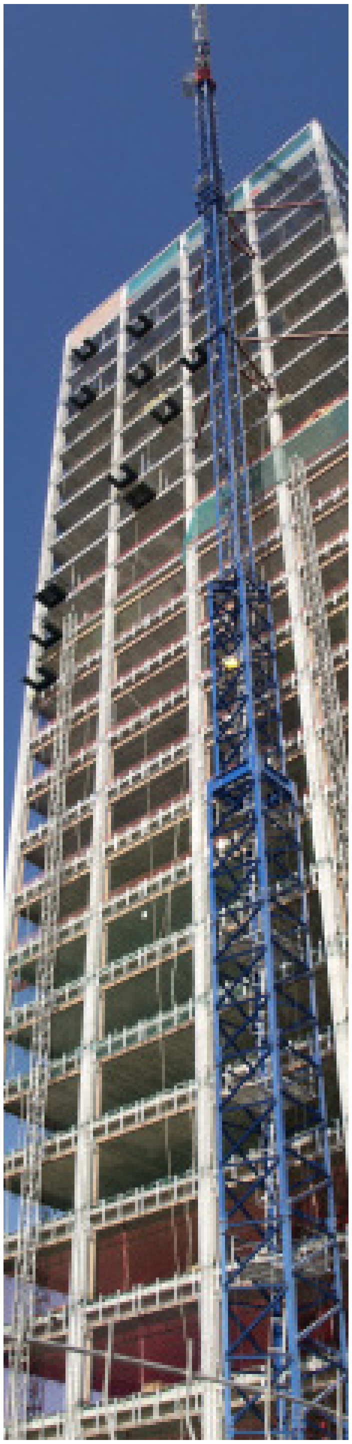
MARSH INSIGHTS:

CONSTRUCTION MARKET UPDATE – FIRST HALF 2013



Economic uncertainty remained the dominant concern for the construction industry in the first half of 2013. Some sectors showed signs of a sustainable recovery, with pent-up demand overcoming uncertainty and attracting capital to US projects. Shrinking public expenditures, however, limited activity in other sectors. The speed of recovery has varied by geography; in markets where profit margins remained tight, competition for skilled labor increased and created pricing pressures for construction firms. The construction industry's unemployment rate has steadily declined in recent months, although it remains above the national average for all industries.

The challenging business climate is driving many contractors to examine longstanding relationships to ensure that value is delivered through expertise and strategic planning tied to their financial plan. Many now look to these relationships for a "forward view" that will identify opportunities to preserve capital and drive margin growth. The focus on data-driven, fact-based decision making is likely to increase as the so-called "profitless recovery" moves into 2014.

MARKET COMMENTARY

PRIMARY CASUALTY

Renewal rates continued to escalate in the first half of 2013 for commercial general liability (CGL) insurance for contractors. Capacity remained strong; however, insurers with contractor business were affected by increases in claim settlement amounts and frequency, rising health care costs, natural disasters, and the aftermath of years of significant insurance premium rate reductions.

The implementation of the new 2013 general liability forms from Insurance Services Office, Inc. (ISO) along with corresponding endorsements is an area of caution. Underwriters that have adopted the new forms have generally tried to scale back coverage afforded to additional insureds. Because the new endorsements are not considered "equivalent" to previous ISO additional insured forms, using these forms may place contractors in breach of contracts that have already been executed.

Many other traditionally available coverage grants are now being negotiated case-by-case, often with associated premium charges. Contractors seeking coverage grants must also be prepared to provide a significantly greater amount of underwriting information to obtain such grants. Read more about the new ISO forms in Marsh's recent white paper.

The workers' compensation insurance market has been relatively stable for high-quality risks. Several large insurers have reduced their workers' compensation capacity as they reevaluated their mix of business. Pricing for workers' compensation insurance escalated in the first half of 2013, with guaranteed cost programs typically increasing more than loss sensitive ones. Insureds with higher loss frequency or severity were likely to experience significantly greater-than-average increases in pricing.

PROJECT–SPECIFIC GENERAL LIABILITY

Pricing for project–specific general liability (GL) insurance increased in most markets, although new market entrants and strong capacity tempered widespread rate increases for preferred risks.

In New York, many owners and contractors purchase project-specific GL in response to Labor Law 240/241 (known as the "scaffold law"). In an effort to eliminate lawsuits between subcontractors, excess and surplus lines (E&S) insurers include cross-suit exclusions. In some cases, underwriters are agreeable to amending these exclusions so that they do not apply to project owners and/or general contractors.

Pricing for GL wraps is increasing in most markets. In New York, where claims under the scaffold law average $1.5 million to $3 million, there are virtually no markets writing GL wraps. In New Mexico and Texas, however, GL wraps are seen as a necessity — statutes in these states restrict one party's ability to indemnify or provide additional insured status to cover the negligence of another party.

Pricing for apartment and condominium projects has increased significantly in the last year. Pricing for non-residential construction is increasing as well, but to a lesser degree. Few insurers are willing to write coverage for wood-frame condominiums. In addition, coverage for "condo conversion" is becoming more difficult to place and much more expensive, due to claims arising out of allegations of defective construction.

We are seeing higher price increases for GL wrap excess than for primary coverage. Some insurers have cut back on the amount of limits that they will provide on GL wraps, particularly with regard to residential projects.

UMBRELLA/EXCESS

The majority of insureds saw low single-digit rate increases in the first half of 2013. Additional capacity entered the market for contractor practice programs and controlled insurance programs. Higher attachment points provide more certainty of projected losses for certain segments of the industry, including street and road contractors, contractors with large vehicle fleets, and situations in which per-project general aggregates are needed. Lead attachment points are still an issue for many underwriters.

CONTROLLED INSURANCE PROGRAMS

The markets for two line — liability and workers' compensation — owner controlled insurance programs (OCIPs) and contractor controlled insurance programs (CCIPs), also known as wrap-ups, remain generally competitive. New York, for reasons described above, is an exception. Although pricing has increased this year, the scale of increases typically depends on the type of construction. Price increases appear most frequently in the lead excess layers. Excess structures have been altered in some cases; insurers often are promising $10 million leads instead of $25 million. Insurers new to this segment have stepped in, providing alternatives to some markets that have grown more conservative over the past two years with pricing, terms, and conditions. This has kept project pricing from increasing to the same degree as contractors practice programs.

General contractors that are able to manage and assume the risk of loss arising out of subcontractor claims are increasingly implementing CCIPs to gain competitive advantages, earn returns on their investment in risk management efforts, and provide a single insurer for GL claims in jurisdictions that limit indemnification and additional insured protection. In light of the increasing need for GL coverage and decreasing financial benefits of providing workers' compensation in a wrap-up, owners and contractors are trending toward purchasing GL wraps.

The evolution of the market for construction insurance, including careful underwriting and the prevalence of loss sensitive programs, has resulted in greater emphasis on cooperation and collaboration between owners and general contractors for project-specific insurance placements. This sometimes occurs in the form of a so called "Co-CIP" or programs that run premiums through an existing CCIP structure with collaboration on enhanced terms and conditions and shared risk and reward between owner and contractor. Health care and educational institutions with recurring capital expenditures are more frequently exploring forms of integrated project delivery (IPD), which demands a coordinated approach to project insurance.

Although fewer markets have capacity and appetite to insure the construction, operations, and maintenance risks on projects, leading insurers are gaining comfort and continue to favor:

- Infrastructure projects, which are often funded with private capital in a public private partnership (P3) whose concessionaires (the private partners) implement CIPs to lower cost.
- Contractors and sophisticated owners that employ extensive loss control measures and represent a source of recurring revenues.
- Well-managed rolling programs, which typically receive coverage for five years of construction operations, plus an extension for completed operations claims of up to 10 years. Coverage for warranty repair work conducted after substantial completion is also available.

BUILDERS RISK

Demand for builders risk insurance has grown in 2013 as more projects began in the first half of the year. Premium rates for builders risk insurance generally remained flat. At the same time, overall rates for catastrophe-exposed property risks increased an average of 5% compared with 2012. An anticipated increase in rates in the Northeast following Superstorm Sandy was not seen.

Although the market remains generally soft, there are no new insurers adding capacity to the so-called contingency markets (liquidated damages and force majeure). Only a few insurers are capable of and interested in writing such coverages.

PROFESSIONAL LIABILITY

The marketplace for professional liability insurance for contractors and architects and engineers has been slowly hardening. Most insurers continued to seek rate increases on renewing business, but at a decelerated rate compared with the increases that marked most of 2012. The first half of 2013 remained generally stable; rate increases of 5% on average are likely into 2014 for profitable firms, though insureds with significant losses are likely to continue to see higher rate increases. In addition, insurers in larger markets have become less willing to provide outside-the-box coverages and continue to be less amenable to requested coverage changes and modifications.

Capacity for contractors and architects and engineers professional liability practice insurance remained plentiful, with newer insurers in the market continuing to aggressively seek business, especially among small and midsize firms. Capacity is also abundant for owners protective coverage and contractors professional liability project coverages, though the number of available markets is more limited.

Capacity for project insurance for architects and engineers professional liability remained limited and more costly than other standard coverages. However, the owner's protective and contractor's protective indemnification forms of coverage continued to offer a cost-effective alternative, with more insurers willing to offer the coverage, at least on an excess basis. There is also a continuing trend toward more layering of limits on project-specific coverages.

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ENVIRONMENTAL LIABILITY

The market for contractors pollution liability (CPL) remained competitive in the first half of 2013. Although insurers looked for rate increases on certain renewals, competition helped to keep overall rates generally stable, typically -5% to flat. The use of CPL coverage increased as more owners required the coverage for varying types/sizes of projects and contracts (for example, energy, infrastructure, P3, and brownfield redevelopment). Although capacity has increased over the past several years, individual carrier limits have actually decreased, resulting in the need to structure layered programs, especially for larger, more complex projects.

Insurers continue to offer CPL coverage on occurrence and claims made forms as practice policies, project polices, controlled programs on behalf of both project owners and contractors, and owners/contractor's protective policies. Key coverages regularly provided include transportation, waste disposal, and emergency response costs. Project terms vary by carrier; however, the maximum term offered including completed operations is 17 years.

CPL is also offered on combined forms with professional liability as well as GL for certain classes of business/exposures. Rates remain generally competitive (ranging generally between -5% to +20%), but are subject to greater fluctuation due to the GL/PL components.

Coverage for cleanup cost cap remains restricted; however, there are now two insurers willing to entertain this coverage for certain types/sizes of projects. Limits up to $10 million are available and are offered for projects with approved remediation plans.

Site specific pollution liability coverage is often used by project owners to protect against the discovery of unknown pollution conditions or against regulatory "re-openers" during a project and post-construction. PLL is also being required of contractors in certain P3 contracts to cover this risk during construction and development, as well as for long-term operations and maintenance (O&M) obligations. Rates for this coverage remained competitive, with multiyear policy terms available.

For more information about construction risk and insurance issues, reach out to your Marsh representative.