A Look at the 2010 Market for Bonds & Insurance

Major Price Increases Haven't Hit Yet, But Changes Likely On Horizon as Underwriters Take Closer Look at Bottom Lines

By Dave Garese

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First, let's talk about the good news on the insurance front.

In 2009 the insurance industry was reasonably profitable in most lines of business. This means economic pressure to raise prices has not hit the insurance industry yet. The insurance company underwriters are under a lot of pressure to grow their books of business and not lose clients. General liability premiums are based on exposures. For contractors, general liability premiums, payrolls and gross receipts are the driving force behind the premiums. As we are all aware, payrolls and gross receipts have significantly decreased in the last year as a by-product of the recession.

Advantage to Contractors

All of this is working to the advantage of contractors. In this market most contractors are estimating lower payrolls and lower gross receipts for their next policy year. Usually, as the estimates go down, rates will increase. However in this market due to the issues above, if presented properly your insurance broker will be able to obtain lower rates for your next renewal even if you have lower payrolls and gross receipts.

Excess liability policies usually are priced as a percentage of the underlying policies subject to minimum premiums per layer. These days the excess layers are following the reduced prices of the underlying polices, but they are even less expensive.

In order to maintain their level of business, insurance underwriters are making deals on the auto, property, inland marine and builders risks polices in an effort to retain existing clients. This time underwriters have figured out that the best clients are the ones that they already have and are pricing their policies accordingly. If your firm has been loyal to your insurance carrier, you will be rewarded by the underwriters recognizing your loyalty with good deals. If your firm has moved almost every year, you might find that the market this year will be somewhat more difficult.

Now that we've looked at the good news, it's time for the bad.

The reforms of the workers' compensation system have worked. However, in the last couple of years, costs have increased due in part to medical inflation. Insurance companies are trying to raise their prices for workers' compensation. Fortunately, not all carriers are consistently pushing the price increase. Therefore, it is important to have your broker shop your workers' comp this year to get a good feel for the current market.

Bonding in 2010

The surety bond market has remained profitable in 2009. Some of the bond markets have taken some hits, but not enough to significantly damage their profits. History has shown that sureties do not experience their worst results until the economy starts to recover. As the recovery begins, contractors that significantly underbid costs may fail as material and labor costs begin to rise in response to the recovery.

In discussions with surety underwriters, it is clear 2009 was not a good year for construction. However, there are some exceptions of contractors specializing in niche markets that have not been hit as hard in this down turn.

The stimulus bill has not resulted in a lot of work to your average contractor in California. There are some exceptions, of course, with a few very large projects underway. These projects do not do much for your average contractor, however. California construction unemployment is over 25%, so we are not looking at a very healthy construction market. Public works is a very difficult market these days with as many as 25 bidders per project; on most projects, being the low bidder may not be a guarantee of profit. With private work a scarce commodity in 2010, this is the only game in town.

Relationships 'Name of the Game'

So how has all of this affected bonding? If your broker has helped you maintain a relationship with your surety, you are in better shape than a contractor just getting into the bonding market. In this market, relationships are the name of the game. The sureties are looking hard at financial statements these days. If a contractor is losing money, the surety is going to be looking closely at the cause. If the cause is lack of work, they will be more lenient than if the cause is losing money on projects.

The sureties respect a contractor that bids work at a price that includes profit and overhead, i.e., having a low hit ratio. If a contractor has taken the appropriate overhead cuts yet is losing money due to lack of work, the sureties will often make every effort to continue the business relationship. Last week we had an email from a surety underwriter stating, "Our client has lost a lot of money in the last fiscal year, but we are going to stay on this account as long as possible."

Balance Sheets Garnering Close Scrutiny

We predict that the difficult construction market has had a substantial impact on the balance sheets of many contractors. This may have a negative impact on weaker firms that entered the public works market late in 2008 and in 2009. These firms have not had the time to develop the relationships with sureties. We think that the sureties will start reducing or eliminating surety credit for these firms when year-end financial statements are produced. This may serve to reduce the number of bidders on bonded projects and may have the effect of bringing pricing to levels that includes profit and overhead.

In closing, the time has arrived to cash in on those relationships you have been building with insurance and surety underwriters to help your firm ride out the current storm.

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