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## Builders Struggle In Tough Times – Larger Contractors Buffered, Residential Firms Battered

The recession and weak economy hammered the construction industry across all segments, with the sharpest blows hitting builders that specialize in private residential construction, and subcontractors and small contractors in all sectors.

Large, diversified contractors entering the recession with strong backlogs protected their bottom lines as revenues sank. In the face of fierce competition, they have pursued profitable work in their competencies rather than chasing unfamiliar work to increase revenues.

The vast majority of contractors in the U.S. are small businesses. Those that have survived have shed employees and costs, but their long-term health is in question, sources said.

"We expect to see more subcontractor failures in the coming months," said Tom Miller, senior vp at Lockton Cos. L.L.C. in Kansas City, Mo.

The total value of all construction put in place fell from $1.167 trillion in 2006 to $803.62 billion in 2010. Private residential construction plunged from $613.73 billion to $238.80 billion in the same period, according to the U.S. Census Bureau. Private nonresidential construction—schools, hotels and office buildings—fell from $408.57 billion in 2008 to $261.80 billion in 2010.

The industry lost 2.2 million jobs from 2006 to 2010—a 28.8% decline and the largest since the end of World War II, according to the Bureau of Labor Statistics.

Unemployment in the construction industry dropped to 13.3% in September, down from 17.2% a year earlier. But much of the decline was due to workers leaving the industry, according to the Assn. of General Contractors of America.

As construction spending fell, there was "a near equivalent reduction" in construction insurance spending, said Tim Kania, senior vp of construction at Liberty International Underwriters, a division of Liberty Mutual Group Inc., in New York.

"For nonresidential construction, I would posit that insurance spend is off 25% to 30%, or even more than that, because rate degradation was going on at the same time," said Mr. Miller.

"There has been a significant impact on the insurance community because they had less (construction) exposure to insure," said Paul Becker, Nashville, Tenn.-based chairman of the construction practice at Willis North America, a unit of Willis Group Holdings P.L.C.

New carriers have entered the market, capacity is ample, and rates have been competitive for most construction-related coverages, sources said. But with the downturn, combined with catastrophic losses in 2011, "we're starting to see signs of rate hardening," said Michael Anderson, U.S. construction practice leader at Marsh Inc. in Philadelphia.

"Insurance companies have come through the downturn and their balance sheets are in pretty good shape," he added.

"How (construction) companies and owners protect themselves is partnering with the right people—not the least expensive, but those who understand your exposure, who have sufficient capacity, longevity and financial stability," said Mr. Kania.

Rates are not as competitive for professional liability, as more contractors take on the added liability for the design as well as the construction of a building, Mr. Becker said. Workers compensation rates also may see a hardening in 2012, sources said.

The surety market is "healthy and profitable," said Rick Ciullo, chief operating officer at Chubb Surety, a unit of Chubb Corp. in Warren, N.J. "Contractors with good business plans and strong financials should have no problems finding surety."

"We have not seen a wholesale closure of businesses or a big uptick in loss ratio," he said. In 2008, Mr. Ciullo said, "we thought it would be a bloodbath in 2011 and it would show up in surety. That hasn't happened."

He added, "We expect failures to increase when the economy picks up" as weakened contractors can't qualify for surety and lose business that becomes available.

**Michael Bosse, chair of law firm Bernstein Shur Sawyer & Nelson P.A.'s construction practice group in Portland, Maine, said that with money tighter, contractors are operating with fewer and often less-skilled employees.**

**"In my practice in the past couple of years, I've seen many more performance bond claims than I ever had before," he said. As a result, contractors have not been able to get bonding, "which cuts them out of a large sector of government work," he said.**

Sources including Ken Simonson, chief economist at Associated General Contractors in Washington, predict this year's overall construction spending will be flat to down slightly. Spending on public works will decline with the end of federal stimulus funding and the completion of hurricane-related work and projects including military base realignment, Mr. Simonson says.

State and local governments, which depend on property taxes, will have less money to spend on needed infrastructure repair, including roads and bridges. "Our sense is there will be an increased move toward public/private partnerships" involving builders financing part of that work, said Mr. Anderson.

Versions of that model, known as P3, in which architects, engineers and builders partner in a risk-bearing consortium, are popular in Europe and Canada and "is starting to take hold in the U.S.," added Henry Lombardi, executive vp for Aon Risk Solutions' construction services group in New York. But the model creates challenges for insurers, who are trying to develop coverages for those projects. Each state has different legislation for these partnerships and "there is no uniformity in contracting," he said.

Sources said there are signs the industry will recover in certain segments beginning in 2012. Apartment construction was up 13% in August from a year ago, with 12-month multifamily housing starts up 55%, Mr. Simonson said.

Improvement also is expected in the energy and power sector—oil and gas structures, pipelines, renewable energy including wind and solar, and shale deposits of natural gas; deep port construction, tied to the widening of the Panama Canal; manufacturing, which includes construction of large data centers; health care; warehouses; and endowed facilities including colleges.