

# CONSTRUCTION INSURANCE

Willis

# PROPERTY & CASUALTY MARKET UPDATE

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**Construction-related firms, including owners, contractors, suppliers and design professionals, will find 2008 challenging on many levels. Every economic forecast indicates a profound slowing of activity, with especially dramatic declines expected in the residential sector. Non-residential construction will feel the fallout from the banking crisis as financing slows for commercial deals.**

Running counter to these trends, however, growth is expected in infrastructure, energy, power and healthcare. Privatization continues to be another central issue, with the potential to alter the construction landscape, but while privatization discussions continue, it appears growth in this area will continue to be slow given the political and financing issues surrounding these projects.

**The insurance industry, by contrast, is calmer. We expect to see a continuation of the competitive rate market enjoyed over the last two years.** The lack of insured catastrophic events in 2007, combined with a strong economy (though it may seem like a distant memory now), led to another great year for insurers. Coming on the back of record results in 2006, insurer appetite for market share grew in 2007, and competition will likely continue through 2008. Rate hardening is unlikely to occur before first quarter 2009, according to current forecasts, although ongoing troubles in the investment markets could accelerate a hardening as insurer assets lose value. Each line of coverage will have its own trends to monitor in 2008, but in general, the year will be a good one for buyers who manage risk aggressively and have average or better loss records.

## GENERAL LIABILITY

General Liability has had its share of controversy recently as buyers question the value of a product that has markedly different coverage interpretations, depending on the state where the policy is applied. For multistate contractors, General Liability is therefore a particularly difficult line. Other contentious issues include interpretation of the business risk doctrine (which questions whether damage to the contractor's work itself constitutes a loss at



all), additional insured statute and form variations, and how statutes of limitations are interpreted.

Concern about residential projects and liability has caused carriers to carefully underwrite those exposures to the point where distinct markets have evolved to address project-level solutions for residential projects. At the same time, mainline carriers have gotten more comfortable with clients who do a limited amount of this work. Carriers often put a 25% cap on the amount of residential work insureds can have in their portfolio. Given the significant decrease in residential activity, however, concerns have eased somewhat as the percentage of residential work in contractors' programs has declined.



Other factors complicating the Liability sector are the broadening of responsibilities of construction firms to include design and construction management, and the advent of blended design ideas (such as building information technologies). Affected firms must be sure to pursue careful coordination with Professional, Environmental, Cyber Risk and other coverages. The good news is that the industry is discussing these issues and is aware of the need to carefully construct policies to make sure that gaps are filled. Marketplace trends for General Liability in 2008 include:

- **Rates:** Downward trends in both retentions and rates continue in 2008. Entities with strong loss records will have more options, but surveys show a general rate softening of 5% to 10%.
- **Limits:** Many carriers are offering higher primary limits as a way to offset premium declines. Buyers seeking higher limits may also benefit from easier Umbrella and Excess Liability negotiations.
- **Coverages:** One of the more significant developments in 2007 saw carriers addressing business risk exposures by developing manuscript coverage forms. Contractors should be sure to ask for their carriers' position on this issue along with relevant amended wordings on renewal. The business risk doctrine centers on subcontractors' operations and their impact on general contractors, so not all contractors will need the coverage. However, all contractors should be aware of the issue and ask the right questions to assure proper coverage is negotiated. In other coverage areas, flexibility is becoming more common, with underwriters granting broader coverage for additional insured wordings, resulting design losses (BI and PD), and broad named insured endorsements that address special purpose entities, such as joint ventures. Underwriters are even discussing difference-in-conditions and limits endorsements for project-specific placements. This last trend is particularly noteworthy as project-specific placements grow, putting pressure on contractor master programs and potentially exposing participants to uninsured losses that could have been addressed by their master programs.
- **Project-Specific and Wrap-Up Programs:** These approaches are gaining popularity as a way to assure both

consistent coverage and dedicated limits of insurance to the statutes of limitation and repose. Major general contractors are showing more interest in sponsoring these (including on a rolling basis), as they have experienced some of the same coverage inconsistencies as project owners, which traditionally have led these placements. .

## WORKERS' COMPENSATION

Workers' Compensation will be among the most competitive lines of coverage in 2008. Last year, dramatic rate decreases in several states (especially California) created a true buyers' market. As a result, renewals should be smooth, assuming losses are contained.

- **Limits:** Overall rate decreases will vary widely state by state, but expect decreases of 5% to 15% or more.
- **Retentions and Deductibles:** Carriers will be more willing to provide lower attachment options this year. Contractors stand to gain but should be careful not to buy down their deductibles if doing so will have an averse effect on safety and risk management cultures.
- **Collateral:** With the popularity of deductibles in this line, collateral has become a big issue for buyers, especially as years accumulate. We

are not sure what impact, if any, the credit crisis may have on carrier needs for collateral in 2008, but the trend at this writing is for more flexibility in the amount of required collateral, both as a competitive tool and as a recognition that in many cases, losses have trended better than expected.

- **Wrap-Ups:** Continued competitiveness in Workers' Compensation has had a direct impact on the size and design of project insurance. Traditionally, Workers' Compensation has been the economic driver for wrap-ups, and relatively small projects (as low as \$100,000,000 in value) were handled in this manner. Now, to support Workers' Compensation in many states, projects need to be significantly larger – often in excess of \$400 to \$500 million – for the wrap-up to make economic sense.
- **Coverage:** While coverage in this line is often straightforward, scrutiny is warranted for marine exposures, foreign operations (including those covered by the Defense Base Act), leased employees and waivers of subrogation.

## AUTOMOBILE COVERAGE

This line is noted for its relative stability and comparatively few coverage disputes. Nevertheless, policies should be assembled carefully with emphasis on coordinating equipment coverage with the General Liability coverage, proper expansions for the transportation of hazardous cargo, and coverage for hired drivers. A recent trend in construction is the outsourcing of trucking activities by contractors as both a risk management and cost savings strategy. Whoever is responsible for the vehicles, contractor or subcontractor, will benefit greatly by focusing on best practices.

Rates will remain competitive as this remains a consistently profitable line for insurers. We expect further declines of 5% to 10% in 2008.

## EXCESS LIABILITY

**When insurers enjoy strong underwriting results, the line that typically sees the most volatility is Excess Liability. Reasons for this are straightforward: ease of entry into this line, the low cost of underwriting, claims and service, and access to reinsurance. The current market is no different,** with many new carriers offering significant limits and creative coverage approaches. Buyers have an opportunity to look closely at their Umbrella and Excess programs as carriers are willing to discuss exclusions and limitations (residential, silica, means-and-methods professional, wrap-up DIC/DIL, and “damage to the work”).

- **Pricing:** Competitive. This line saw decreases in 2007, and we expect further rate competition in 2008.
- **Capacity:** Building towers of liability of \$200,000,000 to upwards of \$500,000,000 is readily achievable in this market.
- **Markets:** Carriers are participating globally, with active markets in the U.S. (on both an admitted and non-admitted basis) as well as in Bermuda, London and Europe. For very large limits, unique exposures or difficult placements, all of these markets should be part of a strategic marketing discussion.

## PROFESSIONAL LIABILITY

Professional Liability marketplace conditions are improving in terms of capacity, rates and appetite. While there are always exceptions, this line is expanding.

- Capacity has increased for A/E and contractor coverage. We anticipate interest by current carriers in contingent coverage for contractors. The London markets are expanding their share of the Contractor's Professional Liability market, creating additional pricing pressure on domestic markets.
- Last year's habitational construction restrictions are easing. Where underwriters previously declined issuing programs with more than 10% or 15% habitational risk, that percentage is rising to 25% or 30%; in some cases, underwriters are looking past this percentage and are underwriting on a case-by-case basis. We are also seeing project-specific professional coverage for condominium work for the A/E when the carrier writes the A/E's master program.



Additionally, fairly significant limit is available for high-rise concrete and steel condominium developments.

- Contractors' Professional Liability underwriters show little interest in covering the construction management (CM)-at-risk exposures on Contractors' Professional Liability coverage forms. The underwriters continue to underwrite CM-agency but are more conservative on the CM-at-risk model.
- Owners are showing increased interest in Professional Liability and are either requiring minimum threshold limits from their general contractors who do not carry professional coverage, spiking existing minimum limits requirements, and/or are pursuing their own contingent Professional Liability policy to treat the exposures. This is an issue for public projects, too.
- Early involvement in large-scale and PPP/PFI projects by project financing entities is driving resurgence in the demand for higher limit project-specific Professional Liability placements. Limits up to \$30 million are available, although rate-on-line for these placements remains extremely high.
- Contractors are increasingly concerned about potential increases in risk as a result of the rapid adoption of building information modeling (BIM) software, and the potential for claims arising out of a possible overlap of design duties with construction means and methods. In the absence of an insurance-based solution, contractors must look carefully at contractual provisions to manage and avoid possible exposures.
- We have observed an increase in design/build activity for many of our contractor clients, delivered for the most part by means of joint ventures with architectural and engineering firms. The structuring of protection for contractors from the acts, errors and omissions of their design firm partners remains very problematic. Project-specific professional policies, wherein the contractor is recognized as an indemnified party only, are proving to be reasonably robust mechanisms for addressing these exposures. As noted above, however, the rate-on-line for this cover is significant and can result in the insurance creating a non-competitive bid price, unless insurance costs are accurately factored into a project's financial pro-forma at the outset of the project budget process.

- While we observe upward pressure on retentions, we expect slight rate decreases on clean renewals.

## ENVIRONMENTAL LIABILITY

Project owners and construction lenders are increasingly requiring Contractors Pollution Liability (CPL) coverage for their projects for two reasons: the recent targeting of the construction industry as a sector with “high polluting” potential by the U.S. Environmental Protection Agency, and the fact that while construction projects do not generally experience a high frequency of pollution conditions, when they do occur, they can be catastrophic. A CPL requirement is no longer reserved for large projects or jobs on environmentally impaired sites. While CPL has traditionally seen steady, profitable growth and is a preferred line of business for most carriers, the underwriting on these policies is not to be taken lightly.

- **Rates have been decreasing in recent years, and while we see some indications that the soft Environmental market may be nearing its end, or at least leveling off, some new capacity is entering the market. Increased competition, of course, usually leads to rate decreases.**

- One major carrier recently reissued their CPL form and included many of the coverages as standard that previously were negotiated separately.
- While terms and conditions have broadened over the past couple of years, the trend has been toward increased project-specific information requests, more engineering of jobsites and more intensive underwriting scrutiny.
- Underwriters will provide multiyear, project-specific policies but will continue to push for annually renewable practice policies.

Some of the developments for site-specific Pollution Liability exposures are:

- Loss history, including some catastrophic losses, in recent years, has resulted in coverage restrictions and increased underwriting scrutiny.
- Underwriters continue to reduce policy terms for new conditions. While that coverage had been available for periods up to five years, the recent trend has been closer to three years.
- At renewal, insureds should expect requests for more location-specific information on their portfolio placements. In some cases, these requests are demands, and coverage is contingent upon more and better information.

Along with increasing their number of requests for information, underwriters are more keenly interested in scrutinizing areas of regulatory interest, such as:

- Vapor intrusion from underground contamination into buildings (not only a concern for the building owner, but also for the contractor performing work such as sewer line relocation)
- Contaminated stormwater runoff from construction sites (which has been getting much more regulatory attention at both the federal and state levels)

The evolving coverage for mold is improving due to increased understanding of the risk and modified construction and maintenance practices; however, insureds should prepare for coverage restrictions for emerging contaminants, such as perchlorate, E85 (gasoline and ethanol fuel mixture), and PFOA.

For remediation projects, cleanup cost overrun policies continue to challenge the market, as these products have historically resulted in unacceptably high loss rates for underwriters. With only a few markets in this arena, we see more restrictive terms, increased information requests, more engineering (including more site visits) and higher minimum premium thresholds. Up-front engineering or commitment fees are now common. The majority of the carriers are only offering this type of product to a pre-selected group of “partner” contractors.

Professional Liability programs for large environmental service firms have been a source of significant losses for Environmental liability carriers. Expect a continued pull-back from accounts with a significant component of traditional design engineering (i.e., non-environmental) exposures.

**The bottom line is that insureds should expect challenging renewals with increasing underwriting scrutiny and should take care with the design and marketing of their programs to avoid erosion of valuable coverage.** The new markets may not be the only ones asking for detailed information – the incumbents may also request information they have never asked for before. Also, for new placements, it will be important to carefully match coverage needs



to the current appetites and offerings of the individual markets. As Environmental insurers become more selective, purchasers able to combine innovative program design with high-quality underwriting presentations will derive maximum benefit.

## BUILDERS RISK AND PROPERTY COVERAGE

Perhaps the most troubled construction sector in 2006 and 2007 was Builders Risk. For obvious reasons, insureds in the southeastern part of the country faced critical challenges in terms of capacity, deductibles and pricing. The rest of the country fared much better and 2008 promises much of the same. More capacity from the markets and continued rate reductions should allow insureds to negotiate higher sublimits, lower deductibles and coverage enhancements. The current market has created opportunities for master builders risk programs, which are increasingly popular.

- While predicted hurricanes did not strike the Gulf Coast in 2006 or 2007 and catastrophic losses did not occur, Builders Risk carriers have not forgotten recent history. While capacity and rates would typically loosen in this short-tail line of coverage following the positive loss results of 2006 and 2007, Southeast buyers should not expect to see significant movement. Carriers will continue to be stingy with capacity and cautious with allocation. Driven by new catastrophic models and rating-agency scrutiny, carriers will retain strict underwriting discipline for exposed areas of the country. In many cases, larger placements will require participation by several insurers to achieve adequate limits, which will require care in structuring programs to avoid coverage dislocations.
- Outside of coastal areas and California quake country, Builders Risk coverage continues to be available and affordable, with rates down 15% to 20%. Interesting (and perhaps short-sighted) was the flood of insurers allocating their capacity to the Midwest and upper-Midwest regions where the New Madrid fault line resides.
- On moderate-to-large projects, underwriters are increasingly asking project managers technical underwriting questions – which means that longer lead times are needed to obtain multiple quotes and optimal terms and conditions.
- Contractors' Equipment pricing is down 5% to 10% over expiring. Loss experience, retentions and geographies must all be factored in, but for the most part, this line of coverage will enjoy stable to reduced rates.
- Permanent Property rates are generally down with concerns for aggregation of risk in certain areas of the country.

## SUMMARY

We expect 2008 to offer buyers the opportunity to address both rate and coverage concerns as the insurance markets remain fairly competitive. This of course is subject to continued good loss experience, including a certain degree of luck in the catastrophic loss area. Counter to the good news from a buyer's standpoint, the underlying construction economy (and indeed the overall economy) may pose a serious challenge to construction-related firms – a situation that could lead to upticks in loss activity as employment softens and projects get suspended or abandoned. Underwriters could respond by becoming more conservative, though, so far, we have yet to see movement in that direction.

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