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Mitigating Project Losses

Project Loss Insurance & Risk Control Strategies for Contractors

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Construction projects inherently bring a large amount of risk to businesses and individual business owners. Many of these risks are deemed non-insurable (for example: blown estimates, production chain delays, subcontractor failures), leaving the business susceptible to substantial project loss, business restructuring, and even shutdown. The best way to mitigate these issues is to implement sound risk control strategies that will ensure a reduction in the frequency and severity of losses. Nevertheless, Travelers Insurance (hereby known as “Travelers”) is developing a new product, **Project Loss Insurance (PLI)**. PLI will transfer these previously uninsurable causes of loss to the Insurer, providing business owners with peace of mind.

PLI will not only share in the risk, it will protect contractors’ balance sheets from a catastrophic project loss, and help ensure continued operations. Catastrophic project losses and contractor failure can come from various causes. Travelers, one of the largest surety and construction insurance companies in the U.S., has recently released data outlining causes of contractor failures over the past decade:

Historic Causes of Contractor Failures *

1. **58% Single Catastrophic Project**

- Problem on a large job
- Poor estimate or large bid spread
- New job type or location

2. **49% Internal Cost Systems Failure**

- Inability to identify issues
- Lack of communication between field and office
- Poor financial control

3. **37% Overextension of Work Program**

- Multiple large jobs
- Growing backlog
- Strain on workforce or financial results

4. **24% Extensive Debt**

- Fixed and long-term debt negatively impacting cashflow

*Percentages are based on an internal review of Travelers’ largest construction surety claims over the last 11 years. In many cases, multiple factors were identified as contributing to the failure of the construction company.

Coverage & Pricing

PLI covers losses due to operational mistakes

and misjudgments, failure or delay in performance by up or down stream parties, and specific site or weather conditions that cause the Insured to sustain a project loss on a covered construction contract. Commercially available insurance coverages are excluded from a PLI Policy, with the exception of surety bonds or Subcontractor Default Insurance (SDI) where PLI would respond in excess.

Similar to Surety underwriting, programs are strictly and continuously underwritten based on business plans, past project loss experience, financial condition, internal controls, and overall proven track record.

Project's parameters are set based on locations, size, type, work category, duration, and procurement method and are endorsed or enrolled at inception with single and aggregate limits subject to both deductibles and co-insurance.

Pricing is unique to each case and varies, dependent on the underwriting criteria mentioned above as well as desired parameters for project enrollment. General rates are from \$1 to \$4 per \$1,000 of total projects enrolled, and average deductibles are \$1 million.

Travelers plans to roll out Project Loss Insurance in late 2020 or early 2021. Details may change over the coming months. If you have additional questions, or are interested in discussing the product in greater detail, please contact our office.

Risk Control Strategies

Every contractor is at risk of a catastrophic loss, and PLI may be a great fit for your company. There are various strategies contractors can implement that will help them lower the possibility

of a catastrophic loss. Some of these strategies include adopting a project risk analysis, enforcing strict cash flow and debt management measures, ensuring proper backlog and personnel management, and performing an internal controls audit.

Project Risk Analysis - Single project losses are the primary reason why contractors fail. Usually, it is not just one issue, but a string of unfortunate events on a job that contribute to the failure. Many of these issues can be mitigated during pre-construction by adopting a project risk analysis procedure including:

- Developing a contract review process that includes your trusted advisors
- Developing and implementing a "Go/No Go" policy on all projects that evaluates the potential risks to either bid with appropriate cost contingencies or to not bid at all

Cash Flow & Debt Management - Cash is king and extended credit facilities such as Lines of Credit and other fixed debt obligations can cause long-term stress to the balance sheet and make navigating a problem much more difficult. Maintaining sound cash flow and debt management measures include:

- Reviewing cash flow projections monthly
- Developing project-specific cash flow projections for large projects
- Reviewing the impact of large fixed asset purchases and leases with your financial and or credit partners to determine the potential long-term impact to your surety and banking facilities

Backlog & Personnel Management - Having a healthy backlog ensures continued revenue for the foreseeable future. However, having too

much backlog can contribute to poor oversight in the field, causing your workforce to be stretched thin and potential issues to be miscommunicated to the executive team. Backlog and personnel management strategies include:

- Performing a workforce audit to ensure you have adequate experienced staff at every level
- Reviewing your hiring and training procedures annually
- Discussing new key employee hires with your outside advisors
- Reviewing your accounting, project management, and estimating systems annually
- Reviewing your Standard Operating Procedure (SOPs) annually to ensure they are up-to-date and address any changes needed from the prior years' experience

Catastrophic loss is a serious concern for all business owners. Whether PLI is the solution that is right for your company, or you simply want to ensure you're implementing the best risk control strategies, we recommend speaking with your risk advisors now and developing a game plan to ensure your company's future success.

The preceding material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with qualified legal and insurance professionals who can provide guidance that considers your own unique circumstances, including applicable employment laws.