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November 2012

THE MAGAZINE FOR THE BUSINESS OF CONSTRUCTION

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[CONTRACTORS' GUIDE TO SURETY BONDING]

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10th Annual Contractors' Guide to SURETY BONDING

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Surety Bonding November 2012, a special section of *Construction Executive*, is published by Associated Builders and Contractors Services Corp.

Surety Market Overview

BY STEPHANIE ROBICHAUX

How Is the Economy Affecting Small, Mid-Sized, Large and Mega Contractors?

The nation's slowly dropping unemployment rate may be a sign that the economy is on the road to recovery. But surety executives still expect the next year to be tough for the construction industry as the impact of the recession and depleted backlogs continue to take a toll on contractors' balance sheets. "Contractors at all levels face significant challenges in acquiring work and getting adequate margins, while dealing with owners who are having budget and staffing issues themselves," says Rod Williams, chief underwriting officer for Liberty Mutual Surety.

Some sectors of the industry have fared better than others. Specialty trade contractors have been hit the hardest, especially those in nonresidential construction, which lost 6,400 jobs in August. There is better news for residential specialty trade contractors—a job increase of 8,200 in August and a 1.3 percent increase compared to the previous year. Heavy and civil engineering construction grew 2.1 percent since last August.

The unemployment rate for construction rose from 11.3 percent in August to 11.9 percent in September, confirming the industry is one of the country's slowest to recover. According to Bizminer, more than 20 percent of all general contractors and operative builders, heavy construction contractors and specialty/trade contractors operating in 2009 were out of business by the end of 2011.

Because of the surety industry's adherence to strict underwriting standards prior to and during the recession, losses are not as severe as they could be. In the small and middle markets, surety executives say this year brought an increase in loss frequency. "It seems like there are fewer qualified contractors due to economic issues, so the base of bond clients has decreased; therefore, competition for bondable contractors has increased," says Jeff Booth, senior vice president and chief underwriting officer of Allstar Financial Group.

SMALL

"Small contractors are showing the most obvious signs of distress, and sureties are underwriting this segment accordingly," says Doug Irvin, vice president and surety unit manager for Lockton. "If the contractor

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has established a good rapport with its surety, the underwriters are generally trying to provide controlled levels of support to give the client a chance to manage through this cycle."

Adds Michael Cifone, senior vice president of surety for American Safety Insurance: "Cash flow problems usually arise much quicker with the smaller contractors, as they are usually squeezed between slow-paying owners and having to meet payroll each week."

However, ample surety is available for qualified contractors with strong balance sheets. "Capacity in the small market is adequate, but smaller firms must demonstrate a certain level of experience and sophistication and have access to capital to obtain surety support. Poor quality financial presentations often are a major limitation for access to surety credit," says Mike Foster, executive vice president of underwriting for Merchants Bonding Company.

Loss activity in this segment has prompted sureties to implement stricter underwriting standards. "Almost all of the sureties are doing some degree of reviewing or re-underwriting for this line of business due to the impact the sustained and deep downturn in economic activity in the construction industry has had on companies in the arena," says Carl E. Dohn, Jr., president of Dohn & Maher Associates and the National Association of Surety Bond Producers.

Well-managed small firms benefitted from set-aside programs through various government agencies and obtained bonding. These programs facilitate the participation of small, minority- and women-owned businesses on major federal construction projects that they otherwise would not be able to bid on or win. "As a result of increased activity within various Small Business Administration programs, it has been our experience that set-aside contractors have experienced an easier time obtaining bonding for projects. This is partially due to the fact that large contractors are seeking opportunities to engage with these smaller firms in an appropriate structure in order to participate in the projects themselves," says Jim Tressel, vice president and senior contract underwriting officer for Liberty Mutual Surety.

While financially sound contractors may find surety bonds available to them, many contractors pursuing set-aside projects are in the same boat as other struggling small contractors. "Many of these companies are new and show limited experience and capital. Most of these cases can only be handled with the support of outside indemnitors or mentor-teaming relationships. In spite of more limited competition for this work, many set-aside contractors are still unable to translate this into higher margin work," Foster says.

Surety executives expect loss frequency and severity to increase in 2013.

Another challenge is each agency with a set-aside program has different rules regarding the arrangements small contractors may enter into with larger contractors. "Until there is consensus, transparency of the bonding arrangement is critical," Dohn, Jr. says.

MIDDLE

With backlogs being depleted for mid-size contractors, an increase in the frequency and severity of claims occurred, especially at the lower end. Surety executives say this segment remains the most competitive with sufficient surety for qualified contractors.

"Contractors of this size have generally done a good job of managing through the down economy and are weathering the storm better than the smaller contractors; however, they too have felt the pains from the limited projects and long bid lists that persist in the marketplace," says Mike Noe, executive vice president of construction services for Travelers Bond & Financial Products.

As with all segments of the market, underwriting remains disciplined, and sureties report that more emphasis is being placed on mitigating subcontractor risk.

"Contractors with subpar results are experiencing more problems than others, but certain sureties have stepped forward to provide solutions that include collateral and other methods to mitigate risk," says Mike Bond, head of surety for Zurich Surety.

LARGE

Large contractors have not experienced as many significant losses, and surety credit will remain available to financially secure contractors. "While the economy has negatively affected many large contractors, they generally have greater staying power than smaller companies," says Doug Hinkle, chief underwriting officer of CNA Surety. "We have seen little change to underwriting standards, and there is adequate surety capacity and availability, particularly with the weak construction market that is presenting far fewer work opportunities."

Because of this staying power, sureties are willing to meet the bond needs of their large clients. "Project size has proliferated in recent years, as has the use of joint ventures, so large customers find themselves working with multiple sureties and multiple partners to compete for the large project work for owners," Bond says.

MEGA

Mega-contractors had larger backlogs going into the recession and the financial capability to absorb losses better than smaller contractors during the last few years. However, many of the jobs that carried mega-contractors through the recession are wrapping up.

"The backlogs are starting to be reduced, and new work may have significantly lower profit levels. It would not be surprising to see some of these accounts get to a position of significantly reducing their operations," Dohn, Jr. says.

Overall, the poor economy did not majorly impact contractors in this market segment. "Consolidation of the customer base has caused sureties to look at their aggregation exposure to these mega construction companies, but to date this segment has received sufficient capacity and underwriting attention to manage through the complex mega-project bond exposures, particularly in the sophisticated infrastructure marketplace," Bond says.

Most sureties serving this market currently focus on retaining existing customers and attracting new ones.

SURETY OUTLOOK

Surety executives expect loss frequency and severity to increase in 2013, especially in the smaller end of the market. "We anticipate a higher-than-average claim count as subcontractors and suppliers

seek to preserve their rights and more aggressively pursue collection of accounts receivable," Foster says.

Adds Hinkle: "I would expect the severity of loss activity to grow as more middle-market contractors struggle with competition and the long duration of this weak market."

Despite anticipated increases, executives say losses currently are in line with historical norms. "The industry in general has remained rational, and there remains plenty of bond capacity, especially for contractors that have responded appropriately to the financial crisis and adjusted their business plans accordingly," Williams says.

Adds Bob Cave, chief underwriting officer of SureTec: "It is ironic that we probably have the greatest amount of surety capacity in memory at the same time that contractors face the most difficulty in obtaining work."

Irvin notes another major concern for contractors is managing the exposure to contractor default and/or underperformance. "Healthy contractors can quickly become infected by one sick subcontractor," he says. "The intense competitive environment often makes it difficult to bond every subcontractor, so it is important for general contractors to have a thorough prequalificiation and management process."

Adds Williams: "Contractors should be very selective in underwriting owners and subcontractors, and be mindful of a trend toward transferring more risk to the contractor. Transparent and frequent communication between a contractor and its surety, as well as other financial partners, is essential."

Businesses that reduced overhead and kept their finances in order during the last few years should be well-prepared to handle the recovering economy. "The hope is that after the election, money will shake loose for construction activity," Booth says.

Yet, Cifone believes it is "unrealistic to expect that we will see any significant improvement in the construction economy in the foreseeable future as the federal and state governments attempt to deal with their runaway budgets. We do not expect to see an increase in public funds allocated toward construction projects, and private funds are slow to invest in new projects," he says. "The low cost of borrowing has been unable to entice a significant amount of private investments in construction-related projects."

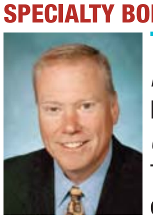
Only time will tell if investments in construction—public or private—will pick up and increase contractors' job opportunities. "Firms whose balance sheets have been negatively impacted during the downturn need to be even more thoughtful in their pursuit of new opportunities," Noe says. "Putting work in place is important coming out of the down cycle, but ensuring it is profitable work at adequate margins is even more critical."

Many contractors will be tempted to downsize or reduce overhead too much in the near future and—when the economy improves—add overhead too quickly, expand their geographic reach and the type of work they do, and take on bigger jobs. "All of this can be challenging in good times," Dohn, Jr. says, "let alone amid the tight economic conditions plaguing today's construction markets."

Stephanie Robichaux is communications associate at The Surety & Fidelity Association of America. For more information, call (202) 778-3629 or email srobichaux@surety.org.

EXECUTIVE INSIGHTS

WHEN UNDERTAKING LARGE PROJECTS, WHAT SHOULD BE A GENERAL CONTRACTOR'S PRINCIPAL CONCERNS REGARDING SUBCONTRACTOR AND SPECIALTY BONDING?



TIM MIKOLAJEWSKI
President
Liberty Mutual Surety
Chair
The Surety & Fidelity Association of America Board of Directors

Unqualified subcontractors or specialty contractors pose a significant risk to general contractors and owners alike. When undertaking very large projects, general contractors must manage highly complex work, making risk mitigation a critical factor in project completion. Subcontractor prequalification is extremely important, as many large projects have longer durations, and the general contractor should be comfortable that subcontractors can complete the work on time.

Bonding subcontractors provides general contractors an advantage, as the surety's role is to prequalify a subcontractor's financial condition, operational capabilities and expertise in the type of work to be performed. If the subcontractor defaults, the surety can help complete the work.

Often, a general contractor may have access to an extremely limited field of qualified subcontractors. Dividing work into multiple subcontracts or into phases can mitigate risk in such situations. Bonding key suppliers is equally significant. Longer duration projects may involve raw material price escalation and can stress a subcontractor's financial condition.

General contractors also are advised to underwrite the surety to ensure the company has sufficient financial strength and capacity. General contractors should leverage their surety's national perspective and experience to help manage project risk.

MIKE FOSTER
Executive Vice President, Underwriting
Merchants Bonding Company

Construction is an extremely risky business. The greatest risks a prime contractor faces are identifying, assessing and managing the risk of subcontractors. Our experience indicates that when a general contractor fails, it is often due to a problem with one or more subcontractors. Subcontractors are vital to the completion and success of a project, but one bad subcontractor can cause all others to be delayed and could result in liquidated damages being assessed, as well as a myriad of problems.

The initial step in ensuring you have qualified subcontractors is to establish a prequalification process. There is no better protection against subcontractor failure than securing subcontractor performance and payment bonds from a reputable surety company. A qualified surety has prequalified the subcontractor and is providing a guarantee to you that the subcontractor will perform per the terms of the subcontract and pay all of its bills. All general contractors should have a subcontractor bonding policy in place. You should consult with your agent and surety company on this policy.

WHAT ADVANTAGES DOES A FULLY BONDED CONTRACTOR OFFER TO PUBLIC AND PRIVATE OWNERS?

MIKE NOE
Executive Vice President of Construction Services
Travelers Bond & Financial Products

Obtaining performance and payment bonds on a construction contract provides many benefits to an owner, whether public or private. First, a fully bonded construction contract helps safeguard an owner's investment in a project by providing a guarantee that the contractor's obligations under the contract will be met, provided that the owner fulfills its obligations, including making payment to the contractor.

Second, before providing bonds for a project, a surety typically will evaluate the contractor's current financial condition and the likelihood of being able to complete the project successfully. The surety reviews the contractor's experience in completing similar projects along with other factors, including the strength of its management team. In the event the contractor experiences difficulties and is unable to complete a project, the performance bond provides a guarantee that the surety, subject to contract and performance bond terms, will provide assistance to the contractor in order to reach project completion or provide a new contractor to complete the project.

Finally, a payment bond serves to protect the owner from claims being made against the project for bills from unpaid subcontractors and material providers, should the contractor fail to make payment. This is particularly beneficial on a private project where certain unpaid subcontractors and materials suppliers can lien the project for nonpayment even though

PROTECTION AT EVERY STAGE

When a large contractor was beginning a reconstruction project for coastal infrastructure in the south, the firm was challenged with a variety of issues—a complex project, difficult worker and public liability exposures, and formidable insurance coverage requirements.

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the owner may have paid the contractor for its services. Given the complexity and challenges of modern construction projects, an owner is best protected by obtaining performance and payment bonds for the complete amount of the contract.

DOUG HINKLE

Chief Underwriting Officer

CNA Surety

The first important advantage that bonding affords both public and private owners is the surety prequalification process that occurs prior to providing the performance and payment bond.

Because of the extensive coverage provided in a performance and payment bond, the surety must perform a thorough analysis of all aspects of the contractor's business. The analysis includes an affirmation relative to the character of the business owners, ongoing financial assessment to confirm adequacy of financial strength, and a review of business capacity to validate the presence of the necessary expertise, equipment and manpower to perform the work. This underwriting process is an assurance to owners that only qualified contractors are bidding their work, which greatly reduces the probability of project interruption through contractor default.

Recognizing the risks in the construction business and that no credit analysis process is infallible, the second important advantage arises when the surety underwriting analysis is proven wrong and a default occurs. In this event, the surety bonds stand ready with the guarantees of both project performance and payment of labor and materials.

JOHN KNOX, JR.

Chairman and CEO

SureTec

Surety bonds assure the public or private project owner that the contractor has been rigorously prequalified to perform the work and pay its bills. Before a surety is willing to put its balance sheet at risk on a project, every aspect of the contractor's operation will be evaluated: financial strength, credit history, experience, reputation, its ability to perform the work and current contractual obligations. When an owner awards a construction project to the lowest bidder, it knows the surety stands behind the contractor's promise to perform the job according to the owner's specifications and terms of the contract.

CARL E. DOHN, JR.

President

Dohn & Maher Associates

President

National Association of Surety Bond Producers

Simply put, a knowledgeable third party vetting a contractor and guaranteeing the contractor has the requisite experience, equipment and manpower to successfully complete the contract in question—including paying all suppliers and subcontractors—is assurance that prudent owners should not forego. A construction project is a huge exposure to the owner. To have experienced and highly trained underwriters evaluate the competency of a construction firm and then back up their evaluation with a financial guarantee is priceless.

A bondable contractor is a better contractor. Contractors will not get bonding if they do not maintain a record of satisfactorily completing contracts by paying their bills and doing the work correctly. They usually have better working relationships with subcontractors and suppliers, and normally work with the better ones in their area.

MICHAEL CIFONE

Senior Vice President-Surety

American Safety Insurance

The decision by an owner, public or private, to invest in a construction project involves many risks. Regardless of how much time and effort is spent in the planning and design phases, the actual execution of the construction contract does not always go according to plan.

Owners attempt to minimize their risks through insurance products and assigning risks to the contractor through the contract documents. However, if the contractor fails to complete the project in accordance with the terms and conditions of the contract documents, the owner could be left assuming some of the risks it intended to assign to the contractor. Using a fully bonded contractor not only assures the owner the contractor (or surety company) will complete the project and pay its bills, but it also assures the owner the contractor has successfully managed its risks as intended.

In addition, a fully bonded contractor has been vetted by a surety company. A contractor that successfully meets and maintains the underwriting standards of the surety company usually has the resources and experience to complete the project.

Owners can further protect themselves by ensuring the financial strength and rating of the surety company satisfies the requirements of their specific project.

JEFF BOOTH

Senior Vice President/Chief Underwriting Officer

Allstar

If properly underwritten and with a reasonable bond program established, a bonded contractor is simply a much safer bet for public/private entities entering into construction contracts. The obvious reason is the protection a contract bond provides. If the surety does a thorough job underwriting the contractor and doesn't rely on one-page applications, the owner/obligee on the project should have a project that is well run with minimal interruptions, lien issues, etc. A contractor should look at an established surety relationship as having an advantage over competitors that cannot obtain a bond. Contractors should view the surety as a partner in their long-term success, just as they view their bank or CPA.

DAVID W. OWEN

Partner and Construction Practice Group Vice Chair

Bradley Arant Boult Cummings

By confirming a contractor can provide bid, payment and performance bonds, owners will receive some measure of assurance that a sophisticated third party with at least as high a degree of self-interest as the owner has reviewed and evaluated the solvency, liquidity, and other financial practices and conditions of the bonded contractor. Sureties are not in a high risk-taking business, especially in this economy. To get a bond, a contractor's finances, management and operational capabilities must be solid. Surety underwriters ordinarily perform a comprehensive review of a contractor's finances and business practices before setting bonding capacity.

Public owners are required by statute to obtain bonds, while private owners have the discretion to require bid, payment or

performance bonds. Private owners have to weigh the additional cost of bond premiums against the benefit derived from bonding. There is value in knowing your contractor has the ability to obtain bonding and in the protection of the surety bond if the contractor fails.

Payment bonds protect owners from the claims of unpaid subcontractors and suppliers filing liens against the owner's property that can trigger default provisions or other unpleasant terms under the owner's financing arrangements. Better subcontractors may be attracted to bid for a project on which the general contractor is bonded because the bond reduces one of their primary risks.

The bonded contract may have a longer life for performance than the unbonded contract because most sureties are longer-lived than contractors. An incomplete project, warranty claim or a latent defect claim may be resolved by the surety even if the contractor is no longer in business or is unable to perform.

Most firms with any experience in the construction industry are aware of projects that would not exist today had there not been a surety to step in and complete the defaulted contractor's work.

WHAT ADVICE WOULD YOU GIVE A CONTRACTOR SEEKING SURETY BONDING FOR A PUBLIC-PRIVATE PARTNERSHIP (P3) PROJECT?

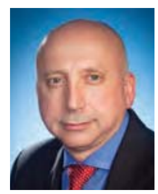
RICK CIULLO
Chief Operating Officer
Chubb Surety

P3s may create opportunities or additional risks. Managed appropriately, however, these projects can contribute to your company's growth and profitability. Each P3 project is unique, but there are a few key areas you should carefully consider.

First, determine your level of participation in the project; whether, for example, it's as a design-build contractor or participating on the concessionaire's team to finance, operate or maintain the asset. Each additional role increases risk. Accept only the roles for which you have experience and only the risks you can price, control or absorb. Many contractors will limit their interest to the design-build aspect. If you're one of those contractors, make sure that risks borne by the concessionaire are not passed along to you through the contract or otherwise.

Second, know your costs, including the upfront costs of preparing and negotiating a successful bid. The stipend only partially covers these costs and does not take into account the frictional and opportunity costs on your organization. Further, change orders may be difficult, if not impossible, to process, particularly if they involve additional expense and time that impact the underlying financing arrangements. Moreover, gauging your competitors is critical, especially to control your sunken costs. Some participants wearing multiple hats may be willing to reduce their construction profit in favor of long-term returns on the concession. You don't want to play a game you cannot win.

Finally, engage your surety and other business partners early and often as the project develops. Each P3 offers unique opportunities and challenges; early solutions are often the best solutions.



MIKE BOND
Head of Surety
Zurich Surety

P3s have proven to be a useful procurement model in Europe and Canada,

and most observers believe the use of P3s will only increase in the United States. Because of the complexity, it is vital to partner with a surety, agent and legal team that has experience with P3s and is committed to the marketplace. The partners a contractor chooses in the P3 segment can make the difference between financial success and severe problems.

P3 work is inherently very complicated, so it takes a big investment of time and talent on the contractor's part to understand and participate in a P3 project. From a surety perspective, each project is unique and requires a great deal of attention from skilled underwriters and legal resources. From a contractor's perspective, they must dedicate legal, financial, and executive talent and resources to evaluate the risks and opportunities. The lack of a consistent legal and risk framework makes it difficult to leverage resources, as each deal is different.

Because each deal is unique, a contractor must be prepared to dedicate an extensive amount of time and resources to properly analyze and structure the P3 contract. That time and those resources, when committed to a P3 deal, are by definition not dedicated to other opportunities in the marketplace. Each contractor must decide if this focus is worth the time and effort.

TARIQ TAHERBAI

Senior Director

Aon Infrastructure Solutions

P3s transfer more risk to the private sector than is transferred under the traditional (design-bid-build) delivery model. Thus, contractors seeking surety bonding must ensure they are comfortable with the risks they are being asked to manage in a P3, and that the surety is aware of such risks regardless of the type of P3 model that is used. For example, it is common for contractors taking part in P3s to be obliged to pay liquidated damages if they are late in completing construction. Sureties will want to know how such liquidated damages are calculated and the associated triggers. In addition, sureties likely will seek to have liquidated damages capped.

Another topic of concern for sureties in a P3 is whether the contractor is being asked to assume any obligations related to the operations and maintenance of the facility. Most sureties will not bond such obligations on the part of the contractor, but may bond them for a limited time on the part of the operations and maintenance provider. Arguably, the biggest concern for a surety is to ensure it is not being asked to bond any obligation related to the financing of the P3.

The bonding of P3s involves sustained effort on the part of contractors and sureties given the broad scope and lengthy contracts of most P3s. Given sureties' reluctance to bond certain obligations, contractors should ensure they present their scope on the P3 project as clearly and as early as possible.

DOUG IRVIN

Vice President-Surety Unit Manager

Lockton

In addition to innovative project financing, P3s shift significant risk from the governmental entity to the private sector, including the contractors. The ability to bond a

P3 project requires intricate negotiations between the contractor, surety, developer, financiers and governmental body to make sure risks are understood and allocated properly. Therefore, it is important for contractors entering this space to work with a surety company that has the experience and resources to help navigate these opportunities.

Depending on the financing structure and the contractor's position, a P3 project could materially alter the contractor's balance sheet or create contingent liabilities that could have negative consequences on its overall surety capacity. Involving the surety early in the process and maintaining open dialogue is critical to bonding a P3 project.

WHAT ARE THE MOST COMMON LEGAL CONCERNS FOR CONTRACTORS WITH RESPECT TO SURETY BONDING?

RICK ALLEN
President, Surety & Fidelity Operations
Capitol Insurance

Contractors and their sureties have to be concerned about the recent phenomenon of city and municipal bankruptcies. Typically, the failure of an obligee to pay contract balances when due to a contractor or to dedicate contract balances to a completing surety constitutes a defense for a contractor or surety. Chapter 9 bankruptcy or state receivership rules may affect the sanctity of those defenses. Likewise, new and unique funding mechanisms (such as those being utilized in cash-strapped California) may affect the longstanding precedent that contract balances are trust funds dedicated for the security of the surety.

GENE CRAWLEY
Account Executive/ Producer
Rutherfoord

In my opinion, one of the biggest legal concerns with respect to surety bonding is an onerous subcontract agreement that is guaranteed by a performance and payment bond. Many subcontractors are desperate for work and willing to sign anything put in front of them in order to keep the doors open and maintain cash flow. This is a huge mistake and extremely shortsighted.

Once that contract is signed and the bonds provided, you are locked into all the terms and conditions within that agreement. Most contractors have to provide personal guarantees in order to secure their bonds, so not only are they putting their business assets at risk, but their personal assets as well.

The contractors that have been able to survive in this economy are willing to walk away from a project if they are unable to reach a reasonable agreement. Some general contractors actually prefer to see a subcontractor mark up their subcontract agreement because it demonstrates a level of sophistication rather than desperation.

Have a professional review all subcontract agreements and then make a business decision as to which clauses you can live with and which ones are deal breakers. If it ends up costing you the job, the old cliché might apply: "The best job sometimes is the one you didn't get!"

Surviving the Economic Downturn: A Tale of Two Contractors

LEESER/VEER

BY FRAN McGRATH AND TOM REES

Although the general economy shows signs of a slow recovery, construction spending remains below November 2006 levels. When the construction playing field changed drastically as a result of the 2008 financial crisis, contractors found themselves spending more money chasing projects with significantly more competition and lower profit margins. Many were not financially or operationally prepared for this shift. Some did not survive, but many did through careful planning, confident leadership and solid decision-making. A key to survival was a close partnership between contractors and their critical advisors, including accountants, banks, insurance agents and sureties.

FROM DEBT-RIDDEN TO STEADY GROWTH

A large road contractor had high growth aspirations but geared up at the wrong time. In a normal economy, purchasing new equipment to support growth opportunities was manageable. In a rapidly shrinking economy, prudent expense management would have been a better choice. Weighed down by idle equipment, maintenance costs and high operating leases, the contractor could not shed its leveraged fixed debt quickly enough, leading to a substantial operating loss.

While the contractor's work continued to be excellent, internal communication needed improvement. A surety team with underwriting, accounting and engineering expertise helped facilitate improved communication and workflow between the contractor's field leadership and financial operations, which were functioning in silos. The result was a realistic plan with buy-in from all parties.

The contractor shed debt, sold excess equipment, reduced materials inventory and canceled certain operating leases. While these self-help measures were being implemented, the surety and contractor agreed on reasonable underwriting requirements and acceptable benchmarks that allowed bonding capacity to be maintained.

Adjusting to the new economic reality was difficult, but today the contractor is healthy, steadily growing and generating double-digit million-dollar profits.

FROM NET LOSSES TO PEAK PERFORMANCE

This heavy engineering contractor was in trouble even before the financial crisis began, as it was undergoing senior management transitions and recently finished a bad job that cost the company millions of dollars. Despite the shareholders contributing personal funds, the company had virtually no working capital, and lost half its net worth in the mid-2000s.

The surety's underwriting staff partnered with the agency and the contractor to develop an action plan. The surety conducted peer group benchmarking to identify improvement opportunities. With a realistic recovery plan in place, the surety maintained a reasonable surety program to help achieve the agreed-upon goals. The contractor implemented new accounting and project management systems, hired top talent, established efficient workflows and realized total engagement from its employees.

A surety that is well-informed about its customers can provide mutually beneficial solutions that support a contractor's business plan and reduce bonding risk.

Even in the midst of a prolonged construction recession, the contractor is now a solid performer with a diversified product set and revenue stream. Because the company has so many satisfied repeat customers, it can be selective in what it chooses to bid in the open market.

TIPS FOR CONTRACTORS

Surety professionals zero in on common themes to survive a downturn.

- **Assess timing.** Is now the right time to invest in or buy equipment? Should the company focus on saving instead?
- **Analyze processes.** Could a new workflow or system help the company gain efficiencies?
- **Ensure operational alignment.** Do field and support personnel have the same objectives?
- **Examine the firm's workforce.** Is everyone engaged and committed to success?
- **Communicate frequently.** Does everyone understand the objectives and the plan?

Additionally, partnering with a surety agent, a surety underwriter and other professional advisors is important. A good surety has a vested interest in maintaining a contractor as a strong ongoing customer. Sharing information is important to protecting bonding capacity. The surety should understand the contractor's financials, evaluate its business plan and give advice (along with the contractor's agent). By tapping into a national knowledge base of construction and economic trends, a surety can offer smart business solutions.

Absent accurate information and open communication, an underwriter may unnecessarily restrict a contractor's surety capacity. A surety that is well-informed about its customers can provide mutually beneficial solutions that support a contractor's business plan and reduce bonding risk.

WHAT'S AHEAD?

While the general economy is improving, construction has continued to lag. Private construction spending peaked in January 2008, declined 45 percent to its low in January 2011, and has recovered to only 27 percent of the peak in June 2012. Public construction spending peaked in March 2009 due to federal stimulus spending before declining 16 percent through June 2012. With continuous government deficits, public construction likely will remain constrained for the next two to three years. To survive, contractors with the right people, processes and partnerships in place will be better positioned to succeed.

Fran McGrath is senior vice president and chief contract underwriting officer at Liberty Mutual Surety. For more information, call (610) 832-8214. Tom Rees is vice president and senior contract underwriting officer at Liberty Mutual Surety. For more information, call (610) 832-8213.

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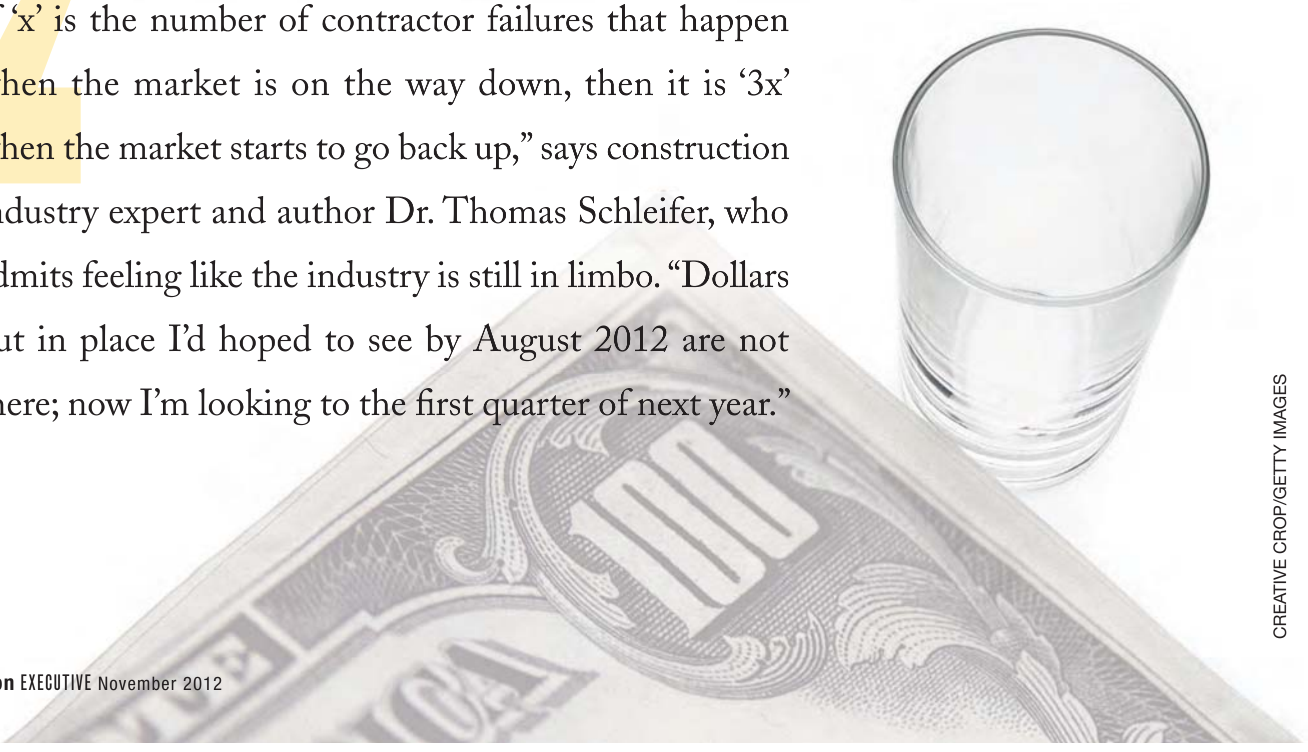
Don't Go Off the Overhead Diet Yet

BY THERESE WIELAGE

"If 'x' is the number of contractor failures that happen when the market is on the way down, then it is '3x' when the market starts to go back up," says construction industry expert and author Dr. Thomas Schleifer, who admits feeling like the industry is still in limbo. "Dollars put in place I'd hoped to see by August 2012 are not there; now I'm looking to the first quarter of next year."



CREATIVE CROP/GETTY IMAGES

Schleifer often cites the 12- to 18-month lag time for the construction industry after the rest of the economy starts to recover, but his "second lag" lesson is the one to watch now. Schleifer's timeline for the recovery looks like this:

- June 2009: Economic recovery begins.
- January 2011: Official end of the first lag; beginning of the second lag (i.e., the margin recovery).
- July 2012: Margin recovery should be over, with put-in-place dollars back to 2008 levels.
- August 2012: Rate of recovery is not happening as it has in the past.

"What we need to get back to is $1.1 trillion put-in-place, which was the level in 2008. That will signal margin recovery," he says. "But in August 2012, we were still sitting at $900 billion."

Schleifer's research includes a look at the seven largest economic downturns since World War II. In three of those downturns, "the failure rate was worse when the economy was on the way back up," he says. "Contractors load up on too much work and too much overhead too soon. They don't factor in things like wage inflation and materials inflation when they bid, and then find out mid-job it's unprofitable work."

Following is Schleifer's list of what causes most contractor failures.

1. Traveling too far for work.
2. Taking on bigger jobs than they can handle.
3. Trying to do unfamiliar types of work.
4. Forming joint ventures to accomplish the first three.

Schleifer cautions contractors about news stories that claim things aren't as bad as predicted and that report consumers are spending again. "They don't explain that the recession we just had was still worse than the depression and the spending is up in remaining stores because many other stores closed," he says.

The situation demands business planning for contractors that takes the timing of the margin recovery into account. Since margin recovery is still months or more away, Schleifer's advice for a bulletproof 2013 strategy includes resisting aggressive pricing and bidding, conservatively projecting likely sales for two years and reducing overhead to fit likely sales.

"That's the tough part," he says. "When you're growing, additional overhead should trail your sales, but when you're in a decline, trimming overhead should precede your sales. I call it the overhead paradox, and having the discipline to get lean and stay lean until margins recover is the key."

Contractors are surviving by taking the advice of experts like Schleifer, construction accountants and professional surety advisors. Because they made necessary cuts before it was too late and remained credit- and bond-worthy, they are positioned for growth when the construction lag finally ends.

Therese Wielage is vice president of marketing at Merchants Bonding Company. For more information, email twielage@merchantsbonding.com.

Dr. Tom Schleifer is author of* Construction Contractors' Survival Guide *and* Glossary of Suretyship and Related Terms. *For more information, call (480) 945-7680 or email tschleifer@aol.com.

What I know:

I know that at any one time, we may have 30 large construction projects underway all over the world.

I know that by hiring 70 percent of our workers from the community in which we're building, we build more than just a project.

I know the only way to run an international construction company is to delegate.

I know that coaching a competitive soccer team relates to running a successful construction company in ways you might not realize.

I know that working with people is supremely satisfying.

I know our success is predicated upon allowing people to do what they know.

I know we can allow Bradley Arant Boult Cummings attorneys to do what they know, and B.L. Harbert International will be well served.

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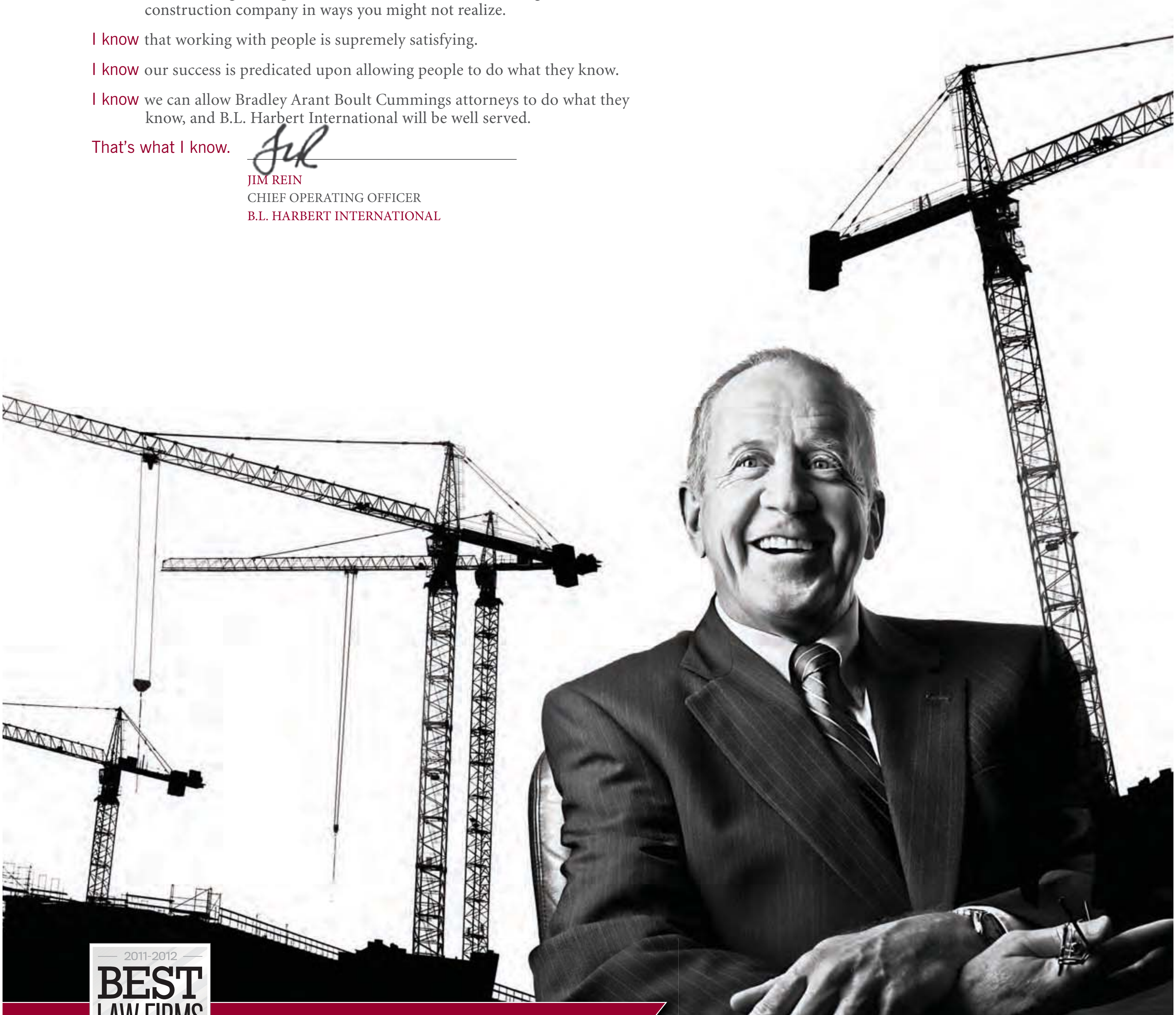

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The Bottom Line's Last Line of Defense

BY WILLIAM WATERS

The public and private capital that funds construction either isn't there or is sitting on the proverbial sidelines, with non-residential construction put-in-place declining 21.8 percent from October 2008 to May 2012, according to the U.S. Census Bureau. Future indicators of construction activity like the Architectural Billing Index are trending downward in 2012 after a brief rise in the latter part of 2011. While there are indications that certain sectors are expanding (e.g., power, manufacturing and health care), the overall outlook for construction is negative in the near term.

As a result, most contractors dramatically scaled back their operations in the hopes of finding the right balance between overhead and the amount of profit that can be earned in today's market. Landing a job with a healthy profit margin gets harder by the day.

The list of what can go wrong on a project is long, but one of the most common problems is subcontractor failure. Margins are so thin that one key subcontractor failure can be the difference between a successful and unsuccessful job. Very little can be done about the inherent weakness of today's construction market, but prequalifying all project partners is one way to take control.

Contractor prequalification is the foundation on which surety bond underwriting is built. Every day, sureties make risk decisions about whom to bond, how much bonding to provide, and under what terms and conditions to issue the bond. Prime contractors face the same choices every day when assembling project teams.

Financial consequences prime contractors face because of subcontractor failure often can be transferred to third parties via bonding or subcontractor default insurance. Subcontractor bonding is the most common form of third-party risk transfer and often is used alone or in combination with subcontractor default insurance. However, transferring the risk to third parties is not always possible, making subcontractor prequalification even more important.

Bonding companies make prequalification decisions by evaluating contractors' financial condition, credit history and experience. General contractors should

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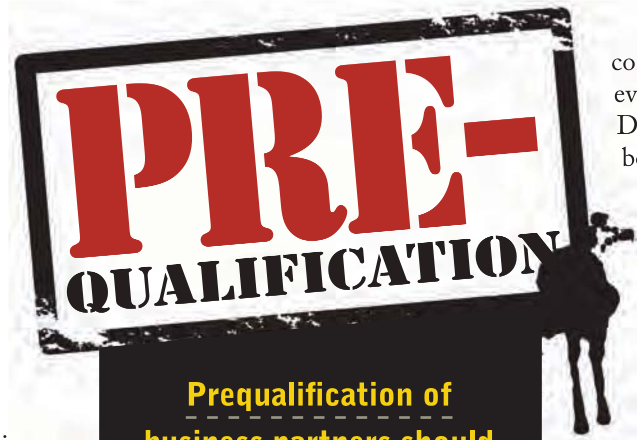
use the same methodology when evaluating prospective subcontractors. They should secure financial statements from the last two to three years, order credit reports and request information on the subcontractors' bank line of credit. Also, create a questionnaire for subcontractors that covers their safety record, a listing of the largest jobs they have completed, brief biographies on key employees, references and insurance coverage with the name of their insurance agent.

Once all that information is evaluated, make a job-specific decision on each subcontractor and determine how much overall risk to "self-insure" versus transfer to third parties.

Even the best in-house prequalification efforts can fail. Bonding companies do this all day, every day, and still make mistakes. The important thing is to implement a process and put the final decision on subcontractor risk in the hands of senior management. Communication within an organization is critical to managing subcontractor risk, and it is becoming even more important now that many contractors have expanded geographically in the pursuit of projects. As a result, it's important to track aggregate exposure of a subcontractor across an entire operation.



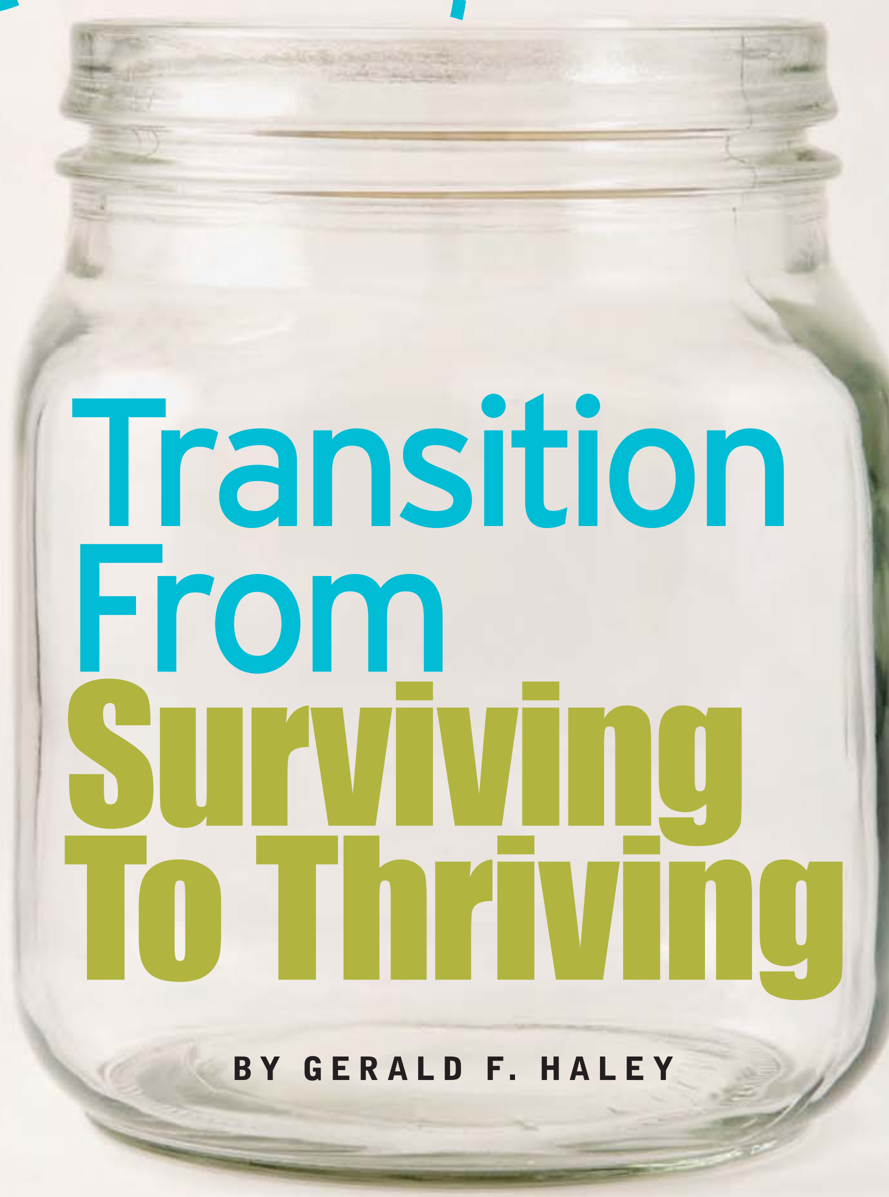
Prequalification of business partners should not be limited to subcontractors.

Prequalification of business partners should not be limited to subcontractors. Project owners, joint venture partners, small business teaming partners, bonding companies and banks also should be evaluated for their financial stability. Determining the financial health of bonding companies and banks is relatively easy because they are rated by independent rating agencies. Project owners are just as financially stressed as everyone else these days, so determining their credit worthiness and the source of their project funding is critical to ensuring contract funds will be collected when due.

For joint venture partners and small business teaming partners, apply the same tools used for subcontractor prequalification.

Proper prequalification efforts require a sizable commitment of resources, but the return on investment is worth the effort. Build a process, work the process and make an informed decision based on the results of the process. Then, require a surety bond as a final protective measure.

William Waters is vice president of CNA Surety. For more information, email william.waters@cnasurety.com.



Transition From Surviving To Thriving

BY GERALD F. HALEY

PETER GRIDLEY/GETTY IMAGES

As 2012 comes to a close, it is important for construction companies to step back and analyze where they stand and determine where they need to be in the immediate future. Introspection is often easier than looking forward, but the latter is more important to implement a strategic market position and take advantage of the slowly improving economy.

2012 is considered the fourth year of the downturn in the construction economy. The total value of construction starts for year-end 2012 is projected to be 23 percent below that of 2008 levels, and is not expected to exceed those levels until 2014, according to McGraw-Hill Construction data.

Despite shrinking margins and the lack of work and local government funding available, bright spots for some segments of the construction economy are emerging. Some construction industry segments such as manufacturing and health care are growing for the first time in several years. FMI Consulting reports that the number of construction projects valued at $1 billion or greater has increased from zero in 2005 to more than 100 in 2011. An increased number of large projects has a multiplier effect on the construction marketplace.

The surety team can provide valuable advice about the risks of dealing with certain owners.

If contractors that were forced to cut overhead and become more efficient to compete can align their resources around their customer strategy, they will be well-positioned to take advantage of the improving economy. Outside consultants may be necessary for some companies, but most contractors likely already have substantial capacity or significant expertise available from their existing CPA firm and surety, agent or broker.

Contractors must move from focusing on cutting costs and reducing overhead to strategically identifying and delivering value-added services for customers. Contractors must look at their past successes, examine market and customer niches, and identify what unique competencies they bring to owners and customers. For example, some contractors have developed unique skills and attributes to complete work more efficiently than competitors. Others have equipment, personnel or geography that supports their ability to deliver work on time and on budget. Identifying strengths also necessitates examining weaknesses and avoiding projects that do not fit with the firm's unique competencies.

Building collaborative, strong relationships with a surety and a professional surety agent can aid this process. Construction companies must carefully choose these relationships based on the total value these parties bring to the construction firm, not on low cost.

A professional surety agent and CPA can add value far beyond writing surety bonds and preparing financial statements. Because they are connected to other well-managed professional contractors locally and nationally, they can introduce a customer to potential joint venture partners that are a strategic fit to their customer's capabilities and corporate culture—which can be the difference in securing new work that otherwise would be out of reach.

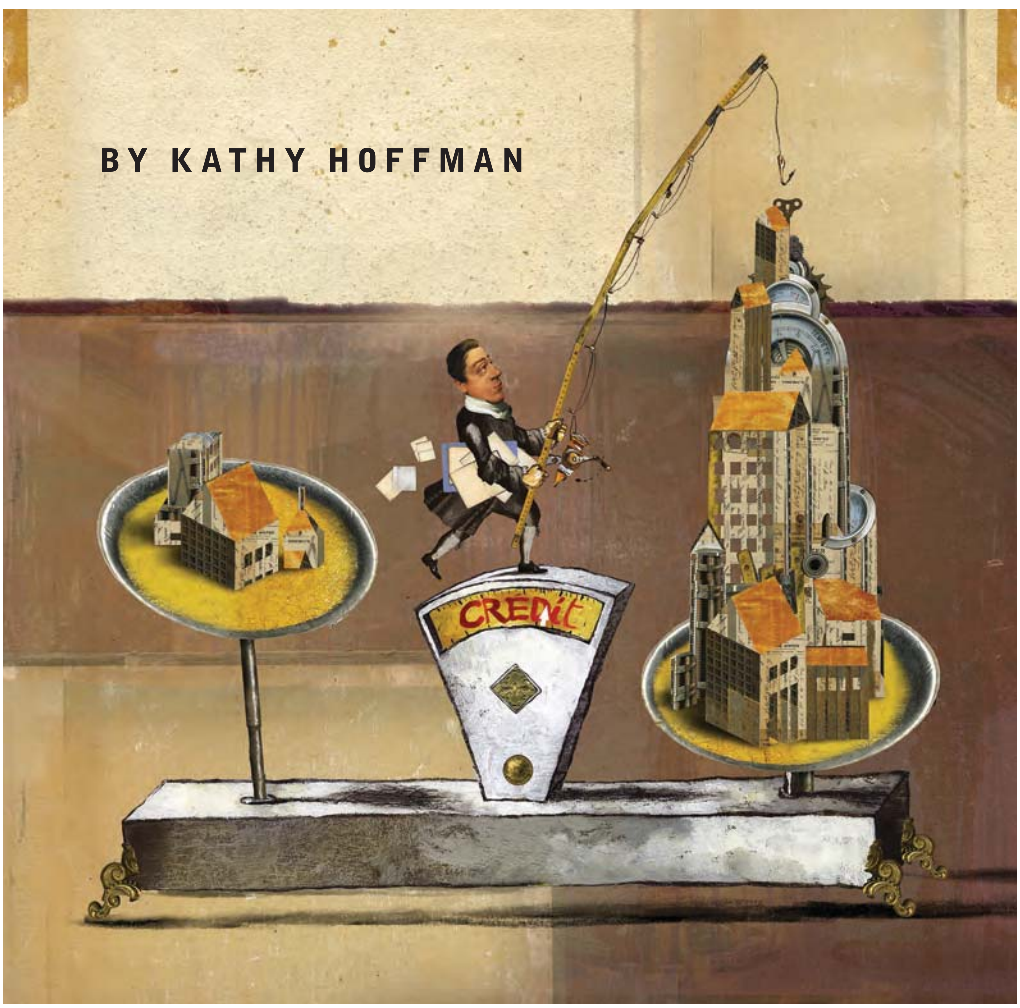
They also can introduce a customer to qualified subcontractors. The availability and performance of subcontractors often is the difference between a project's success and failure. Sureties and surety agents work with subcontractors every day and can be a significant help with this vital decision. Additionally, the surety team can provide valuable advice about the risks of dealing with certain owners, how those owners deal with risk and how those owners may try to transfer that risk to construction firms.

The risks and pitfalls of the construction marketplace are difficult under the best of circumstances, but a properly selected surety, agent and CPA can add significant value as construction firms seek to take full advantage of opportunities going forward.

Jerry Haley is senior vice president of Zurich Surety. For more information, call (410) 559-8723 or email gerald.haley@zurichna.com.

BUILDING AND MAINTAINING CONTRACTORS' SURETY CREDIT In Today's Economy

BY KATHY HOFFMAN



BRUNO MALLART/IMAGES.COM

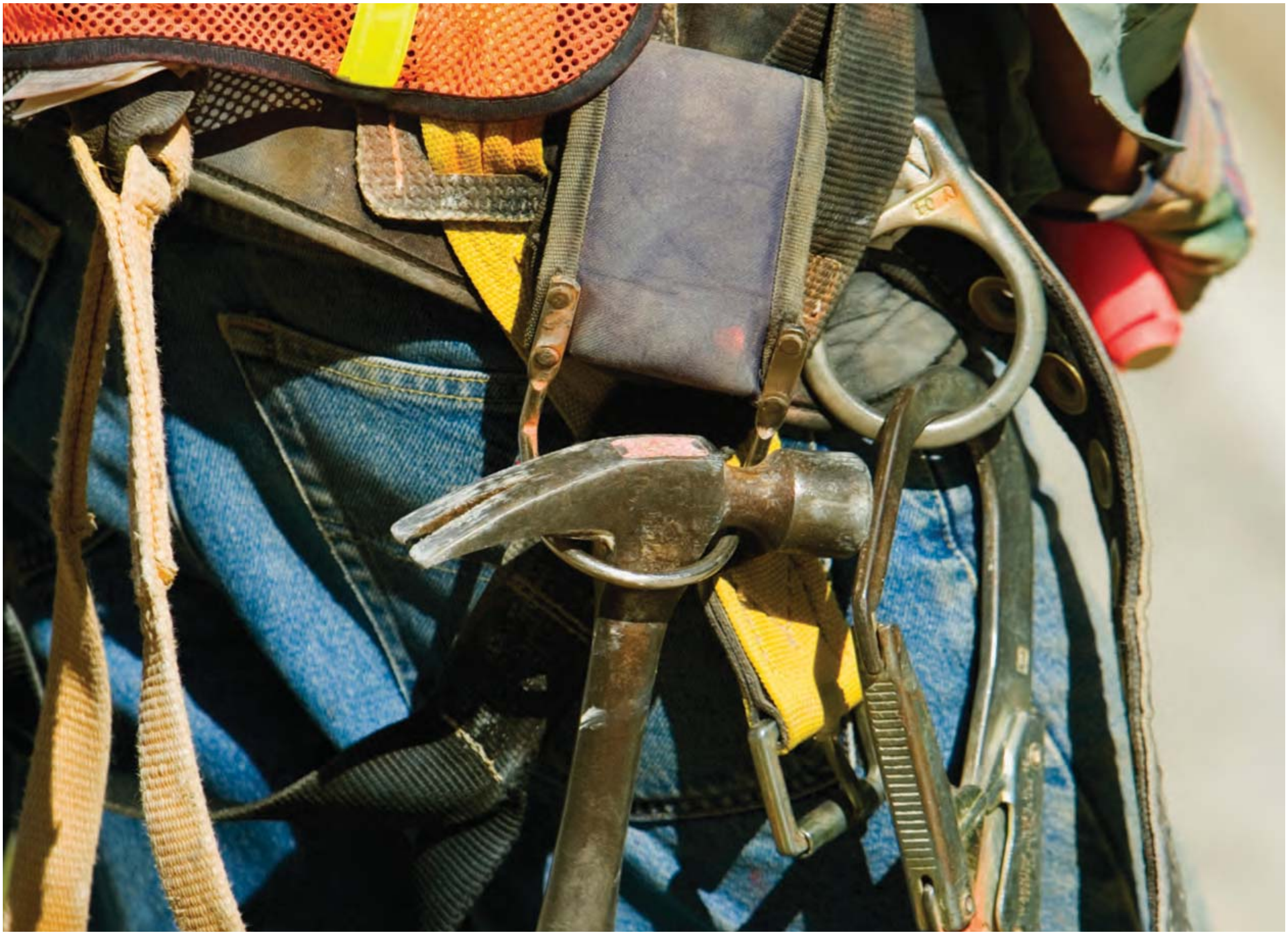
Some bond producers report the outlook for the construction industry has improved slightly compared to a year ago. "There is a greater sense of optimism among many in the industry," says Bryce Guignard, president of Guignard Company, Longwood, Fla. "Despite that optimism, I don't sense that anyone believes we are out of the woods just yet."

Adds Erle Benton, bond department manager at Cretcher Heartland, LLC, Overland Park, Kan., "Right now, contractors have more work than they did last year with a slight improvement in gross profit margins. The backlog was slightly higher, but they sure could use some more. Contractors are blowing through their backlog because it has been so hot and dry in our area of the country."

Like Benton and Guignard, most bond producers believe the tough economy has not passed. "We tell clients to cut overhead, be more selective on bidding projects with good profit margins, renegotiate with banks, make personal sacrifices and protect themselves from unknowns by requiring subcontractor bonds, double-checking financing and scrutinizing contracts," Guignard says.

GOOD WORK IS SCARCE IN MANY REGIONS

In some regions, bond producers have had candid discussions with contractor clients about their operations. "We advise our clients to spend ample time carefully considering how long they want to remain in business in this environment," says Todd P. Loehnert, senior vice president of surety



for Wells Fargo Insurance Services USA, Inc., Louisville, Ky. "Given the lack of margins and in an effort to protect their investment, some clients decide that they are not going to do work for free; they are closing their doors."

Since the economic downturn began, Lawrence F. McMahon, executive vice president/surety manager of San Diego-based Alliant Insurance Services, Inc., has coached clients to cut early and cut to the bone to survive—yet companies are still losing money. "Revenues are down, and there does not appear to be a great deal of good work coming out," McMahon says. "Construction firms have to keep lean and to resist the temptation to travel outside their comfort zone or to try new work that they have not attempted before."

Some clients are going beyond cutting overhead, according to Rich Pratt, vice president of InterWest Insurance Services, Inc., Sacramento, Calif. "In some cases, they are moving into smaller offices and selling company vehicles and unused equipment," he says.

Construction firms have to keep lean and to resist the temptation to travel outside their comfort zone or to try new work that they have not attempted before.

HOW BOND PRODUCERS CAN HELP

Across the board, clients are advised to continue keeping overhead expenses in check. "We recommend that they keep overhead expenses down as their volume and gross profit are starting to rebound. They need to recognize as much profit as they can in 2012, so they can get their balance sheet re-established," Benton says. "Some contractors are experiencing capacity issues because their balance sheet is smaller and project opportunities are starting to add up."

Bond producers also help clients by providing more strategic business information. "Conversations haven't changed much, except that we now provide leads for new banking facilities and assist in bonding or prequalifying subcontractors," Guignard says.

McMahon agrees it's his goal to keep clients abreast of the market and make any connections he can to help clients survive. "This year, I have sent a lot of interesting articles and information to my clients," he says. "I introduced several of my mechanical, electrical and plumbing clients to another client we have from another office that was coming out to work for the military."

Open communication between clients and surety partners is crucial. "We advise them to keep back-up surety markets given the ever-changing surety marketplace and encourage them to find other avenues of revenue—bonded and unbonded," says Guignard Company Vice President Paul Ciambriello.

Bond producers also have been working more with their general contractors to vet their subcontractors. "I have been setting up a staggering number of face-to-face meetings between the client and the local, regional and home office underwriters," says Stuart O'Farrell, a principal with Parker, Smith & Feek, Bellevue, Wash. "It is paramount that the underwriting arm is well aware of the client's business goals and is prepared to support the client's needs."

Adds Loehnert: "We keep clients apprised of prevailing market conditions so they can find good project partners. We discourage arrangements with owners that are not closing out work and that are known for retainage that lasts forever."

Additionally, Pratt advises clients to "keep good relations with their bank, look for non-bonded jobs if their balance sheet won't support bonded work at the level they want to bid, and consider making a loan to their company and subordinate it to the bonding company." He also uses the Small Business Administration's (SBA) Surety Bond Guarantee Program for clients who no longer qualify for standard markets.

ADVICE FOR SMALL, EMERGING CONTRACTORS

Joshua A. Etemadi, a sales manager with Construction Bonds, Inc.—a division of Murray Securus, Herndon, Va.—makes sure clients obtain as much protection as possible if they take on a risky project. "For example, one subcontractor was providing a bond for a privately financed project (with no bank financing), so we did extra research on the developer to assure it was as strong as it claimed," he says. "Also, it's good to ask for copies of the general contractor's bond to make sure it has a payment obligation in case the project goes awry."

"For contractors trying to expand their footprint or venture into a new type of project, we suggest they get involved in trade associations to help strengthen their relationships and build new ones," Etemadi adds.

CCI Surety, Inc., Golden Valley, Minn., works with non-standard accounts, such as small, emerging and minority construction firms that have had challenges. "Today, owners are not just cutting employees, but also top personnel. They also have to evaluate their lifestyles and corporate and personal spending habits," says CCI President Michael D. Williams. "Our job is to try and work them out of those problems."

CCI also spent the last two years building relationships with larger general contractors to assist with their goals of hiring Minority Business Enterprises and Disadvantaged Business Enterprises (DBEs). The company met with the SBA and Procurement Technical Assistance Center personnel to train and help minority firms become certified, as well as match large general contractors with DBEs and provide the required bonds through the SBA Surety Bond Guarantee Program.

"We advise our clients to develop an internal sales plan that may include networking by phone, joining construction organizations, developing new relationships with larger companies and using the Internet," Williams says.

With the uncertainty of the economy and of the sources of construction work through 2013, opportunities for surety bond producers to assist contractors will remain abundant.

Kathy Hoffman is director of communications at the National Association of Surety Bond Producers. For more information, visit www.nasbp.org.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How Does Your Business STACK UP?

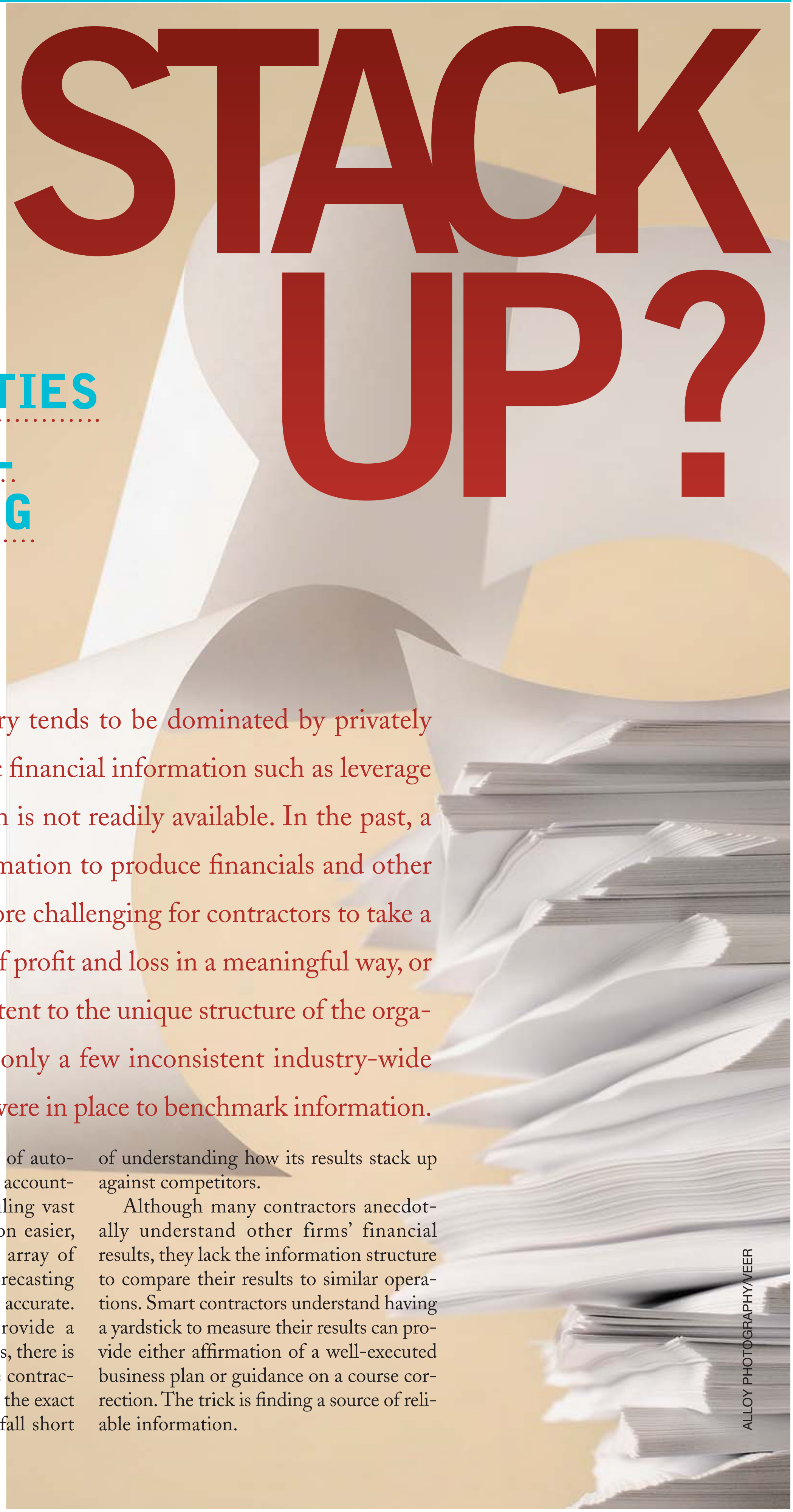
CONTRACTORS TURN TO SURETIES FOR FINANCIAL BENCHMARKING

BY JOHN COYNE

The construction industry tends to be dominated by privately held entities, so specific financial information such as leverage ratios or overhead often is not readily available. In the past, a lack of consistent automation to produce financials and other information made it more challenging for contractors to take a broader industry view of profit and loss in a meaningful way, or apply any reporting content to the unique structure of the organization. Additionally, only a few inconsistent industry-wide reporting mechanisms were in place to benchmark information.

With the continued increase of automation, and a variety of financial accounting programs that make compiling vast amounts of financial information easier, contractors now can access an array of statistics that make trending, forecasting and planning more accessible and accurate. While new reporting tools provide a clearer view of internal operations, there is still little comparative value. The contractor's financial arm could compute the exact percentage of gross profits, but fall short of understanding how its results stack up against competitors.

Although many contractors anecdotally understand other firms' financial results, they lack the information structure to compare their results to similar operations. Smart contractors understand having a yardstick to measure their results can provide either affirmation of a well-executed business plan or guidance on a course correction. The trick is finding a source of reliable information.



ALLOY PHOTOGRAPHY/VEER

To help provide more context and tailored statistics, contractors are turning to outside sources, including their sureties, to understand how they stack up against the competition.

Many sureties realize their portfolios of contractor accounts can provide a rich vein of information. When a surety assesses and evaluates financial information across its accounts of similar size and type, this pool of accounts and data can be used as a benchmark for measuring relative performance. A contractor's individual results can be run against a set of similar outcomes, making what were once flat statistics into relevant and actionable guideposts.

While most portfolios can provide a benchmark, contractors should seek a surety with a broad-based book of various-sized businesses across many diverse construction disciplines. Sureties with accounts in all 50 states and even international clients will serve to further broaden the sample.

Benchmarking can take several forms, from a basic asset and liability analysis to a more in-depth comparison of operating and net income. Depending on the extensiveness of the data, comparisons among job type, size and location are possible. All names or other descriptions are redacted so the contractor receiving the data only knows the other contractors in the pool are in the same industry, in the same territory and produce roughly an equal amount of revenue.

Reports can be specifically tailored to highlight any combination of balance sheet or income statement results.

For contractors, the benefits of a benchmarking presentation can be enormous because these reports can be specifically tailored to highlight any combination of balance sheet or income statement results. A capable surety with a properly diversified pool of accounts should be able to produce a report that takes the contractor's financial data from a broad overview down to very specific comparisons.

A surety well-versed in the numbers will be able to guide the contractor through the various ratios to highlight areas of positive achievement in relation to the group and other outcomes that may lag behind the group.

While affirmations of competitive advantages are beneficial, most contractors express greater interest in where their firms can improve. Instead of being downcast, the best managers use the information to ignite their quest for continuous improvement.

A benchmark presentation can be a provocative tool for both the contractor and the surety. For the surety, it's adding value by providing data not available through the contractor's normal channels. For the contractor, it may be the first comparison of results against a peer group. Regardless of whether it serves as an affirmation or a wake-up call, this type of valuable information can lead to a stronger understanding of how to continually raise the bar and achieve higher levels of success.

John Coyne is vice president of Construction Services, Bond & Financial Products for Travelers. For more information, call (267) 675-3134 or email jcoyne@travelers.com.



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Snuffing Out EQUIPMENT THEFT

BY BOB OPITZ

At a construction site in suburban Houston, after all the workers have gone home, a pickup truck pulls up to the poorly lit back entrance. Someone enters the site through an unlocked gate, returns to the truck with a small load of wallboard and drives off. The next day, he'll be back—to go to work.

Thieves regularly prey on construction sites and equipment dealerships—targeting building materials, tools and large pieces of equipment. These criminals, many of whom are employees, know exactly what they want and steal it with ruthless efficiency.

Equipment and materials theft is a serious problem for the U.S. construction industry. According to the National Equipment Register's (NER) August 2012 Equipment Theft Report, the estimated value of lost equipment in 2011 was $300 million. The report doesn't include additional costs incurred when a piece of equipment goes missing, such as losses from business interruption, short-term rental costs or project-delay penalties. No single organization tracks the loss of building materials, but that type of theft can add millions of dollars to the total losses incurred.

In fact, theft is one of the most serious risks contractors and equipment dealers face in terms of cost and frequency, notes the NER—and that's been true for more than a decade. The frequency and cost of equipment theft is higher than that of vandalism, fire damage, collision or water damage.

Almost 12,000 equipment theft reports were submitted to the National Crime Information Center in 2011. Nearly one-fifth of reported equipment losses were loaders, including skid steers, wheel loaders and backhoes—all relatively common pieces of construction equipment. All of the following were reported stolen in 2011: fork lifts, excavators, generators, bulldozers, trenchers and brush chippers. The theft of such large pieces of equipment might be less common than for smaller items, but when it happens, the loss is more expensive.

NER's report also notes that certain parts of the country are more at risk of equipment theft than others. In 2011, the riskiest state for equipment theft was Texas, followed by North Carolina, Florida, California and Georgia. These areas may suffer more equipment losses than others due to being near an international border or a major port, from which equipment is more easily moved beyond the reach of U.S. law enforcement. Areas in the midst of construction booms also see equipment disappear more often.

MITIGATING THE RISK OF THEFT

Each contractor has to determine an appropriate level of protection considering the value of what might be lost, but even the smallest jobsites can take simple precautions.

- **Psychological deterrence.** Contractors should make fences look secure with "No Trespassing" signs and keep sites well-lit. By themselves, these measures won't keep out an experienced thief, but they show the less-determined thief security is taken seriously on that site.
- **Barriers to entry.** A sturdy fence around the site is a good start, but a system also must be in place to ensure gates and other entry points are closed and locked so an employee cannot enter later through a gate that was "accidentally" left unlocked. Keep equipment away from fences so thieves won't be tempted to jump over and take it, or even use it to climb down the other side of the fence.

75 percent of all employees steal at least once, and half of them steal repeatedly.

- **Appropriate surveillance.** Guards can be a solution to material and equipment theft, but surveillance cameras usually are a more cost-effective option. Another option is using geofencing technology, in which a virtual zone is drawn around a worksite. If equipment that has been tagged leaves the zone, a warning is relayed to site management. The use of tracking devices on large pieces of equipment also should be considered.
- **Audit controls.** Knowing how much of a material should be used on a job—especially items like copper tubing that sell easily on the black market—and how much is actually being used is important to preventing theft. Registering large pieces of equipment with the NER also can help law enforcement identify recovered equipment.
- **Employee screening.** Sometimes the most basic screening and reference checks uncover surprising information. For instance, a reference check could reveal a job applicant stole from his previous employer, but was never prosecuted.

No site is absolutely immune to material and equipment theft. Should a loss occur, a contractor's equipment insurance policy can offer protection for equipment, tools and machinery, including spare parts and accessories that are stolen, lost or damaged. However, this policy may not protect the contractor for employee equipment theft.

Unfortunately, employee theft is much more common than many employers realize, especially during periods of economic recession. The U.S. Chamber of Commerce estimates 75 percent of all employees steal at least once, and half of them steal repeatedly. A crime insurance policy is designed to help protect companies from the costs associated with employee theft. Some policies even cover theft by part-time, seasonal or temporary employees, whom contractors often use. Contractors should consider protecting themselves with coverage obtained through their insurance agent or broker.

A construction project is complicated enough without dealing with the loss of equipment. A few safeguards can go a long way in making sure equipment and materials don't grow legs and walk away.

Bob Opitz is worldwide inland marine product manager for the Chubb Group of Insurance Companies. For more information, email ropitz@chubb.com.

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To learn more about how Hanover Surety and its knowledgeable partners can protect your business, please visit your local independent agent or, to find an agent, visit our website and click on "Find an Agent."

For many contractors, securing a surety bond five years ago was much different than it is today. Finding, choosing and sustaining the right surety partnership in today's economic environment can be a big challenge, plain and simple.

At the core of any solid surety partnership are two key pillars for success – and both are "must haves." One "must have" pillar is alignment with a strong and experienced surety company. The other "must have" pillar is an expert agent or broker who brings a wealth of experiences. Having just one without the other is like having a hammer, but no nails. You can't get the results you want with just one, you need to have both. That synergistic value the company and agent or broker can create together is more than they can each do separately; it's like 1 + 1 = 3.

To avoid surprises when bidding on a project, construction executives should form a surety partnership upfront. Key components would include:

A CARRIER WITH CAPABILITIES AND EXPERTISE

Contractors should look for insurance carriers with experience, expertise, strength, capabilities, commitment and a vested interest in your success. You and the surety are in it together so it is critical that you align with a company that is committed to working with you for the long term and in having a true business partnership with you.

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Our team delivers unparalleled local market knowledge combined with responsive service. In fact, Hanover Surety has dedicated underwriting and claim professionals located in more than 23 locations nationwide who can respond quickly to both commercial and contract surety needs.

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Still, having a strong insurance carrier is not enough without the advice of a trusted independent insurance agent with specialized industry expertise. The Hanover distinguishes itself from its competitors by creating value for clients not only through its own strengths, but through the strengths of its agent partners.

The best contract surety bond producers have an intimate understanding of the construction industry as well as knowledge of contracts and construction law. With this expertise they will help evaluate and improve a contractor's risk profile, before ever going to a carrier.

Some advice that a knowledgeable producer may offer to make a contractor a more attractive surety risk may include: reducing debt and leverage within the company; simplifying and managing the company's financial statement to demonstrate the company's financial strength; and presentation of a comprehensive business plan to demonstrate the professional nature of the ownership and management team. These are all ingredients necessary for success.

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Merchants Bonding Company is unique because our focus for the past 80 years has been exclusively on surety bonds. Unlike other insurance companies with multiple lines of business, Merchants has honed its expertise in contract and commercial surety bonding.

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Our emphasis is on net worth, including personal net worth, because it is the best reflection of a company's past success and future potential.

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Merchants places significance on the personal character of business owners. References, length of time in business and significant personal events offer insight.

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John Knox, Chairman and CEO, is justifiably proud of SureTec's accomplishments. He recounts the history:

"The SureTec management team started in the early 80's. We built Universal Surety of America (USA). USA was sold to Sam Zell's Capsure Holdings in the mid 90's, then merged into CNA Surety. It was regarded as one of the great success stories of the 80's and 90's. In 2000, we were ready to compete. We were licensed, Treasury listed, and had ample capacity. We were ready to build a new surety business. There was only one problem. One huge problem. Market conditions were awful for a new start-up. There was excess capacity in a very soft market. We made the decision not to enter the market at that time.

We considered alternative distribution models; however, we always recognized the major key to success in this business is the producers. The cycle changed, as it always does, and in 2002 our old team and producers from USA joined SureTec."

The surety business is built on trust and relationships. Many of SureTec's producers have had relationships with their clients for decades, sometimes even generations. Likewise, SureTec's underwriters have built relationships with their producers over many decades. Those relationships are a cornerstone that has made SureTec successful, which is why the company will again finish the year with over $50 million in premium.

"SureTec has traditionally written small to medium size contractors with bond needs

under $10 million; however, several years ago we increased our capacity to grow with our accounts and now have significantly increased capacity," said Mr. Knox, adding, "Now we just need a stronger construction market where our accounts need our added capacity."

As the surety industry works through various cycles, SureTec will continue to provide a superior market for its producers. It will use its relationships to write the best quality accounts; those who value having a strong consistent market.

SureTec is licensed in 48 states and the District of Columbia. Privately held, the majority of the company's key officers and directors have invested in the company, as has a strategic partner - an international insurance group that owns 20%. SureTec's financial flexibility is excellent. It is one of the highest rated, privately held, surety companies in the US.

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Lockton Puts Clients First With Construction Focus

Pictured in the photo are John Mundy (left) and Patrick Pribyl (right).

Like most of the contractors Lockton serves today, our roots are humble. In 1966, Jack Lockton, a 29 year-old surety underwriter decided to trade the security of Glens Falls Insurance for an opportunity to start his own construction-oriented agency.

It wasn't easy. Two national brokers had dominated the construction space in Kansas City for decades. They both had more experience and resources. But Jack knew why he started the business: to provide contractors with a level of service that was so extraordinary that it would not be available anyplace else. This vision, combined with Jack's unmatched passion, drove our intitial successes.

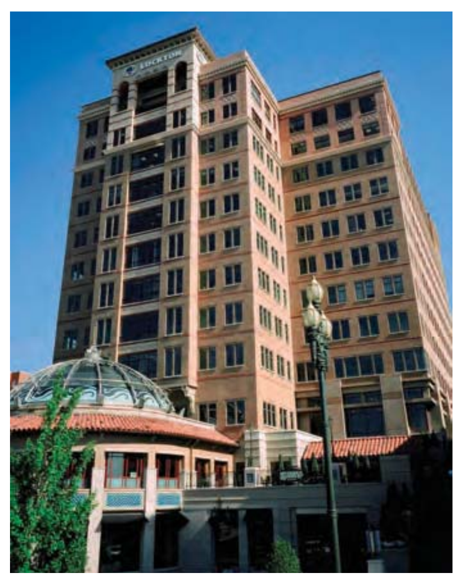
Today, Lockton's construction clients include several of the ENR Top Engineering, General Construction and Specialty Contractors. In fact, Lockton's experience with ENR Top 100 firms is substantial and growing with several new clients choosing Lockton during the past two years.

Lockton's private ownership enables us to focus on client needs instead of quarterly results. This provides clients unfettered access to Lockton's resources.

While many companies focus on innovations that improve their own productivity and profitability, Lockton is externally focused on their construction clients to develop innovative services and solutions.

There have been significant personnel changes within the construction brokerage community during this challenging economic environment. But the executive leadership for Lockton Construction Services remains stable, including Grover Simpson, John Mundy and Patrick Pribyl, all with more than 20 years of tenure with the company.

While Jack Lockton was lost to cancer in 2004, Jack's brother and Lockton Chairman David Lockton spends significant time in construction. Jack's three sons are also in the business, each with significant construction experience. Ron Lockton is President in Kansas City, Steve and Don Lockton are sales professionals. All four Locktons serve on the company's Board of Directors.



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DID YOU KNOW?

Lockton is the largest privately owned insurance broker in the world.

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Lockton has 60 offices in Asia, Europe, Middle East, North America, Latin America and South Africa.

COMPANY HIGHLIGHTS

- One of the top five brokers for surety, professional liability, and construction insurance
- More than $1.5 billion in annual construction premiums
- More than $110 million of annual surety premiums placed
- More than 300 Construction Services Associates, 70 of whom specialize in surety
- An intentional process to help connect clients with business opportunities
- Software-supported services to help general contractors prequalify subcontractors and manage downstream payment risk
- Tools for proprietary profit trending and credit modeling analytics
- Substantial ENR Top 200 client relationships

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That's why, when surety, construction and insurance companies, lenders and others require cost-effective solutions to problem-ridden construction and claims management, they often turn to the one company that began specializing in this niche back in 1989, Guardian Group, Inc.

While there was a strategic decision to focus exclusively on surety needs initially, the company's mounting successful track record and pronounced client needs dictated the addition of personnel, systems and resources. Clients would be best served, the company concluded, via four separate but interdependent departments – The Surety Group, The Construction Defect Group, The Claims Management Group and The Construction Management Group.

THE COMPLETE SOLUTION

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Guardian Group, Inc. provides the surety, construction claims and construction defect consulting services that exceed expectations.

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