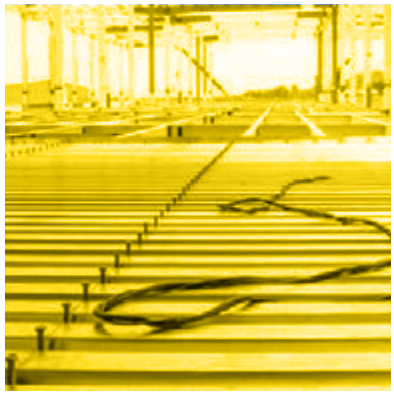
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How North American Construction Contractors Can Mitigate Emerging Risks

Getting ahead of risk is vital for North American construction contractors, as they aim to manage evolving issues, while delivering job safety, solving workforce shortages, and containing project costs.

Key Takeaways

1. Contractors in North America are faced with many risks that challenge their ability to grow profitably in a volatile landscape.

2. In this environment, all project partners should engage in thorough project risk review. A key risk review item is the contractual review process, which is especially critical to establish the sharing of liability among project participants.

3. Making better decisions starts with finding a risk adviser and broker with the right expertise to help contractors navigate and manage myriad project risks.

North American construction contractors are faced with challenging risk conundrums: mitigating current and emerging risks, ensuring job safety, and containing project costs. However, there are ways to navigate these difficulties to remain successful.

Cost control and protecting project profitability are critical for any business, including construction companies. By managing expenses, controlling project costs, optimizing resource allocation, and negotiating favorable contracts, construction stakeholders can maintain profitability and financial stability. This becomes particularly important during economic slowdowns, when demand may decrease and margins tighten.

Top 10 Risks for the Construction Industry

1. Economic Slowdown/Slow Recovery
2. Failure To Attract or Retain Top Talent
3. Workforce Shortage
4. Cash Flow/Liquidity Risk
5. Commodity Price Risk/Scarcity of Materials
6. Cyber Attacks/Data Breach
7. Major Project Failure
8. Political Risk
9. Aging Workforce and Health-Related Issues
10. Regulatory/Legislative Changes

Source: Aon Global Risk Management Survey, 2023.

As a result, project owners have frequently pushed risk to contractors using structures such as engineering, procurement, and construction; design-build; and public-private partnership contracts. However, these models often lead to large losses, causing many contractors to avoid their use.

Instead, contractors are increasingly looking for structures that improve and balance construction risk management, including progressive design-build, alliance, and integrated project delivery.

Current and Emerging Risks in Construction

Near-term volatility is top of mind within the construction and infrastructure industry. Climate issues and emerging technologies are introducing new challenges. Other hurdles found across North America and the globe include the following.

The Current Labor Market

Contractors of all sizes are aggressively seeking ways to find more skilled workers in an industry where nearly 1 in 4 construction workers are older than 55.[1] In February 2024, Canadian construction employment fell by 0.6 percent year-over-year.[2] Further, the construction industry in the United States needs to attract half a million new workers in 2024 to balance supply and demand.[3] With fewer and less-skilled workers available, productivity suffers and jobsite safety is put at risk.

Alternative Building Materials

Mass timber and concrete alternatives are innovative building materials being deployed to address sustainability goals. With these new approaches, there are potential risks that project stakeholders and their insurers must address, including the long-term durability of such materials.

Geopolitical Risks

The conflict in Ukraine, issues in the Middle East, upcoming elections in the United States, and other geopolitical risks are pushing governments to rethink climate spending and reallocate funding to defense spending. This impacts construction spending as projects are scaled down.

Artificial Intelligence

The use of artificial intelligence (AI) in the construction industry can transform an industry that is still strongly associated with manual, in-person labor. AI technology has the power to impact many aspects of construction—from production, design, and bidding to financing, supply chain, asset management, and daily operations. However, at the same time, it can introduce new risks.

“While AI can create efficiencies, more clarity around the liability associated with this technological innovation is needed,” says Brenna Mann, head of strategy and account executive practice leader in Aon’s US Construction and Infrastructure practice.

One example is the use of self-operating vehicles on jobsites. This innovation raises new liability concerns, such as who is responsible if a self-driving vehicle gets into an accident on-site.

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1 US Bureau of Labor Statistics, “Spotlight on Statistics,” 2020.

2 Statistics Canada, Labour Force Survey, Table 2, February 2024.

3 Associated Builders and Contractors (ABC), “ABC: 2024 Construction Workforce Shortage Tops Half a Million,” January 31, 2024.

Subcontractor Default

Emerging project risks also impact subcontractors, who have had to shoulder substantial additional costs, creating cash-flow issues. Consequently, subcontractor default is now a major concern. In 2023, 46 percent of subcontractors reported cash flow as a significant challenge.[4] This issue is mostly linked to risks including labor shortages and a potential economic slowdown.

"We're in uncharted territory in terms of the size of the packages and the ability of subcontractors to get adequate performance security, which doesn't exist when you have ultra-large projects being built," says Martha Gaines, senior vice president of Aon Risk Solutions in the United States. "The risk is concentrated in a few subcontractors and there's not enough capacity. We need to start thinking of alternate ways for contractors, subcontractors, and the surety market to work together."

Design-Build Project Coverage

The complexities of projects are increasing, whether driven by size of contract or scope of work. Contractors are focused on risks associated with design-build projects, which have caused many large losses and cost overruns.

"Contractors have concerns around design-build risk and the inability to adequately insure it, along with the fact that there is little to no cover for liquidated damages due to delay associated with the cascading problems that design-build risk can create," adds Ms. Mann.

Getting Ahead of Construction Risk

Contractors operating on tight profit margins must be able to make better decisions to proactively navigate risk and prepare for evolving market challenges. This includes insurance solutions that provide certainty of claim payments and liquidity upon a loss occurrence.

Contract Analysis: A Crucial Process To Address Potential Coverage Issues

The contractual review process is crucial. At the outset of a project, contractors and project owners should work with a broker that will understand the project, including local coverage nuances. For instance, each state in the United States has its own interpretation of what is insurable and how various insurance policy conditions apply, including the application of limits and deductibles for each project participant and the ability to transfer liability to others.

> *It's only in strong contractual risk mitigation that contractors can find relief, whether seeking compensation from the owner or working with their brokers to modify insurance policy wording to transfer unmanageable risks to insurance companies.*
>
> Jeffrey Segall
> Executive Director, US Construction and Infrastructure, Aon

4 Billd, *2024 National Subcontractor Market Report*.

The Seven-Step Project Advisory Process

Whether working with a contractor or an owner, the broker can be a helpful partner in overall risk advisory. This seven-step process focuses on effectiveness and practicality. Beginning with a meticulous project risk assessment, the process identifies key risk mitigation strategies. It integrates risk management seamlessly into project objectives and budgets, ensuring a more balanced approach to risk mitigation throughout the project life cycle.

1. Project risk assessment: Review risk register, draft contract versions and commentary on risk allocation, insurability, extent of cover, and mitigation.
2. Probable maximum loss (PML) study: Conduct PML analysis through engagement with leading insurers and reinsurers.
3. Loss adjuster tender: Nominate your preferred partner, matching expertise to project needs. Agree on claims protocols and conduct pre-loss preparation workshops.
4. Construction phase support: Coordinate site visits, execute loss mitigation, support major claims, and deploy strategic negotiation to achieve target outcomes.
5. Seamless transition to operational phase: Provide full policy documentation with suitable lenders' endorsements. Bring to resolution outstanding claims and optimizing cash flow.
6. Operational phase support: Leverage project claims experience and lessons learned in reviewing loss adjuster nominations and claims protocols. Continue support of major claims toward expeditious resolution.
7. Divestiture/decommissioning support: Provide warranty and indemnity solutions for a clean exit.

If a contractor doesn't set up the contract so that costs stemming from delay and disruption, supply chain issues, labor shortage, and design difficulty are covered, no insurance policy can respond.

Key contract issues to watch out for include the following.

- Scope creep
- Delay and disruption
- Payment disputes
- Design and specification issues
- Health and safety risks

"It's possible that a contractor or risk manager doesn't see beyond some of the various risk exposures, so the contract must have a fair risk allocation," says Chris McLean, head of Aon's Construction and Infrastructure in Canada. "It's important to work with a broker who advises around areas in the contract that the general contractor would be responsible for so they can use that information in negotiations and build those costs into their estimate."

Four Strategies To Manage Evolving Risks

Contractors can employ the following strategies to manage risks head-on and get ahead of the many challenges associated with operating in a volatile climate.

1. Evaluate contract structure with a focus on required insurance and risk assumptions, such as whether the contractor is responsible for site conditions.
2. Determine liquidated damages or other delay costs that contractors may be responsible for and use risk transfer tools like parametric insurance to address this exposure.
3. Find the right broker—with experience in construction risks—to create a program that best fits the contractor's risk retention, risk-reward, and desired risk profit.
4. Implement risk control measures to ensure jobsite safety.

Learn more about how contractors can manage interconnected risks and notable macroeconomic developments through effective risk mitigation and tailored insurance solutions.

Aon's Thought Leader

James Dunn
Chief Commercial Officer, US Construction and Infrastructure

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