8 Sure Ways to Improve Your Surety

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The truth is, things aren't the way they used to be when it comes to obtaining surety bonds. The days of a contractor requesting a bid bond and receiving immediate approval are long gone. The annual, routine, check-in meetings with surety companies are a thing of the past.

Today, as a result of the construction recession, many contractors are feeling the pinch from their surety company and it's affecting their balance sheet. Every job is scrutinized and subject to intense questioning which leads to slower approvals. Profit margins have decreased; bid lists are long; private work is minimal; and the credit markets aren't loaning money. Now, more than ever, it's imperative that contractors do everything in their power to build or maintain their surety relationship.

Here are eight sure ways to help contractors improve their relationship with surety companies.

1 Fine Tune Financials

Surety decisions are largely based on a contractor's financials. Supplying a fiscal year-end CPA Audit is a must for contractors doing $15,000,000+ in revenue per year. If the need for surety bonds is minimal, a contractor might be able to get away with a CPA Reviewed Statement depending on the company's internal controls and quality of interim financial information. Utilizing a reputable, construction-oriented CPA firm is also a must. The statement should be a comparative statement, including open and closed job schedules that tie to the income statement and have detailed footnotes that explain the company's banking facility, disputed claims and any slow receivables. Contractors must always be sure to notify their surety if they switch CPA firms. Sureties and surety brokers handle many contractors and can actually be good references for CPA firms.

2 Clean Up the Balance Sheet

Construction company owners should resist the temptation to use their company as a personal bank. Working diligently to clean up any shareholder receivables or loans is a smart strategy. Surety companies expect owners to keep their personal funds separate from the company's. If contractors have significant receivables over 90 days old, their surety will move those receivables to a long-term asset or eliminate the receivable from the balance sheet altogether. They should improve their position with the surety company by focusing on improving the turnover of their accounts receivables.

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3 Work on Work-In Progress Reports

The first thing a good surety company will analyze is a contractor's open and closed job schedules. Their balance sheet and income statement are reflective of how well their jobs perform. Typically, a surety company will look at 3 years worth of job schedules. Did under billings result in profit fade? How much do jobs deviate (+/-) from the original gross profit estimate? Contractors must be prepared to address jobs with significant profit fade. Often, there is a good explanation, but a consistent trend of profit fade makes a contractor look less reliable. Bond companies make decisions today based on financial information that is not current. As a result, a contractor's job performance plays a crucial role in building and maintaining trust with their surety.

4 Prepare a Formal Succession Plan

Many construction companies are family-owned, making succession planning easier. However, even if the plan is to have a family member take over the business, a surety company expects a formalized continuity plan. Surety companies, among other creditors, want assurance that the transition will have minimal impact on the balance sheet. Surety will also want to make sure that the business will be in the hands of someone who is qualified and has been groomed to lead the company. In most cases, there is a buy-sell agreement in place between the existing and future owners. It is imperative that the funding of this transition is transparent and achievable without impacting the financials of the company. Typically, this is accomplished with life insurance.

5 Stay the Course

Surety companies do not usually encourage contractors to get involved with projects outside of their typical scope of work or territory. For example, a surety company is unlikely to support a paving contractor getting into the wastewater treatment plant business. They also want to see their clients stay in the territory they know best. If contractors have operated in Pennsylvania and New Jersey for several years, they should have a well thought out plan for moving to a new territory and have a balance sheet that warrants more risk.

The top reasons for contractors failing are going out of territory and getting involved with unfamiliar work. If contractors decide to go outside of their typical scope and location of work, they will need strong financials and a well thought out plan. A surety will need ample lead time to become supportive of these types of endeavors.

6 Protect Against Subcontractor Failure

In today's construction economy, it's imperative to go above and beyond to protect against subcontractor failure. Both profit margins and volume are down for many contractors. Plus, subcontractors work for many different contractors. If a sub is not being paid or having difficulties with other contractors, it will increase the risk of them failing on their work.

Contractors with $100,000,000 + in annual subcontractor volume sometimes utilize subcontractor default insurance to protect themselves against failing subs. For contractors with less than $100,000,000 in annual sub volume, a surety will often require clients to obtain performance and payment bonds from the critical subs of a project. Unfortunately, in a competitive bid environment, the bond costs from subs could prevent them from getting a job. The following are recommendations if contractors opt not to obtain a sub bond:

- Joint checks and supplier reference
- Review of subcontractor's financials
- Copy of subcontractor's bond rates from their surety on their surety company's letterhead. If rates are high or with a non-standard surety, this could indicate weak financials.
- Consent of Surety
- Supervision by your project managers. If a sub is beginning to struggle, the project management team needs to pay close attention so the performance doesn't slip and the subcontractor doesn't bill too far in advance.
- Stick with reputable subs that have a long track record.

7 Evaluate Surety

It is the job of the surety broker to place a contractor with a surety where both parties will be satisfied and a long-term relationship will be established. The last thing a contractor wants to do is bounce around from surety to surety. It is also important for contractors to look at what other contractors their surety writes within the contractor's territory. Do they understand the type of business? Do they write similar contractors? Does a broker have a good relationship with the surety and its home office? How long has the company been in the surety business?

Staying up to date on the surety's credit ratings is also important. Most owners require bonds from surety companies with a minimal credit rating of A or A-. In some cases, a contractor can become in default of a contract if their surety company's credit rating falls below a certain rating. Additionally, if a surety's credit rating falls below an A-, it is a major hassle to replace all of their outstanding bonds. Stand-alone surety companies and surety companies that are a division of a large insurance company frequently go in and out of the surety industry. Sticking with a surety that has a long, successful track record in the surety industry is your best bet.

8 Plan Ahead For Larger Projects

Deviating from a typical scope and location of work will make an approval on a project very difficult for a surety. Contractors may also have a hard time obtaining approval if they want to bid work that is 2-3 times the size of their largest project ever completed.

It is critical to contact surety as early as possible to discuss a larger project. The surety will need to understand where the bulk of the risk is located and what a contractor is doing in order to mitigate the risk. A surety will want a detailed cost breakdown. Financials play a major role in getting a larger job approved. Here are some suggestions in obtaining surety support on large projects.

> **An open or silent joint venture partner.** Surety will have a list of acceptable surety companies to joint venture with. Contractors should communicate potential joint venture partners with their surety.

> **Obtaining surety bonds from critical subs.** For example, if a project is $100,000,000 and there is $30,000,000 of subs providing surety bonds, a surety will conceptually view this as the contractor reducing their exposure by 30%.

> **Capital infusion to bolster financials.** This can be a tough way to go as the owner is required to place a significant amount of cash into the company, and there will be a tax burden if they ever want to take the money back out of the company.

> **Subordinated loan.** The owner can loan money to the construction company and subordinate the loan to the surety until the job is complete. This is often more attractive for the owner of a construction company and somewhat less attractive for the surety company. However, it typically results in a good compromise to help improve a contractor's financials to obtain surety support on a large project.

SURETY CREDIT MAY BE YOUR LIFELINE

These guidelines will help you build and maintain a surety relationship through the good times and the bad. Remember, a good surety relationship gives you a competitive advantage in the construction marketplace.

For more information or to speak with one of Conner Strong & Buckelew's surety experts, call 1-877-861-3220.

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