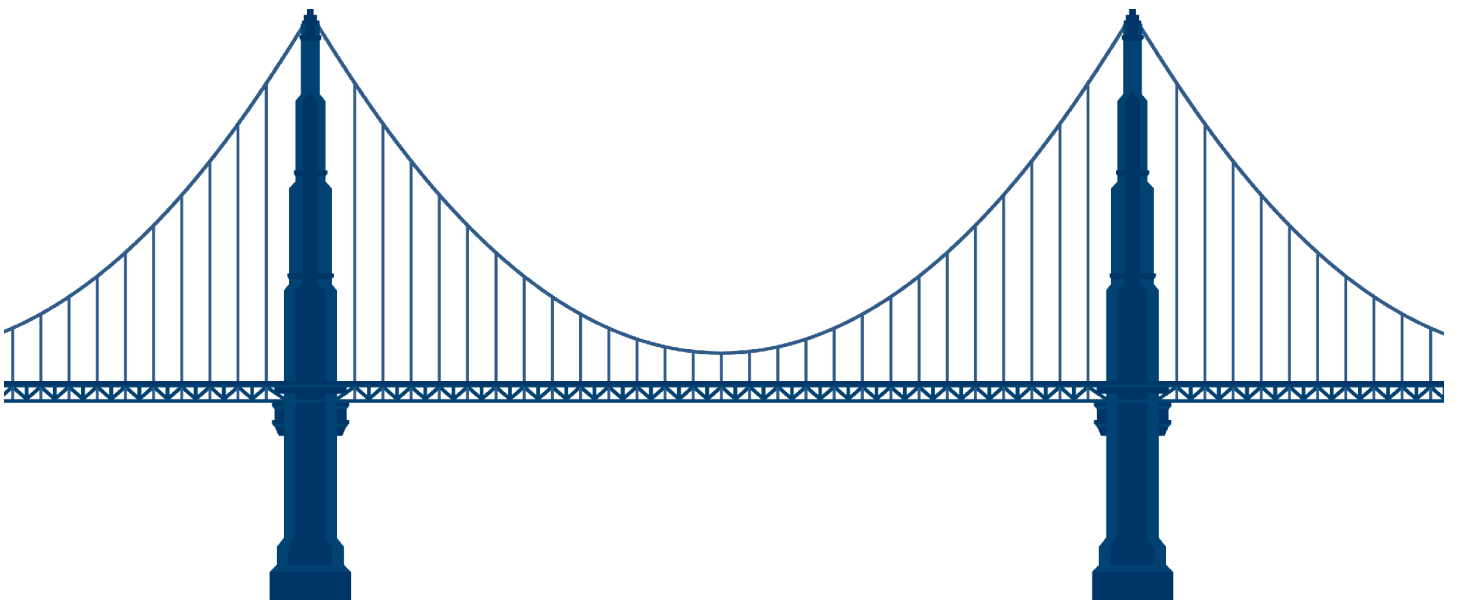


SURETY IN A DOWN ECONOMY

Increased rigor and increased communication by all parties in a surety bond will help everyone weather the current financial storm — and get projects built.



The economy — local, national and global — isn't good, isn't growing and isn't projected to return to solid steady footing until 2011, according to experts representing all aspects of the construction industry. "Harsh effects of this economic turbulence," is a phrase used by William Maroney, former president of the National Association of Surety Bond Producers. This is not news to any credible professional in the business.

The waves of harsh effects are rippling up and down the industry, hitting all involved from the government-entity project owner and its taxpayers to the surety bond companies to the surety bond producers to the construction contractors, subs, suppliers, bankers. And while most public contracts have long required surety bonding, national experts note that more and more private projects today are requiring the protection of surety.

But, what is news, and good news really, is that there are concrete steps industry leaders recommend you take to not only weather this storm but also to come out of it a stronger company well-positioned for growth as soon as growth becomes possible. And this holds true for all parties involved — the surety bond company, the construction contractor and the surety bond producer who works between the two.

"Pay attention to detail" is the common theme among these recommendations.

Tighten up your financial paperwork.

A construction contractor should start by making sure that his/her financial house is in order. Then make sure all financial documentation is in order.

A surety will want to study detailed financial statements for the past three to five years that are independently audited and comply with Generally Accepted Accounting Principles (GAAP). These include: balance sheet, statement of earnings, statement of changes in owner's equity, cash flow statements, notes to financial statements, contract schedules and financial forecasts. Credit reports, banking information and financing available also go to showing financial strength.

Also double check that you have in place the appropriate commercial insurance and liability to protect your project, your company and your personal finances.

Know your banker and financing options.

Contractors: Is your bank and its parent company truly committed long term to construction industry lending? How has your bank been treating you and your existing lines of credit? Will your working credit lines be renewed — and at what terms?

Likewise, the smart surety company and surety producer must know the contractor's bank and its commitment to not only construction lending but to the individual contractor. "The importance for the surety company to understand the contractor's banking relationship also has risen to a new level," Surety & Fidelity Association of America Chairman Rick Kinnaird writes in a January 2009 article to the industry. "Owners and contractors should expect more underwriting questions in this area."



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Tighten up your focus.

Companies in any industry that found themselves spread too thin when the economic downturn hit likely today find themselves at worst out of business, or sold and merged, or at best cutting back to a core base of products and services. This is true across the board and especially true for the construction industry and its intertwined players. So stick to what you do best, what your track record and reputation supports and what you can pay for.

“A standard line from sureties is ‘bid the work, not the competition,’” SFAA’s Kinnaird writes. “This is easier said than done during these trying economic times. Contractors need to choose their battles and take care of customers with whom they have built strong relationships. These are the project owners that will get them through these difficult times.”

Stay current.

In today’s climate it is crucial that contractors, producers and surety companies be on top of current industry trends, starting with green building, experts agree. Construction-related planning and contracting forms Business Information Modeling (BIM) and ConsensusDOCS are two more current trends that should help contractor efficiencies and profits in both the short and long terms.

In addition, surety companies and surety producers must make sure they are current with state and federal regulations, changes and proposed changes that affect the construction industry and surety bonding.

Those involved in surety also need to beware of bundling of public projects, cautions Maroney in a January 2009 article. “(This) is a disturbing trend,” he writes. “Super-sized public projects demand consortiums of contractors to bid on them, resulting in fewer bidders and less competition.”

Tighten up your strategic planning.

If you don’t have a firm handle on your short-term and long-term planning do it now. Surety companies must see that contractors have a viable strategic plan in place and understand it, according to the Surety Information Office and NASBP.

This plan should include financial planning (cash flow, savings, etc.), materials/equipment (back-up suppliers in case one falters, cash flow to pay for materials as needed, equipment maintenance and purchase needs, etc.), personnel (retaining key people, succession planning for loss of key personnel) and future growth/marketing. Your plans should take into account present-day realities as well as contingency plans for unforeseen events.



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Contractors: Tighten up your prequalification requirements.

With your financial paperwork in order and ready to present, work with your surety producer to make sure you have together and ready all the pieces a surety will need before committing to bond a project. These pieces revolve around the four C's: capital, capacity, character and continuity, according to SIO.

Capital — Financial statements and strategic plan, indemnity (corporate and personal), working capital and up-to-date work-in-progress reports.

Capacity — Resumes of key staff and management, the contingency plan in case personnel are lost, a comprehensive business plan including both short-term and long-term projections, proof that the contractor has or can secure any equipment necessary for the contract in review.

Character — References that together communicate the reputation of the contractor. A surety will want to check references from bankers, CPAs, project owners, architects, suppliers and subcontractors.

Continuity — Additional evidence that the contractor not only will get this proposed contract completed on time and on budget, but that the company will be around for future projects. The firm's track record comes into play here. This is a fairly new C, SIO notes.

Do your research.

Surety or surety producer or contractor: You know all the details of your company; you need to learn all about the other two before forming a partnership. Know your possible choices — their financials, reputation and track record, the expertise and other resources they offer you, their customer service support. In researching the surety, contractor or surety producer you will work with, the above four Cs are a good starting point.

For contractors, one of the values a reputable surety producer brings is in-depth knowledge of the various surety companies.

In addition, do the research necessary to know the proposed project and its owners. This should include not just the technical details of the project and its timing, but also the personalities involved, expectations and any potential situations that could occur to affect the project.

CONTRACT SURETY BONDS are three-party agreements by which the SURETY COMPANY guarantees to the PROJECTOWNER that the construction CONTRACTOR will perform the contract (including paying all subcontractors and suppliers). The project owner specifies the bond requirement in the contract documents; the contractor must secure the bond before submitting a bid. The SURETY PRODUCER, often part of a commercial insurance agency, is a commercial insurance adviser with specialized expertise in construction surety. The surety producer works with and for the contractor to create and maintain a relationship with the appropriate surety company throughout the entire project process.

A BID BOND provides financial guarantees that the contractor's bid is submitted in good faith and the contractor intends to enter the contract at the price bid. If the contractor wins the bid but fails to enter into the contract, the surety may be required to pay the owner the difference between the awarded bid and the next lowest bid, or to pay the bond penalty.

A PERFORMANCE BOND protects the owner from financial loss should the contractor default on the contract. If the contractor defaults, the surety will respond as according to the bond.

A PAYMENT BOND guarantees that the contractor will pay certain laborers, subcontractors and suppliers. If the contractor fails to pay what is properly due, the surety will make the payments up to the penal amount of the bond.

- THE SURETY INFORMATION OFFICE



Use all your expert resources, all the time.

It's a relationship business, the experts agree, and the relationships flow in all directions between the surety, the contractor and the surety producer. After you have researched your surety partners thoroughly, tighten up those relationships. Communicate early and often, both formally and informally.

Adds Todd Loehnert, 2009 president of NASBP, "As surety professionals, we are uniquely positioned to deliver practical guidance and advice to our business partners to position them to weather challenges. If we are not upfront in dealing with the issues that face our clients and, consequently, ourselves, and proactive in facing these challenges, we have not lived up to our opportunity to prove our worth as business advisers."

He adds: "We must have access to resources and information that bring up-to-the-minute understanding of the issues that impact surety credit."



Once a project starts, the contractor should have regular check-ins with his producer and his surety company representative. Likewise, both the surety company and the producer should be keeping tabs on the project's progress, as well as other projects the contractor has that might cause a financial drain. With these communications ongoing, contractors will be able to ask for help at beginning of any problem and both the surety company and the producer will be able to show up ready to jump in and assist as needed.

The Surety Information Office has files full of true-life stories of surety bonds at work —examples of when a surety company sent in expert help and/or financing to keep a contractor on the job and the project on schedule, as well as stories of when a surety company took over from a contractor in default to get the project completed for the owner. A good surety company has financial, engineering, planning and other expert resources available to its contractor clients.

"Contractors who already have a surety relationship need to take full advantage of these advisers," NASBP's Maroney writes. "For those who do not yet have a working surety relationship, now is the time to get started. Work with a professional surety bond producer who is willing and able to handle your needs."

Industry experts agree that the well-run company — the firm with tight financial controls, secure professionals on staff, support of outside expert advisors and solid relationships throughout the community — will survive and prosper. Recession or not. Work with a trusted, experienced surety producer and commercial insurance advisor to help make sure you're in that group.

In addition to the resources of your surety bond producer and commercial insurance advisor, these offices in Washington, D.C., offer current information, industry credentials, help and trend analysis:

- The National Association of Surety Bond Producers; www.nasbp.org ; telephone 202.686.3700.
- Surety & Fidelity Association of America; www.surety.org; telephone 202.463.0600.
- Surety Information Office; www.sio.org (link); telephone 202.686.7463. The SIO is supported by NASBP and SFAA.
- The U.S. Small Business Administration Surety Bond Guarantee Program; www.sba.gov/aboutsba/sbaprograms/osg/index.html.



Payne Financial Group provides insurance solutions, surety and employee benefits for private individuals and businesses throughout Montana, Idaho and Washington, with offices in Billings, Boise, Bozeman, Butte, Great Falls, Helena, Kalispell, Missoula and Spokane. For more information, visit www.pfgworld.com.