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# Protecting Projects: Safeguarding Against Subcontractor Default

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**S**ubcontractor financial instability is not a distant threat—it is a daily risk that GCs must actively manage. With escalating labor costs and the potential for new tariff policies injecting additional volatility into construction supply chains and project pricing, even well-established subcontractors are finding it harder to maintain solvency.

With the climbing rate of subcontractor default,<sup>1</sup> the reasons run deeper than poor project management.

This article explores the root causes behind subcontractor default and outlines how GCs can strengthen subcontractor vetting, implement safeguards, and proactively monitor warning signs to protect project performance and profitability.

## THE CAUSES OF RISING SUBCONTRACTOR DEFAULTS

Subcontractor defaults are a symptom of a construction ecosystem under strain.

From COVID-19 pandemic windfalls that inflated bonding capacity to a cooling market and fiercer competition, many defaults are the result of a perfect storm that contractors can't afford to ignore.

Compounding this environment is a surge in megaprojects—airports, stadiums, and data centers—which demand more labor, materials, and coordination than ever before. These trends have pushed many subcontractors to take on projects they may not be equipped to handle.

These limited project opportunities as well as artificially inflated balance sheets and tougher macroeconomic conditions are pushing more subcontractors further past their breaking point.

As a result, GCs cannot rely solely on historical prequalification metrics or

bonding capacity to safeguard against the risk of subcontractor default.

## Influx of Government Funding

According to the Small Business Administration, the construction industry emerged as a significant beneficiary of the Paycheck Protection Program (PPP) during the COVID-19 pandemic, receiving approximately \$98.2 billion in loan approvals across 1.02 million applications. This translates to an average of \$96,275 per loan.<sup>2</sup>

Additionally, many construction companies were the beneficiaries of the Employee Retention Credit (ERC), which supported businesses in maintaining employee payrolls.<sup>3</sup>

The receipt of PPP funding and the ERC were both legal and legitimate with many jurisdictions deeming construction an essential business activity, which allowed GCs and subcontractors to continue working and receiving payment for their services.

Furthermore, NPR reported that as of January 2024, 96% of PPP loans had been forgiven,<sup>4</sup> further solidifying the financial benefits for subcontractors and others in the industry that had received liquidity support from the program.

However, this influx of cash into the construction industry unintentionally increased subcontractor bonding capacity—the maximum project value a subcontractor can undertake, as determined by their surety.

With a greater bonding capacity, subcontractors found it easier to present themselves as financially solvent to GCs, allowing them to bid for larger projects than they might have otherwise been able to pursue. This enabled some subcontractors to expand operations and take on more ambitious projects, even if their underlying financial health and operational capabilities had not kept pace with their inflated bonding capacity.

This dynamic created several challenges for GCs. As construction activity slowed and competition increased, some subcontractors struggled to maintain the same level of financial performance they had during the height of the pandemic because of available PPP and ERC funds. Despite this, some subcontractors' financials at face value continued to support a greater bonding capacity, even as their actual financial health deteriorated.

In some cases, subcontractors were defaulting mid-project, leaving GCs in a precarious position as they attempted to manage ongoing work and mitigate financial risks.

### Market Slowdown & Economic Pressures

Several other market conditions and economic pressures are contributing to the rise in subcontractor defaults, including higher-for-longer interest rates, restrictive lending, developer hesitancy, uncertainty surrounding tariffs and immigration policies, and workforce dynamics.

High interest rates have made it more costly for developers to finance new projects, leading to a slowdown in activity and fewer opportunities for subcontractors.

Lending to the industry has also become more restrictive, further limiting the availability of capital for subcontractors seeking to expand operations or invest in new equipment.

Developer hesitancy, driven by broader economic uncertainty, has also contributed to a decline in new project starts.

Tariff and immigration policies have created additional challenges for subcontractors. Potential new tariffs on imported construction materials may increase costs and disrupt supply chains, while shifting immigration policies have made it more difficult for subcontractors to find and retain qualified workers.

Workforce dynamics, including an aging labor pool and limited entry by younger workers, are also contributing to these challenges. As experienced workers retire without being replaced, subcontractors are finding it increasingly difficult to maintain a skilled and reliable workforce.

### The Shift Toward Infrastructure Projects

U.S. Census Bureau data showed that starts for buildings with five or more units fell dramatically in November 2024, dropping 28.8% year over year to a seasonally adjusted rate of 264,000 units. Additionally, at the end of November 2024, 780,000 units were under construction, which represents a 20.9% year-over-year decline,<sup>5</sup> leaving subcontractors that specialize in multifamily construction with fewer opportunities.

Concurrently, the construction market is experiencing a shift toward large-scale infrastructure projects, such as airports, stadiums, and data centers.

While these projects offer significant opportunities for some subcontractors, they also require different specializations and bonding capacities than traditional commercial or residential projects.

Now faced with fewer opportunities and increasing competition, subcontractors are increasingly resorting to aggressive bidding strategies to win work and generate revenue. This can lead subcontractors to bid below sustainable margins because they may not necessarily know the scope and depth of the work they are estimating.

As a result, subcontractors may take on projects at unsustainably low margins, increasing the likelihood of subcontractor default and multiplying risks for GCs.

Similarly, to keep equipment, employees, and other resources from sitting idle, many subcontractors are bidding on a higher-than-normal number of projects. By trying to maintain a high level of resource utilization, a growing number of subcontractors are becoming overstretched and working on too many projects at once.

As a result, many are missing deadlines and some are even defaulting mid-project, ultimately elevating frustration and risk for GCs.

### A Looming Bubble?

The combination of economic challenges and industry-specific factors has led to a noticeable increase in subcontractor distress and defaults.

According to a 2024 risk survey from the Associated General Contractors of America (AGC), 70% of respondents noticed an increase in subcontractor distress or defaults compared to the previous year. The report also found that financial distress was the number one driver of subcontractor distress and defaults, as cited by 38% of respondents.<sup>6</sup>

## LEADERSHIP & MANAGEMENT

A lack of qualified labor was identified as the second most common factor, with 27% of respondents attributing defaults to this issue, while 24% cited concerns about quality of work as a contributing factor.<sup>7</sup>

These statistics should serve as a wake-up call for GCs — the risk of subcontractor default is no longer a hypothetical concern or rare occurrence; it is a growing reality that demands immediate attention.

Considering these trends, GCs must shift their focus from awarding contracts based solely on price. They must prioritize the lowest qualified bid, which requires a more thorough assessment of potential subcontractors' financial stability, operational capabilities, and past performance.

### VETTING SUBCONTRACTORS

With tight margins and even tighter timelines, choosing the wrong subcontractor can negatively impact a project before it starts.

With defaults on the rise, GCs need to look beyond price. They need to know who is equipped to deliver and reassess what qualifies a subcontractor to earn the work.

#### The Lowest Qualified Bid

The concept of the lowest qualified bid is a critical consideration for GCs seeking to mitigate risk and ensure project success. Vetting potential subcontractors to determine the lowest qualified bid is a best practice that requires additional due diligence.

It's important to consider a wide range of factors that could affect a subcontractor's ability to successfully complete the work, including financial health, bonding capacity, relevant experience, safety record, and reputation.

When evaluating these factors, it's important to consider:

- *Financial health* as it relates to consistent cash flow, access to working capital or credit, and a balance sheet that can support labor, materials, and unexpected costs without disruption.
- *Bonding capacity* that signals that a surety has independently vetted the subcontractor's financial stability and performance history and that sufficient limits are available for the project's size.
- *Relevant experience* that goes beyond years in business alone. GCs should look for subcontractors with a track record of successfully completing projects of similar scopes and comparable size and complexity with minimal claims or disputes.
- *Safety records* that have been measured through metrics like experience modification rate, Occupational Safety and Health Administration (OSHA) incident rates, and a demonstrated culture of jobsite safety.

- *Reputation* that looks at references, prior working relationships, and industry feedback regarding reliability, coordination, and ability to meet schedules.

Since subcontractors and trades perform the majority of the work on a project, completing an evaluation in each of these areas is a critical risk mitigation strategy that can help ensure long-term project success.

By sharpening the focus to the lowest qualified bid, the risk of project delays, cost overruns, and other issues that can arise when working with unqualified or financially unstable subcontractors can be reduced.

By taking a proactive approach to risk management, GCs can achieve better project outcomes and stronger relationships with project owners.

### Financial Factors

When evaluating potential subcontractors, GCs should pay close attention to a variety of financial factors to assess the subcontractor's financial health and stability.

Key considerations include:

- *Normalize the balance sheet:* Request financial information both with and without stimulus funding such as the PPP and ERC. This approach provides a more accurate understanding of the subcontractor's current financial position, given the temporary boost provided by these programs could distort the true financial picture.
- *Obtain audited financials from potential subcontractors:* These statements provide an independent and objective assessment of a subcontractor's financial health. The statements should be recent and prepared in accordance with GAAP.
- *Review key financial ratios:* Assess the subcontractor's liquidity, profitability, and solvency. These ratios can provide valuable insight into a subcontractor's ability to meet its financial obligations and manage its operations effectively.