



COVID-19 AND SUBCONTRACTOR DEFAULT INSURANCE

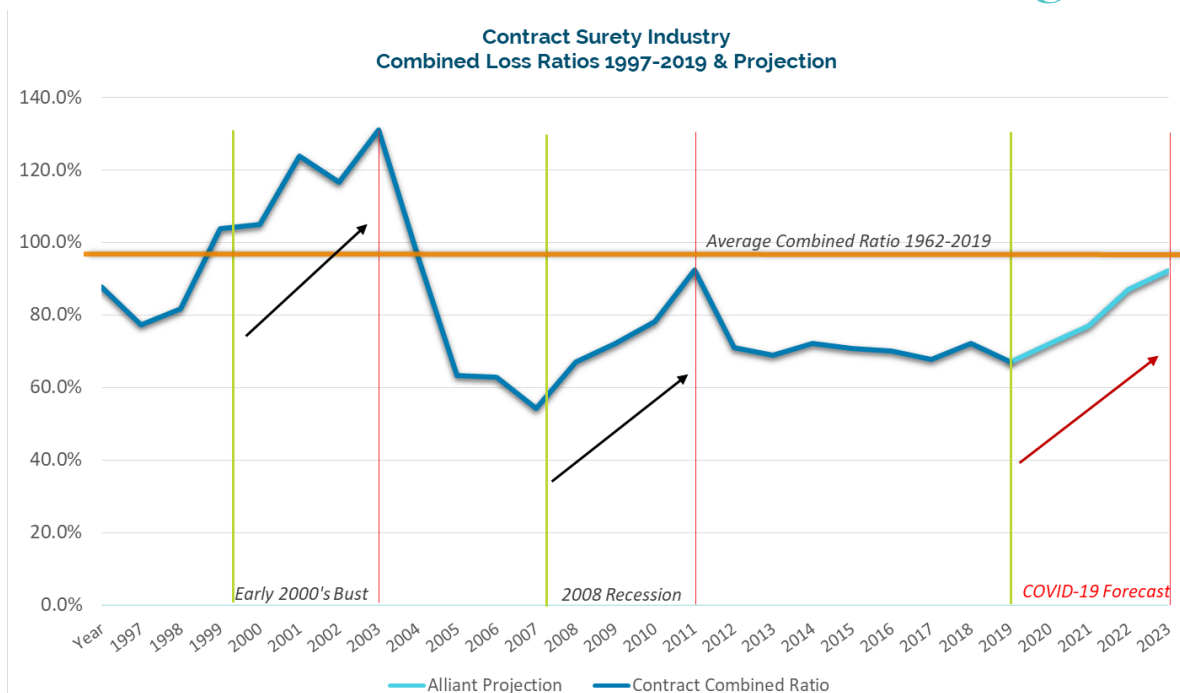
What to do NOW, in 3 Days & in 3 Months

Alliant Guide for Claims Avoidance and Mid-Crisis Management



The sudden halt in the economy caused by COVID-19 will create a much steeper decline of economic output than the 2008 recession. The subcontracting community and the providers of Subcontractor Default Insurance and subcontractor bonding will be severely impacted by COVID-19. According to industry analytics from the recessions of 2000 and 2008, the losses for SDI carriers and surety markets peaked during the economic recovery - not heading into or during the downturn. Using this historical data, Alliant created a 2020 Forecast for SDI and subcontractor bond claims.

**When we get to the other side of
COVID-19, stalled projects will need to be
reenergized.**



*Historical data provided by SFAA and forecast modified by Alliant.
Forecast subject to stimulus impact and adoption by contractors.*

What To Do NOW

It is imperative for construction managers and general contractors to closely monitor subcontractor financial stability, liquidity and ongoing performance. With the SDI product, understanding aggregation exposures, SDI policy limits and policy periods - in real time - is essential.

Subcontractors will need liquidity to push through this crisis. We are hopeful that the impact to our clients, friends and all stakeholders in the construction sector will be short-lived. When this crisis subsides, and we get to the other side of COVID-19, the stalled projects will need to be reenergized. The cash burn caused by a combination of financing overhead during the work shutdown, contract disputes, funding unapproved costs and restarting projects will be considerable. During this remobilization phase, construction managers must closely monitor their subcontractors' liquidity needs.

COVID-19's harsh ramifications on the construction industry is unprecedented. A year from now, construction executives will want to look back and confirm they did everything possible to manage through the crisis and position their company for recovery. The instability in the industry will require new solutions to developing market fluctuations. In order to mitigate unfunded schedule impacts and project delays in your existing work portfolio, make timely decisions and take required action today to address that risk.

Prepare.



DOCUMENT, DOCUMENT, DOCUMENT AND PREPARE! You can't fix something unless you know what's wrong. The COVID-19 crisis continues to manifest and will require real-time out of the box thinking and creative solutions. Every executive will have to rely and lean on the staff, connect virtually and brainstorm even more to identify the consequences of this pandemic. Broad collaboration with trade contractor partners and vendors is a necessity. More than ever before, the advice provided by legal counsel and trusted insurance broker partners is critical to risk mitigation, and the successful navigation of the COVID-19 crisis.

Plan.



Every contract and subcontract should be reviewed in detail. Reduce the critical contract terms to an executive summary and share with your organization's leadership. Cross reference key contractual challenges and focus on aligning with high quality subcontractor labor, material and vendor relationships. We strongly encourage construction management firms to triage portfolio projects for contract and subcontractor issues, and determine which contracts require immediate attention. Identify the projects with the most exposure and use the downtime during a shutdown to create a comprehensive risk mitigation strategy.

The Next Three Months. ACT



Cash management will be even more critically important over the next three months. Knowing and documenting "where you are" on a project with the owner and all subcontractors when the work was shutdown is vitally important. During the shutdown(s) and eventual remobilization, CM's should consider creating multi-purpose teams that cross over departments. Work to create a seamless connection between operations and finance in order to identify and avoid potential losses. Your company must operate as one team, and work closely with both legal and insurance brokers partners to develop a multi-dimensional plan to survive the economic slide. As you develop your COVID-19 strategy, don't lose sight of potential opportunities during the slowdown. You may find some attractive investments in this period of instability that will help your firm emerge from the crisis a stronger company.



Surety Program Strategies to Help Get Through the COVID-19 Crisis

Sureties underwrite on character, capacity and capital. Contractors with strong leadership, high integrity, good transparency and solid reputations with owners and subcontractors will be well-positioned to weather the COVID-19 industry downturn.

We discuss below:



SURETY CONCERNS



PREPARATIONS YOU CAN TAKE



15 QUESTIONS TO THINK ABOUT

Main Surety Concerns

- » CPA's ability to finalize financial statement in a timely manner
 - Inability to do field audits and facilitate client meetings
- » Slowing of bidding and proposals that could lead to shortfall in 2021
- » Acceleration of work, as owner expect contractors to make up for lost time and meet schedules without adequate compensation
- » Liquidity: Stress placed on Banks by increased borrowing
 - Banks with accordion features may restrict additional lending
 - New loan capacity may be unavailable

Prepare

- » In depth analysis of contracts to ensure timely notice provisions are met to inform owners of the possibility for:
 - Schedule delays
 - Labor impacts
 - Supply chain distribution
- » Updated financial projections that include best case, worse case and probable case scenarios based on the COVID-19 crisis
- » Banking, covenant compliance, available headroom and additional flexibility from the bank to get your firm through a liquidity crisis

15 Questions to think about before you talk to your surety provider

1. What are your contingency plans to deal with work stoppage?
2. Is your company's office staff prepared to work remotely?
3. What strategies have been developed to retain workers that are temporarily laid off?
4. If government inspections are suspended, have you identified an outside consultant to provide inspections to maintain social distancing guidelines?
5. Have you evaluated your Force Majeure clauses in your contracts and initialized discussions with owners and subcontractors about time extensions and change orders for project demobilization and remobilization costs?
6. What case law precedent exists in the states where work is progressing with respect to Force Majeure clauses?
7. What subcontractor risk management strategies are being followed to replace, supplement or finance subs with liquidity problems? Be prepared to discuss your Subcontractor Default Insurance (SDI) program or sub bonding program. Please note that SDI allows CM/GC's to default and finance an insolvent sub without having to terminate the subcontract.
8. What supply chain issues do you see on the horizon with material suppliers? Are there acceptable alternatives?
9. What steps are you taking to prequalify owners/developers that may not have sufficient funding to manage through the crisis? Are you monitoring and preserving lien and bond rights where appropriate?
10. What steps are you taking to reallocate resources from suspended work?
11. Have you considered asking for deferred or delayed equipment rental charges on idle equipment?
12. If work has been suspended, are these projects gated and locked down with appropriate security?
13. Have you followed Alliant's project shut down check list?
14. Are you mentoring any of your challenged subcontractors through this crisis?
15. What additional health and safety protocols have you put in place to protect your employees from the virus?



Subcontractor Default Insurance Checklist

Communicate, Communicate, Communicate!!!

- Project Executives
 - Identify the leaders within your organization and review status of their major projects
- Subcontractors
 - Aggregate subs across your portfolio
 - Be in daily contact with the firms that compromise your highest concentration of subcontractor exposure
 - If you pre-qualify, pull those scores.
- Although pre-COVID-19 scores may not mean much individually, the subs with more favorable scores will likely last longer vs. subs with less favorable credit ratings
 - Midterm Qualification (Corona Qualification) Requests
 - Business Continuity Plans (Contingent on Situation)
 - Workforce Status
 - Runway (current overhead)
 - Cash Flow evaluation/Breakeven point
- Identify Subcontractor Risk
 - Low Risk: Manage on their own
 - Medium Risk: Require your support
 - High Risk: Replace with better option
- Owners
 - Aggregate owners across your portfolio
 - Identify Owner financing and project continuation risk

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Limits/Duration of Coverage Sufficiency

Are there any currently enrolled subcontract values that are more than 2X the per claim policy limit?

If yes, consider additional risk mitigation strategies including joint checks or direct material purchases to reduce exposure and preserve limits for performance risk.

Is the aggregation of enrolled sub values for any one subcontractor in excess of 2X your per claim policy limit?

If yes, consider bonding some of this work for projects in the early stages to reduce aggregation exposure.

Is the aggregate policy limit 15% or more of the total enrolled subcontract value in the policy term?

If not, the aggregate may not be sufficient for the heightened default exposure from COVID-19. Consider bonding larger packages to avoid limit exhaustion risk.

What is the Project duration? SDI policies include various duration limitations including 24 month durations for subcontract term, 36 month durations for the project term and a 48 month time limit for the completion of all subcontracts from policy inception. Secure early approval from your SDI carrier for term extensions, as needed, for COVID-19.

Prequalification and Ongoing Measurement of Solvency

1. Have you identified the subcontractors with a high degree of insolvency risk in your current portfolio?
2. Have you asked for updated prequalification questionnaires, financial statements, work in process information, banking and surety capacity letters from high risk subcontractors? (Like the COVID-19 testing for individuals, focus on the high risk, vulnerable subcontractors that may not be able to withstand the economic impacts of the virus).
3. What analysis have you performed on your high risk subcontractors and their ability to survive this economic crisis? Have you performed a liquidity stress test to see if they can survive the next 90 days? Alliant has come out with a tool to evaluate short term insolvency risk in addition to its C2M credit model. The tool looks at cash flow from balance sheet, banking and work in process sources over the next 90 days to determine if sufficient funds are available to operate.
4. Have the higher risk subcontractors been approached to confirm if they have engaged their banks on the following topics?:
 - Waiver of covenants for Q1 and Q2
 - Forego interest payments until the COVID-19 shutdown is lifted
 - Extend balloon payments and term of borrowing facility to allow for recovery
 - Consider project specific loans to finance project restarts with accelerated schedules
 - Draw down on existing facilities to preserve cash
 - Explore Government Stimulus Package Funding alternatives, as needed
5. If subcontractors are qualified but unable to fund projects due to COVID-19, consider advance payments to assist in financing the work based on the following risk mitigation factors:
 - Require subcontractor to post an advance payment bond for the advanced funds
 - Require release of retention bond for the accelerated payment of retainage
 - If a. and b. are not available, consider a funds control account that pays for a sub's project specific expenses only while releasing the sub's profit on an earned basis.
6. Request updated prequalification information on subcontractors that are in the highest risk trades including:
 - Wood framers
 - Curtainwall
 - Drywall
7. Have you asked your high risk subcontractors what steps they are taking to monitor and preserve lien and bond rights on projects that have a high risk of postponement or cancellation?
8. Have you asked subcontractors what supply chain issues they see on the horizon with material suppliers? Are they actively sourcing acceptable alternatives, or do they have a strategy around rescheduling/resequencing of the work?
9. What steps are the subcontractors taking to reallocate resources from projects on hold?
10. Inquire about the need for timely CPA prepared financial statements, which will be more challenging given the inability of CPA's to complete field work.

Claims Prep

- Understand and evaluate pre-default status.
- Establish cost codes for delays and impacts related to COVID-19.
- Substantiate subcontractor default and notify SDI carrier if/when default occurs.
- Establish procedures and protocols.
- Quantify cost and time impacts.
- Facilitate the claim process.
- Resolve all claims and issues.

For more information on **SDI Claims Support and Best Practices**, please visit Imperium Consulting Group's [website](#). Alliant and Imperium Consulting Group have developed a strategic approach for clients which includes comprehensive claims advisory, advocacy and most importantly, a claims preparation strategy for potential COVID-19 losses. Imperium is available to provide an initial consultation, at no cost, to help clients make fully informed decisions.

For further questions please contact one of our specialists:

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