Construction trends – checking the rear vision mirror while keeping an eye on the road ahead

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wotton kearney

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AT A GLANCE:

- The past 12 months in the construction industry have been punctuated by a collection of legislative reforms, pandemic responses and technology advances.
- It's also been a challenging time in which the industry has been dealing with the continued fallout from market-shaping events, such as the Lacrosse and Grenfell Tower fires and heightened rates of insolvency.
- Against this backdrop, there have been opportunities for industry improvement and innovation driven by major infrastructure spending and economic stimulus.
- In this retrospective analysis, we look at the key events of the past year in construction and how they have impacted the insurance industry. We also anticipate the issues for the year ahead.

THE YEAR THAT WAS

The construction industry remained substantially open during 2021, with some exceptions and some adjustments to ways of working.

In fact, 2021 saw a construction boom fuelled by people who had money to invest in home improvements thanks to cashflow boosts, travel bans and the government's HomeBuilder grant scheme. Nationally, there still remains a substantial volume of construction and infrastructure work in progress and in the pipeline.

However, unsurprisingly, 2021 was also a testing year for the construction industry with materials supply-chain interruptions and a reduced density workforce caused by government directions and demobilisation. These factors have contributed to the industry being over-represented in insolvency statistics, despite the boom in construction-related activity.

Notwithstanding the challenges caused by the combination of COVID, materials and labour shortages, and instances of insolvency within the industry, there are many large-scale infrastructure projects underway nationally. The profitable delivery of these projects may well be assisted by advances that are being seen in technology and digitisation in construction.

COVID-19

Delays to projects in New South Wales and Victoria were compounded by construction bans in and around metropolitan and regional areas amid rising COVID-19 case numbers and infection outbreaks. The 'snap' nature of the shutdowns resulted in liquidity issues for contractors and sub-contractors alike and highlighted the importance of agility within the sector.

As part of the reopening roadmap in Victoria, contractors have been required to implement updated COVID-safe plans, appoint COVID site-marshals and issue declarations of compliance. Best practice guidelines have been introduced to minimise the spread of COVID-19 on construction sites, which address physical distancing, safe meal and rest breaks, and safe hydration. Additionally, a permit system and vaccine mandates for construction workers have been implemented and there have been efforts to improve tearoom ventilation.

The post-industry shutdown landscape has been one of increased regulatory scrutiny, COVID-safe restrictions and compliance enforcement. Where COVID protocols are not observed, individual sites are threatened with closures.

Looking ahead:

In 2022, third-dose vaccination of workers is likely to become mandatory across most jurisdictions. With increased vaccination across the country, the industry hopes that labour shortages caused by lockdowns and worker furloughs will be less severe than in 2021.

Unfortunately, the challenges of materials shortages look set to continue with the ongoing disruption of supply chains for imported cargoes.

INSOLVENCY

Acute shortages of timber, resulting from the 2020 bushfires and disrupted supply chains for imported timber, have tempered contractors' ability to take advantage of the increased demand for construction services.

Contractors that have been caught short by unforeseen materials shortages have, in many cases, made losses on projects. The large-scale challenges facing the industry and the passing down the line of bad debt has resulted in thousands of subcontractors being forced into insolvency.

Looking ahead:

The Housing Industry Association predicts the construction boom to come to an end in mid-2022 due to two years of low population growth, higher building costs and the end of the HomeBuilder scheme.

Supply chain volatility is expected to continue, manifesting in delays in the delivery of materials and increased material costs. This will be particularly problematic in fixed-price type arrangements where margins are shrinking. This is expected to result in either insolvencies or increased claims activity as developers and builders look to restore their margins, or cut their losses, as pricing pressures are placed on building projects.

TECHNOLOGY

Emerging technological tools for construction are being explored by state and federal government agencies. These include cloud-based project management systems, virtual reality depiction and simulation of 3-D environments, and integration of planning and project management technologies through digital engineering and airborne data capture.

Cloud-based technologies are also being developed to find process efficiencies with project planning, tracking and management, connection of teams and disciplines, project risk tracking, streamlined payments and real time project information for project participants and stakeholders.

The StrataHub platform, introduced by the Office of the NSW Building Commissioner, has also advanced digital reform initiatives, allowing people living or intending to live in a strata scheme to access basic information about particular buildings.

REFORM

Victoria

The Victorian Government is reviewing the building legislative and regulatory system by establishing the Building Reform Expert Panel. It is focusing on efficient, safe and affordable delivery of sustainable buildings and housing, consumer protection and industry confidence, and enhanced practitioner and regulator support.

It has sought feedback on ways to improve the existing insurance arrangements and is considering a move towards project-based insurance. Reforms are expected to be delivered in 2022, with a new Building Act to follow in 2023.

The Victorian Government has legislated to further extend the time limit for commencing cladding claims from 12 year to 15 years (where the limit for such claims would have been reached between 16 July 2019 and 1 December 2023).

It has also established Cladding Safety Victoria (CSV), which is charged with the responsibility of funding and implementing the replacement of non-compliant combustible cladding across a range on Victorian buildings. Under amendments to Victoria's building legislation, CSV will assume a subrogated right to commence proceedings for the recovery of monies spent to replace combustible cladding, presumably leading to a further wave of claims against construction professionals.

New South Wales

In NSW the *Design and Building Practitioners Act 2020* (NSW) has been introduced. It establishes the liability of design and building practitioners within the construction industry and how they are insured. Most relevantly, the legislative reforms have:

1. created a registration scheme for building professionals, compulsory professional indemnity insurance, the planning portal, and the Office of the Building Commissioner, which are intended to bring transparency to the industry
2. established a new statutory duty of care under *the Design and Building Practitioners Act 2020* (with retrospective application), which is intended to enhance accountability of building practitioners and to address the perceived inequity of subsequent owners being unable to recover from building practitioners for defects in buildings they acquire, and
3. introduced powers to prohibit the issuing of occupation certificates, and rectification orders under Residential Apartment Buildings *(Compliance and Enforcement Powers) Act 2020*, which are intended to protect end users (ie. the buyers of apartments).

Looking ahead:

We anticipate legislative reform and the move towards a highly regulated environment will continue. Governments will continue to intervene in the construction sector, primarily through legislative changes. In Victoria in particular, those interventions are likely to take the form of substantial amendments to the Building Act, which may reflect the changes recently introduced in New South Wales.

We also expect to see increased regulatory action. Building practitioners have reported a significant upswing in investigations and notices being issued by regulators. It is clear that regulators have been given a mandate to pursue inquiries and prosecutions against building practitioners who may be in breach of their various statutory obligations. We see this trend continuing, which will likely place resourcing pressures on smaller construction businesses and result in significant legal spending as practitioners respond to and defend inquiries and prosecutions.

THE INSURANCE MARKET

The difficulties encountered by building practitioners and construction professionals in obtaining insurance over the last 12 months – and the last 3-4 years – are well documented. In the last year capacity has remained tight in the insurance market. Premiums remained high but are now beginning to stabilise.

In a response to the Lacrosse and Grenfell Tower fires, and government attempts to bring increased accountability to the industry, a range of reforms were introduced by way of mandated insurance and insurance arrangements. However, in many instances, the government response was out of step with the insurance industry’s appetite to underwrite construction risks.

The most obvious example of this ‘mismatch’ between government requirements and industry appetite was cladding exclusions. Understandably, insurers have been very reluctant not to include cladding exclusions in their policies. They are also concerned about indirect regulation of the profession through the requirement for construction professionals to be more vigilant in the selection and use of potentially non-compliant building products.

The initial government response was to resist the imposition of cladding exclusions, which were seen as a significant gap in cover with the potential to prejudice building owners, by mandating that building practitioners obtain cover without such exclusions. Ultimately, however, governments had to recognise the insurance industry’s response and subsequently softened their position on mandatory requirements regarding insurance terms.

The government position on insurance did not recognise the common reality that many building practitioners and construction professionals had sought to ‘bulk notify’ potential cladding claims under their existing insurance policies (which did not contain cladding or non-compliant product exclusions) with the effect that many (although not all) cladding claims had the potential to be covered.

Some positive reforms have also been seen. The most notable of these is the limitation of liability through the Building Surveyors' Professional Standard Scheme, which was introduced in 2021. In short, the liability of building certifiers and surveyors has been limited (for certain types of construction) resulting in the professional becoming 'more insurable'.

Looking ahead:

The insurance market has reported concerns around increasing long-tail risks, for example through the increased limitation period in Victoria for cladding actions and the introduction of the new statutory duty of care in New South Wales.

We anticipate a continued and steady flow of claims against building practitioners and construction professionals, particularly from owners' corporations. Events such as the Lacrosse and Grenfell Tower fires have brought into focus issues with non-compliant products and defective building works. In turn, this has empowered owners' corporations to pursue claims in an effort to remedy their common property.

Specialist law firms have been quick to pounce on these opportunities, approaching owners corporations and owners corporations managers to conduct building audits to identify potential building defects, and where appropriate, to commence action to seek compensation. This proactivity will result in increased litigation, both in the courts and statutory tribunals.

Plaintiffs and applicants will, however, need to grapple with the backlog of matters in the various courts and tribunals. The effects of COVID-19 continue to plague courts and tribunals as they seek to clear the cases that have accumulated in their lists over the past 24 months. While the backlog has start to shift recently, we anticipate delays will continue for the next 12-18 months.

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Need to know more?

For more information, please get in touch with our key national Construction PI team contacts on the next page.

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