

CONSTRUCTION

SLOW GOING

Difficulties continue in several construction industry segments. Worrisome credit markets impact many projects, causing delays or outright cancellations. The credit crunch continues to decimate the residential market and much of the commercial market, including gaming, office, retail and hospitality. As a result, we expect the financial health of the construction community to be increasingly stressed as backlogs decrease, which may lead to consolidation and, many fear, increased bankruptcies.

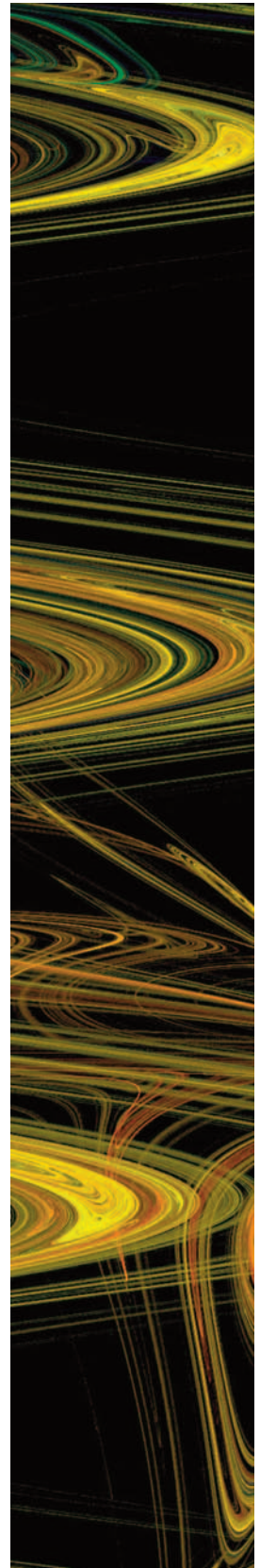
While many were cheered in Q1 by passage of the Obama stimulus package, the industry generally felt it was not large enough to reverse the widespread declines in construction. The spending plan will, however, pour funding into several key areas:

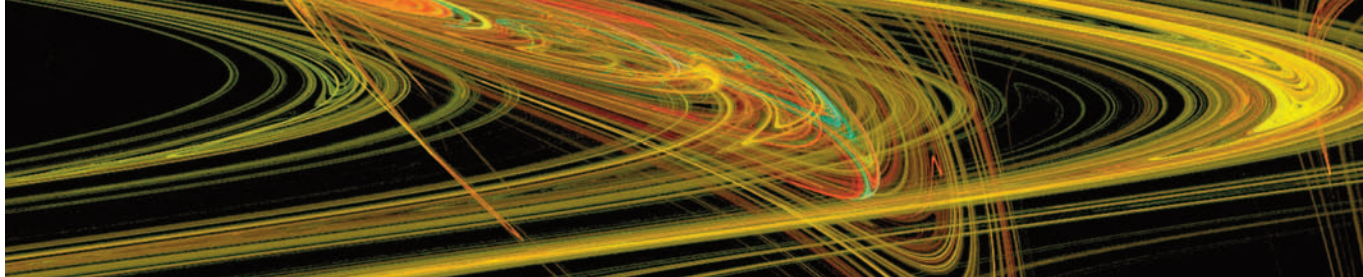
- Transportation – \$49.3B
- Defense/veterans – \$7.8B
- Energy – \$30.6B
- Buildings – 13.4B
- Water and environment – \$20.1B
- Housing – \$9.6B
- State fiscal stabilization – \$53.6B

While growth is anticipated in infrastructure, energy, power and health care, nonresidential building construction is expected to remain at historic lows. The trend toward privatization of public projects continues, but political forces combined with current credit market environments make such projects very uncertain.

In construction insurance, the challenges facing AIG and the impact on the marketplace continue to unfold. AIG has historically been a key player in all aspects of the construction industry, and the uncertainty around the company has caused concern for many. Business has moved to other markets in some cases and new business has been difficult for AIG to come by. Similarly, questions about the financial strength of others, i.e., Hartford and XL, have also caused concern in the industry.

In the marketplace as a whole, the capital crisis may have driven down supply, but the recession has lowered demand, and, as we forecast in late 2008, the competitive rate environment continues for most product lines. Now there is some evidence of change, driven by the reinsurance marketplace in many respects, most noticeably in Property





lines, particularly in the catastrophic areas. In the Casualty lines, renewals are generally flat, although we have seen both selective reductions and increases, a sign that the market has stabilized. We expect upward pressure on rates by Q2 of 2009 in response to several factors: reinsurance pressure, loss rates that have continued to rise in many lines of business, major decreases in investment performance and overall declines in demand due to the economic downturn. The way for construction underwriters to make some of that up is to increase rates.

GENERAL LIABILITY

Early 2009 has shown this line to be flat from a rate standpoint and generally more flexible on coverage terms. General Liability is the most difficult line for construction, as it often encompasses risks from several parties (via additional insured requirements, multiple parties on single sites, etc.). General Liability is also sensitive to court decisions that can abruptly impact the breadth of coverage on a state-by-state basis. This can lead to some confusion as to how the coverage responds unless care is taken in negotiating appropriate coverage extensions.

Recent court decisions highlight this complexity, giving rise to much discussion of horizontal vs. vertical limits exhaustion created when more than one insurance policy may apply to a loss. This typically creates challenges for contractors in complying with additional insured requirements and requires careful policy structuring to avoid potential contractual default concerns. Other areas of focus are Business Risk/Damage to the Work endorsements, proper coverage for new technologies, such as Building Information Modeling (BIM), the impact of recent increases in Green Building initiatives and the blurring of lines between General Liability and Professional Liability coverages.

Overall coverage negotiations have been balanced in the early part of 2009, as carriers are keen to retain their best clients and are showing flexibility in renewal negotiations.

GENERAL LIABILITY HIGHLIGHTS

RATES

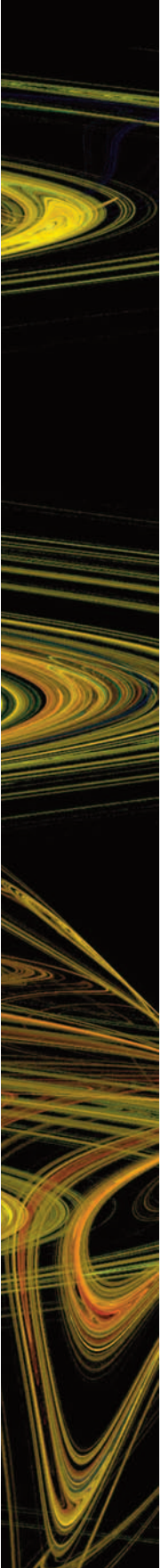
Buyers should keep a close eye on minimum policy premiums. With so much uncertainty in work flow, appropriate flexibility in minimum premiums needs to be a fundamental part of the underwriting discussion. Exposures may fall below the stated minimums, creating audit challenges and causing firms to pay too much for their coverage. This is true across all auditable coverage lines.

LIMITS

Excess pricing continues to remain soft, allowing construction clients to purchase higher limits. We continue to see carriers offering primary General Liability limits of \$3 million per occurrence or \$6 million aggregate and Auto Liability at \$3 million.

WORKERS' COMPENSATION

Workers' Compensation continues to be competitive, although impending increases in California rates (see the *Marketplace Realities* piece on Workers' Compensation) and recent decreases in Louisiana highlight the variability by state. Workers' Compensation continues to be affected by flattening activity in the construction industry and declining payrolls.



WORKERS' COMPENSATION HIGHLIGHTS

RATES

Rate competition is still evident, as this line remains profitable for insurers. We expect the market to remain competitive through at least the latter part of 2009, when we believe rates will be flat or will gradually begin to increase.

COLLATERAL

Collateral has become one of the most difficult aspects of buying insurance. Carriers are closely reexamining their current holdings, as well as the banks that typically provide letters of credit and the viability of contractor balance sheets. Collateral issues are now driving decisions on the type of plans contractors can buy. Carrier input can impact the contractors' banking relationships, as carriers are reducing the number of approved banks from which they are willing to accept LOCs.

ALTERNATIVE MARKETS

Contractors are increasingly discussing alternative markets, particularly group captives. Captives are generally appealing to contractors who want to take additional risk via higher retentions, fund losses over time and join forces with their peers. Forming groups is often attractive to contractors, as groups tend to encourage safe work environments and help reduce losses over time. In hardening markets, group captives usually grow because their costs typically are more stable than those of individual contractor deals.

WRAP-UPS

A notable trend in wrap-ups is the reduced number of traditional programs that include Workers' Compensation. Many projects and rolling CCIP programs are insuring lines other than Workers' Compensation (General Liability, Environmental, Professional and Builders Risk). This is driven by the effort required to manage Workers' Compensation programs, resistance from subcontractors and the lack of clear financial incentive to put Workers' Compensation

under the wrap-up aegis. While wrap-ups that include Workers' Compensation are still popular on very large projects (over \$350 million in some states), smaller projects are being done routinely without enrolling subcontractors for Workers' Compensation, which often eases the administration of these projects significantly.

AUTOMOBILE

Auto rates will track with other Casualty lines in that we expect some firming toward year end, with individual results perhaps seeing increases sooner if losses are worse than average.

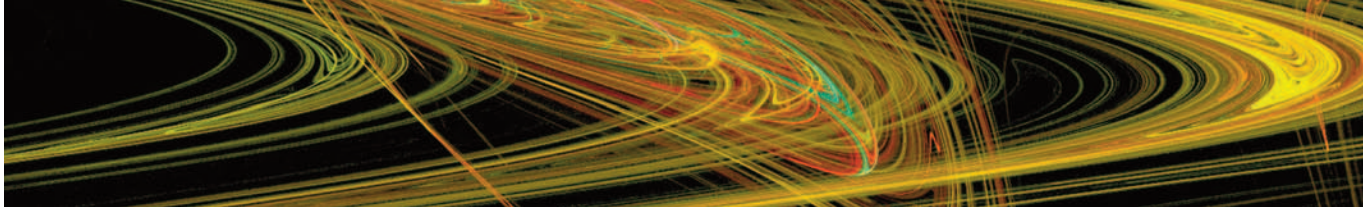
EXCESS LIABILITY

Umbrella and Excess Liability underwriters continue to pursue this line of business aggressively, and the marketplace is drawing many Lloyd's syndicates now coming onshore. It is easy for new carriers to enter this market and, not surprisingly, significant capacity has been added by new players. Going forward, keys to this line will be reinsurance and buying behavior. Given the recent uncertainty in the financial services marketplace, some buyers are moving away from substantial limits with single carriers and restructuring programs to have more insurers involved. This reduces the exposure to carrier failure and creates relationships with other viable excess carriers. While in a few cases this can cost additional premium, it is an increasingly attractive way to building umbrella/excess capacity for larger construction firms.

EXCESS LIABILITY HIGHLIGHTS

PRICING

We expect this line to firm up mid year with some increases on selected accounts occurring now. Pricing remains benign, with modest rate movements through Q1 2009. We



don't see significant upward pressure on rates as of this writing. As in other Casualty lines, we expect some upward movement later in 2009, although this should be modest.

CAPACITY

Expansion of capacity from a number of carriers has been noted over the last year. This has created excess capacity for construction, further flattening rates. Building towers of liability from \$200 million to upwards of \$500 million is readily achievable in this market. Total capacity available is above \$750 million – should it be desired.

PROFESSIONAL LIABILITY

While Professional Liability rates in the London market firmed up in 2008, the U.S. market remained highly competitive. Catlin's entry into the contractor and architect/engineer segments created significant competition for large contractor and design-builder Professional Liability programs. AIG's problems late in the year also fueled the tug of war between the dominant domestic markets for new and renewal business.

One of the biggest recent shifts in the Professional Liability market is a trend towards broader coverage, marked by Catlin's decision to incorporate mitigation of loss wording into their standard form. Previously sought primarily in the London market or through manuscripting, mitigation of loss is an excellent coverage element for design-builders and contractors delivering building components through the use of performance specifications. It is our expectation that other domestic markets will make this coverage more readily available during 2009.

The economic slowdown is severely impacting design firms, and owner defaults and project financing challenges are beginning to impact the frequency and potential severity of disputes with and claims against design firms. Deteriorating combined ratios for underwriters' Professional Liability books – combined with declines in investment income – will continue to place upward pressure on rates and retentions during 2009.

POLLUTION LIABILITY

Because 2008 was a soft year for Pollution Liability, and given the difficulty insurers have faced economically, many of us have been expecting pricing to remain flat or even firm slightly in 2009. Indeed, some of the larger insurers had provided guidance that rates would remain flat or increase compared to 2008 levels.

However, late 2008 and early 2009 have been remarkable in that significant new capacity has entered the marketplace. Today, there are over 20 insurers offering Environmental insurance, and Contractor's Pollution Liability (CPL) is a standard product line for all. As a result of this additional capacity and increased competition, we now believe that the market will remain soft for 2009.

Regarding coverage terms and conditions, many insurers have recently updated their product offerings, adding to their forms coverage enhancements that were previously only added by endorsement. Coverage for transportation, replacement costs and non-owned disposal sites have become standard.

BUILDERS RISK AND PROPERTY

Domestic competition and capacity has increased for Builders Risk and Property with the arrival of some Lloyd's syndicates, i.e. Hiscox and Beazley. Insureds in the Southeast faced the most critical challenges in terms of capacity, deductibles and pricing, while the rest of the country continues to fare much better. AIG's financial issues and their desire to retain business have also helped rates to remain competitive in early 2009. However, the devastation of Hurricanes Ike and Gustav has impacted some Builders Risk premiums in select regions. This has been felt early in 2009 with reinsurance treaties. Our reinsurance experts tell us that carriers are pushing up rates in catastrophe-prone areas, so we expect more difficult placements along the coasts and in earthquake zones. Outside of those areas, however, we are seeing continued rate competition with significant capacity available, though we do expect some increases in rates and retentions will occur in late 2009 or early 2010. The current market still provides opportunities for master Builders Risk programs, which a number of our larger clients use to ensure predetermined coverage and rate structures which allows easier bidding.

BUILDERS RISK AND PROPERTY HIGHLIGHTS

- Hurricane Ike and Gustav increased reinsurance costs, which will create upward pressure on Property rates. Aggregation of risk in certain areas of the country continues to be a concern for carriers.
- Outside of coastal areas and California quake country, Builders Risk coverage should continue to remain soft in the near term.
- On moderate to large projects, underwriters continue asking project managers technical underwriting questions and requiring risk control assessments, which means that longer lead times are needed to obtain multiple quotes and optimal terms and conditions.

CONTACT

Tim McGinnis

Willis HRH Construction Practice

972 715 6263

tim.mcginis@willis.com