Summer 2024 Construction Market and Industry Update

Gallagher

Insurance | Risk Management | Consulting

1. Construction market conditions

While we started 2024 with concern over a slowing market, it appears that the market has stabilized.[1] ENR's Construction Industry Confidence Index (CICI) registered a confidence rating of 52, with a rating of over 50 showing a growing market. The greatest strength appears to be in the manufacturing, educational, and healthcare markets.[2] The surge in manufacturing activity stems from federal subsidies provided under the CHIPS and Inflation Reduction Acts, as well as a strategic aim to diversify and re-shore supply chains following the pandemic. However, the pace of new initiatives is hampered by labor shortages.[3]

The office market continues to be generally dismal, especially in the Midwest.[4] However, New York and some other coastal areas are seeing increased office occupancy.[5]

Outside of downtown areas, however, retail real estate has shown surprising post-pandemic strength and landlords are reducing, if not eliminating, rent discounts.[6] As supply becomes tighter, we are seeing more construction activity in the retail market.[3]

Another bright area is power generation and distribution, as electric vehicles need to be charged and data centers providing artificial intelligence (AI) require large amounts of electrical power. Indeed, at the end of March 2024, the Department of Energy announced that it was lending $1.5 billion to the owner of the Palisades nuclear energy plant in Michigan to reactivate the plant.[7]

Other major projects include airport expansions, such as the addition of a new $855 million terminal at Dallas Fort Worth International Airport, multiple new data centers, and various hospitals and amphitheaters.[8,9]

Residential construction is rotating back to growth after the Federal Reserves' interest rate hikes made mortgages more costly. After falling about 6% in 2023, starts are expected to stabilize in 2024, and then increase by 6%–7% from 2025 through 2028.[2] In contrast, multifamily construction is expected to fall through 2026 as more than 1 million units that were in development in 2023 become available and rent growth slows.[2] Indeed, in the first quarter, multifamily construction starts declined about 9%.[3]

The American Institute of Architects (AIA) publishes the monthly Architectural Billings Index (ABI), with a score below 50 representing a decline in billings. At the end of 2023, the ABI index was at 45.4.[10] However, the pace of the decline has slowed considerably and the ABI index had risen to 49.5 by the end of February 2024, with a positive index (50.8) in the Midwest and the greatest weakness

(44.0) in the Northeast.[11] More importantly, the index for design contracts was at 51.1 — showing an increase in new projects starting design.[12]

We should note, however, that while the industry has shown unexpected strength in the first quarter, there are still some signs of a slowdown. The Dodge Momentum Index (DMI) measures the value of nonresidential building projects going into planning and uses a baseline score of 100 based on construction planning the year 2000. In January 2024, it stood at 184.1.[13] But by March it had fallen to 164, with the greatest drop in institutional work.[9]

Also, much of the bullishness on industry conditions seems to have followed bullishness in the stock market, as parties expected the Fed to reduce interest rates. CPI was unchanged in May on a seasonally adjusted basis, after rising 0.3 percent in April.[14]

2. Insurance market conditions

A. Commercial property

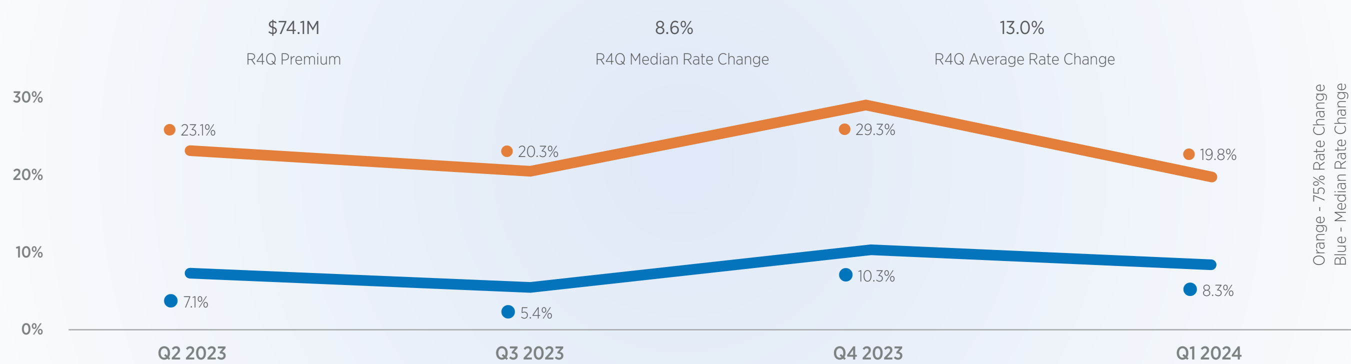
The insurance market continues to suffer many challenges, but we are seeing stabilization within the commercial property market.[15] Many owners will continue to see difficulties with their renewals. On the east coast, Colorado State University has predicted 2024 to be one of the most active hurricane seasons on record as Pacific waters transition from El Niño (warming waters) to La Niña (cooling waters) and Atlantic Ocean water has become record-warm in most areas.[16] Accordingly, we expect to see continued double-digit rate increases, although the rate of increase has been declining.[15]

Insurers have banded together to create the Geospatial Insurance Consortium, to provide an industry source of imagery from drones and planes in the US and over 30 other countries.[17] This imagery is then used to confirm building conditions, such as roofs, building features, and pools to search for environmental risks such as wildfire or water hazards. Insurers are using imagery to charge higher rates on properties that are less well maintained and drop coverage on certain properties.[18]

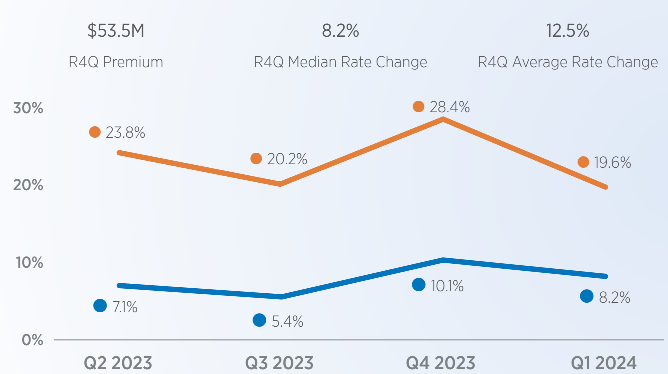
As insurers de-risk their portfolios, you will need to pay special attention to your risk submissions and use creative approaches to property insurance. Information on building updates and improvements will be essential. Condominium and other homeowners' associations will need to show that they have performed adequate reserve studies and are accumulating reserves to perform proper maintenance and appropriate upgrades. Property owners in seismic zones should also focus on seismic design criteria and retrofitting on older properties — especially those along the West Coast and around the intersection of Missouri, Arkansas, Tennessee, and Kentucky. The United States Geological Survey (USGS) has identified those locations as places where damaging earthquakes are most likely to occur.[19]

We are continuing to see limited capacity for catastrophe coverage in many areas, such as Florida and New York. Many policies now contain sublimits and enhanced deductibles for windstorm damage.[20] Proper preparation requires insurance buyers to consider these limits and to make financial provisions for reduced coverage.

PROPERTY RENEWAL RATE TRENDS



SINGLE-LAYER PROPERTY RENEWAL RATE TRENDS



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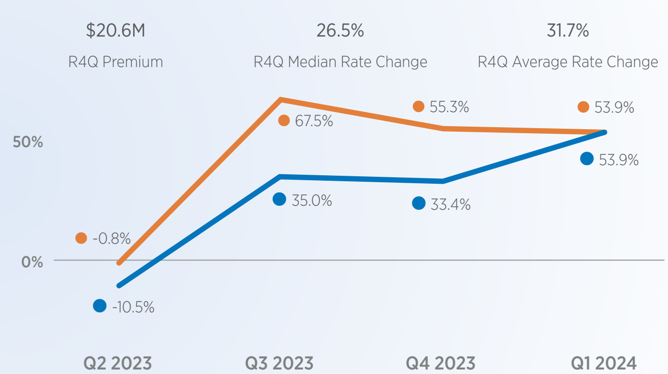


B. Builders risk

Within the builders risk subcategory of property insurance, we see a bifurcated market. Within the non-catastrophe market, we see stabilized rates, although placements greater than $25 million often require multiple carriers.[21] The catastrophic market, however, is tight and applications will need to address the insured's efforts to mitigate losses from theft, fire, and water. There is difficulty in placement for structural renovations to existing structures — especially older buildings and landmark structures.

Another issue is coverage extensions. We are seeing greater reluctance by carriers to extend coverage beyond the original coverage period, and insureds should consider obtaining 60-day or longer pro rata extensions with the policy.[20]

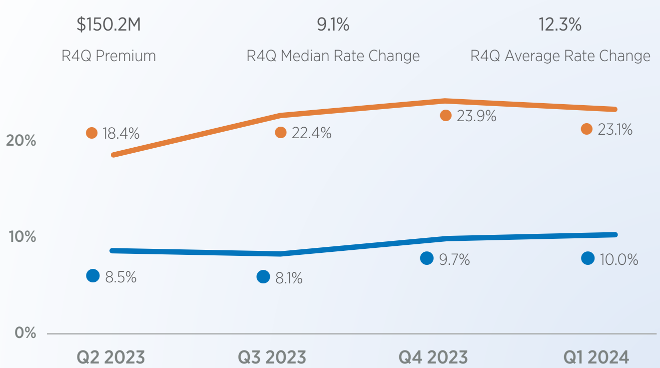
C. Casualty insurance

Casualty insurance, including general liability, excess liability, and commercial automobile rates are also rising, driven by social inflation, nuclear verdicts, and the increasing costs of auto repair.[15] However, the rate increases in the single digits — about 4.5% for general liability, 8.1% for umbrella coverage, and 8.3% for automobile coverage. With respect to automobile coverage, businesses should consider fitting their fleets with telematics to help control risks — a technology auto insurance carriers are now trying to apply to private vehicles as well.

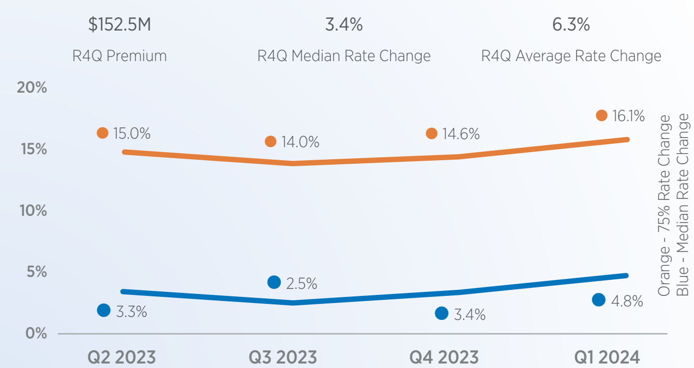
Based on nuclear verdicts and a seeming increase in the number of crane accidents, we are also seeing increased rates on crane insurance, along with more coverage limitations and reduced excess capacity.

Of particular concern to contractors are increasingly common exclusions for claims arising from "forever chemicals" or polyfluoroalkyl substances (PFAS). PFAS are found in many construction materials, like roofing, paints, and sealants.[22] They have also been linked to numerous health effects such as various cancers and hormonal issues. During construction, PFAS can be carried into water systems, thus exposing the public to harm. While it appears that damage from PFAS used in construction is fairly speculative, the same could have been said of other construction materials, like asbestos, which turned out to create much more exposure than people thought at the time, which is why insurers are adding these exclusions to their policies.

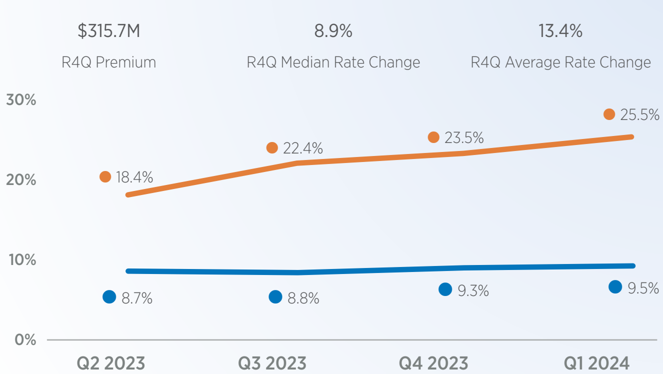
COMMERCIAL AUTO RENEWAL RATE TRENDS



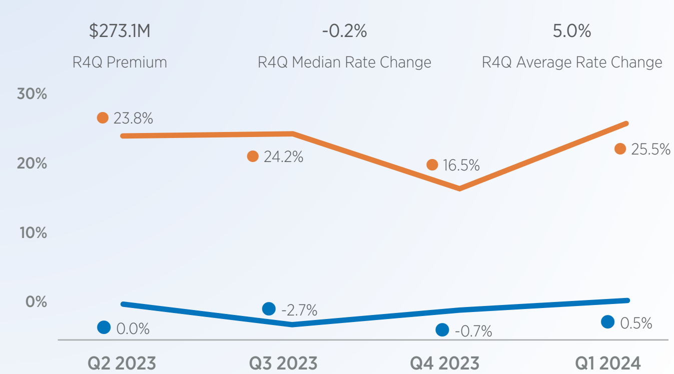
GENERAL LIABILITY RENEWAL RATE TRENDS



UMBRELLA AND/OR EXCESS LIABILITY RENEWAL RATE TRENDS



WORKERS COMPENSATION RENEWAL RATE TRENDS



D. Cyber insurance

Although cyber insurance rates have flattened in 2023, rates are volatile.[15] A recent survey predicts cyber attacks will cost businesses up to $9.2 trillion in 2024 and grow to 13.82 trillion in 2028.[23] By comparison, President Biden's 2024 FY budget is only 6.88 trillion.[24]

AI may be responsible for much of the growth as cybercriminals are expected to use AI for automated hacking, brute force password cracking, and deepfakes for phishing attacks.[25] In the case of deepfakes, AI can create highly realistic voices and images to convince a target that they are talking with a trusted person, when they are really just talking to a computer.[26] These pose new challenges, and we would not be surprised to see a surge in AI-generated claims. This will require even greater sophistication by insurance buyers to access more capacity and better terms and conditions for their cyber policies.[15]

3. Hardening infrastructure

Infrastructure is almost always at the top of the agenda, but after Baltimore's Francis Scott Key Bridge was taken down we expect to see more emphasis on hardening existing infrastructure. In June 2016, the Panama Canal Authority completed expansion of its lock system, leading to the construction of class of cargo ships known as New Panamax freighters — which are the largest ships allowed through the canal. Prior to the lock expansion, Panamax vessels had a maximum tonnage of 52,500 DWT and 106 ft beam. New Panamax vessels have a tonnage of 120,000 DWT and 168 ft beam.[27]

Bridges are designed with elements to protect them from ship damage. A common method is to build circular concrete structures around supporting piers and columns. These are known as "dolphins." In the case of the Francis Scott Key Bridge, the dolphins had not been upgraded in any significant way since the 1970s.[28]

With over twice the tonnage of traditional Panamax vessels, New Panamax vessels like the Dali travel with enough force to overcome dolphins designed for older Panamax vessels. While the NTSB investigation is far from complete, we expect that it will recommend that dolphins and other pier protections around similar bridges be modified to protect bridges from today's much larger ships.

Another key problem was that the Francis Scott Key Bridge was a fracture critical bridge, meaning it could fail if one critical piece of the bridge fails.[29] The NTSP lists 17,468 US bridges as Fracture-critical, including such major bridges as the Tacoma Narrows Bridge in Washington, Golden Gate Bridge in San Francisco (this is privately owned), Verrazzano-Narrows Bridge in New York, Chesapeake Bay Bridge in Virginia.[30] Each bridge authority needs to be looking at hardening the protections for these bridges.

Many such authorities are already looking to harden existing bridges. For example, the Portage Bay bridge near Seattle is seismically vulnerable based on its 1960s era design, and a contractor has recently been awarded a $1.4 billion contract to replace it with seismically upgraded bridges.[31]

4. Labor shortages

Labor shortages and supply chain issues have been dominant issues for the industry. Labor shortages persist, but we are seeing signs that those shortages may ease as new workers are entering the construction trades. In January, Associated Builders and Contractors (ABC) estimates that the construction industry will need 501,000 new workers in 2024 to meet demand.[32]

The good news is that we are seeing some relief as younger workers entering the workforce are trading college for trade school. Since 2018, the number of students enrolled in community college programs focused on construction trades has increased 23%.[33] For the past four years, the median pay increase for new construction workers (5.1%) has risen faster than it has for new hires in professional services (2.7%), and now exceeds that of new professional services hires ($48,089 vs $39,520).[33] Increased pay has led to both more workers in the trades and a welcome reduction in their median age. For example, over the past decade, the number of electricians has grown by 229,000 while their median age has dropped by 2.9 years.[33] Unfortunately, because it takes time for an apprentice to become a journeyman and then a master at their trade, the skilled labor shortages will persist.

Women are also emerging as an important new labor source. Women currently represent about 11% of the construction industry workforce.[34] While significantly less than the proportion of women overall in the population, this is up from about 9% in 2017. To the extent women have been involved in construction, it has generally been in more white-collar roles that take a less harsh physical toll. However, increasing use of robotics in the field allow women more opportunities in the field.[33]

To encourage greater female workforce participation, employers can take several approaches, including:

- Providing day care.[35]
- Taking a close look at pay practices to ensure that female workers are paid the same as male counterparts with similar experience and qualifications.[34]
- Ensuring that women employees are present for job fairs and other recruiting events.

5. Labor regulation

Labor and overhead costs will also be rising for many contractors due to new regulatory requirements. It seems that many trends begin in California and spread from there. Effective July 1, 2024, almost all businesses operating in California will need to institute new workplace violence prevention programs, which will need to be customized for each workplace.[36]

We are also seeing more construction projects subject to Davis-Bacon wages, and similar laws that increase labor costs.

6. Supply chains

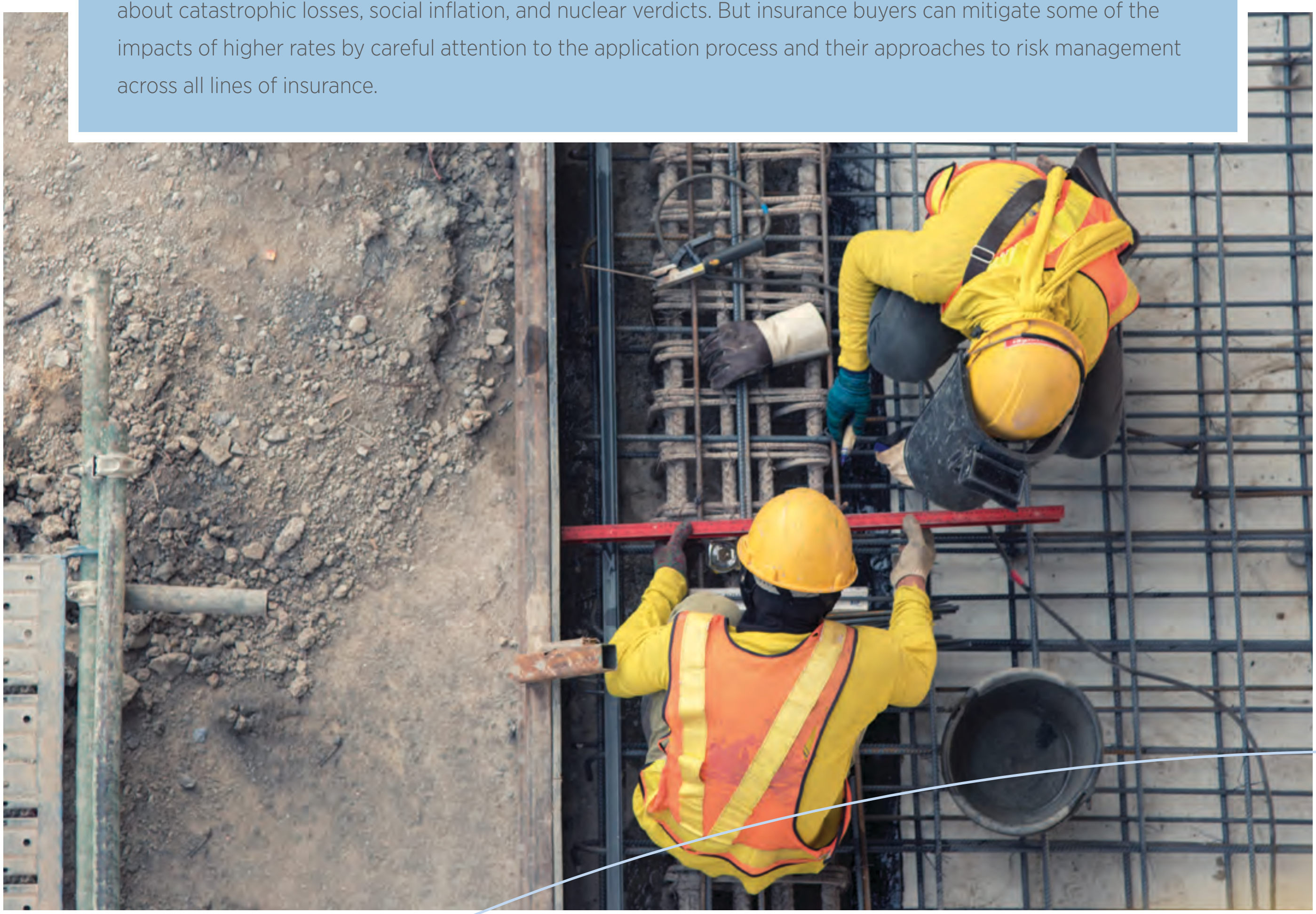
Supply chain issues now seem to be limited to specific items, especially for MEP work. Supplies of cement, steel, and softwood lumber are no longer a significant issue as reflected in moderated price increases.[3] But delivery times for switchgears have moved out from 20 to 40 and even up to 60 weeks. Transformers can take up to a year to arrive on site, and electrical panels and generators are also in short supply.[37]

Likewise, mechanical and plumbing trades are experiencing strains.[38] Additionally, the pricing for some mechanical equipment has actually fallen over the last several years, but there is increased demand for technicians. Federal regulations are requiring a 30% drop in HFC refrigerant production, which is leading to a shortage of many refrigerants — especially R-410-A. This translates into higher prices.[39]

Another supply chain issue to keep in mind is the supply of nickel used in stainless steel and EV battery production. Indonesia is the world's largest nickel producer, but its ORE supplies are expected to run out in six years.[40] Environmental protests in the Philippines, the world's second-largest producer, are challenging government efforts to expand production.[40] Nickel prices have thus increased by over 10% since the start of 2024.[40]

CONCLUSION

At the start of 2024, it appeared that the construction market was slowing, but it showed surprising strength. Labor shortages persist and supply chain challenges have started to resolve with important exceptions — particularly with respect to electrical trades. Insurance rates continue to rise as property insurance carriers worry about catastrophic losses, social inflation, and nuclear verdicts. But insurance buyers can mitigate some of the impacts of higher rates by careful attention to the application process and their approaches to risk management across all lines of insurance.



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