IS YOUR CONSTRUCTION COMPANY

HOW TO OBTAIN, KEEP AND EXPAND YOUR COMPANY'S SURETY BOND CAPACITY

Accepting every job available is not a wise strategy. A good construction company positions itself to choose which projects to pursue.

The best contractors understand their organizations, capabilities and experience to maximize their economic returns. "We are seeing contractors being much more selective on the work they are acquiring," says Terry Lukow, executive vice president, Travelers Bond, Construction Services, "and they are using these criteria to manage their profit potential."

To capitalize on opportunities—today and tomorrow—construction companies need a strategic business plan to manage growth and risks. The professional surety bond producer and underwriter are strategic risk and risk management advisers and should be considered key partners on a contractor's business team.

"Just as you don't walk into a bank one afternoon and ask for $3 million or $4 million, you shouldn't submit a bond request for millions of dollars without having a previous commitment from the underwriter," says Michael Greer, vice president of surety, Pennsylvania National Mutual Casualty Insurance Co.

To benefit from these business partners, companies must first recognize the qualities that sureties look for in bond-worthy contractors. Then, they can see if their company matches up. Sureties look for contractors that are well managed, with consistent positive earnings histories, good accounting and estimating systems and proper controls and procedures in place to catch problems early.

"We want to see a company that has a thought-out game plan for where it is going, not a company that reinvents itself every couple of years," Greer says.

As for a contractor's financial statements, the surety looks at work-in-progress and work-completed contract schedules. Contractors also need to show a solid relationship between their liquidity level (cash, accounts receivable) and debt level, as well as a consistent and growing level of equity as a buffer between the surety and a possible loss. In other words, keep debt low and focus on retaining money in the business to support future growth.

William Cheatham, president, Zurich North America Surety, agrees that sureties like to see incremental growth, consistent results and a strong financial condition. "The contractor should make a commitment to grow its financial base (or equity) commensurate with its revenue growth," Cheatham says. "Sureties are more nervous about contractors who leverage their equity."

"Beyond performance and credit quality," adds Michael Cusack, senior vice president and managing director of surety, Aon Construction Services Group, "sureties are interested in firms with solid reputations that demonstrate an ability to generate quality internal financial and work-in-process information in a timely fashion."

The basic principles—known in the surety business as the "3 Cs": character, capital and capacity—never really change. "Sureties look for contractors with strong character and the ability to complete the work they plan on taking on and a strong balance sheet to support their business plan," says Timothy Mikolajewski, senior vice president, Safeco Surety.

BOND-WORTHY?

Sureties evaluate a contractor's financial strength by looking at net worth, working capital and whether the company has a history of long-term profitability. Henry Nozko Jr., president, ACSTAR Insurance Co., ranks experience, prior performance record and longevity and continuity of management as the most critical ingredients. "When reviewing financials," he says, "we look for availability and liquidity of assets, quality and quantity of net worth, and the quality and quantity of working capital."

Contractors also need to understand risks and make sound judgments to evaluate their risks. "It's an ability to recognize, evaluate, understand and deal with risk," says Stephen Cory, president, National Association of Surety Bond Producers and president, Cory, Tucker, & Larrowe Inc. "There are all these outside factors that you can't control—owners, weather, material prices—and you have to weigh your internal risks—finances, equipment, staff, capital. Be disciplined and selective."

To maintain and increase surety capacity, a contractor must demonstrate trust, mutual respect and accountability consistently over time. For example, contractors should provide the surety with profit and loss statements based on percentage of completion. An inflated profit and loss statement with significant profit fade by the end of the project raises a red flag, which could have a significant impact on the contractor's bonding capacity.

Open communication will result in the sureties' respect and confidence. Contractors must keep their surety informed of any potential problems, and sureties must explain their decisions and requests for information. Frequent, open communication allows both parties to understand what changes need to be made to strengthen the relationship.

The surety also needs accurate, detailed and consistent feedback on the contractor's business. As the contractor earns the trust and respect of the surety company, the surety is more likely to support additional bonding capacity.

SURETY UNDERWRITERS LOOK FOR:

- Consistent profitability and history of successful projects;
- Work experience and description of past, ongoing and future work;
- Financial statement prepared by a construction CPA;
- Comprehensive business plan, forecast and short- and long-term strategies;
- Organizational depth of leadership, accounting, estimating and project management;
- Continuity—business perpetuation plans in the event of death or loss of key personnel;
- References—subcontractors, suppliers, architects and engineers, business associates and advisers;
- Banking relationships and history;
- Type of ownership (stock, buyout, changes); and
- Disclosure of joint ventures and subsidiaries.

The Surety Information Office, Washington, D.C., is the information resource on contract surety bonds. For more information, call (202) 686-7463 or email sio@sio.org.