2022 construction forecast: trends and future risks

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Kennedys

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Foreword

2021 proved to be a particularly challenging year for the construction industry hampered by the pandemic, Brexit and climate related risks. In spite of this, UK construction output rose 1.4% in January 2022 month-on-month, hitting its highest level since September 2019.

2021 was the year of sustainability and we saw an increase in policy and business initiatives to tackle sustainability both pre and post COP26. In October 2021, the government published its Net Zero Strategy (particularly relevant to the construction industry) and the Heat and Buildings Strategy.

The UK Green Building Council (UKGBC) launched the Net Zero Whole Life Carbon Roadmap for the UK Built Environment at COP26 in November 2021. The roadmap details the necessary actions government and the construction industry must take to achieve net zero across the sector.

COVID-19 accelerated the transition to digital solutions as a result of necessity and has seen the construction industry embrace new technologies with gusto. We predict that 2022 will see the emergence of smart contracts, digital twins, 5D BIM and augmented reality.

Robotics (including drones), automation and AI are already beginning to play a major role and this is only expected to increase in the coming years. Likewise, Modern Methods of Construction (MMC) will continue to be key in addressing the struggles faced by the construction industry (such as the housing crisis and materials shortage). Last but not least, we will surely see a boom in green technology given the government's green agenda and Net Zero campaign.

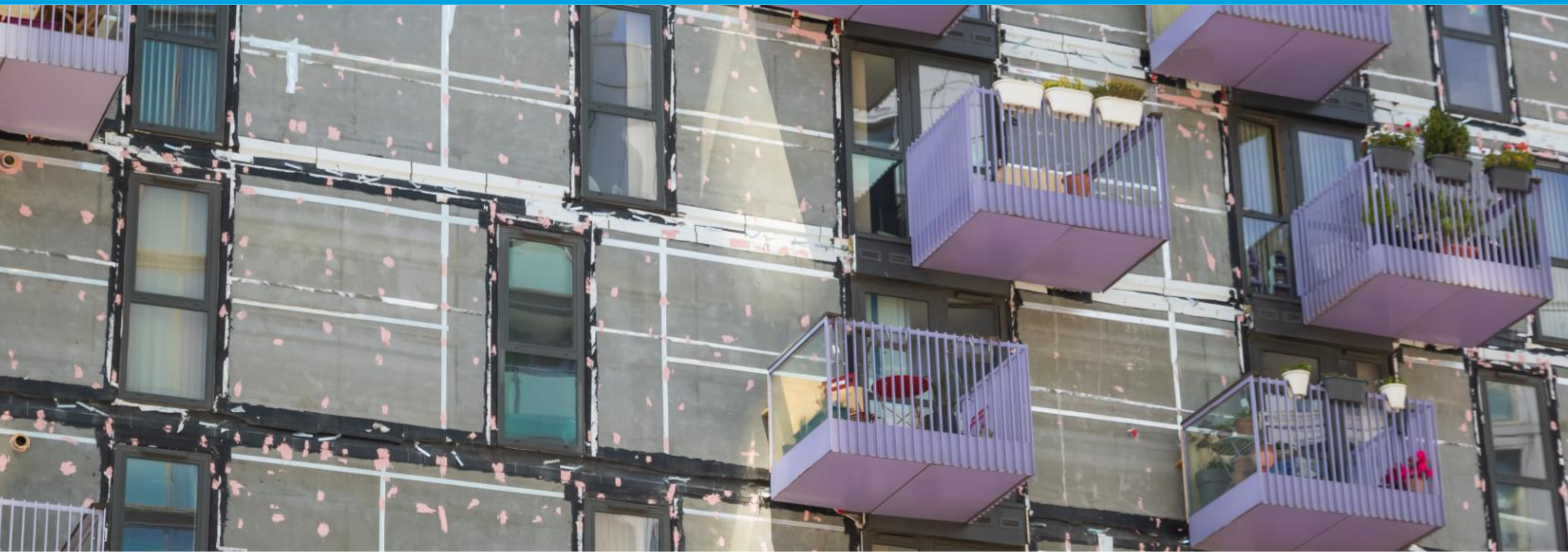
Net Zero will continue to be at the forefront of the agenda for all sectors this year. Going forwards, the conversation will widen from net zero and climate change to broader ESG (Environmental, Social & Governance) related risks.

Turning to the present, the first two months of 2022 have seen a rapid series of responses from the UK Government addressing the cladding and building safety crisis. These cover policy announcements, an FCA investigation and amendments to the Building Safety Bill.

Whilst building safety, technology, sustainability and Net Zero are all strands of ESG, ESG also includes social elements such as social value and diversity and inclusion (D&I). D&I recruitment drives in particular will be invaluable to address the skills and labour shortages currently at hand.

As we move into Q2 of 2022, we expect to see a continuation of these challenges with concerns that the Russia/Ukraine crisis will disrupt global supply chains further. Fears remain that Russian sanctions will stem growth with many firms set to feel a cash squeeze. Resilience will continue to be the overarching theme for 2022.

Against this background, we highlight some key legal and regulatory developments and provide an overview of the business critical topics that the construction sector and insurers should consider as they plan for operational resilience in 2022 and beyond.



Legal and regulatory developments

> “2022 will be a very significant year for the construction and insurance industries with the UK Government’s landmark building safety legislation likely to be approved by law makers. The legislation will usher in a much tighter regulatory framework for construction organisations with the objective of creating a culture of quality in construction.
>
> The insurance market, which has been affected by the UK’s cladding crisis, will cautiously welcome the new rules but also need to determine how policy wordings will need to be reviewed in response.”
>
> ***Paul Lowe, Partner, London***

“Build Back Better” has been Boris Johnson’s rallying cry as the way forward to economic recovery from the financial impacts of the pandemic. Here, we explore all developments and impacts of this policy pledge.

Cladding claims

The Department for Levelling Up, Housing and Communities (DLUHC) started the new year by announcing plans to force developers to “fix the cladding crisis”. This was followed by the publication of a new plan to protect leaseholders with the aim of making the construction and insurance industries fund the crisis.

> **The DLUHC then set a deadline of March 2022 for developers to agree a fully funded plan of action for the cladding crisis, currently estimated to be in the region of £4 billion.**

The plan is still awaited, due to, in all likelihood, remaining concerns within the construction sector (including insurers) as to how developers will fund contributions.

It is likely that developers will look to the original project teams, supply chains (including product manufacturers) and the insurers of those entities via claims. Consequently, there remains uncertainty - both in general terms and on a project specific basis - as to responsibility for the costs involved. Ultimately, it may take new regulation/legislation to clarify these issues.

FCA investigation into fair value

Insurers and brokers across the UK have also been recipients of ‘Dear CEO’ letters issued by the FCA. These letters have started an in-depth review by the FCA and the Competition and Markets Authority (CMA) of the availability and cost of buildings insurance, specifically for multi-occupied residential buildings.

The FCA's letter to insurance firms drew attention to the issue of 'fair value'. In particular, it reminds firms of their obligations to consider the costs borne by leaseholders when determining whether a product is 'fair value'. The investigation reflects the DLUHC's policy, expecting the insurance market to play a part in alleviating the cladding and building safety crisis.

> **However, many cladding claims are subject to professional indemnity policies which have limitation clauses such as claims made, aggregate limits and exclusion clauses. Insurers are not going to pay for risks they did not write.**

The FCA/CMA investigation is due to report back before September 2022 and this may result in further regulation.

The Building Safety Bill

The Building Safety Bill will impact all buildings and not just high-rise multi-occupied residential buildings and we anticipate that it will achieve royal assent in September or October 2022.

The Bill changes applicable standards for design and construction. It also provides for a new 'gateway' regime to ensure building safety risks are considered at each stage of the design and construction. Compliance with the Bill will be a heavy obligation for firms that requires a lot of work, time and resources and we recommend that planning should start now.

The Bill will further empower the Architects Registration Board to monitor architect competency, set relevant criteria and remove an architect from the register if they fail to meet these criteria. As such, the Bill will have major financial and practical consequences for developers, property owners, construction professionals and their insurers.

Of great concern to practitioners are the proposed amendments to the Defective Premises Act (DPA) and the Limitation Act.

> **The proposed amendments to the Limitation Act would more than double the time for a claimant to bring an action in respect of damage or defects from six to 15 years.**

With retroactive application, claims which had previously been out of time may now have an additional nine years in which to be brought.

The potential extension of limitation under the DPA to 30 years is also a cause for concern, particularly where insurance cover for fire safety related claims is not now commonly available. In the event these amendments come into force, we expect a rise in both notifications and claims.

> **Grenfell accelerated an already hard market for professional indemnity insurance, creating potential gaps in cover for some design professionals and/or increased premiums, deductibles and more onerous conditions. The Bill is anticipated to exacerbate this trend.**

There also remains the very real prospect that faced with an ever growing number of claims, those involved in the external façade of buildings, and with the expertise to put right defective works, will be forced to cease trading and/or be uninsured (due to prohibitive premiums) in respect of any works undertaken to remedy fire safety issues. This will inevitably add to the skills shortage crisis.

These concerns will have to be addressed by developers and the wider construction industry and its insurers if a successful framework for

remedying fire safety issues is to be successfully established.

The Levelling Up White Paper

The long-awaited Levelling Up White Paper (the White Paper) was released by the DLUHC on 2 February 2022. The White Paper outlined the government's 12 key 'missions' to rebalance opportunities across the UK and reverse the decline observed in certain areas.

Disappointingly, the White Paper did not include a plan for the retrofitting of homes although it announced a £2.2 billion funding scheme to address the worst (energy) performing homes and those least able to pay.

With the exception of a retrofit plan, the White Paper covered a broad spectrum of areas (infrastructure, housing, education, social issues and devolution of power), all of which impact the construction sector. Many of the elements fall within social value measurements, indicating the increased focus of ESG considerations.

The White Paper also announced a 'local skills improvement plan' (the Plan) to be rolled out with funding across England. This will give local employers and stakeholders a statutory role in planning skills training in their area.

The aim of the Plan is to make sure the skills gap is being addressed on a proportionate regional level and it is hoped that construction training will play a large part of the Plan.

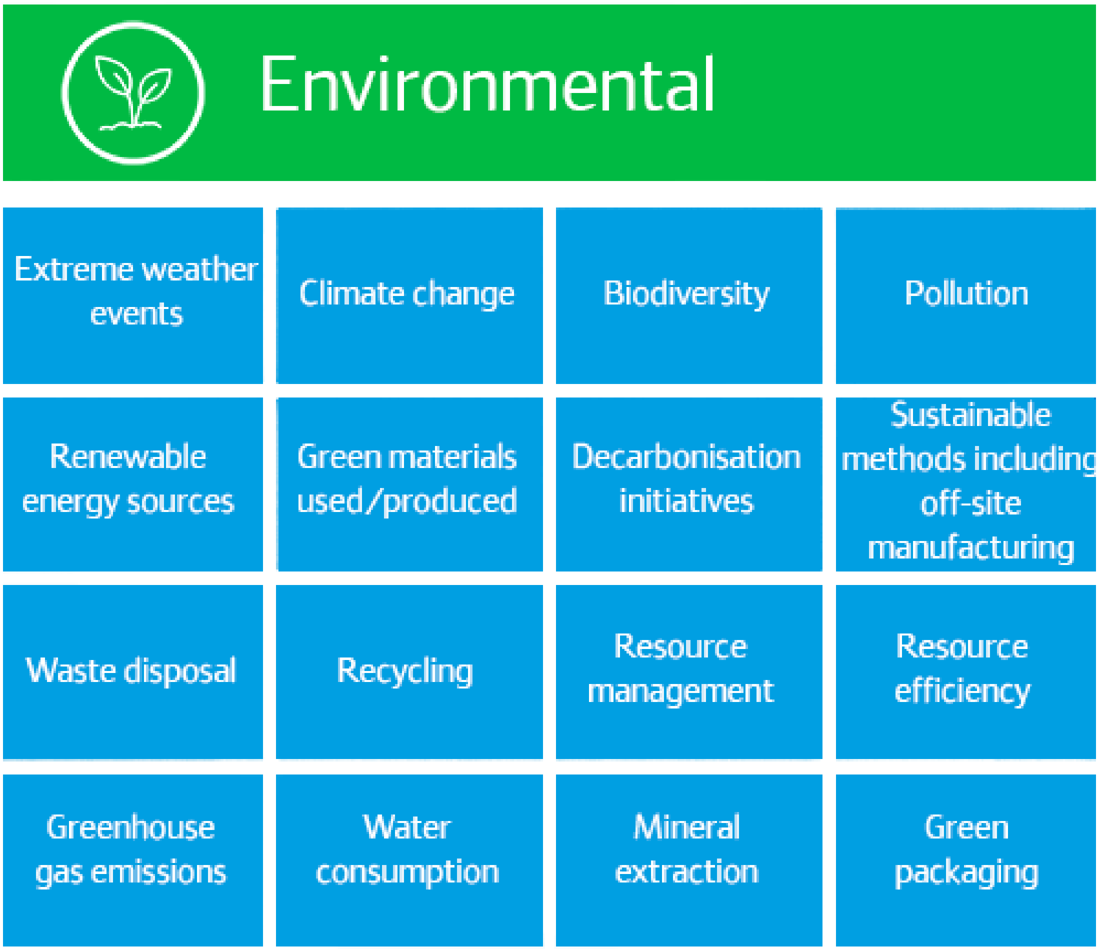
If the funding is allocated correctly, the Plan has the potential to go some way to plug the current skills crisis.

Key topics to watch in 2022

Having considered all key legal and regulatory developments, we summarise the impacts of the three main topics that will continue to dominate the remainder of 2022, namely environmental, social and governance risks (ESG), disruptive technology, the driver of ESG and supply chain impacts.

Sustainability: ESG

ESG is not a new concept, but it has been brought into sharp focus by the pandemic and has moved from a fringe concern to the centre of business decision making in all sectors. With that comes new kinds of risk for all construction parties and their insurers to navigate. But what are the key ESG considerations for the construction industry?



Social

Corporate Social Responsibility	New technology	Health & safety	Healthcare
Accessing financial support	Training & education	Human rights	Diversity & inclusion
Community impact & social value	Employment opportunities & rights	Privacy & data protection	Exploitation & modern slavery
Responsible investment	Emergency response planning	Product liability & product safety	Legacy planning

Governance

MMC policy & regulation	Project delays	Constitution of governing body of project location	Supply chain issues
Procurement	Corruption & bribery	Corporate governance	Corporate behaviour
Industry standard certification	Relevant permissions	Anti-competition practices	Financial system stability
Policies	Strategies	Diversity, equality & ethics	Stakeholder engagement

(i) Environmental considerations

“With many of our insurance clients experiencing a rise in claims relating to renewable energy projects and sustainable methods of construction, now is the time for consideration of policy wording to deal with these trends. Insurers will also need to work with Insureds to help them reduce their carbon footprint and to upskill in these new technologies. This should assist with the environmental impact of construction projects and, at the same time, reduce the number of claims in this arena.”

Iain Corbett, Partner, London

The Climate Change Committee aims to decarbonize the UK power sector by 2035 with electrification, supported by low-carbon hydrogen. As we strive for a green economic recovery, renewable energy technologies remain a priority.

Particular to construction, this will involve the increased build of renewable energy plants such as windfarms, the increased use of solar panels and new greener materials such as low-carbon concrete, energy efficient UV filtered glass, cross laminated timber and climate neutral bricks.

In addition, the newly established Building Research Establishment Environmental Assessment Method analyses the sustainable value of a construction development against various metrics including land use, construction methodology and as-built energy efficiency.

This method is not yet a legal requirement but is specified as a planning condition by some Local Planning Authorities.

There will also be a push for responsible sourcing of building materials under British Standards BES 6001 and BES EN 8902 and BREEAM certification. Other sustainable certifications now available include Leed, GRIHA, CRRM, GSAS, EDGE and WELL but again, these are not yet mandatory.

All of these initiatives present significant economic opportunity for the sector but they do not come without their issues.

Given the timescales involved up to Net Zero by 2050 and the call for mandatory energy performance disclosures and whole life carbon measurements, we are likely to see an increase in construction claims involving renewable technology, green methodologies (such as MMC) and materials.

Key areas of liability for the following renewable energies include:

- **Wind projects** - the positioning of subsea cables for offshore windfarms, workmanship in the manufacturer of key parts and completed projects not meeting forecast output levels.

- Waste to energy products - the building and civil and structural engineering design are secondary to the process plan design. Hence, accurate data concerning the process plant is necessary to both the designer and contractor at an early stage to avoid errors and delays.
- Solar projects - despite their increasing popularity, solar projects represent a major area of potential liability (predominantly fire damage). This is particularly so with residential construction projects where liability arises at the installation and 'use' phases of solar panels.

Consequently, careful consideration should be given to design and build contracts and insurance policies to ensure contractual obligations fall as intended when relying on all new technologies in general.

> **For construction professionals in particular, innovation and new approaches will lead to mistakes in design and consequential remedial works at the expense of PI insurers. Construction professionals must therefore stay up to date with regulations, climate change technology and innovation.**

Most importantly, to make sure they properly consider all risks when designing climate resilient buildings and to record their decisions so that the project team is aware.

Thorough reviews of CAR, EAR and TPL policies need to be undertaken to ensure emerging, sustainable technologies are covered.

Where they are not, the industry is turning to new insurance solutions to supplement traditional coverage such as:

- Energy Efficiency Insurance which covers the value of remediation concepts and financial losses resulting from a faulty remediation concept.
- Tokio Marine & Nichido Fire's Mega-Solar Package Program which combines coverage across construction, liability and warranty with risk consulting services for solar power plant facilities.
- Swiss Re's customised, index-triggered protection products for wind and solar energy that safeguard against loss of income due to adverse high or low wind conditions, lack of sola irradiation or variations in water levels.

Parametric insurance, whilst not new, is on the rise. Similar to a financial option, it insures a loss that occurs when a measurable value is exceeded or not reached.

> **Parametric insurance can smooth out volatility and establish more comprehensive protection in circumstances where there is lack of sun for renewable energy or too much/too little wind for electricity generation.**

Alternatively, protection/coverage gaps can be plugged by drafting new sustainability clauses in traditional policies. The Chancery Lane Project has brought together insurance lawyers to draft clauses which insurers can look to incorporate in policies, to provide for the repair, rather than replacement, of damaged property and/or use of parametric insurance (where the policy is triggered if certain objective criteria, such as wind speeds, are met).

All the steps outlined above could see the construction insurance sector tackling new claims effectively, while also making positive movements towards a more renewable future.

(ii) Social considerations

Social value

“Many of our clients have long embraced their role in the community by providing educational, charitable and environmental initiatives, as part of a social value policy. For the larger players in the construction market, the increased demand for focused and measured social value will be managed as a valuable part of their business plan.

However, it will be difficult for the whole supply chain to respond in this way – especially with market pressures around inflation, labour and materials shortages. Smaller businesses may need to collaborate with others, or be more creative, to deliver social value in a measured way.”

Helen Johnson, Partner, Sheffield

Social value, the inclusion of community benefits within construction contracts, is not a new concept but is one that is growing in focus within the industry. It currently holds greater weighting in bids and tenders, giving it serious commercial implications.

This is predominantly due to the amendments, introduced in January 2021, to the Public Services (Social Value) Act 2012. Consequently, all major central government procurement must explicitly evaluate social value.

This challenge has been totally embraced and we are seeing social value being built into a construction project from the outset across the whole of the public sector, not just those schemes being procured by central government.

In particular, it has given local authorities added confidence to demand that their suppliers deliver against the policies outlined by central government and placed social value at the heart of delivery.

There has therefore been a clear shift in mindset over the past 12 months and the private sector is following suit.

Many private sector developers and contractors are now committing themselves to delivering social value within their construction projects as part of their commitment to the ESG agenda.

This is due to the changing expectations of investors, stakeholders and customers which has inextricably linked social value to business resilience. Taking social value seriously can improve brand perception, employee satisfaction and productivity. Failing to do so can result in loss of talent, falling revenue and reputational damage.

However, there are some issues which bring uncertainty (and therefore increased risk) to construction projects, namely:

- There is no legal definition of social value.

- The capturing and measuring of outputs is inconsistent due to the subjective nature of social value and the objective need to measure and communicate social value practices. Consequently, there are a number of measuring tools available resulting in inconsistent standards.

> **To assist these issues, the Construction Playbook has set out five key themes to clarify social value, namely: COVID-19 recovery, tackling economic inequality, fighting climate change, equal opportunity and wellbeing.**

Further and to overcome inconsistent standards, many in the industry are calling for disclosure of ESG data to develop benchmarks to get a true picture of what social value means to every area of the country.

Diversity and inclusion

Another social consideration is diversity and inclusion within the construction industry. The more diverse and inclusive the industry is, the more likely it is to attract young workers and new talent. This, in turn, will help address the current skills and labour shortage that the industry is facing. The key to attracting diverse, new talent, it appears, is education.

> **Women account for almost 50% of the UK's workforce, yet only represent 13% of the construction industry.**

A recent survey carried out by Munday & Cramer found that offering alternate educational routes into the industry (such as apprenticeships and T-levels) would attract more women at entry level.

Another solution to the skills shortage is to appeal to a younger, increasingly environmentally conscious workforce.

(iii) Environmental governance

Biodiversity net gain (BNG)

The Environment Act 2021 has introduced a new condition to every planning permission granted: a Biodiversity net gain (BNG) of 10%.

> **Whilst BNG will not come into force until late 2023 at the earliest, the public sector has been encouraged to include BNG in all public procurement as of now.**

The aim of BNG is to ensure that when a new development is completed, there are more potential habitats for animals and plants to thrive than before the development began, hence a gain in biodiversity. Not all construction developments are required to comply and there are exceptions.

Whilst the policy is welcomed, there will be challenges the industry will need to overcome. These include:

- Longer planning permission processes for new developments with the new BNG regulations.
- Project costs could increase with the added cost on the preservation and advancement of habitats.
- Build times for developments could be increased due to more work to complete impacting developers and the people waiting for property.
- There may be a lack of knowledge among people within the construction industry over what biodiversity is and how they're going to take actions to improve it.
- There needs to be awareness spread by the people enforcing Biodiversity net gain to ensure that the industry is aware.

- There is no indication, at present, of how the measures are going to be regulated and enforced.

Hence, if these considerations are not factored into the development and all project contracts, we may see claims for delay, design errors and potential penalties for breach of the BNG provisions.

Schedule 3 of the Flood and Water Management Act 2010

There is widespread support for the implementation of Schedule 3, which has not yet been passed as part of the Flood and Water Management Act 2010 in England, to tackle the growing incidence of surface-water flooding. It will give powers to local authorities to approve new sustainable drainage systems and the way they connect to public sewers.

It has been reported that Schedule 3 could be introduced in the coming months to align planning policy that is related to sustainable drainage systems as recommended by the Climate Change Committee.

If so, the design and build times will need to be factored in, failing which we may see claims for errors and delays. As with all new technology, there may also be a lack of consultants and contractors familiar with sustainable drainage systems.

The role of technology

The key enabler to the adoption and implementation of ESG commitments is digital transformation and technology.

Until now, the construction industry's focus has been on reducing operational carbon as outlined above. The next great challenge for the industry is to reduce embodied carbon. The industry is therefore being encouraged to take a whole life carbon approach to construction and to balance the carbon cost of installing greener materials against their operational carbon footprint.

One new technology already available that can take a whole life carbon approach to construction is digital twin technology.

A digital twin is a virtual representation of an existing physical entity that relies on data to offer valuation information in the form of analytics. The technology can be used to improve the safety and efficiency of a building. It can also ensure that a building meets sustainability requirements.

Another feature of digital twins is that they can predict a failure before it happens and can even offer solutions to prevent them from happening at all.

Other new technology which we predict will grow in use are:

- **Smart contracts**: built from blockchain technology, smart contracts offer all construction parties a shared system to do business, allowing them to buy, track and pay for services. Construction companies can use smart contracts as an all-in-one tracking system where rules and deadlines are set which the blockchain then enforces. Consequently, this system will enable faster completion, increased security, better project tracking and an automated supply chain.
- **Augmented reality (AR)**: AR is a technology that overlays digital information onto the real world. It can be used to overlay instructions onto objects, show 3D models of buildings and help with safety. It is expected that AR will this year become a staple in the construction industry as it helps workers overcome many common challenges such as working in difficult or dangerous positions, inspecting complex structures and using heavy machinery.

> **These new technologies will create new risks and liabilities but will also bring new opportunities. The industry has, so far, adapted well to the transition to net zero and we are confident it will continue to be resilient in the face of these new challenges.**

Supply chains

Extreme weather events linked to climate change coupled with the pandemic and geo political impacts (such as the current Russia/Ukraine conflict and Brexit) will continue to disrupt global supply chains in 2022.

> **China currently has 37 million people now in lockdown, resulting in "yet more growth-sapping turmoil in global supply chains".**

The International Panel on Climate Change (IPCC) report, published in February 2022, confirmed global temperatures are currently 1.1 degrees C above pre-industrial levels, with temperature rise currently projected to overshoot the recommended 1.5 degree Celsius target over the next 20 years. Consequently, we will see an increase in extreme weather events and a growth in severity.

> **80% of timber used in the UK is imported predominantly from Canada and Sweden which suffered wildfires and insect damage in 2021 as a consequence of extreme weather events. This, in turn, has had a detrimental impact on stock.**

The shortage of materials has resulted in a significant rise in prices that cannot be underestimated. The Trade Federation (TTF) reported that timber prices had surged by 50% between January and May 2021.

Data from BEIS indicates that structural steel costs were 72.6% higher in October 2021 than the previous year. In November 2021, we saw steel prices increase for the seventh time in 2021. With these and other shortages across the board, it's a "perfect storm for disruption in an industry built on tight margins".

To avoid the direct impact to operations and the associated reputational damage to a company's brand, supply chain resilience is now a priority issue for the construction industry including insurers.

Key contacts | get in touch

If you would like to discuss any of the issues raised in this report in more detail, please reach out to your Kennedys client relationship partner or get in touch with any of the contacts listed below.

To find out more about our services, expertise and key contacts, visit our website.

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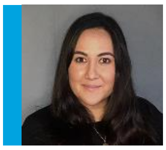
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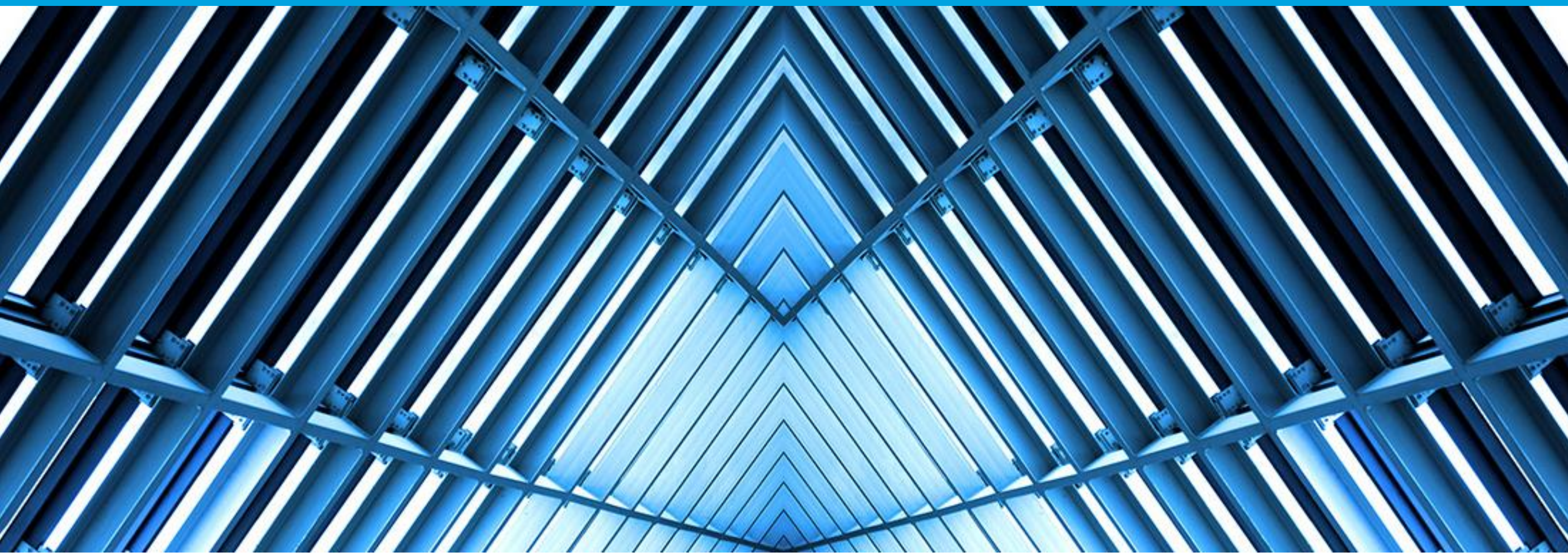

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