Consider Labor and Risk Strategies Before Renewing Insurance

BY DOUGLAS L. RIEDER

Following the extreme contraction of the construction market, many workers left the industry permanently, resulting in a much smaller labor pool. As the industry recovers, the demand for labor is beginning to outstrip availability.

That worker shortage means projects may take longer to complete. Even if a contractor finds enough workers, it may cost more to keep them, as other companies may be willing to pay a higher wage. In particular, self-performing builders and developers may be able to afford to pay substantially higher salaries for the skills they need because their return is driven by the economics of the project rather than the construction fee.

Longer term projects and higher paid workers must be addressed through the structure of the contract, budget contingencies or possibly subcontracting more labor to lock in the cost. The more self-performance a contractor does, the more this risk will come into play in the next few years.

Some longer term strategies to consider include:

- deploying additional technology in the field to get more productivity from existing labor;
- using internship programs to introduce young people to the business and build up the talent pipeline;
- partnering with vocational schools and technical colleges;
- implementing an in-house training program;
- working with state and local organizations to source job candidates; and
- expanding prefabrication capabilities, which can increase efficiency and improve safety.

Recognize Market Forces Outside The Firm's Control

Major building projects don't happen overnight, and the market can change significantly in the time it takes to move from planning to groundbreaking. For example, projects developed during the low point of the economic downturn (around 2010) had a 3 percent margin. When construction finally broke ground in 2012 or 2013, the margins improved to 5 percent, so firms were facing a tight financial situation even without labor issues.

Additionally, other costs may rise concurrently with labor costs, including payroll taxes, workers' compensation and other "burden"-related costs.

To more fairly allocate risk against reward, contractors have been successful in moving owners to work based on cost-plus-fee or guaranteed maximum price (GMP) arrangements. In these cases, the owner bears more of the risk of rising costs. The flip side of this is contractors don't reap the rewards of controlling costs or production efficiencies that would normally accrue to them under a traditional lump sum contract.

Investigate Other Insurance Options

Given that the cost of insurance has been increasing gradually during the last couple of years, purchasing less coverage can be a smart move. Because companies are constantly growing and changing, they should reevaluate their insurance on a regular basis.

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In a soft insurance market, it may make the most sense to transfer risk to an insurance company by purchasing "first dollar" insurance with a low deductible. The carrier provides it cheaper on a relative basis due to competition and the ability to make money on the "float" (premiums held that can be invested until claims are paid). Because the industry is in a cycle with low interest rates, carriers with limited ability to make money on the float are charging more for the privilege of transferring that risk to them.

This is particularly salient to companies that consistently outperform the industry in terms of insured losses. Firms with strong safety cultures, risk transfers and loss controls may benefit from taking on more of the risk and keeping some of the profit they have been sending to their carriers.

Following are loss-sensitive program structures to investigate.

- **Retrospectively rated program**. Under this structure, the carrier charges a minimum premium while the insured bears the losses incurred up to an annual maximum. This kind of structure can be much cheaper while affording the security of knowing the company's maximum downside.
- **Larger deductible**. One of the simplest loss-sensitive strategies is to take a larger deductible. This means a smaller premium, but can result in large aggregate exposure unless the deductible is capped with an annual aggregate. It is important to fully understand the potential for loss before proceeding with this structure.
- **Share large deductibles**. In group captive insurance, a company's risk is pooled with other like-minded, safety-conscious businesses. Insurance is purchased as a unit, and there is a large deductible risk in the group.

In the current environment, companies should refrain from automatically renewing their insurance policies. Take the time to figure out what insurance the company really needs and what structure is best suited for the business' risk appetite. CE

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