result of lockdowns and closed borders;
3. finance and cash-flow;
4. contractors and subcontractors entering into contracts without proper consideration of risk allocation; and
5. contractors and subcontractors entering into unfair/one-sided contracts in order to start a business relationship, which can result in potential legal proceedings.

The warning signs

In an environment of multiple and potentially diversified projects, spotting the signs that a construction company is struggling may not always be apparent. "Monitoring project performance from tender to hand-over is essential in a time where many factors that are outside of a business's control can impact a project's financial success," Spring says.

Some warning signs to look out for include:

- any slowdown or delays in projects or deadlines that have lapsed;
- delays in payments to subcontractors or others in the supply chain;
- subcontractors refusing to go on-site;
- lack of contractor education and legal advice – contractors and subcontractors to readily accepting onerous terms.

"These signs indicate a company is struggling with its cash-flow and it's important to recognise them and take early action," Spring says. "While the ATO has taken a compassionate approach to its debt collection efforts during the past 19 months, that won't be the case forever. In fact, the ATO is already starting to send letters to businesses that are behind in their tax."

In circumstances where accrued liabilities, such as tax debt, are becoming apparent on a company's balance sheet, further questions around project profitability and pipeline forecasts are the next investigative step. "Often we see companies in this industry fall behind due to one or two projects that overrun on costs and/or timing, with the losses eroding all working capital and creating a proverbial 'rob Peter to pay Paul' scenario," Spring adds.

Early action

Identifying a potential problem early expands the options available for the business, ensuring that any financial contagion does not spread further than necessary. Options such as Safe Harbour, the Small Business Restructuring Process and Voluntary Administration are business rescue programs designed to protect companies and the people behind the companies in the event of financial distress.

“Our firm has vast experience in the construction sector, which means we can hit the ground running when brought in to help a construction company in distress or whose directors are unsure of their risk exposures, and we can suggest proven solutions to help rescue or put the company back on track,” says Spring.

**Infrastructure Australia, 2021*

About Jirsch Sutherland – jirschsutherland.com.au

Established in 1984, Jirsch Sutherland is one of Australia’s leading national independent insolvency specialists. The Jirsch Sutherland team works closely with small and mid-size accounting, finance and legal firms – and their clients – to provide a wide range of expert corporate and personal insolvency services including liquidations, voluntary administrations, receiverships and bankruptcy.

With head offices in Sydney, Melbourne, Brisbane, Newcastle and Perth, supported by a network of regional offices, Jirsch Sutherland’s national reach combined with a local presence underpins the company’s ongoing success. For over three decades, Jirsch Sutherland has earned a well-deserved reputation for protecting and guiding clients through the insolvency process in a fair and ethical way.

In Western Australia, Jirsch Sutherland trades as WA Insolvency Solutions (WAIS).

For further information:

Lisa Llewellyn

Llewellyn Communications

0419 401 362

lisa@llewcom.com.au