Surety Outlook 2018: Slow and Steady Wins the Race!

By James Schabarum II, CPCU, CRIS, AFSB
Jase Hamilton, CPCU, AFSB

In 2018, the surety industry in the United States will continue to post further growth in overall premiums and below average loss activity.

The total direct written premium was $5.88 billion for the calendar year end 2016, up 4.5% from 2015, which was $5.62 billion. At the same time, the surety industry loss ratio fell in 2016 to 15.5% from 18.3% the previous year (see Table 1). This high-water mark for surety industry premium volume continued to increase through the second quarter of 2017 to $3.13 billion in revenues with a 13.6% loss ratio (compared to $2.98 billion in revenues with an 18.4% loss ratio at the second quarter of 2016).

Strong growth and profitability since 2005 has attracted an increased number of new sureties to the market creating fierce competition for market share. During the last five years alone, start-up front-line contract and/or commercial surety company operations include:

- AmTrust
- Axis
- Ironshore
- Freedom Specialty
- Allied World
- Berkshire Hathaway
- QBE
- Euler Hermes
- Navigators
- Crum & Forster
- Patriot
- Endurance
- Everest
- Sirius
- Markel
- Argonaut

Additionally, the number of surety re-insurance companies has almost doubled since 2008 from 17 to 32 (see Table 2). Although underwriting standards are relatively stable, overall supply has out-paced demand. This fresh credit capacity will cause future increased pressure to relax and soften terms and conditions (i.e., capacity, rate, indemnity, etc.) throughout the surety market.

The slow and steady economic growth has extended the current building cycle at a sluggish pace. This has also lengthened the surety industry’s positive historical results. Continuing labor shortages, inflation, interest rate hikes, and other factors will likely further slow the economic engines in the coming years. Wise contractors are now getting margins, building their balance sheets and conserving for a rainy day. Contractors should begin positioning themselves for the impending shift ahead by retaining the best management team and labor talent, closely managing material, field and overhead costs, and demanding acceptable margins to ensure long-term success.
Surety Industry

Total written premiums for the U.S surety industry is on track to exceed $6 billion in 2017, another record year. The steady surety market growth can be largely attributed to the stable progression of the current economic business cycle. Although pursuit of growth and profits has brought new surety company players to the market, the surety industry as a whole remains optimistic. In fact, a recent survey by the National Association of Surety Bond Producers (NASBP) indicated that 85% of all surety companies surveyed agreed that the current surety market outlook remains optimistic.

Stable and relatively low loss ratios since 2006 have been another significant driver to a 10-year long stretch of strength and success in the surety industry. Whether this is due to advances in analytics, claims management, use of technology or overall efficiencies and sophistication of underwriters and contractors, recent result are well below the industry breakeven loss ratio of 32%.

Table 1 - Surety Industry Strongly Profitable Since 2005
U.S. Surety Premium vs. Loss Ratio

source: Surety & Fidelity Association of America

2018 Risk Management Seminar Series

Accommodating Injured Employees
Wednesday, Jan. 10
7:30am Registration
8:00am - 10:00am Program

Safety Update for 2018
Wednesday, Feb. 7
7:30am Registration
8:00am - 10:00am Program

Sexual Harassment Prevention Training
Wednesday, Mar. 7
7:30am Registration
8:00am - 10:00am Program

To register, click on the ‘register now’ button in the announcement email, or contact Nicole Laforteza at nlaforteza@cavignac.com or call 619-744-0540.
In a typical saturated market with an overcapacity of credit and low loss ratios, there would be a natural expectation of a shift to looser underwriting policies with a softening of terms and conditions. The surety industry is no exception. Over the last few years, surety companies have expanded their battling techniques in an attempt to increase market share. However, as surety losses will inevitably increase with a lack of discipline, surety companies will shift back to tighter underwriting standards in the coming years. At that time, sureties will strengthen their underwriting practices and cautiously re-evaluate their agency and client relationships.

It is critical now for contractors to solidify their relationships with not only their primary surety partner but to secure back-up surety options. This will ensure the proactive contractor is well informed and insulated when the surety industry begins to correct.

Labor

Overall, the employment outlook remains relatively optimistic in 2018. Through June of 2017, the U.S. economy has created over 1 million new jobs and is expected to continue a similar trajectory for the next few years (see Table 3). The U.S. economy is anticipated to reach full employment (4-5% unemployment rates) by 2020.

Although the overall employment numbers are healthy, the construction industry continues to struggle to attract new talent and has failed to create the amount of new jobs needed or generated by other sectors. The construction industry created only 110,000 new jobs in the first half of 2017, which is only 10% of all new jobs created in the U.S. With the unemployment rate continuing to dip lower, contractors may continue to struggle to attract and retain workers at all levels of operations.

It is further anticipated that labor shortages will continue to plague the U.S. construction industry over the next decade and potentially beyond. New generations of workers will continue to flock to technology, financial and other sectors. This will force the construction industry to increase salaries, benefits and incentives to compete for young talent. Due to the gaps in the current and expected labor markets, it is wise for contractors to frequently hone their hiring and other human resources practices. Emphasis should be placed on further developing comprehensive marketing strategies.
for attracting new talent and retaining exceptional performers.

**Material Cost Management & Margins**

Over the past years, construction related commodity markets in the U.S. have seen a significant surplus in both major commodities (i.e., oils and metals) and basic building materials (i.e., lumber, cement, plywood, etc.). Combine this with relatively low demand, many contractors were able to benefit from low material costs and increased margins.

However, over the past 12-18 months, costs for many of these products increased between 10-20% (see Table 4). Material cost escalations have forced contractors to take a closer look at their current and future margins. Longer lead times on unique or large material buys, advance purchase requirements, change order negotiations and other payment-related issues have resulted in strained communications with many owners and design firms. Today, in a climate of inflationary material costs, there are often delayed project negotiations, downsizing of scope or size of projects, or even postponing projects until there is stability or a decrease in material prices.

Due to the increase in material costs, profit margins trended down slightly in 2017. However, in 2018 there should be an increase in available project opportunities. This will create increase margin possibilities for disciplined contractors. As competition continues to increase, putting stress on profit margins, seasoned contractors will recognize the importance of holding to their margins and not falling into the trap that typically comes with over extending capacity.

**Conclusion**

As we enter 2018, the surety industry will continue to see record growth. While we may see a market correction in loss ratios in future years, the surety market will continue to show increased profitability through the
next year. New aggressive surety players will continue to saturate the market leading to even more softening in surety underwriting policies. Although, the surety market remains very stable, a large loss from a major insurance company or a large merger could quickly disturb capacity. While the industry is riding high and surety credit is easily available, sophisticated contractors are taking the time to develop high-level relationships with their current and back-up surety markets to ensure long-term success.

The short- and long-term labor talent gaps will remain a top focus for contractors. As new policies and administrative budgets begin to unfold, we anticipate an increase in infrastructure spending along with the introduction of new procurement methods and more complex projects. Most contractors will continue to see larger backlogs, causing an increase avoidance to perform more difficult, high-risk projects. As such, it remains critical to focus on hiring and retaining great long-term employees and to promote educational and career development programs.

As the global economy continues to vary and the U.S. administration increases barriers on obtaining cheaper foreign materials, the construction industry will continue to see increases in material costs. While this may deter some owners and lenders, the next 12-24 months should see an increase in demand for new construction, making it even more imperative that contractors stick to their business plans and remain committed to acceptable profitable margin levels.

We will see a very similar marketplace in 2018 as we did in 2017. The surety industry will continue to see record growth; the short and long-term talent gap will remain a priority for contractors, and managing material costs and margins will be top of mind. Being able to anticipate and proactively manage these issues will separate the successful contractors from their competitors.

Table 4
Producer Price Index: Construction Materials

![Graph of Producer Price Index: Construction Materials]

source: Bureau of Labor Statistics
3 Charitable Giving Ideas for This Holiday Season

For some, the holiday season is synonymous with charitable giving and showing kindness to your friends, family and even strangers. With that season once again upon us, here are three best practices for charitable giving:

1. **Consider what charity you want to help.** Choosing a charity can be a daunting task, but it doesn’t have to be. Think about what is important to you. Once you’ve identified the type of charity you want to help, you can use GuideStar, a website that provides as much information as possible about IRS-registered charities, to find nonprofits that support the causes that are important to you. You can enter in your location as well to find charities that are close to where you live or work.

2. **Conduct a little research before you donate.** Unfortunately, despite the fact that there are numerous charitable organizations, not all of them are as reputable as they may claim. In addition to researching the charity on GuideStar, you can also look up your chosen charity on a website called Charity Navigator to see how the charity spends its money and uses donations.

3. **Consider how you want to give.** There are many ways for you to donate. Regardless of how you give or how many charities you donate to, you should keep in mind that there are processing costs associated with every donation that you make.
Tips for Sticking to Your Diet During the Holidays

With so many social gatherings during this time, it can be difficult to avoid treating yourself when you’re offered good food and drinks. Whether you’re dieting or just trying to maintain your healthy lifestyle, fear not—you can survive the holidays and wake up on Jan. 1 without feeling remorse or guilt. Consider the following tips:

- Eat before attending a party so you don’t arrive on an empty stomach and devour everything in sight.
- Pace yourself when drinking. Alcohol can be dangerous at holiday parties, as overindulgence cannot only cause embarrassment, but also pack on the pounds.
- Eat slowly. Be mindful of every chew. It takes your body 20 minutes to realize when it is full.
- Don’t feel pressure to eat leftovers. If you have an abundance of leftovers after hosting a party, don’t feel like you have to eat them just because you don’t want them to go to waste.
- Practice self-control. For example, allow yourself one plate of food at a party, and promise yourself that you won’t go back for seconds.

OLD FASHIONED BREAD PUDDING

PREPARATIONS

1. Heat oven to 350 F. Spray the bottom and sides of a 9-by-9-inch pan.
3. Dump bread, sugar and raisins into prepared pan.
4. Blend eggs, milk, salt and vanilla together in a bowl. Pour over bread mixture in pan.
5. Bake uncovered for one hour. Pudding will be done when a table knife inserted in the pudding comes out clean.

Makes: 6 servings

Nutritional Information (per serving)

<table>
<thead>
<tr>
<th>Nutrient</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Calories</td>
<td>230</td>
</tr>
<tr>
<td>Total Fat</td>
<td>7 g</td>
</tr>
<tr>
<td>Protein</td>
<td>8 g</td>
</tr>
<tr>
<td>Carbohydrates</td>
<td>36 g</td>
</tr>
<tr>
<td>Dietary Fiber</td>
<td>1 g</td>
</tr>
<tr>
<td>Saturated Fat</td>
<td>2 g</td>
</tr>
<tr>
<td>Sodium</td>
<td>300 mg</td>
</tr>
</tbody>
</table>

Source: USDA
Spotlight On

Cavignac & Associates is proud to support local and non-profit civic organizations, including the Challenged Athletes Foundation

MISSION
It is the mission of the Challenged Athletes Foundation (CAF) to provide opportunities and support to people with physical challenges, so they can pursue active lifestyles through physical fitness and competitive athletics. The Challenged Athletes Foundation believes that involvement in sports at any level increases self-esteem, encourages independence and enhances quality of life.

OUR VISION
Challenged Athletes Foundation vision is to be a recognized leader in a movement through which physically challenged athletes are accepted and respected at the same level as able-bodied athletes, to have a great and significant impact on each physically challenged athlete served, and to reach out to the physically challenged community by providing inspiration, awareness and mentoring.

For more information, go to www.challengedathletes.org