CHOOSING YOUR SURETY TEAM

The Right Bond Producer and Underwriter Are Essential Business Advisers

by Marc Ramsey

It's brutal out there. Private nonresidential construction put in place was down 24.3 percent in February 2010 over February 2009, according to the U.S. Census Bureau. Eight out of eleven sectors from lodging to manufacturing experienced double-digit declines in construction spending during this period. Competition is stiff for the few jobs out there.

Contractors looking to obtain more work may find some in public construction. While public construction is not for everyone, it is one area where there should be growth in the near future. Many contractors are considering moving into this arena for the first time. There is one caveat—to be eligible to bid on public work, contractors are almost always required to obtain surety bonding. Federal, state and local governments require surety bonds to manage risk on construction projects and protect taxpayer dollars. Not all contractors will qualify for surety bonding, but those who do can expand their opportunities to acquire work.

Since most surety companies distribute surety bonds through the agency system, the first step is to contact a professional bond agent or broker, known as a producer, who specializes in contract surety. A bond producer guides the contractor through the bonding process, helps establish and foster a business relationship with a surety company and assists in managing the contractor's surety capacity. It is important to find the right bond producer to meet the contractor's specific needs. This is the start of what should become a valuable, long-term business partnership.

Surety Bond Producer

The bond producer is an important adviser to the contractor and should:

- Offer advice, management consulting and technical expertise to help the contractor maintain a profitable business
- Assist with identifying other professional service providers, such as construction attorneys and certified public accountants, who will be helpful to the contractor to formalize his or her business and risk management infrastructure
- Review financial documents for submission to the surety company and analyze the financial statements to determine the contractor's working capital, net worth and current revenue
- Match the contractor's needs and strengths to a surety company suited to meet the contractor's needs, then nurture a successful relationship between the contractor and the surety company
- Review completed contracts, current contracts and proposed bids to allow the producer to advise the contractor on the amount of risk he or she is taking on the total work program
- Recommend an appropriate line of surety credit
- Guide the contractor through a formal presentation to the surety company and tailor the contractor's submission to meet the surety's particular requirements
- Maintain communication channels between the contractor and the surety through periodic reports on work progress, financial performance and business plans
- Maintain communication with the contractor
- Assist and advise the contractor on how to obtain or increase his or her bonding capacity, if warranted

One place to look for a bond producer is the website of the National Association of Surety Bond Producers

(NASBP), www.nasbp.org. The trade association's members employ more than 5,000 professionals who specialize in surety bonds for construction and other purposes. Bond producers have broad knowledge of the surety marketplace and the business strategies and underwriting differences among surety companies. To begin, simply click on "Find a Producer" and select a state.

Contractors should look for a bond producer who:

- Is appropriately licensed
- Is well respected and has a reputation for integrity in the construction industry
- Demonstrates a personal interest in the contractor's success
- Has a track record of building solid relationships with surety underwriters
- Possesses an understanding of the construction industry
- Has knowledge of accounting and finance, especially construction accounting procedures
- Has knowledge of construction contracts, subcontracts and related contract law
- Is aware of local, regional and national construction markets
- Is experienced in strategic planning and management practices that promote successful contracting
- Is actively involved in and supports local and national construction and surety industry associations

Types of Bonding

Bid Bond
The bid bond assures that the contractor's bid is submitted in good faith, that the contractor will enter into the contract at the price bid and that the required performance and payment bonds will be provided.

Performance Bond
The performance bond protects the project owner from financial loss in the event that the contractor fails to perform the contract in accordance with its terms and conditions.

Payment Bond
The payment bond assures that the contractor will pay specified subcontractors, laborers and materials suppliers associated with a project.

Subcontractor Bonds
When a contractor requires its subcontractors to obtain a bond, the contractor is the obligee and the subcontractor is the principal. Subcontractor bonding protects the contractor from subcontractor default.

Fidelity Bond
Employee theft is a risk that affects all businesses. Such losses can devastate a contractor's capital and liquidity or even cause the business to fail. A fidelity bond protects the contractor against loss incurred due to the dishonest acts of the employee.

Source: Surety Information Office, www.sio.org, and The Surety & Fidelity Association of America, www.surety.org

Surety Company Underwriter

Once the bond producer connects the contractor with a surety underwriter, it is essential that the contractor develop that relationship. Underwriters want to know how a contractor runs his or her business, so they can understand the company's operations in order to be in a position to add value. Underwriters are interested in contractors who are profitable and who have successful performance track records, solid financials and good reputations with owners, suppliers, subcontractors and lenders.

Each surety company has its own underwriting standards and requirements. Before a surety underwrites a bond, the contractor undergoes a thorough prequalification process. Among other information, a contractor will need to provide:

- An organizational chart of key employees and their responsibilities
- Detailed resumes of key employees
- A business plan outlining the types, sizes and locations of work the contractor expects to pursue, where the contractor plans to be in the next five years and how he/she intends to make that happen
- Current work in progress and a history of the largest completed jobs including information about

the owner, contract price, date completed and gross profit earned

- A continuity or completion plan outlining how the business will continue in the event of the owner's death or disablement
- Evidence of a bank line of credit from a financially stable bank that is committed to construction and the contractor
- Letters of recommendation or references from owners and others on completed projects

The surety also will request the fiscal year-end statements for at least the past three years and may require a financial statement audited by a certified public accountant. Financial statements typically include the accountant's opinion page, balance sheet, income statement, statement of cash flow, accounts receivable and payable schedules, schedules of contracts in progress and contracts completed, a schedule of general and administrative expenses, explanatory footnotes and a management letter conveying the CPA's findings, observations and recommendations about the contractor's business.

The surety company and its corporate assets stand behind the contractor, and in return, it expects the

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contractor to perform its contractual obligations under the bond. The surety will continuously evaluate the contractor's overall performance and financial position. If the surety says "no" to increased surety capacity, there is a reason for it. The surety would be doing the contractor a disservice if it allowed the contractor to take on more than the company could handle. Listen to the underwriter's advice and understand what improvements or steps need to be made to achieve extended surety capacity.

There are questions the contractor may want to ask the underwriter to ensure that he or she meets the contractor's individual needs such as:

- How will you help my company grow?
- What is your success record?
- What percentage of your company's overall property and casualty insurance business is devoted to contract surety bonding?
- Do you have sufficient staff to handle my needs?
- How much experience do you have in underwriting construction companies?
- What primary market segments does your surety company handle?
- What are your surety company's financial results over time?
- Are you licensed in the proper jurisdictions?
- Is your surety company listed on the U.S. Treasury Department's T-List and what is your AM Best credit rating?
- Are you available to meet my day-to-day needs?
- What individual size bond and total aggregate amounts are right for me?
- What is my risk profile and how can I improve?
- Does your surety company have a professional claims department?
- Do you support my business plan?

Contractors who put the right surety team together will have access to a wide variety of resources and expertise. This professional surety team is committed to helping contractors become successful, more profitable businesspeople who understand how to allocate their surety capacity most effectively in order to grow their construction companies. ■

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