

2024 MARKET OUTLOOK



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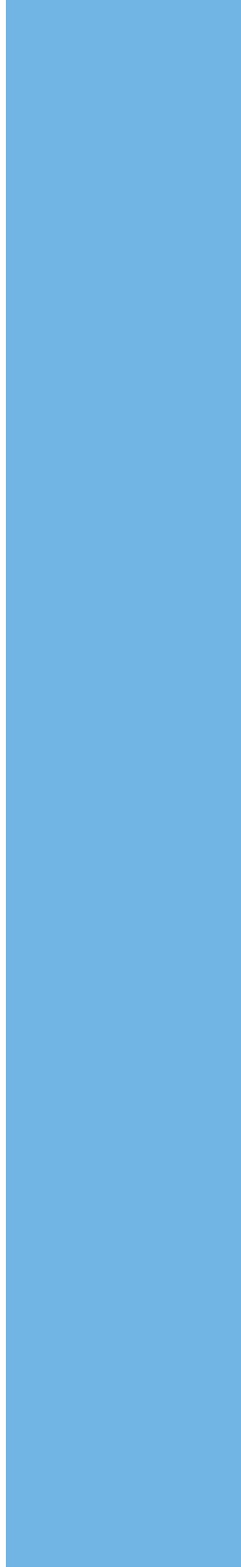




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it was the economy that
took centerstage
in 2023.



Introduction

American Global is pleased to present our 2024 Market Outlook. This guide is designed to provide useful information about the current state of the marketplace and growing trends in insurance and surety for the construction industry. Our team has shared their expertise and insight to help clients better understand potential risks, in order to successfully navigate the complexities of a challenging marketplace moving forward.

Overall, despite a challenging economy, the construction industry experienced strong growth in 2023. That growth is expected to continue throughout 2024, particularly for those in public works such as transportation, infrastructure and data centers. However, certain private industry sectors including office construction and multi-family residential has slowed and will face challenges.

While more than two thirds of 1,000 contractors surveyed by the Association of General Contractors (AGC) plan to hire this year, confidence in the market is not as high as it was. The uncertainty of the economic landscape is likely the leading cause of concern.

Without a doubt, it was the economy that took centerstage in 2023 and will remain a major factor in 2024. Every household, business and industry faced the challenges of rising interest rates, steep inflation and price escalation, further complicated by the uncertainty of how ‘hard or soft’ a landing we might expect, once the economic dust settles.

The ongoing labor shortage continues to be a major concern as well. The aging workforce and retiring baby boomers put pressure on the economy, and construction in particular, where a shortage has far reaching effects. The lack of skilled labor not only slows project schedules, but brings greater concern in terms of quality of workmanship and potential increase in injury claims with more inexperienced workers on the job.

While remnants of supply chain concerns remain, clients indicate they are less severe and widespread than in prior years, with extended delivery times being the most common issue, rather than a complete lack of supply.

Geopolitical risks are also top of mind. The potential volatility of ongoing conflicts could impact the global economy, including supply chains and energy prices. Worldwide immigration/migration issues (which also play a part in the labor shortage) will be further complicated and politicized by a 2024 presidential election year.

Artificial intelligence (AI) has quickly made its way into every industry and construction is no exception, with drone technology, telematics and safety enhancements leading the way. However, as with all new technology, we must be keenly aware of its pitfalls, while we learn how to harness its power and potential.

Our final ‘market disruptor’ raises a concern over the growing number of contractors facing financial uncertainty due to erosion of balance sheets as a result of macro-economic factors stressing project performance, particularly work secured during or prior to the pandemic. Many contractors have exhausted the financial stimulation of ERC and PPP infusions received during the COVID-era economy and yet are still digesting lower margin work.

It is critical that your broker possess a broad perspective and solid understanding of how the economy and other market challenges will affect the industry and more importantly, your business, in the year ahead.

At American Global, our diverse team of experts continually monitor shifting economic and industry trends in order to minimize risk and protect our clients, while searching for new opportunities and innovative ways to move your business forward.



Project Delivery Models & Procurement Trends

American Global continues to be an active participant in the development of construction project delivery models and the shaping of project procurements through efforts aimed at optimizing the potential for project success. Working hand-in-hand with our clients in procurement phases, participating in risk allocation discussions and contractual negotiations with both public and private owners, we bring our depth of knowledge and years of experience to the table, to improve the positions of not only our clients, but for all project participants and stakeholders.

The trend for fairer risk allocation among project participants continues, as both public and private owners aim to increase the number of contractors willing to bid their projects. Thus, owners are modifying “precedent” contractual provisions to place risk with the party most able to control such risks and to share risks that are unknown or uncontrollable.

2023 was a record-breaking year in terms of legislation introduced, and passed with high success rates, which authorizes states and municipalities to procure construction projects utilizing alternative project delivery models. Last year saw an influx of alternative delivery procurements, such as design-build, progressive design-build and construction manager at risk, across many different industry sectors including transportation, water/wastewater and aviation. Based on our involvement in progressive design-build projects and industry data, we anticipate that this delivery model, in particular, will significantly reduce project risks for all participants and result in the successful delivery of projects on time, on budget and with minimal or no claims.

This year, and for at least the near future, we expect that the upward trend in the utilization of alternative delivery procurements will continue and we are optimistic that we will also see an increase in the delivery of successful projects.

Only a handful of P3 projects reached financial close in 2023, the majority being university housing projects, and the number of projects being procured in the P3 sector continues to lag behind expectations.

To further support our clients, American Global remains actively engaged with many local and national organizations, advocating for changes desired by the construction industry, and promoting the development of much needed infrastructure improvements through project delivery models that are best suited—and tailored to—each project’s individual and unique aspects.

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Market Disruptors



INFLATION, INTEREST RATES & PRICE ESCALATION

Inflation, while down from record highs of 2022, remains one of the top concerns for the industry moving into the new year. In 2023 the economy was further complicated by rising interest rates, resulting from the Federal Reserve's efforts to curb inflation and avoid a full-blown recession. Price escalation followed, and compounded the challenges of an already difficult market.

Higher interest rates increased the cost of construction, forcing many contractors (particularly those in the private sector) to push, postpone or even cancel some projects altogether. Contractors who were bound to lump sum contracts are most affected but multi-year project programs adjusted on construction value (and to a lesser extent, payroll) also have reason for concern.

Project financing grew more difficult in 2023 as well, as lending requirements became more stringent, making loans harder to obtain. Insurers struggle to determine if their insureds are doing more work—thus creating more exposure—versus doing the same (or lesser) amount of work which is more costly to do, thus creating less exposure.

As 2024 unfolds, interest rates have begun to stabilize in anticipation of the Federal Reserve easing or ending their stance on further rate hikes. However, our experts agree that the industry must maintain a close eye on rates throughout the year to see how they may affect new project starts.



In Canada, price escalation, due to continued inflationary pressures, will also remain a concern and could affect capacity with project values continuing to increase, thereby making it harder to find full capacity for projects or realistic pricing options.



LABOR SHORTAGE

There was no shortage of work in most sectors of construction and backlogs remained strong nationally in 2023 (an average of 8.6 months according to ABC in December). However, contractors and subcontractors continue to face the monumental challenge of a persistent labor shortage. Once again, the lack of skilled labor remains high on the list of top concerns and market disruptors for 2024 and beyond.

Employers' ongoing struggles to find skilled workers in an already-limited labor pool grow more difficult as the industry's aging workforce retires. Currently, more than 1 in 5 construction workers are age 55 or older, with an average retirement age of 61, according to the Center for Disease Control and Prevention. Clients have reportedly had to turn down certain projects due to lack of access to labor in certain markets. The situation will only worsen in the foreseeable future, with few, if any, short to medium-term solutions on the horizon.

As contractors step up efforts to attract and retain key employees for continuity and efficiency, higher compensation is often involved. That becomes a contributing factor to yet another industry concern: higher labor costs, which have been exacerbated by economic pressures mentioned previously.

For those who are able and willing to fill open positions with new and/or unskilled laborers, challenges persist. A bevy of new workers often results in slower/lower

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quality of work, which can lead to delayed starts and/or longer job terms. Until backlogs subside, or a more comprehensive plan to train and grow the workforce is implemented, the industry will continue to grapple with this issue.

Loss claims, like many other costs, are not slowing down and several factors are at play. The increased frequency and severity of natural disasters have led to historically large loss claims. Price escalation due to inflationary pressure is also raising the cost of claims. And the labor shortage has not only put a greater number of new/unskilled laborers on the job—resulting in more worker injuries—but clients who utilize third party administrators (TPAs) report the shortage has had an unfavorable effect on claims outcomes due to the retirement or resignations of key/senior executives in that space.

Combine all the above with factors that contribute to rising 'social inflation'; increased litigation and larger/nuclear jury awards; public perception on corporate accountability; the lack/erosion of tort reform; attorney tactics and broader definitions of liability, and you have the makings for an insurance market that will continue to be challenged in the years ahead, not only in the U.S. but in Canada as well, where losses have been at a record high.

Market Disruptors

GEO-POLITICAL


The influence of government and politics around the world always brings an element on uncertainty and volatility to the global economy—particularly in an important and contentious U.S. election year. Government debt and deficits are elevated globally, which may soon require some form of economic policy change or action.

While energy prices have dropped as of late, we are reminded by sporadic flares of tension in the Middle-East that things could change quickly. Any move by China, in the wake of Taiwan's recent elections, could also raise strong political concerns. And, the ongoing Israel-Hamas and Ukrainian wars have the potential to escalate and demand greater attention, commitment and/or resources from world powers, which would affect political and economic landscapes domestically and abroad.

We are pleased to note that while there are some exceptions, the majority of critical supply chain issues which we experienced during the pandemic and post- COVID, have been largely resolved.

Finally, global migration/immigration has become another hot-button political topic turning the western world on its head, particularly in North America, the United Kingdom and the European Union. The policies put in place over the next few years could have long-term global impacts on the availability of labor in our industry and others for decades to come.

As a result of the population slowdown in US, the Congressional Budget Office estimates that that by 2042, population growth in the US will come from immigration, not births.

 To address the growing labor shortage in Canada (where they estimate that by 2025, there will be one retiree for every two working persons) they have raised immigration goals, as 60% of immigrants are trained in urgently needed job skills such as skilled trades, heavy equipment operators and healthcare¹.



ARTIFICIAL INTELLIGENCE & THE TECH REVOLUTION

While not a 'market disruptor' in the negative sense, Artificial Intelligence (AI) is the single hottest topic in our industry today, and we are not alone. There is seldom a magazine, newsletter, seminar, or webinar, that does not promote the promise of AI and the newest technology revolution. In construction, many are already utilizing some form of AI for telematics and data analytics.

Technological advancements for the field, such as drones and other safety-related tech are being implemented already. Some use of nanotechnology to enhance the stability and strength of certain construction materials has begun, while use of actual robots and 3D printers seem to be a little further down the road for most.

As with every revolution, there will be promises and pitfalls. Cautious optimism and a methodical approach to implementation is urged. The possibilities of AI are limitless, and the industry (together with the rest of the world) must find a way to intelligently (pun intended) deploy and implement it effectively. Most firms already suffer from information overload, how can we ensure that AI will not exacerbate the problem or create even bigger ones?

At American Global, we continually seek out new opportunities to identify innovative ways to improve our services and solutions, and AI is certainly an asset we have begun to utilize. However, just as those who work with their hands to build our businesses, homes and infrastructure, there is a great deal of personal skill and human intelligence that cannot be replaced (at least yet!). Therefore, while we expect more to come from AI, we want our clients to know they can and should continue to "expect more from their broker."



Once again, the lack of skilled labor remains high on the list of top concerns and market disruptors for 2024 and beyond.



FINANCIAL STRESSORS/ BALANCE SHEET ISSUES

Some have expressed concerns about business viability, continuity and succession. A few of our experts are finding that some balance sheets remain inflated from several good years, thanks to Employee Retention Credits (ERC) and the Paycheck Protection Program (PPP) and owners are wanting to get their money.

On the flip side, subcontractors (in particular) coming out of the COVID era who can no longer rely on government funds, must go back to making an operating profit. However, due to economic, capacity and labor issues discussed previously, their balance sheets are now being stretched, putting stress on their financials. Some have witnessed long-standing companies close their doors over the past 24 months and expect they may see more in 2024.

There has already been a noticeable increase of Merger & Acquisition (M&A) activity (including ESOP & PE) which we expect to continue in 2024, as large valuations on service contractors make it appealing to sell to private equity.

Insurance Renewal Expectations

General Liability

STABLE MARKET

Moving into 2024, contractors can continue to expect rate increases of 5-10% on average from their General Liability carriers, with this range greatly depending upon the type of business and overall claims history within the last 5 to 7 years. The underwriting process continues to be a challenge, with insurers requesting detailed company claims and financial histories, along with accident prevention and mitigation plans in order to more accurately assess the business' true risk.

Regionally, contractors operating in New York City and the Five Boroughs of New York will continue to face high insurance premiums due to New York Labor Law and larger claim litigations which keeps pressure on rates. While the litigious nature of construction defect claims in the Carolinas and Florida continue to put pressure on rates in the south. Carriers in these areas are either pulling appetite completely or only considering risks with higher deductibles in certain classes of business, such as street and road and residential construction.



Auto Liability

CHALLENGING MARKET

Automobile Liability is the most challenging line of business for many contractors due to extreme social inflation, nuclear verdicts, litigation funding, and the increased cost to acquire and maintain vehicle fleets. These factors, combined with a lack of qualified drivers and increasing rates of distracted driving, leave many insureds and insurers with the near insurmountable task of addressing the risks presented by an auto fleet of any size and make-up. Premium rate increases are exceeding the national averages of 8% to 12%. Premium rate increases of 20% or more are not uncommon.

Underwriting continues to be a challenge, with insurers seeking detailed claims data, accident prevention and mitigation plans to assess a company's risk. Great attention is being paid by all parties to the various technologies available in order to identify and mitigate the risk present by an insured's auto fleet. These technologies include the use of forward and rear facing cameras and telematics that track behaviors such as hard breaking and speeding, with a focus on changing driving behavior to increase safety in the aggregate, thus reducing the likelihood and/or frequency of accidents.



Workers Compensation/Employers Liability

COMPETITIVE MARKET

Ample competition, capacity and coverage continue to be available in the Workers Compensation market. Insurers and insureds alike continue to place a heavy focus on loss prevention, claims management, return-to-work programs and other loss mitigation factors which all contribute to the stable Workers Compensation environment.

There is less stability in certain states such as New York and Florida due to a variety of factors; certain Federal Coded classes such as USL&H are more difficult to find coverage for. Nonetheless, the stable and Competitive environment is expected to continue bearing premium rate increases of 0% to 2% on average subject to risk class and loss experience.



Excess Liability

STABILIZING MARKET

Excess carriers are expected to continue to raise rates in 2024 in the range of 10%. Factors such as challenges around insuring auto fleets, poor loss experience and high hazard scope of operations could push these rate increases even higher. Social inflation, nuclear verdicts and litigation funding continue to adversely impact the Excess Liability marketplace as well.

Insurers continue to monitor their aggregate limit deployment and manage their policy limits carefully. We expect Excess Liability carriers to limit the capacity they provide and press for increased attachment points on their scheduled underlying policies, with a specific focus on General Liability and Auto Liability. This may not cause much of a ripple for the small to mid-sized Excess Towers, but it will be a challenge for larger Excess Towers of insurance that are required for larger clients and projects across the U.S. Fortunately, small to moderate amounts of new capacity have emerged and continue to enter the market. As a result, proper terms and conditions are obtainable and rates are stabilizing.



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Contractors Professional Liability

STABLE MARKET

Recent History

In 2023, the Contractors Professional market exhibited overall stability. Carriers sought modest annual renewal rate increases, typically capped at 5% for claims-free risks. However, pricing dynamics were still driven more by client-specific factors than a market-wide push for rate adjustments. Clients with substantial design-build portfolios, especially in civil infrastructure projects, experienced heightened rate pressures due to ongoing market concerns with the delivery model. The issue stems from claims that arose from pricing/quantities which were submitted based on design that was often less than 30% complete at the time of bid.

One of the trends that continued throughout 2023 was carriers encouraging their insureds to adopt larger retention amounts, offering premium credits. However, most insureds maintained existing retention levels, deeming the credits insufficient to offset increased risk.

While the market for project-specific policies for contractors remained steady, carriers displayed selectivity in insuring projects. Mega-projects (\$1 billion+) posed challenges, with premiums often reaching 30%-40% (or more) of the limit outlay, and usually coupled with a seven-figure retention. However, amid a deteriorating market for Architects and Engineers Professional Liability, the construction community continues to shift focus toward Contractors' Professional project policies.

2024 A Look Ahead

The Contractors Professional market is anticipated to remain stable in 2024 for annual practice policies but is likely to face ongoing challenges in the project-specific segment. As the Architect and Engineer (A&E) project policy market deteriorates, contractors are likely to increase their reliance on the Contractors Professional market for project policies. This, in turn, is expected to cause carriers to institute some tighter controls around underwriting. Anticipated market responses include adjustments to rating models, leading to escalated costs for project-specific policies. Carriers may also restrict overall capacity and sublimit first-party coverages (Protective Indemnity and Rectification coverages), particularly for high-risk projects such as large-scale civil infrastructure.

Concerns persist among insureds regarding staffing, with challenges in attracting and retaining top talent. This workforce issue ripples through the Professional Liability market, contributing to claims arising from services provided by inexperienced staff. Inflation and supply chain security will also continue to be leading disruptors in the market; increasing the cost to build and subsequently, the cost to insure projects.

Amidst these challenges, the progressive design-build model shows promise, fostering optimism within the market about this evolving delivery approach. While the delivery model is relatively novel and lacks an extensive track record, proponents believe it will encourage a more collaborative approach. There is optimism that this model might effectively address, or even eliminate, issues that have historically afflicted the Professional Liability market—specifically, claims stemming from bids submitted on limited design.



The Contractors Professional market is anticipated to remain stable in 2024 for annual practice policies but is likely to face ongoing challenges in the project-specific segment.

Insurance Renewal Expectations

Contractors Pollution Liability

STABLE MARKET

Construction activity throughout 2023 continued to be robust, in particular with the introduction of the infrastructure bill (and the roll out of funds to address the aging infrastructure in the US – albeit slowly). This is fueling the demand for Contractors Pollution Liability (CPL) coverage, a trend expected to extend through 2024. Market capacity remains strong with several dozen active markets vying to write this desirable class of business. Despite this, anticipation of slight rate increases are on the horizon as carriers strive for adequate rates across their portfolios.

The Contractors Pollution market in 2023, saw carriers pushing moderate rate increases, commonly in the 5% range. However, similar to the Contractors Professional market, client specific factors, coupled with strong competition, meant most renewals (that had favorable loss history) were being accomplished at flat to 3% rate increases.

Moving into 2024, to attain a rate that is aligned with loss experience and risk appetite, carriers are adopting more strategic underwriting methods. As a consequence, we may see the market adjust their rating models, leading to increased premiums, and reduced capacity in their renewal portfolio. That said, we do not anticipate a push on rate to be any more than 5%-10%.

Site Pollution faces more pronounced rate hikes, ranging from 5%-15%. This surge is attributed to heightened claim activity, escalating remediation costs (including labor), and regulatory uncertainties tied to emerging exposures such as PFAS. These factors collectively shape the evolving landscape of Contractors Pollution Liability coverage in the current market.

Property

CHALLENGING MARKET

We continued along the path of volatility in 2023 with what was a very challenging Property Market. While we did not see as many major Atlantic hurricanes make landfall in 2023 as we did in 2021 and 2022, the massive insured property losses that resulted from CAT 4 Hurricane Ian in 2022 (estimated between \$53 billion to \$74 billion) remain fresh in the market's mind.

In 2023, the U.S. had 28 confirmed weather/climate disaster losses exceeding \$1 billion each. However, it is important to note that most January 1st treaty reinsurance renewals went relatively unscathed as major Property insurers were able to obtain significant rate increases in 2022 and 2023 to account for these anticipated losses and level out their balance sheets, in particular, bottom line or pre-tax operating income.

As we enter 2024 we anticipate a sustained or leveled out Property Insurance market with rate increases ranging from 7.5% - 15% on average. Florida continues to be a challenging market based on the availability of Named Windstorm Capacity on most risks and the uncertainty of what the 2024 Hurricane season may bring.

We expect the introduction and adoption of Insurtech to continue into 2024 helping mitigate risk with technology including but not limited to, water monitoring services, security camera and motion detection systems, claims data tracking systems, and artificial intelligence (AI).

All of these trends can change based upon macro-economic factors such as: inflation, rising property values, real estate values and acquisition costs, war or civil and political unrest, combined with significant losses within the frame-habitational sector and downstream energy accounts in the Oil & Gas and Power Generation industry sector that we expect to continue into 2024 and beyond.



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CHALLENGING MARKET

The Builders' Risk Property market has seen a significant increase in the volatility of construction projects and several attritional losses emanating from Water Damage, Fire Loss and Construction Defects. New water monitoring, leak detection and site security products have continued to evolve in 2024 with more carriers offering discounts to clients that install and utilize this Insurtech. As respects to defects, we saw recent case law in late 2023 that has contributed to many carriers re-visiting defects exclusionary wording clauses and tie-in to their insuring agreements.

We are seeing a shift in early 2024 with carriers in the U.S. offering more standard exclusions, being Cost of Making Good or LEG 2. Currently, with an inflationary economy at roughly 4% comparative to 2022 and 2023, construction material costs continue to escalate. This has resulted in developers and contractors looking for alternative construction methods to build quicker and at a lower cost. Wood frame construction capacity is still abundant, but more clients are looking at Mass Timber or Cross Laminated Timber construction methods which are still new to the Builders' Risk carriers. There are increased concerns around replacement times and the limited number of manufacturers of these wood products.

This movement from traditional, non-combustible construction has directly resulted in higher retention and deductibles, more stringent terms on large complex civil construction projects, and ultimately, increased premiums. Rising transportation and fuel costs and the continuation of supply-chain issues with regard to delivery time of construction materials within the construction industry are anticipated.

For project risk that is being built in hurricane-exposed regions from the Gulf Coast through the entire state of Florida and up the eastern seaboard, we are seeing less available capacity and increased Hurricane and Flood deductibles. Wildfire and Earthquake continue to be monitored with our neighbors building in the western U.S.

With a rise in non-tropical CAT events like snowfall, microbursts, heavy rainfall, hailstorms and tornadoes, carriers have offered products like Parametric weather which carve out specific covered perils and can be bought with different limits and deductible intervals based upon saturation amounts, barometric pressure, wind speeds, and proximity to the project site. These products can provide an alternative risk solution to our clients, where they don't necessarily have to incur actual damage to their project site.

Globally, construction property rates have steadily increased at +5% and, although we do expect a leveling out of rates in early 2024, we anticipate this hard market to continue. We saw some new U.S. capacity arrive early in 2024 which does paint an optimistic picture as respects to available capacity on both Frame and Non-Combustible projects.

Overall, we expect carriers to still manage risk tolerance levels when deploying meaningful capacity.



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Insurance Renewal Expectations

Cyber

STABLE MARKET

In 2023, we observed a stabilization of Cyber rates with more selective limits for specific coverage. Despite an uptick in loss trends, with both ransomware and funds transfer fraud claims occurring at increased rates and with more severe impacts, the market conditions of Cyber insurance have softened. However, the growing use of e-commerce, mobile banking, electronic accessing of medical records and more, has led to higher risks and rates of data breaches and cyber attacks.

By market estimates, cybercrime is projected to exceed \$10.5 trillion globally by 2025. Fortunately, the Cyber Insurance market is continuing to grow and adapt to help mitigate these risks. Last year saw an estimated \$11 billion in Cyber insurance in the US, which grew from less than \$1 billion in 2012. Part of this increase can be attributed to the rise in the number of markets, both new and old, that are currently writing Cyber policies. This increase, along with the continued implementation of more advanced cybersecurity systems, has led to a decline in average premium cost by 20% over the past year.

As the adoption of artificial intelligence (AI) continues to rise, it begs the question, "How could this possibly bring forth new systemic cyber risks and exposures?" As is often the case, new technology can be used in both positive and negative ways. On one hand, AI (which has been exposed to certain datasets) is being used by cybersecurity systems to predict areas of vulnerability in an insured's systems. Unfortunately, threat agents have also started using AI to increase the effectiveness of their attempts at social engineering.

One growing trend in the Cyber marketplace is increased collaboration between insured and insurer. Through routine network scans, consistent communication and insightful recommendations, clients not only help mitigate their risk of a detrimental cyber attack but can lower their policy premiums as well. Conversely, companies whose security capabilities are absent or below standard, may find it difficult to procure Cyber coverage.

Moving into 2024, we anticipate the Cyber market will begin to implement more strategic requirements, as the nature of costs surrounding claims due to investigations, settlements and penalties are a growing concern for underwriters, but still expect rates to remain stable.



Through routine network scans, consistent communication and insightful recommendations, clients not only help mitigate their risk of a detrimental cyber attack but can lower their policy premiums as well.

Drone Liability

STABLE MARKET

Many carriers have expanded their offering for Drone Liability through more comprehensive and customized insurance plans for commercial drone operators. In the past year, Drone insurance market size has increased from \$1.33 billion to \$1.45 billion, with estimates that it will continue to rise to \$2.09 billion by 2028.

As drone usage has increased, the number of drone accidents followed that same trend. But, with continued government regulations on drone usage and safety, together with the implementation of emerging technologies such as artificial intelligence and data analytics, the ability to avoid drone-related claims should see an improvement. As a result, we anticipate the Drone market in 2024 will remain stable.



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Insurance Renewal Expectations



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Employment Practices Liability

STABLE MARKET

Headed into 2024, Employment Practices Liability (EPL) coverage premiums are expected to remain fairly stable, with increases typically only getting as high as 10%. That being said, certain states still present difficulties, namely New York, New Jersey, Florida, and California.

Changes in EPL risks are also present in 2024. First, as we move further away from the 2020 pandemic, an increasing number of companies are pushing for employees to return to the office, at least a few days a week. In order to mitigate risk resulting from this workplace adjustment, it's important for companies to present clear guidelines that are implemented consistently, as to best avoid potential cases of discrimination. Conversely, it's also important for companies to be understanding of potential exceptions, as a person requiring the ability to work remote isn't as impactful on the company's operations as it once may have been.

Additionally, due to low unemployment levels made worse by a general labor shortage, there is an increased amount of hiring taking place. With the implementation of AI in the hiring process—which may not be immune to the effects of certain biases—it's imperative that companies provide all applicants a fair opportunity for employment.



In order to mitigate risk resulting from this workplace adjustment, it's important for companies to present clear guidelines that are implemented consistently, as to best avoid potential cases of discrimination.

Fiduciary Liability

STABLE MARKET

After some slight hardening last year, the Fiduciary Liability market has seen some more stabilization of late. Rates have stayed mostly flat, although markets are looking to offset their risk.

While most carriers are not restricting coverage, retentions have increased and carrier capacity has decreased, with \$5M in limits now more likely than \$10M. Fortunately, more markets are beginning to write Fiduciary Liability coverage, which is a major factor in keeping rates flat in spite of individual carrier changes.

Management/Directors and Officers Liability

SOFT MARKET

The Directors and Officers (D&O) market has continued to be one of the softer markets as we move into 2024. A driving force behind this is the emergence of additional carriers into the marketplace. Additionally, the availability of higher limits for excess D&O is there for larger risks. However, certain classes of business or companies with multiple claims may still experience some challenges in acquiring coverage.

Subcontractor Default Insurance (SDI)

Subcontractor Default Insurance (SDI)

For contractors who utilize subcontractors for the delivery of construction services, subcontractor default is a significant exposure. The elevated risks of construction, together with macro-economic dynamics, can drive uncertainties in subcontractor performance, making the utility of Subcontractor Default Insurance (SDI) in today's marketplace more important than ever.

On the heels of a “surprisingly strong” performance in 2023, a new American Institute of Architects (AIA) report predicts that declining property values, tighter credit and higher input costs will hamstring construction growth this year and next. Along with the AIA, other economists have spotted indicators that a slow-down may still be looming. Associated Builders and Contractors’ (ABC) Economist Anirban Basu noted at the turn of 2024 that, despite three consecutive months of price moderation, geo-political factors could still play a heavy hand in the economic environment.

With the overall increase of project and subcontract values, contractors should be on guard, particularly those who do not have market sector or geographic diversity (55% of subcontractors surveyed by PlanHub said they rarely bid on projects from general contractors with whom they have not previously collaborated). These weaker conditions make SDI a more valuable and viable tool for contractors versus those who rely on traditional—or riskier—methods of selecting subs based solely on instinct, legacy relationships, or word of mouth.

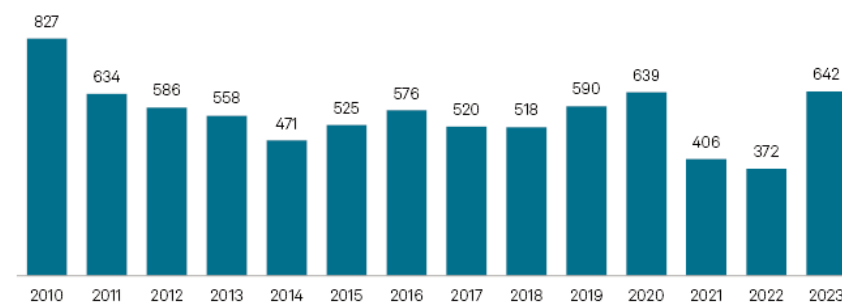
SDI provides coverage for unforeseen circumstances that adversely affect subcontractors, which general contractors (GCs), owners and lenders have had no prior knowledge about. Situations that can contribute to a subs failure may include: insolvency; over-extending themselves on too many projects; failure to have a succession plan; escalation costs; mismanagement; supply chain issues and sub tier issues.



“

On the heels of a “surprisingly strong” performance in 2023, a new American Institute of Architects (AIA) report predicts that declining property values, tighter credit and higher input costs will hamstring growth this year and next.

US bankruptcy filings by year



Source: <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-bankruptcies-hit-13-year-peak-in-2023-50-new-filings-in-december-79967180>

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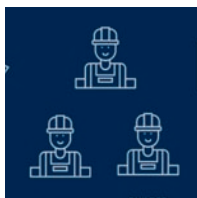
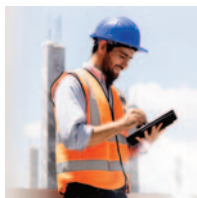
Subcontractor Default Insurance (SDI) - continued

Red Flags

Following are some insights and 'red flag' trends in the current SDI Marketplace:

- An uptick in default notices in 2023, on the back of 2022. With roughly 40% of issues being financially driven, there is a significant increase in lien activity and bankruptcies on enrolled SDI projects.
- In addition to previously noted sub loss leaders in wood framing, drywall and building envelope, there has been a significant uptick in electrical defaults and certain subsets like fire suppression. "We continue to see electrical subs have problems. Thinning balance sheets and lack of qualified workers being the common thread," stated Charlie Tasto, SDI Risk Engineer at Hudson Insurance Group. "Rework costs eclipsing the subcontract value by a factor of three is the norm" he continued, exacerbated by "fraudulent documentation for stored materials." According to AXA XL Subcontractor Default Insurance claims data, there has been a substantial increase (58%) in default claims notices from 2021 to 2022, with 2023 trending similarly, and electrical subcontractor defaults surpassing all other subcontractor trades.
- With economic uncertainty, there's been elevated risk associated with a rash of subcontractors expanding their operations into new trades or territories with which they are not familiar. Given broader market dynamics, this put significant stress on a subs' balance sheets and overall operations (60% of defaults have been operationally driven).
- Private equity, merger and acquisition (M&A) activity and broker labor have led to contractors performing work as a subsidiary under a parent organization that begs upstream and downstream risk from both an operational and financial perspective.

Beyond some of these more negative market trends, the product has endured 3+ economic cycles, closing in on its 30th year of service, and has truly become "mainstream" in its use in the industry. Capital is strong and underwriting discipline is ever-present amongst the limited group of SDI carriers.



Additional carrier entrants into the market bolster the product's long term stability. New product twists like Vantage's SubSelect SDI feature allow smaller to middle market Contractors/Projects to utilize a product that's traditionally been reserved for much larger contractors. With the right qualification(s), the product can even be utilized on a single shot project basis (and as a bridge to a rolling program).

In addition to SDI's important utilization on rebounding construction segments like hotels/hospitality (see: Investors To Return To Hotel Sector With Gusto This Year: JLL at www.bisnow.com), we are noticing a trend of healthcare systems specifically requesting SDI usage on their projects; and even the smallest of MOB/Outpatient Care type work (Less than 50M in construction value).

Beyond the inherent benefits of control and coverage to the contractor and project-at-large, owners, and developers, lenders and rating agency's look favorably upon SDI as a performance risk guarantee and veritable credit enhancement (See DBRS Morningstar excerpt from October 2023 bulletin, below).

SDI has proven to be a valuable risk management tool in the construction industry and, in turn, is helping to foster the economy. Market conditions continue to be competitive for best-in-class contractors. Contractors that can demonstrate active and successful subcontractor prequalification processes, as well as sound sub management/mitigation strategies (e.g.; Strong QA/QC controls for Habitational Builders) will find capacity, rates and terms that are competitive for all but the extreme risk profiles.

Construction Credit Enhancements
 Surplus financial resources tend to be limited in most PPPs, providing ProjectCo with limited protection from substantial cost overruns incurred (e.g., when a nonperforming contractor needs to be replaced). As a result, PPPs are typically supported by construction enhancements provided by the construction contractor to secure its performance. These provide a financial cushion against unexpected shocks and increase the likelihood of successfully replacing a defaulted contractor and achieving completion, thereby somewhat loosening the tie between the contractor's and the project's credit quality and allowing ProjectCo's rating to exceed that of its construction contractor. This approach also places significant emphasis on the construction contractor replacement mechanism embedded in the contractual framework, making it a key element of support in the construction-phase rating. When assessing the quality and degree of ratings uplift provided by construction enhancements, DBRS Morningstar considers the size, timeliness, and certainty of the package, which may include letters of credit (LOCs) and/or cash reserves; performance bonds, labour, and materials bonds; or other types of insurance and/or trapping mechanisms as explained below:

DBRS Morningstar Appraisal of Financial and Performance Supports* During Construction	Notching Impact	Notes
Cash and/or LOCs to meet delay liquidated damages from target substantial completion date to PA long stop date (and for at least 12 months)	+1	Benefit is capped at one notch
5% Cash and/or LOCs, in addition to the amount above (as calculated and denoted in as a percentage of the construction price)	+1	Benefit is cumulative
50% Performance bonds and labour and materials bonds	+1	Benefit is capped at one notch
Subcontractor default insurance**	+1.5	Benefit is capped at 1.5 notches
Liquid Surety Products	Varies	Depends on liquidity and structure of instrument

* Expressed as a percentage of the construction price. ** When properly structured.

Surety

Surety

With an economic ‘soft landing’ seeming far more likely today than it did a year ago, we hope to have left the extreme inflation and interest rate hikes of 2023 behind. Labor and material prices, while no longer spiking, still remain at, or close to, peak levels in many instances, however major supply chain disruptions have subsided for the most part, with a few exceptions.

Entering 2024, the economy appears to be showing signs of both resilience and the ability to pivot, avoiding more unfavorable outcomes. There is still much work to be done to address the significant downturn in office occupancy, debt refinancing and defaults that could stem from a higher interest rate environment but, to date, the downside impact on the overall economy has been limited.

Losses in the surety space did increase in 2023, as expected, and there are no signs that this higher level of contract default will decrease in 2024. However, higher losses have not impacted overall capacity offered by the surety market, though it has caused some types of bonds to be viewed as higher risk, making them more difficult to obtain.

If interest rates drop in the second half of 2024, leading to more privately financed work, then perhaps our forecast for 2025 will have fewer surety loss discussions and more positive comments about the marketplace. Currently, this seems a likely scenario, however more insights from 2024 will be needed to see if this prediction holds true.

There has been a move from underwriters, in general, to push for more timely and detailed underwriting information from their contractors, but if properly managed there appears to be no significant reduction in support. Underwriters in 2024 are focused on a few key areas, some familiar and some new concerns. These include:

- **Labor Availability to Support Higher Backlogs:** Contractors performing publicly financed work of all sorts, have record backlogs and more work still available in their pipeline, some of it with far less competition, predicted higher margins, and less risk for the contractor. It is believed that these higher levels of support will lead to higher profits that will grow both working capital and net worth. However, until those earnings are generated and retained, the surety metrics of total program size to balance sheet size, is being pushed to much higher levels than has historically been the case.
- **Concentration of Risk Among the Largest Projects:** The combination of recent bid inflation together with a decades-long trend to push more work into a single contract, has created a concentration of risk that is challenging the construction and surety space. Some consolidation is driven by owners and advisors, trying to limit the number of parties they need to negotiate with and manage, while another factor is the growing number of large projects which may be too difficult to break into pieces. Whatever the reason, the challenge is real for both the construction community and the surety industry. In response, there has been an increased push for alternatives to lump sum bidding and this trend is likely to continue for the foreseeable future, despite owners struggling with the lack of price certainty.
- **Prolonged Higher Interest Rate Environment:** After experiencing some of the largest rate increases in recent history, interest rates have come down but remain higher than anticipated which has a depressing effect on new, privately financed work. The longer rates remain high, the greater the impact will be on the bottom lines of contractors who rely on bank borrowings to provide working capital or to finance equipment. Most expect the central bank will begin to reduce rates later this year, however the longer that process takes, the more negative impact we will see.



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Surety - continued

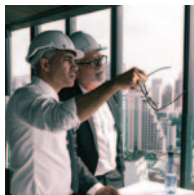
Our advice to contractors

The uncommon events of the last several years have left even the most seasoned surety experts struggling to find lessons that are helpful in guiding future decisions. However, given the current environment, our advice to our contractor clients remains much the same – get back-to-basics. Fully understanding your business and how the surety business operates is key. Here are three important pieces of advice:

- **Stay close to your surety/sureties:** Make certain your sureties see each other regularly and press them to confirm that they know how your company is performing. If you are having challenges, be sure to provide that information to your surety as soon as possible – together with an explanation of how you are addressing those challenges - before they hear about it elsewhere. Negative impacts are often minimized, and surety support can increase significantly, when contractors maintain a ‘no-surprises’ approach to their surety relationship. All companies occasionally have issues, but sureties want to understand how businessowners/leaders plan to address those issues, as a key part of formulating their underwriting response.
- **Use a broker who has extensive experience** with companies similar to yours, and deep relationships with underwriting leaders both at the field office and home office level. In today’s environment it is more important than ever to find a broker with true expertise and deep relationships to represent you and provide strategic advice that will help foster a strong relationship with your surety.
- **Underwrite both your broker and your carrier,** just as your carrier underwrites you. Ask how their business is performing and the types of challenges they are facing. Their answers can provide valuable insights to you about both your carrier and broker partners.

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American Global is one of the largest privately held insurance and surety brokerage firms in the U.S. specializing in all aspects of construction risk management. We support contractors, owners, and developers throughout the entire scope of their project and across every milestone of their business, protecting against the risks and exposures specific to the construction industry. American Global has multiple offices across the United States, as well as in Canada, England and Italy, to serve clients throughout North America, Latin America, the United Kingdom, and Europe.

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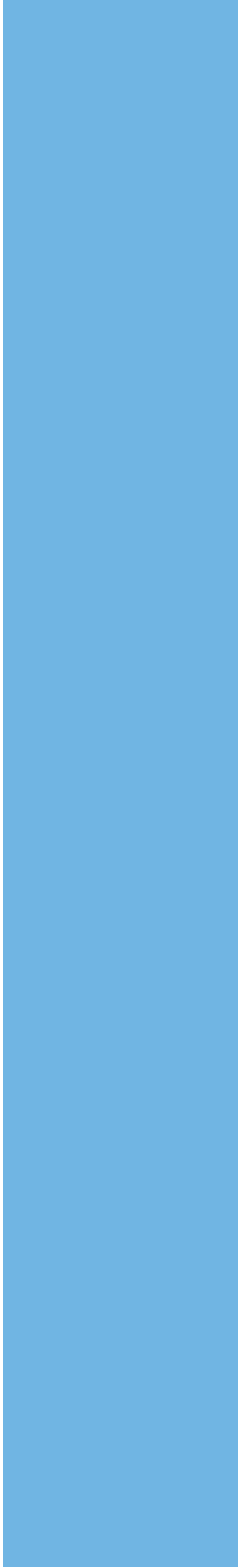
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