

# DRAGON SLAYERS

## Insurance vital link in risky building trade

When developers and contractors decide to undertake the task of building a project, insurance must be in place to cover the development, the workers and the company. But with the high cost of doing business and the mushrooming lawsuits, insurance companies and contractors can find themselves on opposite sides of the fence trying to find a middle ground. In today's business climate of higher costs and looming lawsuits, finding that ground can be tough.

"Construction is a risky business," says Steve Minard, president of Minard-Ames Insurance Group. "When people die, when people get hurt, when property is damaged, there is usually quite a bit of expense involved. Because of that, construction pays a higher percentage of their revenue to an insurance product than a lot of other industries."

And this risk, according to Richard B. Usher, managing member and CEO of Hill and Usher Insurance Surety, revolves around more than just earthquakes, floods and major natural disasters. "What I'm referring to are the inherent risks involved in dangerous activities in construction that result in life-threatening injury to construction workers," says Usher. "I'm also referring to property loss on partially completed projects due to construction techniques that failed, causing collapse and explosion."

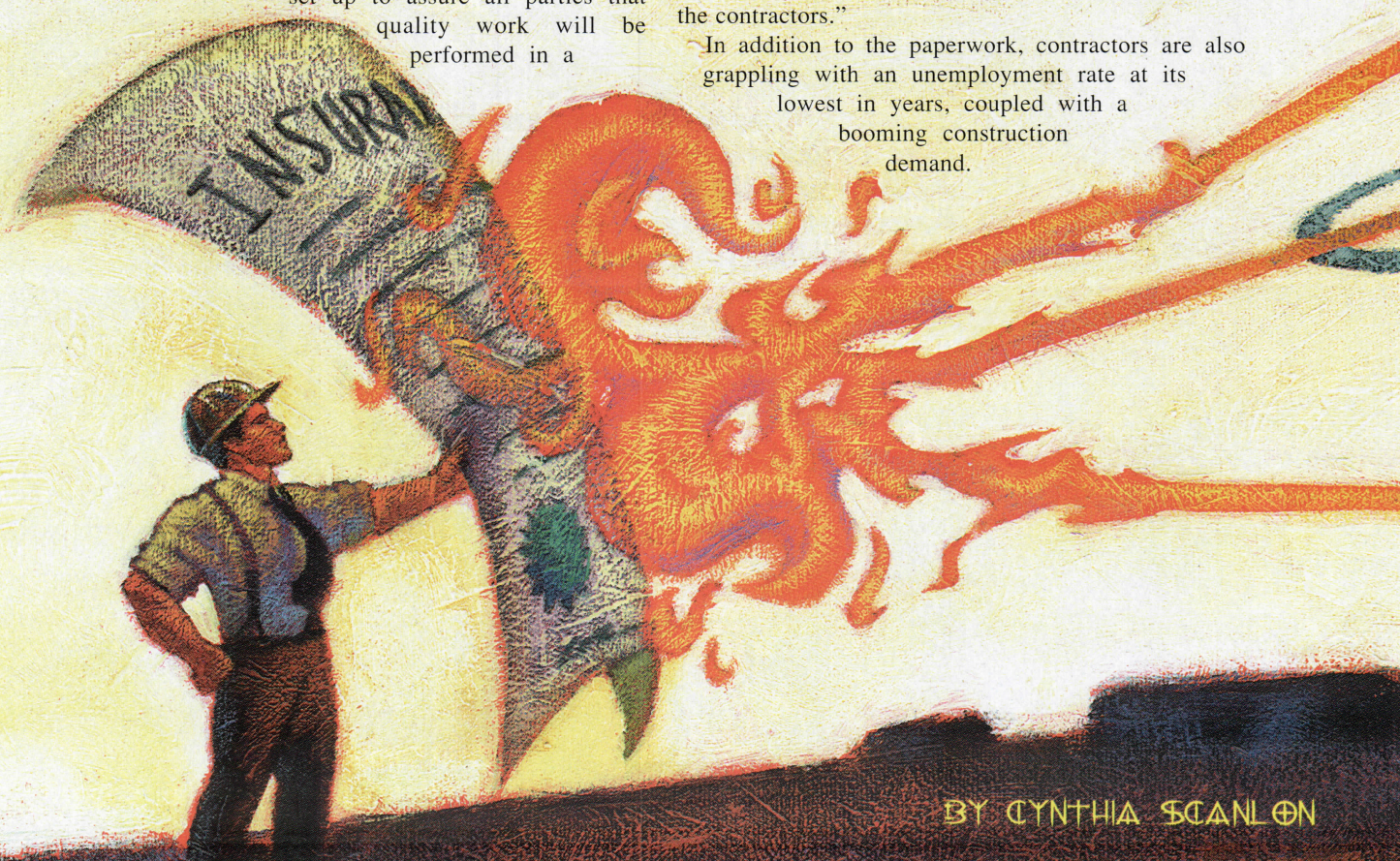
But insurance is not only for catastrophes. Some insurance is set up to assure all parties that quality work will be performed in a

timely manner. For contractors working on public works projects, for instance, insurance works a little differently, but there are still rules and regulations that must be met. "When contractors perform any kind of public works, they have to post a surety bond guaranteeing the work to be completed, in accordance with the contract, for the dollar amount they bid on, and within the timeframe they are given," says Sharon McGuinness, bond manager for Great American Insurance Company. "If they do not, the surety company steps up and either pays for the completion of [the project] or will get another contractor in to finish it."

In order to qualify for a surety bond, says McGuinness, contractors will have their business practices and financial records scrutinized as closely as a bank examiner might go over a business loan. "We'll get credit checks and we'll talk to suppliers and subcontractors they work with to determine their qualifications for doing the job," says McGuinness. Once a contractor passes muster, a bond insurer might still impose certain escrow agreements, fund controls, limit the dollar amount or require the contractor to post collateral."

All of this red tape can have a tendency to hamstring a project, McGuinness says. Consequently, many contractors work with an insurance company that specializes in the construction field. "Not only can we help the contractor get what he needs, but we can give him advice and help him build his business," she says. "We try to work as a team with a lot of the contractors."

In addition to the paperwork, contractors are also grappling with an unemployment rate at its lowest in years, coupled with a booming construction demand.



BY CYNTHIA SCANLON

Since most projects, public or private, have a completion deadline, finding qualified workers to meet those dates has proven to be challenging, to say the least, to many Valley construction companies. This double-whammy of a shortage of workers with a breakneck development pace has contributed to some buildings going up so fast that quality has sometimes not kept pace, according to Minard.

"When you've got a lot of growth, you've got some sloppy builders," says Minard. "We have a lot of excellent builders in this town, but there's so much construction that even a sloppy builder can get work. So there's probably some buildings being built that should have a higher quality standard than they actually do."

All of this has led to more construction industry lawsuits, especially in construction defect litigation, according to Minard. "Construction defect litigation appears to be an industry in the legal profession that is blossoming in Arizona," he says. "It's been in California and Las Vegas pretty heavy. Now we've had some California law firms open up here and use the same word processing documents and the same expert witnesses to start suing Arizona contractors."

Minard

adds, "The problem with construction is that it's not perfect. You're not building computer chips in a clean room, and you can always find something wrong with any building. So it's a perfect lawsuit target."

Usher agrees. "Fast-paced construction sometimes leaves quality behind, and consumers of construction services notice after completion of construction that the construction is less than what they expected it to be," he says. "The

plaintiff's bar and attorneys have gotten ahold of this situation and they have escalated it into larger class action litigation."

Usher points to what this kind of litigation has done to the California residential construction industry, mainly restricting the condo market severely. "It's a direct result of the inability to insure the exposure," he says. "Many contractors are



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being instructed or advised to stay out of residential construction entirely and pursue commercial because residential is more difficult to insure."

To help contractors effectively deal with some of these legal challenges, Minard says the insurance industry has developed products that were not available a few years ago to help protect itself from parts of the construction defect litigation problem. Still, contractors will have to continue to address the problem.

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And like many businesses, locally and nationally, contractors are also grappling with the sometimes severe labor shortages in the construction trades. According to McGuinness, this shortage can not only undermine the completion of a project, but also impact the bidding process and financials that insurance companies depend on to correctly insure a project. "When you don't have qualified people when putting a bid together, you're not going to estimate the correct labor hours," says McGuinness, pointing out that new people require more training and may take longer to complete tasks. "One of the most important problems that we have going on right now is the lack of skilled labor."

This lack of labor can mean cost overruns and deadlines being missed, all of which raise an insurance eyebrow. McGuinness says contractors are acutely aware of how the shortage can ruin construction timelines and impact bottom lines. Many are taking steps to correct the situation, she says. Examples include project managers learning Spanish in order to

communicate better with some of their work force. And contractors are offering benefit packages, flex-time and higher salaries, all in an effort to keep their employees happy.

According to Minard, the construction and insurance industries go through cycles, like a delicate dance, where one industry benefits more than the other, and then a shift takes place and the other benefits. These cycles sometimes conflict, he says, and right now, it appears that construction insurance is leading, with premium prices starting to rise.

"Construction insurance will probably become more expensive [in the future]," says Minard. "For instance, you look at the worker's compensation premium reductions for the past five consecutive years and ask, 'Was it really overpriced that much five years ago?' Probably not, but we've had a very competitive environment that has driven it down to a level where it's not profitable anymore."

Also in the future, Usher says, he sees a restriction of available liability coverage in the marketplace, particularly for residential contractors, "We see standard carriers, which have covered the lion's share of construction risk, withdrawing from the marketplace," he says. "Or they are offering restricted coverage. That poses problems for the future availability of coverage for contractors."

On a brighter note, Minard says he is seeing prices go down for contractors in specific niches such as tenant improvements. Those contractors, who are loss-free, are also watching some of their premiums trend downward, he says.

One thing is for sure. As long as there are construction projects going up, insurance companies will always be part of the equation. With a sharp pencil and an even sharper eye, insurance companies like to remind contractors that they are not there just to collect premiums, but to ensure safety during all phases of a construction project.


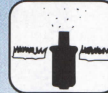
"A disaster at a construction company level would be having someone killed," says Minard. "Most of the effort on both sides is put into preventing that from happening."

**AB**


*Cynthia Scanlon is a Phoenix free-lance writer.*


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