Gallagher

Insurance | Risk Management | Consulting

NHS Construction Market Update: May 2024

NHS hospital sites across the United Kingdom are subject to constant evolution to meet the healthcare needs of the population, and these hospital estates require almost continuous renewal to update ageing facilities, and expansion to meet a wider scope of healthcare services.

The demands on the construction sector from the NHS have increased further with the government's New Hospital Programme, a commitment to build 40 new hospitals in England by 2030 with capital funding of £3.7 billion up to March 2025, with additional funds to follow for the following five years.[1] The complexity and scale of these construction projects require careful consideration of the current insurance market conditions.

One of the biggest challenges faced by the construction insurance market is the rising cost of claims. There has been an increase in the number of claims filed (particularly escape of water claims), causing higher premiums.

These factors have made it difficult for construction companies to afford the necessary insurance coverage, especially for small and medium-sized enterprises. Increasing premium rates are caused by a number of factors, including:

- Severe labour shortages, increasing the likelihood of accidents, HSE interventions, and project delays.
- Material shortages and supply chain delays, especially when imported from Europe. Insufficient materials increases the risk causing delays and use of unsuitable alternatives. Lorry driver shortages have impacted domestic projects (e.g., HS2) consume a vast amount of concrete, creating a knock-on effect.
- Inflation results in pressure on wages and building materials. The risk of underinsurance increases. Inflation has affected claims values, capacity deployment, and the adequacy of deductibles. Many claims far exceed the original build costs incurred at the inception of the project.
- Financial pressure across the sector is a threat to health and safety standards. This is linked in part to labour shortages and more reliance on inexperienced workers. For insurers, there is concern that businesses are cutting back on their health and safety programmes, which could lead not only to claims but also to associated disputes arising from alleged policy breaches or non-disclosure.
- The Grenfell Tower disaster has led to a major remediation programme to remove dangerous cladding and improve fire safety across the sector. For insurers, there are a large number of claims in the pipeline connected to cladding and other risks connected to building materials.

[1] "New Hospital Programme." *UK Parliament Committees.*

The Building Safety Act 2022

The Building Safety Act 2022 (BSA) has presented a cultural change to the construction industry.

One of the key objectives for the BSA to achieve, based on the outcomes of the Hackitt Report, is increased regulation and control of high-rise buildings to assure the quality and safety standards of such buildings moving forward, with the overarching goal of building a safer future. The Act presents a number of challenges to the construction insurance market, including:

- Extension of the limitation period to 30 years. Many policies include exclusion clauses for these circumstances. The extension of limitation periods may require amendments to standard-form building contracts.
- Building Liability Orders and the challenges in circumstances in which these are to be applied. New means of recourse, such as Building Liability Orders under 130 of the BSA 2022, present fresh uncertainties. In what circumstances will these be granted against 'associated' companies, who might seek such an Order, and will insurers pursue such a claim as part of their subrogated rights?

Since October 2023, the regime of gateways introduced within the BSA has been implemented. The Building Safety Regulator (established previously by the BSA) will approve and sign off on all high-rise buildings moving forward, from the planning stage through to completion. High-rise buildings are defined as those 18 metres and above. This increased regulation requiring further certification prior to handover may impact construction project timescales.

Modern methods of construction

With a growing emphasis being placed on sustainability in construction contracts, the inclusion of Modern Methods of Construction (MMC) is becoming more prevalent. MMC is a collective term to describe alternative construction practices, which can include:

- Off-site, factory construction of component parts of the properties, such as ready-made floors or roofs, is transported to the project site for assembly. Factory-made modular construction can cover an entire building to be transported to site.
- Timber frame construction — structural frames that have been made off-site in a factory, e.g., floors and roofs, to help form a combined structure that can be clad in another material, such as brick, on-site. Due to their prototypical nature and lack of loss history/claims data compared to steel and concrete buildings, UK insurers have capacity restrictions on their reinsurance treaties. For example, a £100mn new build of steel and/or concrete frame would be underwritten by three or four construction insurers. For timber frame risks of a similar size, there could be up to 15 insurers on the contract work placement. Higher fire and water damage deductibles will apply, along with an enhanced rate.
- Zero-carbon concrete (or cement-free concrete). Insurers are generally only willing to consider it if it does not form part of the structural integrity of the building(s). If it is being utilised for temporary works or solely for architectural features, then that is favourable. If it is structural, insurers will likely take a cautious approach, and it may fall outside of their appetite.

- Sustainability incorporating technology:
  - » Electric vehicle charging points — insurers require details of the devices, including confirmation of whether or not they will be operational, before practice completion. The location plan should be provided during design for insurers' consideration. It shouldn't be a major concern unless coupled with a certain construction type and their location, e.g., a basement due to waterproofing concerns and structural timber due to a fire hazard.
  - » Solar panels — an equipment specification and details of the installer are also required, and if works are retrofitted, then the construction method statement is required. Typically, these are a fire concern during commissioning, especially if a structural timber development.

Despite the benefits that MMC brings, including reduced construction costs, improved health and safety, and enhanced environmental, social, and governance performance, the insurance industry's appetite for such risks remains variable. Additional risks are created, including transit risks, supply chain concerns, modular building, which brings an increased inherent defect risk, and the ability to invest/rectify damage on site. UK construction insurers have less experience with MMC and therefore adopt a conservative approach to underwriting projects utilising MMC. Insurers do not yet have years of data/claims experience relating to MMC to allow them to predict the volume and severity of future claims.

When ensuring suitable insurance coverage applies for MMC projects, clear policy language is required on the deductible application, the definition of off-site storage/manufacture, and the assignment of liability during manufacture, delivery, and on-site erection. A clear understanding is required regarding where the manufacturing, transit, and contractor work policies start and finish to avoid liability disputes. Contract work insurers might not wish to cover high storage/transit risks, requiring a separate goods in transit/marine policy.

The use of MMC has contributed to a cautious PI insurance market and a conservative approach to underwriting certain construction risks. MMC refers to the design, manufacture, and pre-assembly of construction materials and components in a factory environment prior to installation on site. Given the relatively new nature of these techniques, concerns are around the speed and quality of this work and the potential exposure to repetitive failures requiring rectification on a mass scale.

Whilst not a modern method of construction, Reinforced Autoclaved Aerated Concrete (RAAC) is celebrated for its environmentally friendly nature due to its low carbon footprint and energy-efficient production process.

RAAC has been an issue affecting a range of public entities, including the NHS with a number of hospitals identified that their construction contains an element of RAAC which is now at the end of its intended design life.

Priority has understandably been given to the rebuilding of these hospitals by 2030, given the safety risks posed to NHS employees and patients. One of the foremost concerns with RAAC is its structural integrity.

Buildings constructed with RAAC walls and structures have faced questions about the material's long-term durability. This has prompted an increased emphasis on reinforcing and retrofitting RAAC-built buildings to ensure public safety. In addition, public buildings have had to address concerns regarding dust emissions, which can pose respiratory health risks, especially during construction, renovation, or repair projects. Maintenance and repairs of RAAC structures can be more complicated and costly than with traditional construction materials. Often, the challenge is finding skilled contractors and specialised materials to address RAAC-specific issues, making it particularly challenging and expensive. This could potentially affect future rebuilding valuations used to reinsure buildings, potentially leading to underinsurance.

Under the Health and Safety at Work Act 1974, employers are obligated to safeguard the health and safety of their employees and individuals who may be affected by the employer's operations, even if they are not employees. Violations of these regulations can lead to criminal investigations and resultant penalties.

Professional indemnity market conditions

Since 2018, the PI construction insurance market has seen narrowing coverage and increasing premium rates. Conditions are improving with the expansion of capacity within the PI market with new market entrants/growing appetite among established insurers. However, the risk averse nature of insurers in this area will remain a key challenge.

One positive change is the availability of cover for cladding and fire safety. The standard International Underwriting Association (IUA) cladding and fire safety clauses, however, remain. Cover remains on a restricted basis, limited to a negligence trigger with single aggregate limits, increased excesses, and consequential loss exclusions. Future conditions remain uncertain with the introduction of the Building Safety Act (BSA) in 2022, which has increased the potential for civil claims. The Act extended the limitation period from 6 to 30 years under Section 1 of the Defective Premises Act 1972, and Section 38 of the Building Act 1984 has led to a further tranche of new precautionary notifications being made as firms widened the scope of their past project reviews to include all relevant buildings constructed over the last 30 years.

The function of PI insurance within construction/professional services contracts has become problematic, potentially resulting in unbalanced contractual relationships and risk allocation or where the professional services supplier cannot comply with the contractual insurance obligation.

The reductions in scope/levels of PI insurance have been a feature of the insurance market in recent years. Insurance losses associated with significant events (e.g., the Grenfell Tower tragedy) have meant insurers have become more risk-averse, providing reduced insurance offerings.

Historically, the transfer of the professional services breach of professional duty risk has been to utilise an obligation to provide PI insurance within contracts. As PI insurance is provided by insurers on a claim made form of policy wording, also means there needs to be contractual obligations to continue to procure such insurance post-expiry or earlier termination to protect against incurred losses but not report claims. Such issues have created circumstances where the 'traditional' role of PI insurance as a risk transfer mechanism needs to be interrogated under a construction contract.

NHS resolution risk pooling scheme coverage

The NHS Resolution risk pooling scheme coverage should be considered when setting appropriate insurance provisions in a construction contract. The Property Expenses Scheme (PES) covers existing structures subject to a £1,000,000 limit on any one claim, and contract works subject to a £1,000,000 limit on any one claim.

Joint Names — PES will only cover the interests of the Trust, not the contractor. A number of construction contracts (particularly those involving work on existing structures) require the insurances to be arranged in the joint names of the employer (i.e., the Trust) and the contractor, in this scenario, the Trust cannot rely on the PES coverage or additional commercial 'top-up' property damage insurance (at least in its standard format). By agreeing to joint name coverage, insurers of the existing structures would effectively lose their subrogation rights following a claim incident (e.g., rights to recover their costs against the negligent contractor). As this increases their exposure, they may be unwilling to grant this cover/charge an additional premium.

Construction contract insurance due diligence

The NHS must ensure their interests and those of the wider public purse are suitably protected during all phases of procurement. Contractual risk allocation is a fundamental part of any agreement between major parties involved in a significant construction project. Gallagher has extensive experience in advising a broad range of clients with contract risk, with experience relating to all major forms of contract such as NEC3, NEC4, PF2, and JCT, as well as being very familiar with dealing with bespoke forms.

We advise which parties might be best placed to procure insurance (i.e., the NHS or the contractor), undertaking an Owner Controlled Insurance Programmes (OCIP) vs a Contractor Controlled Insurance Programme analysis. When undertaking this analysis, the following factors are considered:

- Control — which option offers greater control of the insurance programme and panel of insurers approached.
- Cover — need to ensure the scope of the insurance cover can be tailored specifically for the project risks.
- Consistency — including ensuring all contractors of all tiers benefit from the same broad levels of cover.
- Cost transparency — considerations include who will ultimately pay the project insurance costs, will additional costs/overlaps in insurance coverage apply if the programme is arranged by a third party.
- Claims — which arrangement will help avoid disputes between the project parties?
- Contractor Insolvency — impact on the continuation of insurance cover.
- Ability to protect anticipated project revenue.
- Contractual requirements — which arrangement can be tailored to comply with lender requirements.
- Cover duration — needs to cover whole project period and not be subject to third-party cancellation.
- Ease of administration (minimising multiple insurance programme validation exercises).
- Procurement process efficiency considering 'pushbacks' from bidders.
- Risk Management — insurance programme needs to incentivise best practices.

Why Gallagher?

Gallagher's Public Sector team is one of the largest in the UK, supporting over 5,000 authorities and being an influential broker in the NHS/Healthcare sector, supporting NHS FTs and NHS organisations. Our public sector practice contains over 120 highly qualified insurance professionals specialising in providing insurance services to public entities. Within the wider public sector team, we operate our Government Insurance Advisory team, consisting of experienced insurance specialists who have supported UK government bodies for over 40 years.

Gallagher has placed a number of large-scale construction and infrastructure projects on behalf of publicly funded organisations, including NHS Trusts. The Gallagher construction division is one of the largest in the London market, with 110 subject-matter experts covering all construction sectors. The team possesses expertise across all construction matters, including the following insurances: contract works insurance; construction plant/equipment; third-party liability; environmental impairment/contractors pollution liability; cyber liability; cargo/transit/storage; delay in start-up; latent defects; legal indemnities; subcontractor default; construction claims management/risk management. We also benefit from a market-leading design and construct PI insurance team based within our construction division.

Would you like to talk?

For more information on how we can help, please contact us.

Alex Ross
Director, Government and Health
T: +44 7756 216 324 | alex_ross@ajg.com

AJG.com/uk | gallagher-uk | @GallagherUK

Arthur J. Gallagher Insurance Brokers Limited is authorised and regulated by the Financial Conduct Authority.
Registered Office: Spectrum Building, 55 Blythswood Street, Glasgow, G2 7AT.
Registered in Scotland. Company Number: SC108909. FP720-2024 Exp. 15.05.2025.

Gallagher
Insurance | Risk Management | Consulting