2022 CLM Construction Conference
Sept 21st – 23rd 2022
San Diego, CA

Construction and Insurance Caught in Today's Crosshairs:

Pricing, Labor Shortages, Material Shortages, Restrictive Municipal Regulations, Homelessness, Inflation, Rising Interest Rates, Climate Change and New Litigation . . . Challenges into 2023 and Beyond

I. Introduction

The recent and ongoing pandemic, inflationary trends, and the recent conflict in Ukraine amongst other things have cause upheaval in both the construction community and the insurance community specific to pricing, labor shortages, material shortages, restrictive municipal regulations, homelessness, inflation, rising interest rates, climate change and new litigation. Add to that, increasing natural disasters, challenges to new product development, changing laws and regulations, and both the construction industry and insurance industry will face challenges like none seen in the past before. All these factors, and more, will impact this brand of risk to all those in the construction, underwriting and claims communities. Simply utilizing recent technology does not necessarily improve our various practice. The central focus of the issues of this discussion into our everyday practices to improve both efficiency and quality of our work. This session will address how do we incorporate these issues to improve our practice.

II. Identifying the Problem

Specific characteristics of identifying the issues of the construction community as they relate to insurance are both different, and the same, in many aspects as they impact one another is so many ways.

Pricing of insurance related products will have an impact when it comes to labor shortages, material shortages, new materials, municipal regulations, inflation, rising interest rates, climate change and new litigation amongst other things. They will present new and unique challenges to both industries well into 2023 and probably beyond.

While labor shortages continue to be a current day issue in 2002 and have been problematic in the construction industry for many years prior to 2022, the question is what steps can be taken to reduce the labor shortage issue that benefit both the construction trades and their insurance pricing policies. The lack of construction professionals, with an estimated 430,000 additional construction workers needed to address a US nationwide housing shortage specifically in the southwestern United States believes that to address current demand and another one million more construction professions will be needed in 2022 and 2023, according to the U.S. Bureau of Labor Statistics.

If demand continues to increase, contractors will need to increase wages and benefits to attract these workers

And . . . if an unexpected natural disaster hits a well-populated area, thousands of homes may need repair and replacement, pushing the costs of materials and workers yet higher. History along alone has proven this aspect to be a certainty.

Material shortages, increased transportation costs, and material delivery delays will remain a problem well after 2022. With items like timber, steel, drywall, copper piping, pex piping, and other building materials seeing dramatic increases, the cost of housing continues to increase. Given recent news events at the times of the preparation of this paper, lockdowns in China and elsewhere as well as the unpredictability of Covid increasing in other parts of the world certainly are causing these supply chain problems to take longer than expected to normalize so we can expect they may remain an issue well into 2022, 2023 and beyond thus resulting in further price increases. The ongoing conflict in Ukraine strangles many supplies chain items, and the Russian response seems to be tightening that stranglehold.

At the time of the printing of this paper, inflation is a major problem facing the American family and rising home and credit card interest rates are two other big concerns. Rising interest rates have historically deteriorated the value of homes value thus leading to the possibility of more interest in making construction defect claims putting pressure on underwriters and claims professions to respond to these matter as they did in the early 1990's and early 2000's.

As those who have been in the insurance industry know from experience, high inflation will result in weaker underwriting performance, changing reserve levels and an increase in claims activity, while making it hard to keep pricing and claims expenses in pace with these volatile loss trends.

Municipal rules, increased regulations, and court caselaw decisions always play a part in construction, building restrictions on construction always play a part inn the construction of new structures. Where and when contractors build, the labor they use, the design implications that are there as well as the materials that will go into the new construction are all under the microscope of municipal regulators

One major unpredictable issue facing every industry is climate change as it causes more unpredictable, certainly more frequent and in many cases severe catastrophic events and losses that both the insurance industry and construction communities have not seen before. Mother nature's wrath clearly exceeds man's ability to respond to it, but things can be done to try and reduce the potential for loss given these conditions which will be discussed later in this paper.
The one thing all experts agree upon especially given the NOAA recent reports that from January through September 2021, rising global temperatures contributed to 18 weather-related disasters in the U.S., with losses exceeding $1 billion in each case, the last record recorded but certainly a record high.

Climate change alone is not the only issue by itself, but the resulting effect of a disaster is what happens after a weather-related event occurs. By way of example, the most damaging events of 2021 was Winter Storm Uri, an extra-tropical cyclone that in Texas brought down the independent Texas electricity grid, causing the country's largest outage in almost 20 years. More than 4.5 million homes and businesses were without power for several days, resulting in a record volume of property claims for burst pipes, collapsed roofs, spoiled produce, damaged equipment, and business income interruption.

Lastly, one of the ongoing and growing problems is homelessness and its effect on the construction and insurance communities. Much of this election season has focused on the problems involving homelessness. There is no question that demand for more affordable housing for the current homeless will certainly be on the horizon especially in places where property is at a premium. With the reduction of the restrictions involving pandemic related moratorium regarding foreclosures and evictions, increases in cost and availability of rental units, both evictions and foreclosures have seen a significant increase in homelessness. The pressure this will put on the demand for construction funded by the government and/or the private sector places a further strain on the availability of construction labor as well as material supply.

III. Identifying higher risk areas for loss.

Throughout the past 30 years, both the construction industry and the insurance community have seen dramatic increases in the number of claims arising from construction defect/product defect related claims. By way of example, first it was soils failure resulting in the reexamination of building stronger foundations to deal with poorly compacted soils. We saw the increase of mold related claims and the redesign of homes to create mold avoidance techniques additionally supported by mold exclusions from the insurance community focusing on changing the losses to the construction community. Pex piping failures, forced air system failures, roofing material failures composite sliding failures were amongst many product failures which lead to improved products as well as techniques to repair such failures in existing building. A cross section of industry professions can be developed to further seek out and test such new products and technologies in different areas of the country before they make it into market. Such ideas will reduce litigation in the construction and insurance communities.

Insurers and brokers can help clients to mitigate and manage these risks by taking proactive steps such as improving building methods in design, construction, actual sequencing amongst other things by providing premium incentives to using such methodologies.

They also need to ensure their business continuity plans address all natural hazards to protect their most exposed and critical assets and focus resources and capital on mitigating the impact of these exposures on their properties, by not only using risk modeling based on historical data as same is no longer dependable but also adapting same to current conditions.

- Impact and long-lasting effects of COVID-19.

Hopefully the Impact and long-lasting effects of COVID-19 would have taught us all lessons on what to expect as future pandemics are sure to develop. The implementation of new and improved technologies such as Zoom combined with more people working from home will certainly reduce the chances of widespread virus contamination.

- Cost of construction materials and skilled labor.

The first issue will have to be the recruiting of qualified personnel. To attract young people in this day in age to the construction trades is difficult especially considering advanced request for college degrees as well as competing salaries in other industries. So, inducements have be propounded by the construction community in advanced training, better pay, better benefits and long-term employment. Many of these cost and expenses can be offset by lowering premiums supported by lower claims because of better quality work as well as new advanced use of technologies.

The construction industry must develop alternatives to be used to supplement or replace current materials which fall into short supply. Recently, by way of example as it applies to timber products, the use of recycled materials bonded into a stronger setting have proven advantageous. Additionally, the use of 3-D material printers has also shown to lower costs and improve quality.

New material development was born out the necessity of material shortages as discussed above. The question for both the construction community and the insurance community are simple. Will they work? Have they been tested across many climate conditions, and will they work when incorporated into other materials in the construction of structures and what are the new risks that will occur with these new materials.

Unfortunately, both price volatility and development of fully untested new products and materials makes it increasingly difficult for underwriters and claims professionals to value the replacement costs of construction materials as well as pricing coverages accurately and comprehensively for new policies accordingly.

- Addressing new products and new municipal regulation

Construction products and processes are evolving rapidly, and with the evolution brings uncharted risk factors. Modular construction and 3D printing of construction components which are in short supply from the supply chain shortages come immediately to mind. One developer has announced plans to build an entire community with 3D printed homes which will break new ground and potentially open the door to a new genre of claims for which risk transfer must be considered.

Overlaying the new products is the increased regulations imposed by respective entities charged with overseeing the construction. As climate related risks increase in frequency and severity, we see the emergence of more regulations and focus on fire-resistive construction and building envelope issues where water intrusion is top of mind.

We foresee additional regulations forthcoming, labor shortages coupled with the lost talent which completely left the industry following the 2008 crash mean we are seeing new and inexperienced labors doing extremely complex and dangerous jobs in the field. Some have opined that this toxic combination could lead to an increase in construction site accidents, of which there is some evidence this could indeed be the case.

High profile catastrophic failures of bridges, buildings and building structures such as balconies have led to new regulations, new statutes, new obligations which will invariably give rise to new causes of action or theories of liability.

- Difficultly for insurers to price and respond to losses

Underwriters, to price proper insurance premiums, to value for businesses need develop new underwriting application to address the issues of this paper. New consideration must be considered so that issues like business interruption will be considered just as is Business Risk, Bodily Injury, Property Damages, and specific issues to a particular policyholder to assist clients in calculating appropriate exposures while ensuring the financial health of the carrier.

III. Conclusion

Given recent world events, a discussion of why sometimes the “old ways” are best but how can we incorporate those ideas into current ideas to create viable and useful alternatives which provides substance and adds value to the community.

The consequences of addressing these issues wrong can and will be severe. If the true cost is undervalued, this can adversely affect the construction of new properties as well as premium and claims modeling outputs will result in less well-informed construction and insurance decisions, planning and inadequate premiums claims adjustment and actuarial studies for both industries.

Overall, identification and advancements in practice that are beneficial to identify and gather data that translates into useful and persuasive information for more effective and efficient practices that result in better results and/or savings by the construction community, insurance carriers, their counsel and support vendors must be made now.

Lastly, these problems place policyholders, the public and municipalities to set aside enough capital to cover their retained risks or have sufficient coverage limits.