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Construction After COVID-19

Things are not all bad, but check your insurance

By: Joseph S. Harrington, CPCU, ARP

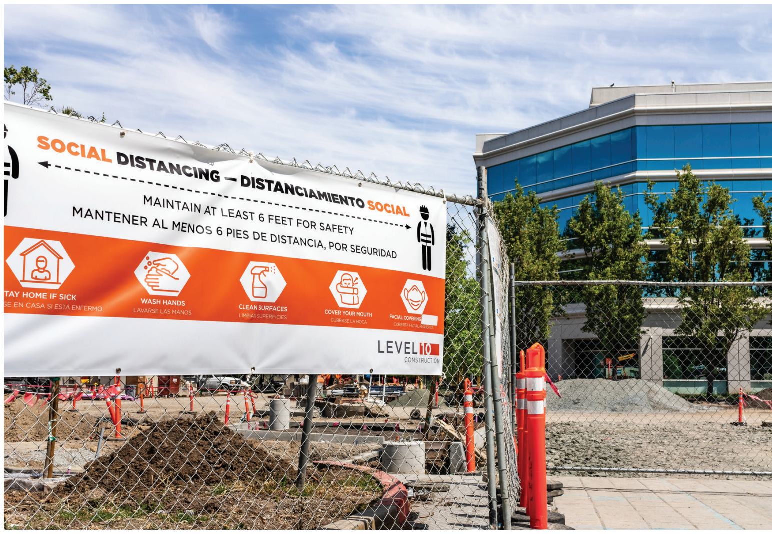
If you own or use commercial buildings, it's almost certain that you'll be involved in a construction project someday. When that time comes, it's equally likely that your project will encounter some type of complication, whether with delays in shipments, difficulty in scheduling contractors, discovery of structural problems, or any of a number of things that make a project more complicated and costly than anticipated.

While a few such complications should always be anticipated, a property owner wouldn't normally expect to encounter all of them at the same time. That, however, may be the case for the rest of 2021 and well into 2022, and perhaps even beyond, as the impact of the COVID-19 pandemic on construction is likely to last indefinitely or remain permanent.

The pandemic's impact on construction was widespread and profound, but not entirely negative. Many projects were suspended as the economy was shut down starting in March 2020, but the sector recovered fairly quickly in the summer. The construction recovery faded, however, with the coming of fall weather and a resurgence of coronavirus infections.

Safety Precautions

Overall, the pandemic added costs and delays to projects as access to and movement within job sites was tightly regulated. As modest as some of the restrictions may seem, they added marginal costs and contributed to delays. It's



by no means clear if or when such safety measures will no longer be required.

Gordian, a leading provider of construction cost data and related services, believes they're here to stay, at least on projects involving schools, hospitals, and other facilities either publicly owned or for a public purpose.

"[Construction cost] estimators still have to plan for the types of [precautions] COVID has brought on," said Bob Mewing, chief engineer for Gordian, in a 2021 web presentation. Those precautions include temperature checks, frequent hand-washing, social distancing, wearing masks and gloves, and the supervision required to see that health and safety guidelines are followed.

Sheila E. Salvatore, Editor | Editor@AdjustersInternational.com

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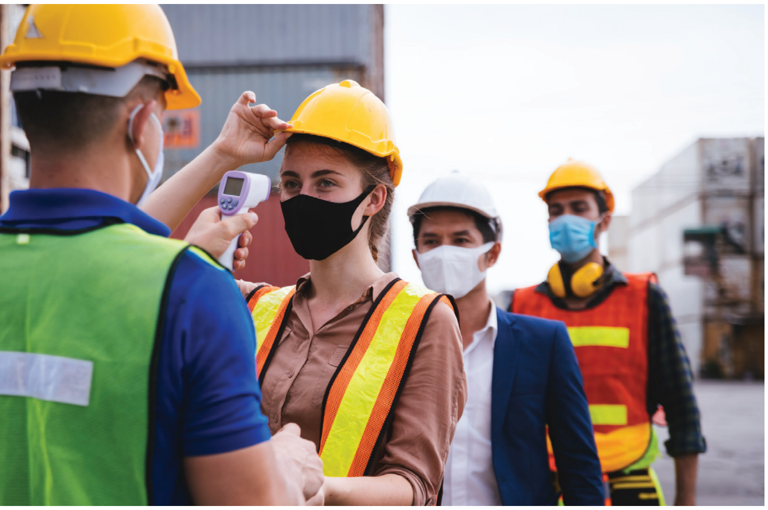
Given that new reality, Gordian has developed modifications to the well-known RSMeans construction cost estimates (which Gordian acquired in 2014) to account for the added costs of infectious disease precautions and biohazard remediation at job sites.[1]



The costs of infectious disease precautions might not be significant if they did not come at the same time contractors are struggling to recruit and retain skilled workers, a problem the sector has wrestled with since thousands of artisans retired or left the business following the real estate collapse of 2007.

Faced with both a labor shortage and restrictions on how they can deploy labor at a jobsite, contractors are getting creative in utilizing the workforce they have. For example, firms are utilizing both video surveillance and QR codes to monitor compliance with safety guidelines. Also, there is evidence of a growing use of prefabricated components created offsite and installed in a project as a means to reduce the number of workers needed at a job site.[2]

Materials Cost
Compounding the stresses of a tight labor market are recent spikes in the cost of building materials.

"Over the past 12 months, the upward trajectory of material costs has been striking," said Rider Levitt Bucknall (RLB), a construction cost data firm, in its report on the first quarter of 2021. According to RLB, copper, aluminum, oil, and lumber all experienced significant price hikes during the pandemic.[3]

That observation was shared by CBRE, a leading construction analysis firm, which reported that by May 2021, steel and lumber prices were more than three times their level at the end of 2020. "Rising costs are creating sticker shock for developers," CBRE writes, "[This is] causing some to cancel or postpone projects. Others are increasing their pre-pandemic construction budgets by as much as 20%."[4]

According to Jay Hannah, president of Woodus K. Humphrey & Co., part of Amwins, a leading insurance intermediary, lumber mill owners expected construction demand to fall in the wake of the pandemic. Unexpectedly, he says, "most homeowners were sitting in their houses, looking around, and thinking it was time to renovate with a new deck, a new addition, or even a new house.

"Suddenly there was huge demand and a significant backlog in the supply of lumber." Fortunately, he adds, timber management practices implemented in the 1990s and 2000s resulted in an abundance of available trees, and the lumber industry has begun catching up with demand.

It's not just the cost of materials that concerns contractors, but also volatility in the supply of materials, whatever the cost. "Contractors are afraid they're not going to be able to get their materials, or they're going to come significantly later than they planned," says Mewing of Gordian.[5]

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Impact on Owners
Given the backlog of projects, shortages of skilled labor, and supply chain disruptions, MarshMcLennan finds that "contractors are likely to be more selective in the jobs they bid for, the conditions they're willing to accept, and the partners they work with."[6]

So, for at least the next several months, property owners will find it to be harder and more costly to execute a construction project than in the years before COVID-19.

For those hoping to be "first out of the gate" with a new or renovated commercial building project following the pandemic, that will be hard to accomplish unless you're willing to pay substantially more than normally estimated cost for expedited delivery. Even with that, there's no guarantee your project won't be thrown off-schedule by a shortage of materials.

Given that, many property owners planning to build or renovate may choose to wait for the construction market to reach a new equilibrium.

As of mid-2021, we have yet to see how the widespread work-from-home pattern established during the pandemic will permanently affect the design and market for commercial office space. Since it is likely that another virus will emerge at some point, major innovations are anticipated to enhance ventilation and allow for efficient social distancing in all types of commercial space.

Since property owners can't assume that their property will serve the same purposes after COVID-19 as it did before, it may be just as well that they wait to see what demand emerges. At that time, the final costs of construction will be better known.

Insurance Valuation
Of course, if a property suffers damage from a fire, windstorm, or some other hazard, the owner won't have the luxury of waiting for the construction sector to stabilize before having to rebuild. In anticipation of such a possibility, all property owners are advised to review their property insurance to see if their coverage is adequate to address the high cost of materials.

A surge in materials costs can affect property insurance coverage in two ways:
- In the case of a total loss to the property, the cost of replacing it may exceed the amount of insurance available; and
- Even in the case of a partial loss, the amount recovered for repair could be reduced by a "coinsurance" penalty.

Coinsurance provisions require that the amount of insurance purchased for a property be at least equal to a certain percentage of the property's overall value, typically 80%. If the limit of insurance is less than the coinsurance percentage, the amount paid by an insurer for any loss will be reduced by a corresponding percentage. (The logic behind this practice is that large properties have a greater possibility for loss, and the premium collected should reflect that.)

Ethan A. Gross, CEO of Globe Midwest/Adjusters International, says pandemic-related disruptions have created a "perfect storm" of conditions that has restoration contractors struggling to complete repairs for amounts agreed to by loss adjusters.

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"With experts predicting an above average 2021 Atlantic hurricane season, as well as increased potential for an intense wildfire season, these factors create a recipe for disaster," Gross writes. Fortunately, he adds, there are several steps property owners and their insurance agents and brokers can take to prepare.[7]

In July 2021, the American Property Casualty Insurance Association (APCIA), a trade association for insurance companies, released a white paper citing policy conditions property owners should be aware of. These include:

- Replacement cost coverage, which pays an amount necessary to replace a structure with materials of like kind and quality. This contrasts with actual cash value coverage, which pays only up to the depreciated value of the damaged structure or components.
- A factor to reflect the effect of inflation on repair and replacement costs.
- Coverage for the additional costs of bringing undamaged parts of a damaged structure into compliance with building codes and ordinances.
- "Extended" replacement cost coverage, which increases the amount of coverage available to rebuild during periods of "demand surge," when the costs of labor and materials rise in the wake of widespread damage.[8]

Also, Gross encourages commercial property owners to ask about being insured on an agreed value basis, which could be more costly but eliminate the possibility of a coinsurance penalty. That may be a good option until the construction market works itself out.

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[1] Gordian, "COVID-19 Construction Costs Roundtable: A Year Later," accessed at https://www.gordian.com/resources/covid-19-construction-costs-roundtable-a-year-later/; and "2021 RSMeans data Release Webinar," accessed at https://www.gordian.com/resources/2021-rsmeans-data-release-webinar/

[2] See David Burczyk ,"10 Positive Construction Trends to Come Out of COVID-19," March 8, 2021, https://constructible.trimble.com/construction-industry/10-positive-construction-trends-to-come-out-of-covid-19

[3] Rider Levett Bucknall, *RLB Construction Cost Report North America Q1 2021,* p. 2; accessed at https://www.rlb.com/americas/insight/rlb-construction-cost-report-north-america-q1-2021/

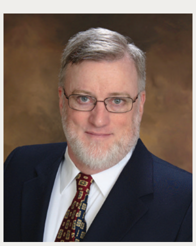
[4] CBRE, U.S. MarketFlash: Steel & Lumber Prices Raise Costs but Don't Dent Robust Construction Pipeline, May 2021; accessed at https://www.cbre.us/research-and-reports/US-MarketFlash-Steel-Lumber-Prices-Raise-Costs

[5] Gordian, "COVID-19 Construction Costs Roundtable . . .," op. cit.

[6] MarshMcLennan, *Five Ways COVID-19 Has Impacted Construction Companies,* October 2020, https://www.marsh.com/us/insights/research/five-ways-covid-19-has-impacted-construction-companies.html

[7] Ethan A. Gross, "Surging Construction Costs Create Surging Risk of Being Underinsured," NU FC&S Expert Coverage Interpretation, Feb. 22, 2021

[8] American Property Casualty Insurance Association, *U.S. Property Insurance Market Struggles to Balance Supply & Demand,* July 2021, p. 8; accessed at https://www.apci.org/attachment/static/4383/ accessed at https://www.globemw-ai.com/assets/EM07-6148_GlobeAI-FCS_SurgingConstructionCosts.pdf



About the Author

Mr. Harrington is an independent insurance writer and communications specialist. He served for over 20 years as communications director for the American Association of Insurance Services (AAIS). His work has been published in *Best's Review, Rough Notes,* publications of The Institutes, and elsewhere.