**Publication: Contracts Journal**; **Date:**Jun 28, 2006; **Section:**Plant News; **Page:**20

# That sinking feeling

## As the UK steels itself for a hot, dry summer, Francesca Breeze looks at how climate change could affect the claims landscape, how insurers will cope and what demands will be put on contractors in their supply chain.

Climate change is now considered to be a real and active phenomenon. The Climatic Research Unit at the University of East Anglia reports that in the past 100 years, the average temperature of our planet has increased by 0.8°C, while global sea levels have risen by 20cm.

While this may not seem severe, the consequences are. The 2005 Atlantic hurricane season was the worst in recorded history, and in the same year Europe fell victim to its first tropical storm. Hurricane Vince formed 830km east of the Azores, much further north and east than is usual for hurricanes and in waters colder than those previously thought necessary for the creation of a hurricane.

With the incidence of natural disasters increasing at an alarming rate, environmental experts are at long last having their global warming research taken seriously, and those with the most to lose financially have
realised they must react to this issue today, not tomorrow.

The hurricane season started on 1 June and with it came a prediction from insurer-rating agency AM Best that major windstorms in the US could cause $100bn-worth of property loss and wipe out 20 to 40 insurers. Not surprisingly, the insurance industry was quick to react with a report that climate change policy and research now tops its agenda.

Much attention is justifiably given to the global situation, but what about closer to home? In 2005, Northern Ireland and Scotland were affected by windstorms when wind-speeds reached 124mph. How will climate change affect the UK claims landscape, how will UK insurers cope and what demands will be put on contractors in their supply chain?

In May this year, a leading direct insurer warned that two million London homes are at risk of subsidence if the winter drought is followed by a hot, dry summer. Hosepipe bans have been in force in London and the South East for some time and properties within the M25 have been identified as particularly vulnerable, due to their clay base.

Subsidence claims

The prognosis doesn't look good and already there is talk of another 'event' year. Insurance experts fear a repeat of 2003, when the long, hot summer left tens of thousands of homes needing repair. In that year, subsidence claims rose from 32,000 to 54,100 and costs doubled from £183m to £390m.

Historically, a subsidence surge has coincided with a recession in the construction industry, therefore contractor capacity hasn't traditionally been an issue for insurers. In 2003, the subsidence surge hit at a time when the construction sector was reason
ably buoyant, but service levels were maintained. Will it be the same now?

The specialist contractor landscape has changed, and if insurers are not careful, they could be left high and dry. The subsidence market is shrinking and contractors have moved away from insurance work into other areas.

Insurers' procurement models now favour national contractors above the regional specialists (although in the majority of cases they have to subcontract to meet demand), so there are fewer suppliers able to provide the required large-scale solutions.

With smaller contractors being squeezed out of the equation and greater emphasis being placed on mitigation and superstructure repairs, there's less underpinning work to go round. Currently, some 5%

of subsidence claims result in underpinning, and those who deliver this solution often fall victim to insurer payment delays.

The Association of Specialist Underpinning Contractors recently reported that more than 50% of its members invoices are sitting with the insurance industry for 60 to 90 days, despite being presented with a 30-day term.

In a bid to tackle the payment issues, the Subsidence Forum, formed in 2004 to “represent all those interested in, or affected by subsidence” has set up a working party on supply chains. Payment has been identified as a key area for attention.

“Improving the payment proc
ess is a top priority for us and it is something that will be addressed,” says chairman John Parvin.

Despite the assurances, underpinning contractors are turning to other sectors to secure a stable work flow. Twenty-five years ago, the number of contractors working for insurers would have topped 50. Nowadays, it’s less than 20. Not only are there fewer contractors, but less of their work is for insurers. Five to 10 years ago, more than half of a contractor’s turnover would have been insurance-funded; in some cases now, it’s less than 3%.

The demands of having to provide a nationally-based solution, coupled with a shrinking market and sluggish payments, have certainly taken their toll.

“We’ve all had to change our approach and look for new solutions and innovative techniques,” says Rob Withers, managing director of subsidence repair specialist the Withers Group.

“I’ve built up a national network of repair companies – Withersnet – with 24/7 access to supplier partners to meet the increasing coverage demands of insurers. I’ve also developed an environmentally-friendly, lowcost, void-forming technique – With-a-void – that reduces claims costs by a third and reduces the amount of material left in the ground.”

The Withers Group, like so many contractors, also spends more time undertaking superstructure repairs and has moved into other areas such as new
build foundation work and retro-fit basements.

But what are the implications if 2006 or 2007 is an event year? “If there were around 40,000 to 50,000 claims, the industry would react as before and cope,” says Withers. “But there’s one big difference – the 5% of claims that result in underpinning would hit contractors in the 2007 to 2009 period, right in the middle of the Olympic Village construction.”

As there are only a certain number of subsidence experts and resources would be severely tested during a surge period, in the future, insurers could be hard-pressed to find enough contractors to meet demand.

Boom time

It’s boom time for the construction sector. An eye-watering £15bn has been allocated to Olympic-related construction (more than has been spent in the entire history of subsidence claims), then there’s post-2012, the Thames Gateway and public sector regeneration.

Large £100m-plus projects include the Kings Cross redevelopments, port projects at Shellhaven, Felixstowe and Harwich, the East London Line Underground extension and the Victoria station redevelopment. Will contractors really want to focus on subsidence claims when there are rich pickings elsewhere?

“It will be a dilemma,” concedes Withers. “Contractors who have a strong relationship with their insurers will stay loyal, but
there’s no doubt skilled operatives will be in demand. They’ll be sourced from the midlands downwards, which could leave insurers without national cover.”

If figures from the Construction Skills Network (CSN) are anything to go by, the insurance industry will be exposed. The 2006 CSN report reveals that the UK construction industry needs 87,000 new recruits every year until the end of the decade if it's to meet the anticipated surge in workload.

Effectively, this is 348,000 recruits by 2010. The biggest average annual requirement on site is going to be for wood trades (11,000), electricians (8,100) and managers (10,500). In a supply and demand culture, the cost of labour will rise. Insurers will therefore have to pay higher rates for services – something they must factor into their claims costs projections.

And it's not only labour costs. In its April 2006 briefing, The Building Cost Information Service concludes that materials costs had risen by 21% in the year to Q4 05, while nationally agreed wage rates rose by 5.4% in the same period. It predicts that materials prices and wage settlements are likely to rise above the rate of inflation over the next year.

What if 2006/07 is that 100-year 'event' and mitigation works carried out on more than 95% of properties in 2003 and previous years, fails? The percentage of underpinning claims in the 2007 to 2009 period
would rise to 10% or beyond.

Contractors faced with an increased demand for their services may not be well-disposed towards an industry that has not treated them well over payment issues. Insurers will face many re-opened cases, customer satisfaction levels will plummet and claims costs will soar.

Risk management

While this may appear pessimistic, this scenario needs to be considered. After all, aren't insurers experts in risk management and used to considering every eventuality?

"We are aware that the construction boom could impact upon the service we receive from our contractors and also that the pressure of inflation could affect labour and material costs," says the Subsidence Forum's Parvin.

"However, we're hoping our contractors stay loyal – the majority of UK insurers are working to build and maintain strong relationships with contractors so that claims volumes, if there is a subsidence surge or weather-related event, can be met. While we'd like to maintain a steady work flow, the very nature of claims means they do peak and trough."

Let's hope that climate change doesn't result in too many claims peaks. Tony Boobier, subsidence expert and vice president of Marshall, Swift & Boeckh, the world's largest provider of property and land data systems, has been urging the insurance industry to factor the impact of climate change, the construction boom and increased materials costs into its claims and underwriting projections.

"We need to have some joinedup thinking here," says Boobier. "If a major claims surge and the construction boom cause a shortage of contractors and materials, it will affect rebuilding and repair costs. I believe there's emerging evidence of a power shift from insurers to suppliers and the industry needs to recognise and respond to it."

"Supply and demand dictates that contractors will only work for companies that either pay a premium for their service and/or pay them in a reasonable time," adds Withers. "In the supply chain, payment is not generally a measured criteria.

"Service Level Agreements are all about customer service and initial response times. But this customer service may fly out the window if contractors decline to work for insurers when they can secure better margins and payment terms in other areas of the construction industry."

While subsidence repair specialists may want to remain loyal to their past paymasters, they can be forgiven for being tempted to jump ship to other sectors. The construction boom will undoubtedly bring capacity issues for many contractors, but they would be foolish to turn down opportunities based on fear of a possible event. After all, cashflow is king – more important than profitability for many organisations.