



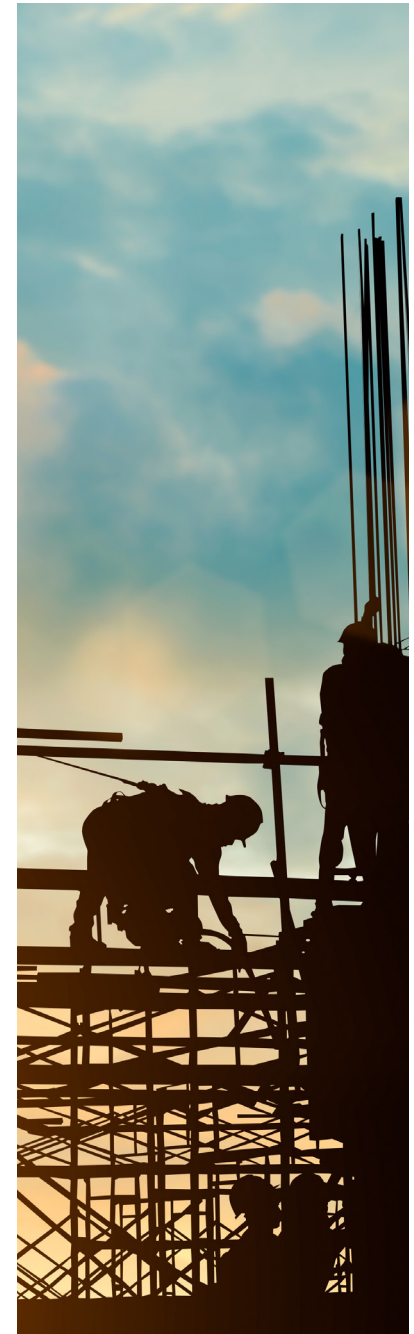
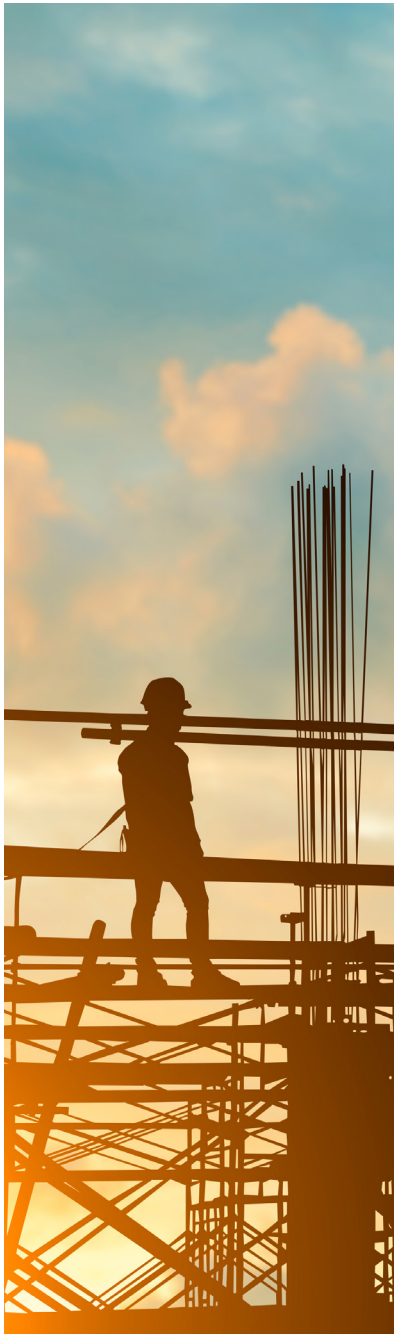
# The BDO 2020 Construction Survey Report

**BDO**



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# FOREWORD



**JAMES MACQUEEN**

Construction and Real Estate  
National leader

This is the third year of the BDO Construction Survey, focused on the vertical or building sector. The survey questions were divided into two parts: (1) the state of the sector prior to the impact of COVID-19, and (2) the initial consequences of and responses to the impacts of COVID-19. The data collected pre-COVID will be a useful benchmark for a high-tide mark from which to measure our eventual recovery.

Fortunately, despite being very challenging, the recent period of growth had left most industry participants in their strongest financial position for many years. That financial strength will be critical to the resilience of the sector and its participants through the next economic cycle, as participants' greatest concerns relate to the reducing pipeline of future work and reducing margins required to secure work, both of which could fuel a 'race to the bottom'.

Without doubt, the COVID-19 pandemic has had a significant impact on the sector, as it has with most other sectors. What it has done is focused attention on, and magnified the issues which have existed for some time in the construction sector, being;

- the importance of strong cashflow
- allocation and management of risk
- the adequacy of gross margins for a sustainable sector
- resilience to the shocks
- staff; skills and availability
- funding performance bonds and retentions

For the sector to experience a strong recovery, decision makers in the industry need to make a collective effort to ensure businesses' profitability and sustainability.

The survey responses made it clear that participants want to be measured and win work based on their non-price attributes as they are confident they have strong professional businesses, great teams, and can deliver well-built projects.

We would like to express our gratitude to everyone who participated in the collection of the data for this year's survey. Your contribution has ensured that we can produce an informative report to help guide the sector. We trust the results presented in this report will provide a useful insight into the reality of the NZ vertical construction sector at present.

# KEY INSIGHTS



- The greatest impact of COVID is **uncertainty of future work**
- 69% had contracts **cancelled or delayed** due to COVID-19.
- **Number 2 concern** is falling margins
- The '**race to the bottom**' is at risk of being underway
- 25% plan to **reduce staff numbers**
- **42% (twice as many)** projects with delays over 3 months compared to 2019
- **90%** needed to apply for the wage subsidy
- 58% **cancelled or delayed** salary increases
- **Costs** from unreasonable transfer of risk **increased**
- 70% have had a **bad experience** with an engineer to a contract
- **31% reduced** or delayed dividends
- 92% have **adequate bonding capacity**
- **85% can pay** their creditors when due
- The **forward work** pipeline (pre-COVID) improved
- Balance sheet **resilience** is **UP**
- The majority wish to be compared based on **non-price attributes**



# REPORT BREAKDOWN

The BDO 2020 Construction Survey Report aims to create an accurate snapshot of the current state of New Zealand's vertical construction sector and the organisations within to find opportunities for growth and improvement, particularly considering the unique challenges the industry and the nationwide economy at large is currently facing due to the global pandemic.

## WHO PARTICIPATED?

Shareholders/directors, as well as senior staff members from all sectors of the vertical construction industry participated in this survey. This includes a strong mix from the housing and commercial sectors, head contractors (60%), subcontractors (20%), and others.

## WHEN AND HOW WAS THE SURVEY CONDUCTED?

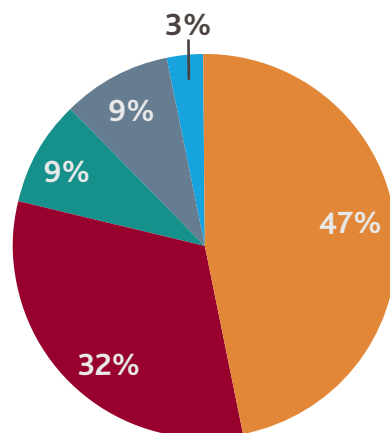
Data was collected during July and August 2020, following the first lockdown to try to control COVID-19. This allowed us to collect pre-COVID as well as post-lockdown data from our participants.

Questions were digitally sent to the survey participants.

# COVID-19 AND THE CONSTRUCTION SECTOR

## THE IMPACT OF COVID-19 ON PREVIOUSLY CONFIRMED PROJECTS

The industry started the year with a high level of forward confirmed work. However, projects that were previously confirmed started being cancelled or postponed. This was an almost immediate impact of the pandemic and the imposed restrictions.



Have you had previously fully confirmed projects cancelled or postponed with no known start date by your clients arising from COVID-19?

- Yes, but so far, we have sufficient work to remain in business and remain profitable
- Not yet
- Not yet but have had communications suggesting this is likely
- Yes, we do not currently have sufficient work to remain profitable but plan to persevere
- Yes, and it is on a scale where our business must significantly restructure or will likely be forced to close

12% of respondents lost over 25% of future projects by value and a further 24% lost projects between 10-25% by value.

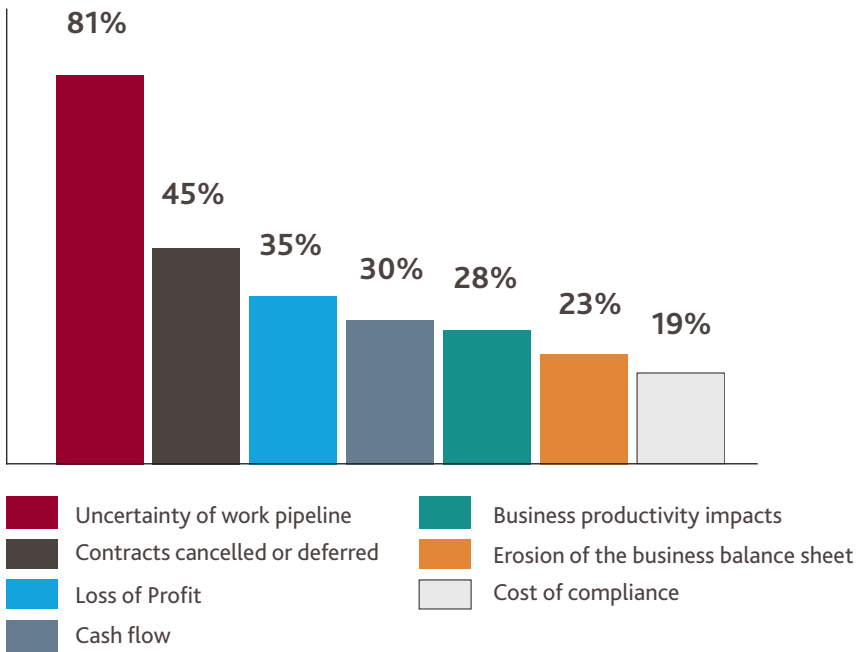


## THE MAIN IMPACTS OF COVID ON BUSINESSES

The question on the main impacts of COVID-19 on businesses in the sector revealed very telling results.

It is the uncertainty of the work pipeline which is the greatest impact and will be the sector's biggest challenge.

Cancelled or deferred contracts contribute to this uncertainty as well. Loss of potential profit is a natural consequence of the two.



The results may change over time as the country adapts to a new economic and operating environment. Currently, businesses are also adapting and determining strategies to manage many of these impacts.



## WE ALSO ASKED ABOUT THE MAIN CONCERNS

Industry players are facing forward work challenges, impacting procurement & gross margins

Forward work, reduction in gross margins, and “low ball bidding” are at the top of the list of concerns.

The greatest concern identified by our respondents was forward work, which has impacted 81% of businesses. While half of our respondents had work for a further 6 months, most expressed significant concern about what will happen once this period ends.

Furthermore, many of the simmering issues discussed in previous surveys have come to the fore and will continue to be an issue until addressed, such as staff quality, cost of compliance, etc.

### CONCERNS OVER THE POST-COVID ECONOMIC OUTLOOK ARE HIGH ON THE RADAR

Not only has the pandemic caused clients to delay or cancel future projects, but some businesses are also still in the process of recovering lost profit and restabilising cash flow.

The risk of future outbreaks and lockdowns also remain ever-present. Economic weakness and uncertainty are an overarching concern.

### LOW-BALL BIDDING IS SPEEDING UP THE 'RACE TO THE BOTTOM'

Many respondents raised the concern of gross margins falling as the number of new projects coming onto the market becomes scarcer, creating more competition where the lowest price wins. Some industry players are struggling to win work that will enable them to remain profitable.

This ‘race to the bottom’ has been an ongoing concern in the past few years, and has only been exacerbated by the effects of COVID-19.

### THE BALANCE BETWEEN STAFF QUALITY VERSUS QUANTITY IS PRECARIOUS

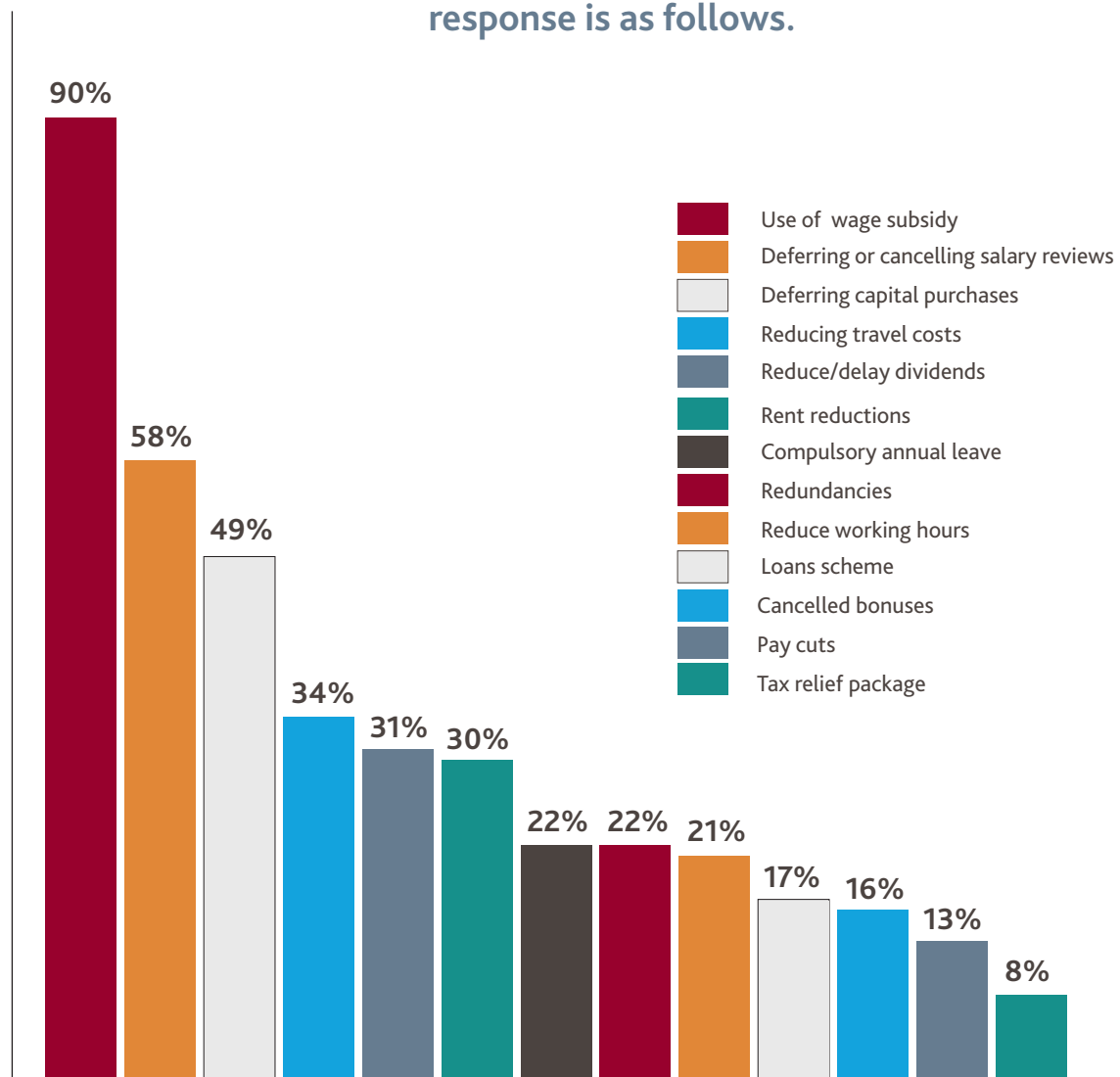
In 2019, the greatest challenge identified by our respondents was staffing. While the availability and quality of staff is still a concern to many of our respondents, it is not as significant as our surveys from the last two years.

Many respondents are still highly concerned about finding high performing/qualified staff despite the economic slowdown. On the back of that, however, many of them also expressed the challenge of how they can keep staff employed with the wage subsidy ending and lack of forward work.

Keeping the balance of acquiring/retaining quality staff as well as profitability will be an ongoing challenge for the foreseeable future.

## MEASURES TAKEN TO OFFSET COVID-19 ISSUES

We asked business owners what measures they'd taken within their business to offset COVID-19 issues, and their response is as follows.



The importance of the wage subsidy to keep people in employment during the initial period of uncertainty is immediately apparent.

Due to payroll costs being the largest controllable overhead and driver of costs, many companies were quick to look at further cost savings, particularly around deferring or cancelling salary reviews. Some also reviewed the need for future staff and started commencing a redundancy process.

There were also active steps among directors of maintaining strength and resilience in their balance sheets, with over 30% of companies reducing or delaying proposed dividends, and half deferring purchase of new fixed assets, plant and vehicles.



## FURTHER CONCERNS

### RISK OF BOTH HEAD & SUB-CONTRACTOR FAILURE

Both head contractors and sub-contractors expressed concern around the potential financial failure of their counterparts. Trust needs to be built here through honest communication between contracting parties to reduce anxiety and focus on successfully completing projects to a high standard. The concern also extends to clients being unable to meet their obligations.

### INAPPROPRIATE TRANSFER OF RISK

Increasing levels of risk are being pushed into the sector and down the chain. This occurs via contractual risk, design risk and project risk such as poor ground conditions. The cost of this risk transfer is covered later in this report.

### COMPLIANCE IS COSTING TIME AND MONEY WHILE BUREAUCRACY AND PAPERWORK ARE TYING UP RESOURCES

Respondents expressed concern over the increasing cost of compliance. Due to the competitive nature of the current market, high compliance costs cannot be passed to clients.

In addition, local government rules and bureaucracy for consents push out time frames and thin the pipeline of available work. Respondents are finding it very difficult to deal with Councils' red tape and processing times.

These cost and resource requirements are detracting from getting the work done and are creating capacity issues in an industry that's already experiencing staffing issues.

### THE SKILLS SHORTAGE ALSO EXTENDS TO LOCAL GOVT AND OTHER PROFESSIONALS IN THE INDUSTRY

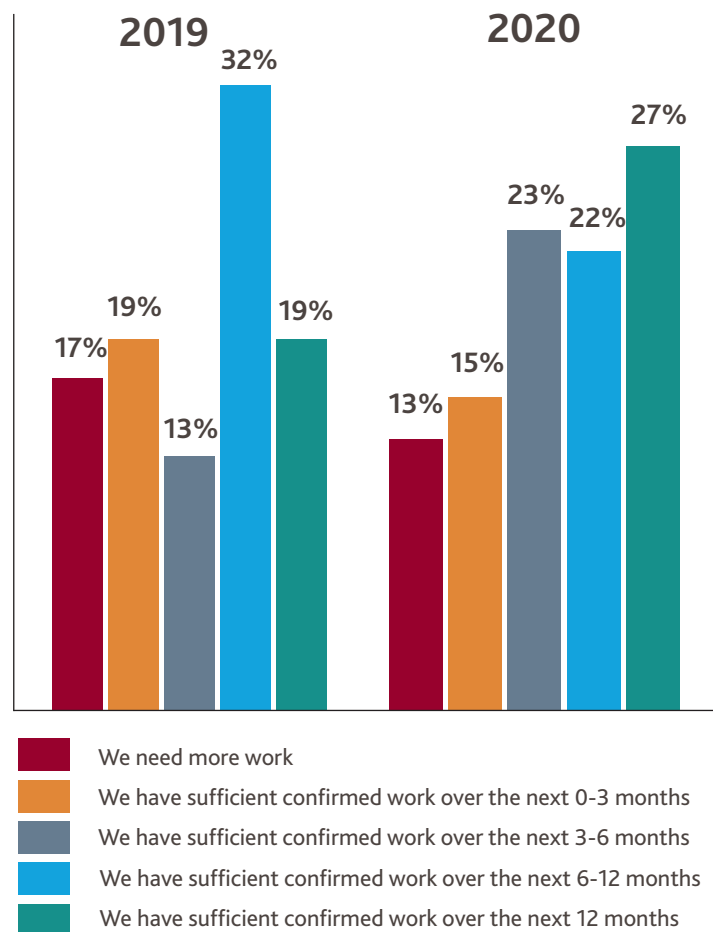
Many respondents raised concerns regarding the poor quality of design documentation, including coordination issues and incomplete work done by design consultants.



# CONFIRMED FORWARD WORK

Our survey asked respondents about their forward work position in the coming months to a year, accounting for the immediate impact of COVID.

The results show a slight improvement on our 2019 survey, with **27% of respondents in 2020 saying they had more than 12 months profitable forward work, compared to 19% of respondents in 2019.**



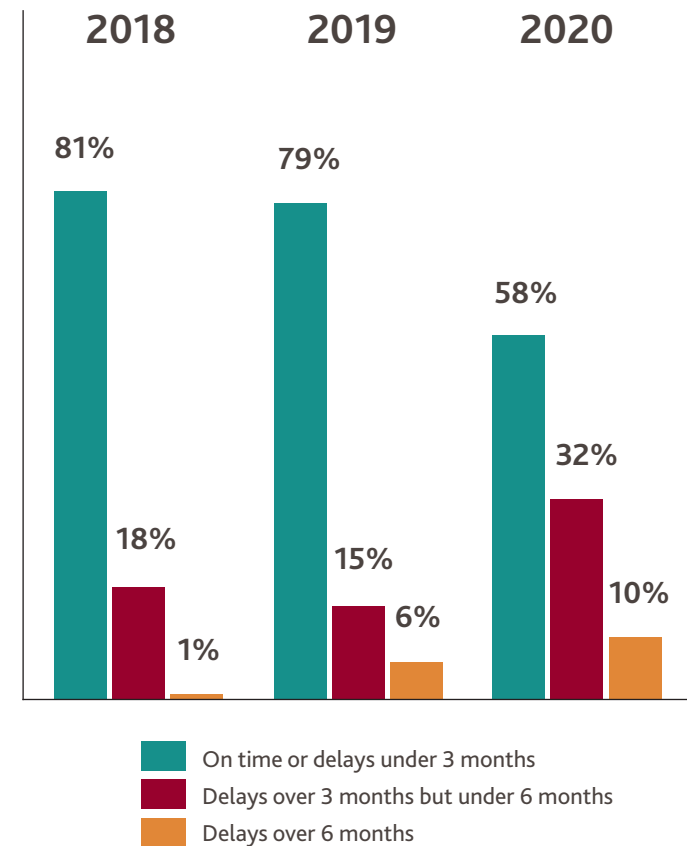
Some sectors, particularly the private commercial projects, are showing a marked decline in opportunities.

It is pleasing to see how many of our respondents have started the current economic cycle with a strong forward work position.

However, almost all of these contracts would have been entered into pre-COVID. The real challenge for the industry from a forward work perspective is that insufficient new opportunities will come onto the market once these contracts have been completed.

## PROJECT DELAYS

There has been a significant increase in delayed projects relative to the previous years. Causes include staff and capacity constraints as well as bureaucratic delays, mostly during the consenting phase.



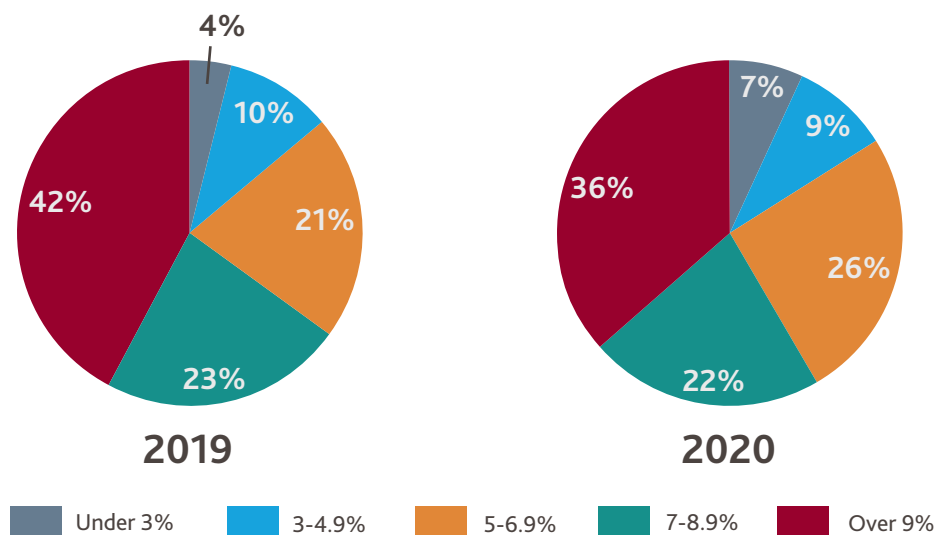
# GROSS PROFIT MARGINS

Pre-COVID gross profit margins for both head contractors and sub-contractors indicated that the sector had a satisfactory financial year.

## HEAD CONTRACTOR MARGINS (PRE-COVID)

To gauge the profit margin levels prior to COVID-19 for head contractors, we asked, "When competing for new projects as at Feb 2020, at what margin were you missing out on winning the contracts?"

The median for winning or losing contracts for head contractors was a gross margin between 7 to 9%. The pre-COVID threshold between winning or losing a new contract can be seen below.



This shows general stability from 2019-2020 following the trend of improving margins evident between our 2018 and 2019 surveys.

We also asked our head contractor participants to provide their gross margin % from the 2020 financial year. The average gross margin for head contractors is between the 7% to 9% range, which is consistent with the preceding question.

These profit margin levels meant that 2020 was a satisfactory financial year for many in the industry and has allowed balance sheets to be strengthened. This has been necessary for the level of risk involved and the underlying overheads and balance sheets required to support the activity levels.

When we dig a little deeper, we identified the following trends:

- Those obtaining better margins appear to be larger companies. This is likely to be because they undertake larger, riskier projects which many smaller companies don't have the resources to take on.
- Margins for the housing sector are generally higher than the commercial sector. This is likely to be because of the smaller scale of the housing projects and less use of subcontractors, so the housing sector requires a higher margin in comparison.
- There is general consistency when analysing margins between different regions in NZ.
- Performance on projects was on average at margins close to or slightly above project budget. This is expected, as projects are usually priced in anticipation of finding some efficiency gains during the project and with risk factored in. As these risks are resolved, the extra margin is released. It is concerning, however, that close to 10% of the respondents have noted that most of their projects ended up well below the budget.

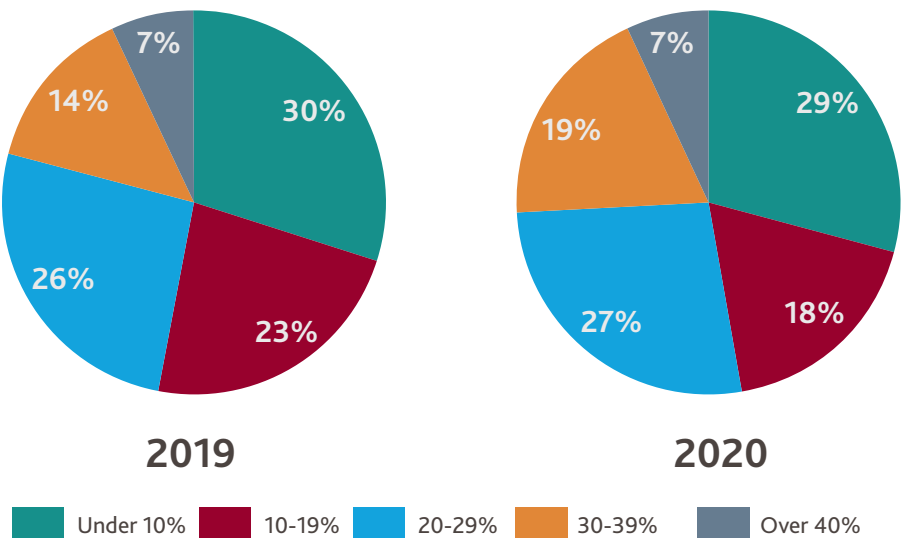


## SUB-CONTRACTOR MARGINS (PRE-COVID)

To gauge the profit margin levels prior to COVID-19 for subcontractors, we asked our respondents, "When competing for new projects, at what margin were you missing out on winning the contracts pre-COVID?"

The median for winning or losing contracts for subcontractors is a gross margin between 20-29%. This is consistent with our 2019 survey results. The average subcontractor margins from our survey for the 2020 financial year is 24%.

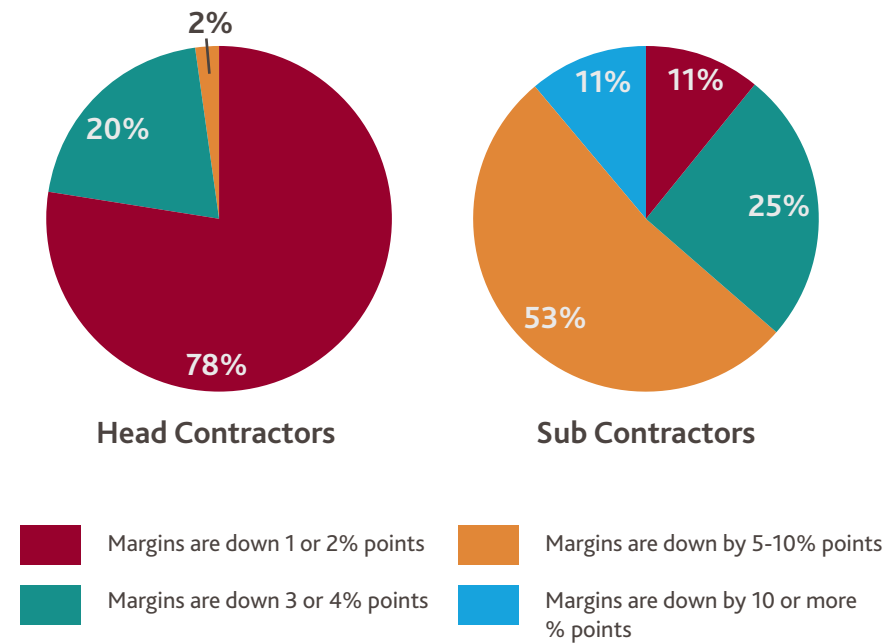
Subcontractors generally have a much lower turnover than head contractors and also generally have a higher proportion of overheads to sales and so need a higher margin to be profitable.



## PROFIT MARGINS AFTER COVID DISRUPTED THE ECONOMY

To understand the effects of COVID-19 on the profit margins in the industry we asked our respondents, "What are the expected profit margins on projects tendered or negotiated subsequent to the lockdown in April 2020?"

### IMMEDIATE CHANGE IN MARGINS ARISING FROM COVID-19



## LOW BALL BIDDING IS ON THE RISE POST-COVID

From recent discussions with industry participants, the early trends of lower margins arising from COVID identified in the survey are continuing, which is concerning and dangerous. The margin-cutting actions of a few are now forcing others to do likewise. Clients seem to be taking price into consideration in awarding new contracts, which accentuates this.

There are too many companies (head and subcontractor alike) that are now pricing low simply to secure work when they should not do so. This is likely driven by a desire to ensure a continual flow of work comes through so employees are kept occupied and there are no quiet patches, especially in current times where there may be gaps due to previously secured projects that have been lost or delayed due to COVID-19.

There is currently a lot of emphasis being put on price to win work, with risk not being priced correctly. Even very experienced companies who understand the dangers are undertaking similar approaches to ensure that they secure sufficient work.

It is hard to understand how some of these companies will remain profitable after accounting for their overheads at these new margin levels and likely lower activity levels.

This is especially applicable to the head contractors competing for projects at margins three or more % points lower than they were prior to the lockdown, and the sub-contractors competing for projects at margins ten or more % points lower than they were prior to the lockdown.

This can create a 'race to the bottom'. Some of these new margins are unsustainable and will put in question the financial viability of many companies. This will amplify the wedge driving the separation of the sector between robust and fragile businesses. *(See next page.)*

The failure of one industry participant has a detrimental effect to many others in the industry. The domino effect to the industry caused by the failure of head and subcontractors is significant.

To avoid this, the message is clear—the industry and its participants should be more selective with the projects they choose to work on and not take on new work just for the sake of keeping busy to lose money. They should also put less of an emphasis solely on price and price their projects after accounting for the relevant risk. This is going to require significant reconfiguration of some businesses to survive.



# NEW ZEALAND'S DUAL TIER CONSTRUCTION SECTOR

## GAP WIDENING BETWEEN GOOD OPERATORS WITH ROBUST BUSINESSES AND FRAGILE BUSINESSES

We introduced our dual tier summary as a way to summarise many of the findings from our previous surveys.

It has proven effective in identifying weak companies and the factors that need to be urgently addressed to ensure future survival.

Low-ball bidding will quickly reduce resilience and increase fragility.

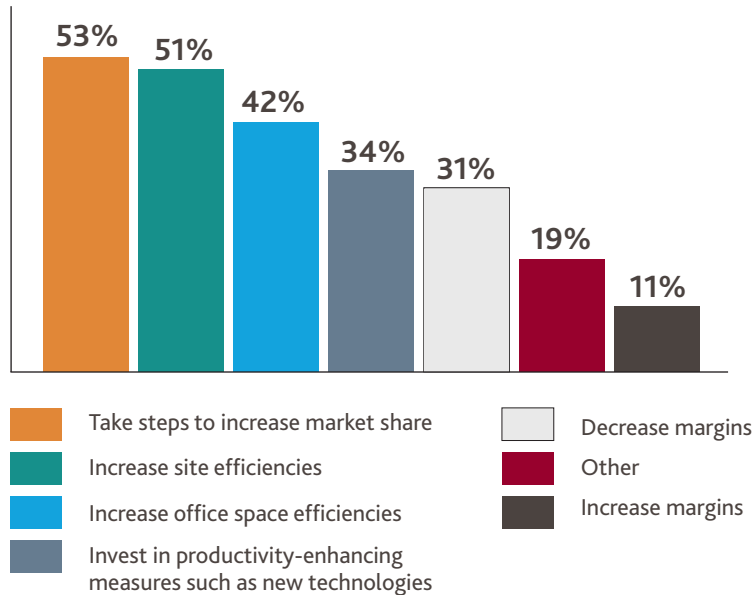
Strong governance and speedy action will be needed to address the forces of the downward spiral, build resilience, and strengthen both the industry and its individual participants.





# INITIAL STRATEGIES TO RESPOND TO COVID-19 IMPACTS

The strategies that respondents initially identified to mitigate the impacts of COVID-19 on their business are set out in the following graph.



The other strategies included reducing overheads, expecting administration staff to do more with less resource, attempting to reduce dependence on competitive tendering and focus on strategy, increasing business development activities, and slight diversification. A few have expressed that they will simply “take the hit” and carry on as usual.

With the benefit of hindsight, increasing margins is unlikely to succeed as the emerging market trend subsequent to the collection of our survey data is decreasing margins.

The focus on greater efficiencies, however, is an enormous opportunity for the industry and will require focus to properly implement.

The industry has lagged compared to other industries in productivity improvements in recent years. There are new technologies, particularly in areas like Building Information Modelling (BIM). The current situation provides an opportunity and incentive to innovate, identify and implement these improvements.

In general, we see too many industry participants not understanding and not using their software and other technology correctly, so we encourage both adoption and correct use of the new technologies to maximise the benefits to be obtained. Initially reducing margins was only adopted by a few but anecdotally others are being forced to match this behaviour to win work.

## THE INDUSTRY IS ALERT TO ITS NEEDS TO ENSURE SURVIVAL AND GROWTH

When we asked our participants what the industry should do to reduce the number of failures in the future and the way the industry operates, we received an overwhelming response of positive constructive comments.

Industry participants have a very good sense as to what is required. The challenge is to translate these good, well-considered ideas into action and gain the support of clients, consultants and other relevant parties.

These initiatives should not be further undermined by enabling and accepting behaviours that encourage the ‘race to the bottom’ through focus on lowest price and inappropriate transfer of risk.

# PARTICIPANTS SUGGESTED STRATEGIES FOR THE SURVIVAL AND GROWTH OF THE SECTOR

## GENERAL STRATEGIES

- A better collaborative approach across all facets of the industry to focus on the best for the project outcome rather than an adversarial approach currently taken between consultants, contractors and subcontractors.
- The industry needs to become more resilient and build balance sheet strength.
- Increase efficiency at the tail end of projects to ensure compliance does not hinder final payments.
- Favour New Zealand-owned businesses.
- A licencing scheme for commercial builders that includes an independent review of their finances and gives each company a rating.
- Continued focus on affordability and confidence in residential housing/development.

## MARGIN MAINTENANCE STRATEGIES

- A need to maintain margins at sustainable levels as we are already seeing members starting to reduce margins which will ultimately lead to their failure.
- Contractors not taking work at low margins to drive the industry profitability down.
- Promote value add tenders rather than lowest price conforming tenders.
- Avoid re-tendering as it keeps driving margins down.
- Pricing needs to be realistic so the contractor can make a fair margin to stop the 'race to the bottom'.
- Increase non-price attribute weighting on tendered work.
- Discard the lowest price in procurement.

## GOVERNMENT PROGRAMS

- Comments both for abolishing retentions and strengthening the retentions regime.
- Change contracts at Government level which are crushing the head contractors to an untenable level.
- Include more vertical construction projects in the Government "shovel ready" list.

## RISK REDUCTION STRATEGIES

- Contract conditions need to have a more equitable transfer of risk.
- Main contractors need to push back when the risk is unfair and not priced in.
- Ensure conditions of contract are fairer and then contractors act fairly.
- Less bullying of subcontractors and less transfer of risk.

## BRIDGING THE KNOWLEDGE GAP

- Share knowledge better across the construction sector so that lessons can be learned before it becomes an issue for other businesses in the industry.
- Educate an inexperienced participant to grow slowly.



# PROCUREMENT

## LOWER PRICE VS. NON-PRICE ATTRIBUTES

In recent years, there has been significant debate on procurement processes and the basis on which contracts are awarded. Historically, the priority was on lowest price rather than non-price attributes. Over the last few years, however, there has been an increased focus on non-price attributes. Scepticism has remained as to whether they are truly considered and valued by the market.

To gain greater understanding of the market, mostly from the perspective of construction companies and subcontractors, we asked "Which of the following procurement initiatives are affecting your business?"

Increased focus on lowest cost	37%
Deviation from standard contract terms	31%
Increased recognition of non-price attributes	24%
Increasing use of panels amongst local Government and CCOs	22%
A shift towards social outcomes	20%
The inclusion of more environmental outcomes	18%
Bundling of contracts	18%
Increased early contractors involvement	15%
Greater focus on whole of life costs	8%

There is a real risk in a lowest price approach as some business failures are inevitable and the strength of a company's financial position is becoming more important.

These responses were based on an understanding of the industry before the impact of COVID-19 had forced big changes in the industry. At the current time, there is intense competition based on price. Anecdotally, the focus on lowest price seems to have even greater prominence recently.





## PROCUREMENT METHODS TO AVOID LOW-BALL BIDDING & 'RACE TO THE BOTTOM'

We asked participants which procurement method can help stop low ball bidding which sends companies closer to the brink of failure.

### FOCUS ON NON-PRICE ATTRIBUTES

Over half the responses and the overwhelming preference was greater focus on non-price attributes. Whilst this should be common sense, there is an obvious theme that non-price attributes are not given the weighting, or are perceived to not being given the weighting, that they deserve.

It is also a testament to the strength and professionalism within the sector that companies, not only are willing, but wish to be compared against their peers based on non-price attributes. There were a number of comments relating to financial strength, health and safety methods/certifications, smart construction methodologies, and quality.

### TENDERS AND FIXED MARGIN

Very few suggested tenders as a method to stop this practice. Of those that did, some thought the lowest price should win the job and an equal number believed the lowest price tender should be discarded and the 'next one up' considered. This is not an uncommon pattern where most tenders are in a tight price range and one tender is much lower, either because they made a mistake, or they were desperate to win a project to keep their team busy.

Fixed margin was more commonly preferred than tenders. This approach does allow a heavy emphasis on non-price attributes and or ECI, while still maintaining a tight control over project cost.

### DESIGN & BUILD APPROACH

A few favoured design and build approaches where the design risk is incorporated into the contract. One preferred this so that consultants are financially tied to the final outcome, which seems to be a reaction to current challenges with incomplete design or drawings being provided prior to construction.

### EARLY CONTRACTOR INVOLVEMENT

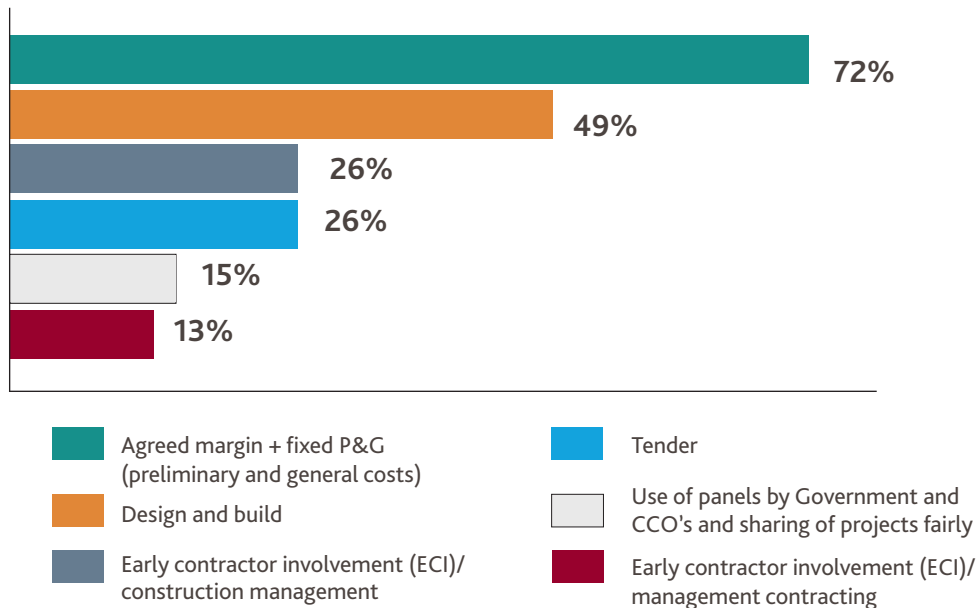
The second most frequent suggestion was more ECI (early contractor involvement). The benefits of this are obvious; it leads to better quality work (as finding the optimum design, materials and construction methodologies that provide the client with the best outcome during this stage), as well as better whole-of-life outcomes.



## THE BEST PROCUREMENT METHOD FOR THE BEST CLIENT OUTCOME

To provide an opportunity for the industry to give feedback to its clients, we asked,

**"What procurement methods will give the client the best outcome?"**



The agreed margin approach enables better allocation of risk as it allows:

- mutual selection of preferred subcontractors,
- unforeseen issues to be efficiently and openly resolved, removing the need for the contractor to price in that possibility and reducing the risk to the contractor of the cost of such issues,
- reflection of current industry pricing,
- building time optimised for the client, e.g. the extra cost of a crane to accelerate the build time can be the client's decision,
- better accommodation of non-price attributes.

For more complex projects, ECI has significant benefits to the client and sharing of projects amongst contractors by large clients allows better allocation and use of resources in a geographic area.



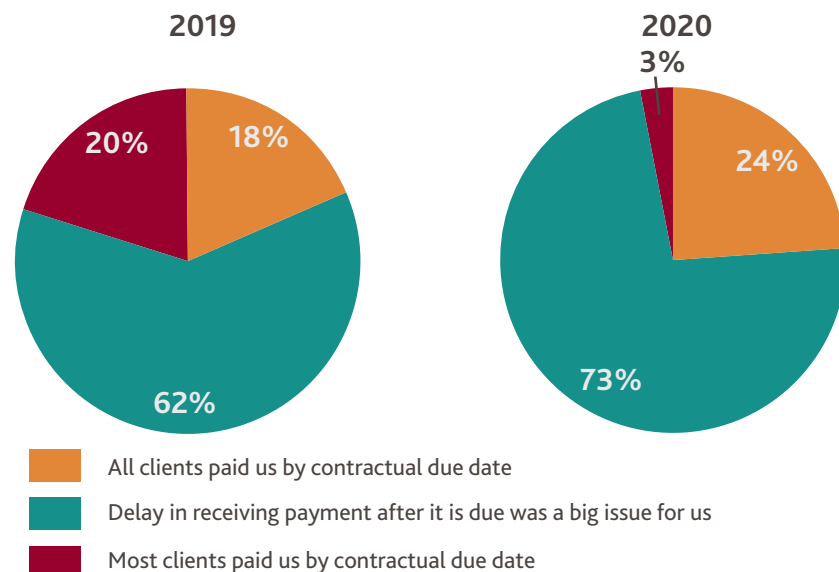
# CASH COLLECTION AND CASH RESOURCES

Cash is king in the construction sector, especially in a time of significant economic downturn caused by COVID-19. Companies with a large cash reserve and strong balance sheet should be more resilient against shocks in the industry.

## FEWER PAYMENT DELAYS

In the construction sector, there is a contractual due date for payment and industry practice is to pay by this contractual date.

In our 2020 survey, only 3% of our respondents have said that delay in receiving payments was an issue for them prior to the lockdown in April 2020. This is a very significant improvement from 2019 when 20% of respondents had indicated delays in receiving payment being an issue.

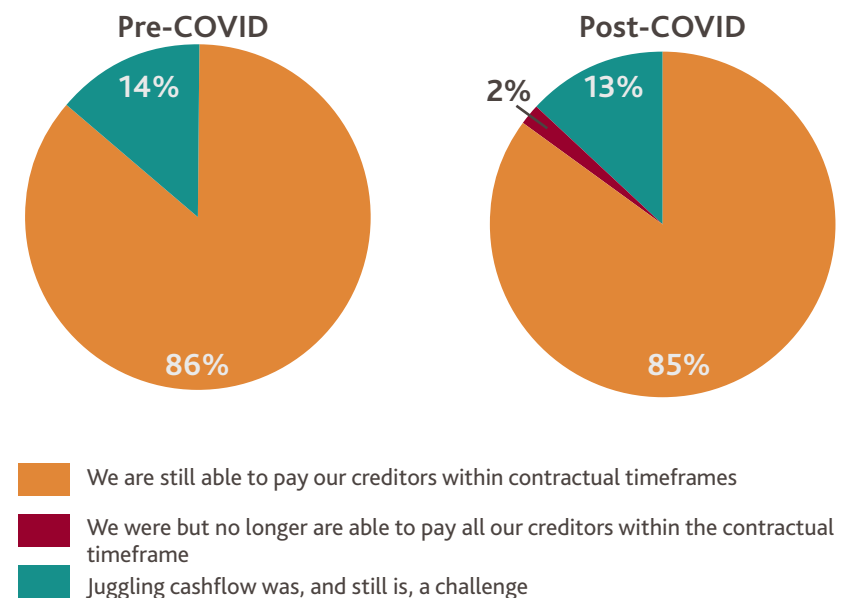


## CASH PAYMENTS

To report on our respondents' cash resources before COVID-19, we asked them about their ability to make payments when due.

86% of our respondents were able to pay their creditors within the contractual timeframe, with the remaining 14% indicating cashflow challenges.

This is an improvement when compared to last year when 35% of the respondents indicated challenges with cashflow. This positive trend also indicates that the majority were in a healthy cash position going into the lockdown.

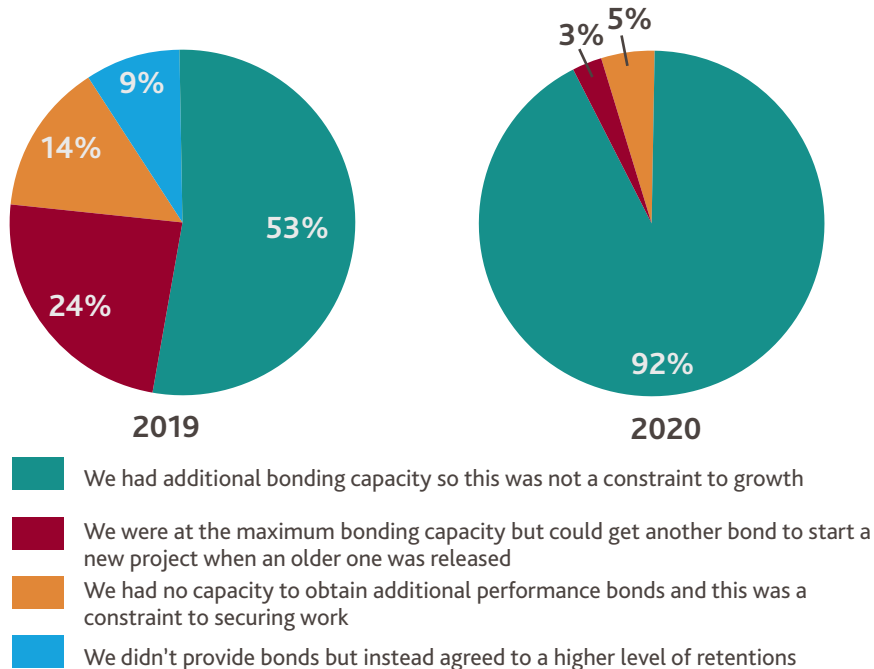




# ABILITY TO PROVIDE PERFORMANCE BONDS

Pre-COVID, 9 out of 10 of those respondents required to provide performance bonds had additional bonding capacity.

92% of our respondents who needed to provide performance bonds had additional and/or spare bonding capacity, prior to the lockdown in April 2020. This is a significant increase from 53% measured in 2019. The high proportion of the respondents having spare bonding capacity is encouraging. Profitable trading in the last year is likely to have helped achieve this improvement.



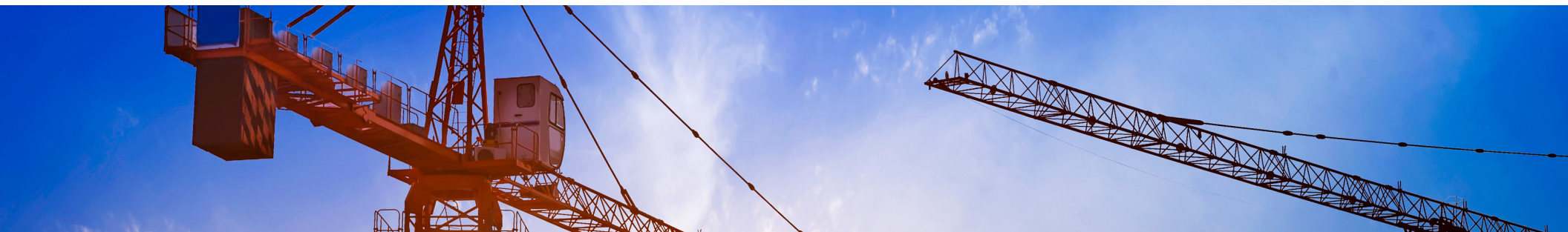
## POTENTIAL CHALLENGES TO ACQUIRING PERFORMANCE BONDS POST-COVID

Based on our discussions with banks post the lockdown in April 2020, they have indicated that they are taking a more cautious approach going forward with the level of performance bonds they are comfortable in issuing and the additional security they require. This is due to their previous losses as well as perception of the risks facing the construction industry, and may make obtaining performance bonds more difficult.

To test this, we asked our survey respondents whether obtaining bonds has become significantly more difficult in the current COVID-19 impacted environment. Luckily, only a few have indicated this to be the case. While this is encouraging, it may be too early to see the full impact.

Going forward, we anticipate that before renewing existing bonding arrangements and/or increasing the bonding limits of its customers that bond providers may:

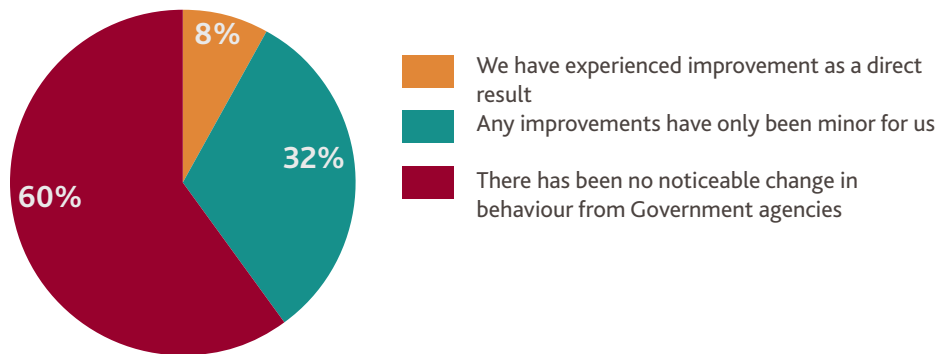
- ask for more security,
- have tighter financial covenants, and
- increase financial reporting requirements.



# CONSTRUCTION ACCORD

The Construction Accord was launched in April 2019. To help implement it, the Construction Sector Transformation Plan was launched in January 2020. The Accord was long overdue in terms of improving cooperation between Government and quasi Government organisations and the sector.

There has been significant scepticism, however of the 77% of potentially impacted respondents, the responses were as follows:



There was a variety of comments made by the participants, from the Accord being a “talk fest” with no real benefit, through to comments that there now appears to be more willingness on the part of Government organisations to engage. They also report some minor improvements in contract terms and payment arrangements.

Notwithstanding the survey observations, the industry leaders working with the government have made some significant progress including the protocols developed to allow the sector to return to projects at Alert Level 3 lockdown.

With the prospect of less work in the sector overall and a greater proportion of government projects, there will be additional pressure on the government to ensure that its practices help maintain a healthy sector and don't encourage some of the behaviours that lead the ‘race to the bottom.’

# RISK MANAGEMENT

## CHANGES MADE TO RISK ACCEPTANCE AND MANAGEMENT

When asked, “In light of COVID-19, what changes has your business made to risk acceptance and management?”, 27% of respondents advised that no change had been made, presumably because they already had appropriate risk acceptance and management strategies in place.

For those who had made changes, these were implemented in the following areas:

- Improving health and safety processes including investing in new processes
- Greater selectivity of clients and subcontractors to minimise risk
- Greater scrutiny and selectivity of contract risks
- Greater use of technology
- Increased focus on liquidity and cash flow
- One mentioned increasing their risk profile to secure more work.

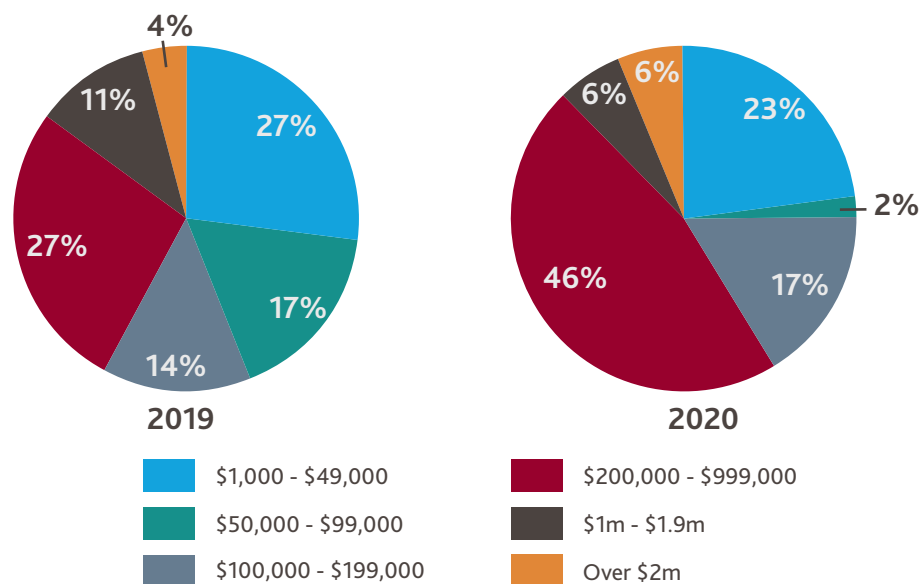


## UNREASONABLE TRANSFER OF RISK

A defining difference between the current and previous construction cycle is the allocation of risk. Clients and their consultants push as much of the risk down to the construction companies as possible, and these businesses, where they are able, try to push the risk further down to the subcontractors.

To determine the extent to which this is a real rather than a perceived problem, we asked the question, "How much do you estimate that unreasonable or inappropriate transfer of contractual risk has cost your business in the last year?" The focus of the question is on the word "unreasonable". 44% (2019 60%) did not identify any cost, and an analysis of the remaining 56% (2019 40%) is shown in the graph.

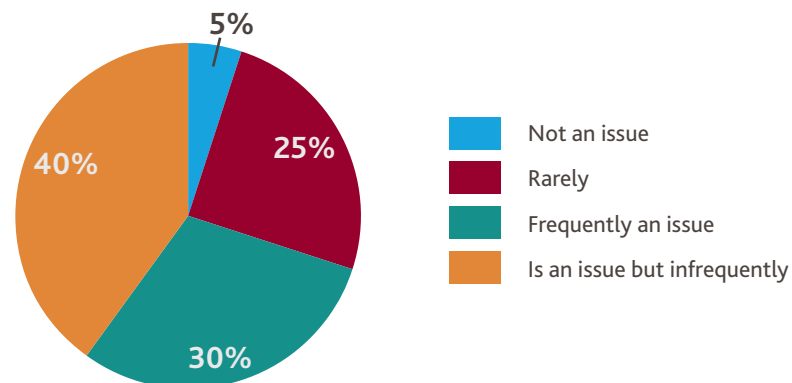
There is a clear trend of both an increase in the frequency of unreasonable transfer of risk and the cost of those situations.



## ENGINEER TO THE CONTRACT

The engineer to the contract is a person appointed under the standard form contract: NZS3910: 2013. They are usually appointed by the principal and have two key functions: agent for the principal and an impartial quasi-judicial decision-maker. Because they must act in the best interests of the principal, yet be an impartial administrator of the contract, there is an inherent clash of responsibilities when difficulties arise. This is particularly the case where there is a dispute between the contractor and the principal which is referred to the engineer for his determination.

### How often do you question that impartiality?



These responses indicate both the importance of construction companies being happy with the proposed engineer to the contract before the contract is signed but also the importance to the client that a suitable person is nominated.

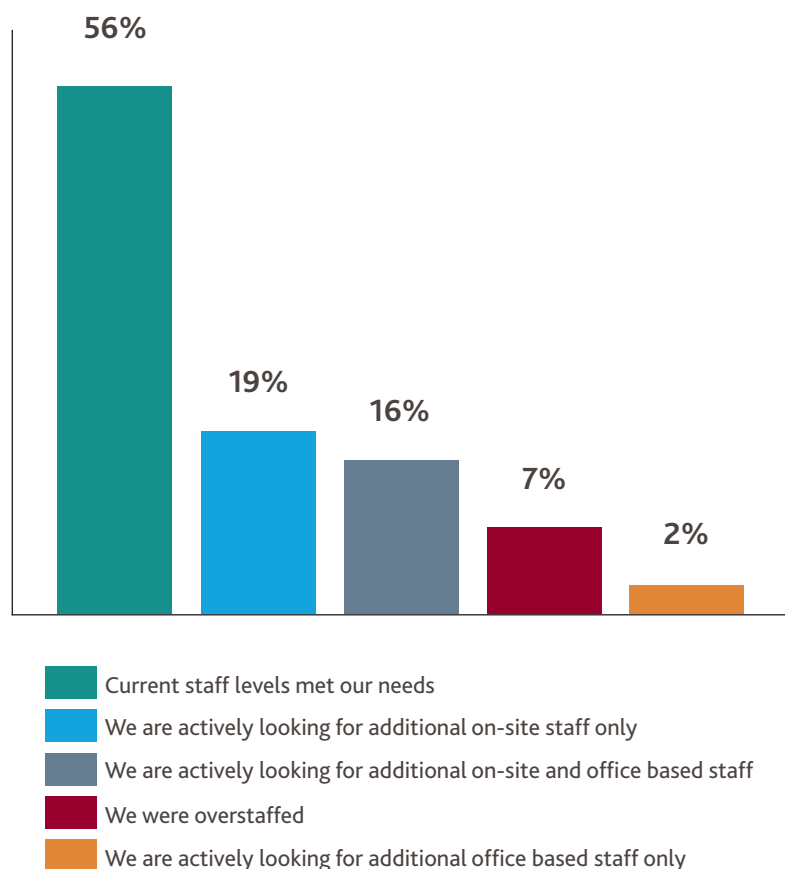
This approach will not resolve all issues. Once an engineer to the contract has been appointed, there is usually very little that the construction company can do if the engineer fails to act impartially.



# STAFF

## STAFF VACANCIES PRE-COVID

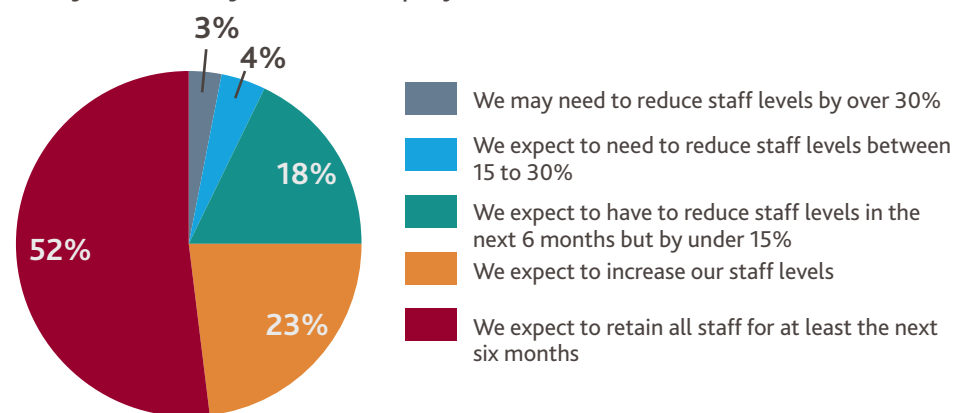
Pre-COVID, 55% of our respondents said that current staff levels met their needs, with a further 35% actively looking for on-site staff. This is down from our 2019 survey, where 39% of our respondents were looking for on-site staff.



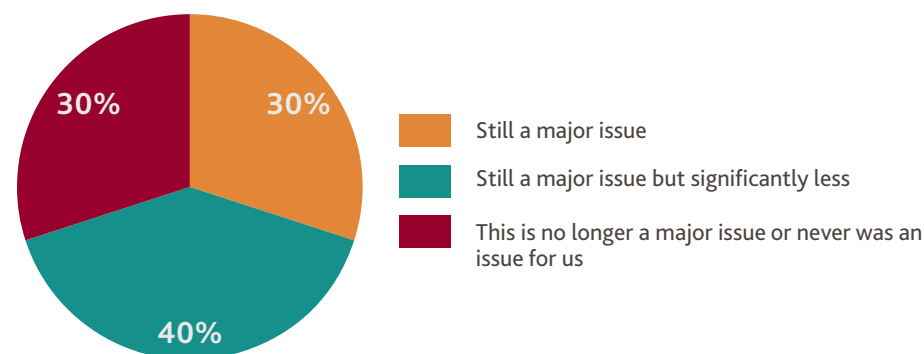
## STAFF LEVELS POST-LOCKDOWN

The position deteriorated after the first lockdown. 25% of construction companies surveyed said they expect to reduce staff levels over the next six months, compared to just 10% saying they were over-staffed pre-COVID.

The number of respondents looking to increase staff members has decreased from 37% pre-COVID to 23% post-lockdown. This is likely driven by uncertainty over future projects.



The availability of sufficient appropriately skilled staff is still a concern for our respondents, with 70% considering it a major issue in the industry.

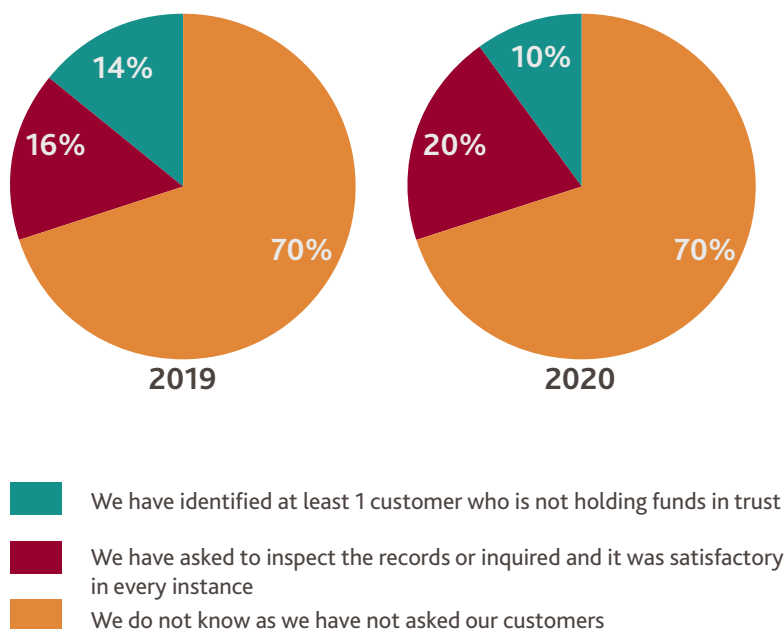


# RETENTIONS REGIME

The Retentions Regime has been in place since April 2017. The regime places the onus for enforcement on those that have retentions from their progress claims by giving them the ability to inspect trust records at any reasonable time.

**70% still do not inspect that funds are held in trust.**

There appears to be no clear explanation as to why companies do not do this, as a high portion of their profit will be within the retention receivable balance.

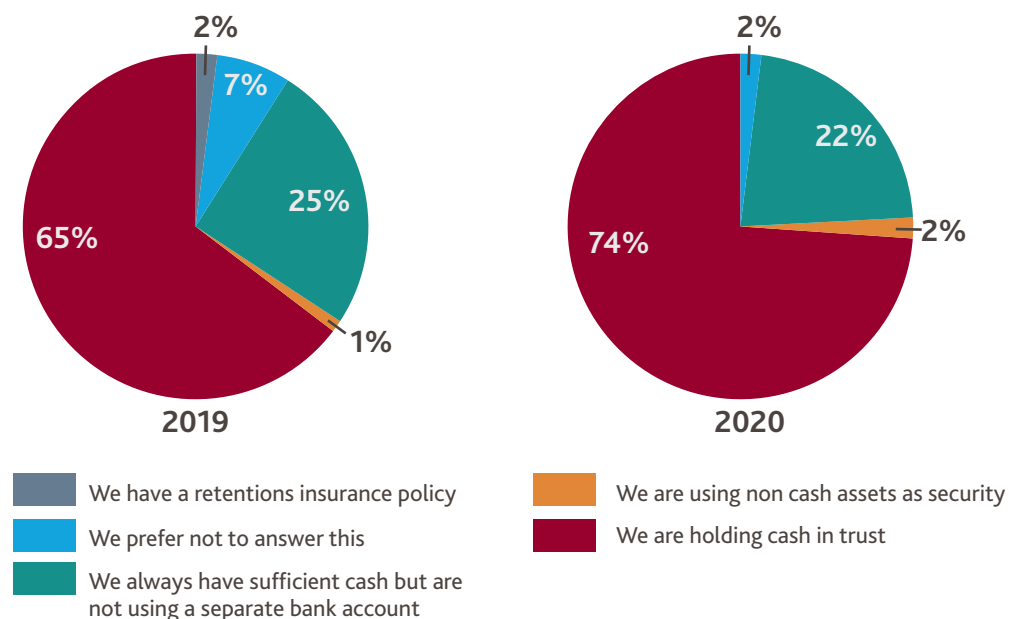


## SIGNIFICANTLY IMPROVED COMPLIANCE

Compliance with the Retentions Regime continues to improve. In 2018, just 72% of respondents who had retentions payable held these funds in trust; this has improved to 93% in 2019 and 98% in 2020. This is a clear indication that the Act is now understood.

While the majority of our respondents hold retentions owed in a separate account being 74%, a further 22% are intermingling these funds with other cash held. While this is currently allowed under the Act, it is not considered best practice.

The government announced proposed modifications to the regime in May 2020 including strengthening how retention monies are held which will impact the 22% that intermingle and there is a proposed penalty regime with fines of up to \$200,000 for companies and \$50,000 for directors. There is no mention of other necessary modifications, including administering retentions in an insolvency situation. Further details are still awaited.



# THE BDO CONSTRUCTION TEAM

## JAMES MACQUEEN



Advisory Partner,  
Construction and Real  
Estate Sector National  
Leader

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### Qualifications

Chartered Accountant (B.Com)

Member of NZIOB

Member of NZ Society of Construction Law

### Executive Summary

With more than 40 years of advisory, business services, tax, corporate finance and audit experience, James maintains a proactive partnership approach with his clients who benefit from his multi-disciplinary range of services and experience across a wide range of industries.

James passions include construction, manufacturing and family business. He has great insight into the issues and challenges facing these sectors. James develops a very close relationship with his clients and provides practical and pragmatic advice.

His clients appreciate his strong industry expertise and look to him for leadership in emerging issues.

## NICK INNES-JONES



Advisory Partner and  
Construction Specialist

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### Qualifications

Chartered Accountant (B.Com, LLB)

### Executive Summary

Nick has more than 14 years' business services, audit, business recovery and restructuring and commercial experience in New Zealand and overseas.

He works with a range of clients in a wide variety of businesses, including property, construction & family businesses. Nick is involved with corporate finance transactions and general business advisory work.

Nick worked for BHP Billiton, the largest company in Australasia in various finance roles for three and a half years working in London, Johannesburg and Australia. He returned to Auckland in 2013, joining BDO to focus on construction and corporate finance.

## HUSAIN SUTERWALA



Advisory Manager and  
Construction Specialist

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### Qualifications

Chartered Accountant (B.Com)

### Executive Summary

Husain is an Advisory Manager in the construction team where he works closely with James and Nick. He has client service responsibilities for many of the more complex construction groups and is frequently the first point of contact for a wide range of issues raised by clients or which they need assistance with.

He has a strong understanding of the IFRS financial statement issues impacting construction companies, the tax issues which are particular to the industry and the construction specific software packages commonly used. He assists with many of the succession plans, valuations and banking negotiations which arise. Clients appreciate his direct and comprehensive advice on a wide variety of issues for both head-contractors and sub-contractors as well as developers.



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