

Junk status impact on construction industry widely exaggerated

Dentons SA discusses the real effect of junk status on SA's construction industry

There has been highly publicised, widespread concerns about how South Africa's downgraded status by international agencies will affect the local construction sector. Fears of non-payment, rising credit costs and a number of projects being put on hold are some of perceived threats leading contractors to consider terminating contracts with state owned entities.

"The real impact of South Africa's junk status on Government led projects is widely exaggerated," says Nikita Lalla, Partner at Dentons SA, a global law firm that advises on a wide range matters including infrastructure, disputes, energy, natural resources, private equity and project finance.

Lalla says whilst the cost of borrowing and raising other forms of credit may have increased due to increased beta factors, this will not have an impact on a sponsor's ability to fulfil its contractual obligations.

"While I agree that investment coming into South Africa will be significantly impacted by our country's new status, the money the South African government has allocated to infrastructure and energy projects isn't going to disappear.

There are also contracts in place to ensure that contractors on these projects receive timeous payments," says Lalla.

Infrastructure and energy projects won't just disappear

According to National Treasury, energy expenditure by Government is expected to total R180.7-billion over the next three years and there are countless other large-scale infrastructure projects, such as the Gautrain Commuter Expansion, the Johannesburg-Durban High-Speed Rail Link and the Gauteng Freeway Improvement: Phase II Bulk Distribution System, for example, that are all underway.

"Contractors shouldn't have a knee-jerk reaction to the junk status analysis being published in the media and terminate current contracts due to fear of non-payment, because infrastructure and energy projects are part of the country's long-term development plans and strategies," says Lalla.

Government allocates funds at the start of the project and many of the projects will take many years, even decades, to complete. A good example of this is our country's nuclear strategy, which has recently been in the media after Energy Minister Mmamoloko Kubayi announced that Government will be renegotiating its inter-governmental agreements with vendors.

"South Africa's nuclear plans aren't being put on hold indefinitely; the purchasing and acquisition processes are simply being restarted," says Lalla.

Payment disputes can be prevented by drawing up proper contracts

While non-payment is rarely an issue on these types of projects, there are instances where payment disputes arise. These disputes are generally due to inconsistencies in claims that need to be resolved, but even under these circumstances, contracts and processes are in place to help contractors proceed with work in a cash neutral position as soon as possible.

"The two main contracts that are used for these types of projects are the NEC and FIDIC Contracts. Under the NEC Engineering and Construction Contracts, employers are obliged to make payment within four weeks. Finalising a dispute under the FIDIC suite of contracts may take longer due to the number of stakeholders involved in the arbitration process, but relevant parties will generally push to resolve the dispute as quickly as possible," explains Lalla.

"Our advice to contractors is to avoid terminating contracts. Engage in mediation, pursue an amicable solution and research ways to fast track your dispute. There are many long-term infrastructure projects in South Africa's pipeline and it's financially beneficial for contractors to continue working on these projects and follow the right channels if a payment dispute arises," concludes Lalla.