[SPECIAL SECTION: CONTRACTORS' GUIDE TO SURETY BONDING]

Construction EXECUTIVE

YURA BEL'MESOV/THINKSTOCK

INCLUDING THE 2014 DIRECTORY OF SURETY BOND PROFESSIONALS

11th Annual Contractors' Guide to

SURETY BONDING

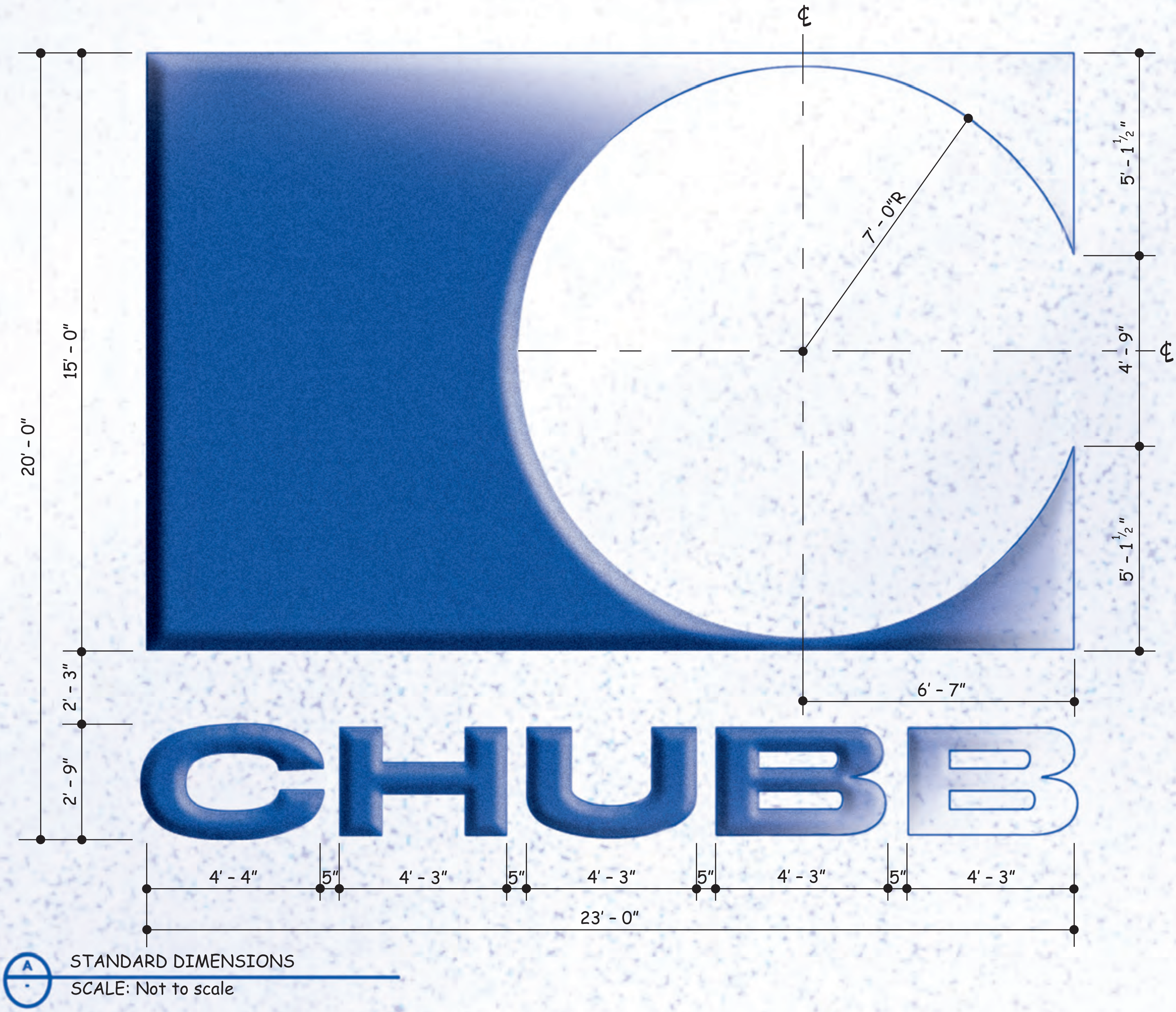

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TABLE OF CONTENTS

EVERYTHINGPOSSIBLE/THINKSTOCK

40 Surety Market Overview

44 Executive Insights

58 First-Timer's Guide to Being Bond Ready

62 Keys to Improving Small Contractors' Surety Credit

64 How Character Impacts Surety Credit

66 The Construction Recovery's Labyrinth of Risk

70 Managing Against Subcontractor Default

72 The Hidden Dangers of Expanding Markets

76 SFAA Bonding Assistance Program Spurs ABC Webinar Series

80 2014 Surety Bonding Directory & Resource Guide

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Merchants Bonding Company

Merchants Bonding Company Salutes these Surety Pros

(in alphabetical order)

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THE RUNDOWN ON CAPACITY, AVAILABILITY AND LOSSES FOR EVERY SIZE CONTRACTOR

SURETY MARKET OVERVIEW

BY STEPHANIE ROBICHAUX

POSITIVE INDICATORS ARE FINALLY STARTING TO trickle into the construction industry. The Architecture Billings Index was 53.8 in August, demonstrating an increase in demand for design services, with the highest scores in the West (54.8) and Northeast (54.4). Additionally, September construction unemployment was down to 8.5 percent, compared to 11.9 percent in September 2012. However, this drop may not reflect an increase in hiring, but rather a reduction in skilled workers who were forced to leave the construction industry during the economic downturn. Furthermore, the recent government shutdown contributed to the uncertainty regarding the future of public spending on construction and caused a huge drop in consumer confidence. The good news is that contractors that adjusted their business plans and survived the recession will find ample surety credit available to them. Surety executives advise that contractors make sound business decisions and not overextend themselves when the market improves to ensure they survive the recovery as well. >>

LIUFUYU/THINKSTOCK

CONTRACTOR SIZE (ANNUAL REVENUE)	SMALL (LESS THAN $10 MILLION)	MIDDLE ($10 MILLION – $100 MILLION)	LARGE ($100 MILLION – $250 MILLION)	MEGA (MORE THAN $250 MILLION)
Capacity	"The small contractor area is the most competitive, with many markets pushing to write these companies. Another trend in this area is the new surety markets that are set up to target this segment. Even so, small contractors seeking surety credit may need to take another look at all their expenses and costs and make adjustments. Once they know their true costs and expenses, then they can bid accordingly. It is important that they focus on smaller, quicker-turning jobs for cash flow reasons." —Lawrence F. McMahon, Executive Vice President & Surety Manager, Alliant Insurance Services, Inc., and President, NASBP	"There is ample surety capacity for well-managed middle-market contractors that are properly financed. Contractors in this category need to be sure to communicate regularly with their professional surety agent and underwriter." —Mike Foster, Executive Vice President, Merchants Bonding Company	"This is a highly sought after market by both surety agents and the national brokers. It is also a target market for virtually all of the top 25 surety companies. It is credit sensitive whereby the better credits are getting favorable terms and conditions and adequate capacity, which is often more than a contractor can use these days." —Michael Herrod, Executive Vice President / National Surety Director, Aon Risk Solutions	"Capacity has increased for the mega account segment in recent years in response to very large projects being let, the generally high credit quality of contractors in this segment, the frequent spread of risk through strong joint venture partners and profitable results by the surety industry." —Rod Williams, Executive Vice President & Chief Underwriting Officer, Liberty Mutual Surety

CONTRACTOR SIZE (ANNUAL REVENUE)	SMALL (LESS THAN $10 MILLION)	MIDDLE ($10 MILLION – $100 MILLION)	LARGE ($100 MILLION – $250 MILLION)	MEGA (MORE THAN $250 MILLION)
Availability	"Because climbing losses have caused sureties to be more deliberate, and because mergers, acquisitions and liquidations have somewhat reduced market alternatives, the availability and access to the abundant capacity is currently somewhat constrained." —Henry W. Nozko, Jr., President, ACSTAR Insurance Company	"The national sureties and many regional sureties have targeted medium size contractors in the $10 million to $100 million annual revenue range. I'm aware of about 25 bonding companies actively writing contract bonds in Arizona. Approximately one-third of these companies has the financial horsepower to adequately support medium size contractors. As an industry, bond premiums are down from prior levels. Sureties are hungry for new contractor business and have a real appetite for medium size contractors, so underwriters are actively marketing for new contractor business." —Michael D. Specht, Vice President, INSURICA	"For the most part, and especially for strong contractors, surety is relatively easy to secure. Contractors with a good track record and a strong financial statement should have no problem securing bonds from a number of qualified surety companies." —Michael J. Mitchell, Vice Chairman, The Graham Company	"Surety availability remains strong for most customers in this segment because of their financial strength and expertise, but sureties are monitoring very large projects closely because of the increased risks due to the increased use of joint ventures, growing complexity of projects, extended timeline of large projects, and increased subcontractor default risk related to the extended decline in the public construction marketplace." —Mike Bond, Head of Surety, Zurich North America Surety

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Losses	"Small-market losses have increased during the last few years and will continue to increase until the global economic structure becomes static, allowing for accurate construction spending projections for public and commercial project owners. This will allow contractors to make the decisions required to develop the financial structure needed to function as a profitable and viable construction entity." —Melissa Current, Surety Manager, First Insurance Company of Hawaii, Ltd.	"Despite modest improvements in the construction economy, we can expect loss frequency to maintain its current levels, if not increase, in the near term. Sureties will continue to experience losses where contractors are susceptible to one troubled or unprofitable job. Consequently, sureties exhibiting underwriting discipline in extending surety credit to contractors will remain profitable in the next 12 months." —Stephen Ruschak, Chief Operation Officer & Senior Vice President, The Guarantee Company of North America	"Surety industry calendar year loss activity continues to trend negatively. Our own contract portfolio remains very profitable with a similar frequency of loss activity compared to prior years, but we have experienced some increased severity in our large contractor book of business." —Doug Hinkle, Senior Vice President & Chief Underwriting Officer, CNA Surety	"Though our loss experience has been steady, elevated claim activity across our industry continues to point to the ongoing struggle contractors face coming out of this extended downturn. One thing that has become evident to us as we underwrite and meet with contractors is that adherence to sound business practices, coupled with successful field execution, remains a strong formula for success for any construction firm in any business climate." —Bob Raney, Executive Vice President of Construction Services, Travelers Bond and Financial Products

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


COMING IN MAY
BE COMING?

EXECUTIVE INSIGHTS

WHAT NEW TECHNOLOGIES OR PROCESSES HAVE BEEN INTRODUCED TO AID THE BONDING PROCESS?

RICK ALLEN

President of Surety & Fidelity Operations

Capitol Insurance Companies

Technology has been introduced at all stages of the bonding process—application, underwriting, bond issuance and billing. Either through proprietary technologies or third-party vendor solutions, sureties, particularly with respect to small-dollar transactional business, are able to obtain the application, assess the applicant's credit and issue the bond, all electronically. Even in cases of more complex transactions, technology can assist the underwriter in making an assessment by providing information and facilitating the financial analysis. Reporting the executed bond from agent to company has been streamlined so the report of execution is submitted electronically.

In the contract segment, we have added five dashboards to our systems that allow us to manage our contractors on an individual account basis, as well as on a macro portfolio basis. This includes an automated 16-variable risk rating profile and reports that show our portfolio by trade, geography, industry, financials, ratios and trends.

In the commercial segment, 32 percent of our new business and renewals are processed in our agency-facing, online decision-making engine called Capitol Express. We will soon be adding a fast-track commercial and construction contract capability. Capitol Express makes the underwriting decision instantly and prints the bond, POA and execution report in the agent's office, making it very easy for our agent partners to do business with us. If credit is poor, instead of a declination, the account is automatically referred to our non-standard program for a quote.

HENRY W. NOZKO, JR.

President

ACSTAR Insurance Company

The process of surety underwriting can be slow and frustrating for both contractors and agents. Advances in information systems are improving the process considerably. In less advanced surety information systems, underwriting data such as

financial statements might be separately maintained from another system tracking outstanding bonds, which might be separate from the claim and loss tracking system, that again might be separate from status reports and completion information.

Under the circumstances, making underwriting decisions and modifications to underwriting parameters may become a slow and tedious process. A sophisticated information system draws and collates all information together so a complete recreation of an account may be instantly reviewed on one screen at one time, based on up-to-the-minute information in all categories. Such a system can replace the slow and tedious underwriting process. Stopping to underwrite an account can be replaced with a continuing underwriting work in progress. With such an improved system, major and accurate underwriting responses can become almost immediate, greatly enhancing and improving the ability of a surety to provide timely responses to inquiries from agents and principals.

WHAT COST REDUCTION STRATEGIES AND ADVICE CAN YOU OFFER TO SMALL SUBCONTRACTORS IN THE CURRENT CONSTRUCTION ENVIRONMENT?

DOUG HINKLE
Senior Vice President & Chief Underwriting Officer
CNA Surety

Many viable subcontractors operating today implemented business plans at the beginning of the construction downturn that have enabled them to effectively manage through this difficult business cycle. These plans generally have common strategies that focus on cost reductions while achieving greater operational efficiency during periods of falling revenue and profit margins.

When we think of ways to reduce operating costs, we often focus solely on labor and fixed costs. Clearly small subcontractors would benefit from thoroughly reviewing these areas of their operations, but there is another area that warrants review: cash management.

Small subcontractors should emphasize the development of their cash management skills. Forecasting cash flow on a project-by-project basis, and for the company as a whole, will help develop these skills. A constant, disciplined focus on cash flow will lead to stronger billing and collection procedures and stronger project cash flow management. The additional cash produced from this discipline will enable the firm to take better advantage of supplier discounts and reduce borrowing costs through less bank dependency, both of which enhance profitability.

HAVE YOU SEEN AN INCREASE IN CLAIMS THIS YEAR? HOW SHOULD CONTRACTORS WORK WITH THEIR SURETIES IN CLAIMS SITUATIONS?

BOB O'BRIEN
Regional Vice President, Claims
Liberty Mutual Surety

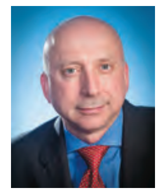
We have not seen a significant increase in claim activity this year compared to last year. However, we have seen claim activity increase in both frequency and severity during the past two to three years. This being said, we have experienced a slight downtick in the second half of 2013.

We cannot over-emphasize the need for early communication and cooperation. If a contractor has not experienced a serious claim situation, it often is not familiar with all the requests for information and documentation, especially all the inquiries about the company's financial condition. Contractors should take claims very seriously and promptly respond to their sureties with all the information requested. Contractors and sureties should be working toward a common goal: to resolve all claim issues for all parties involved in the most economical manner possible.

BOB RANEY
Executive Vice President, Construction Services
Travelers Bond and Financial Products

Our claim experience in 2013 has been fairly consistent with the previous couple of years. We continue to be impressed by the resiliency of our client base to perform in what remains a challenging environment for contractors. When claims have occurred, we typically find that economic factors are only indirect causes of the contractor's difficulties. This tells us that good business disciplines are effective survival tools even in a difficult market.

Throughout the claims process, open communication and transparency are important. This helps us fully understand the claim, determine its validity and arrive at an appropriate resolution. Parties to a surety claim, either performance or payment related, often underestimate the competing obligations of the surety to the other parties involved in the claim. We believe it is important to be responsive in claim situations, and the ability to obtain the necessary information regarding a claim is one of the most frequent obstacles we encounter.



MIKE BOND
Head of Surety
Zurich North America Surety

We have seen an increase in the frequency of loss and in the severity of loss in the middle market construction segment. The litigious nature of society and the problems with the financial capabilities of public owners is leading to increasing friction. We recommend that contractors choose to do business with a surety that has an experienced, in-house claims department. We also recommend that contractors have an open line of communication with their surety in order to access the substantial experience the claims staff can deliver.

It is vital to get the claims team involved early on if problems arise. The mistake that some construction firms make is they only reach out to the claims team when it is too late for the surety to have a positive influence on the situation. The surety claims team has access to substantial in-house resources, as well as specialized legal expertise from the best independent counsel available. This value-added service has proven invaluable to many contractors as they face complex, challenging situations.

RICK CIULLO
Chief Operating Officer
Chubb Surety

Surety claim activity is a point-in-time metric. The real story is surety loss activity, which is up significantly in the industry. According to The Surety & Fidelity Association of America, during the six quarters ending June 30, 2013, the direct loss ratio of the U.S. surety industry increased seven points to 21 percent compared to year-end 2011. This translates

into a combined ratio (claims payments and related expenses, minus recoveries) of 75 percent. Three insights from this trend are worth noting. First, this is a 50 percent increase in a relatively short period of time. Second, several surety companies' loss ratios have deteriorated much more quickly than this. Finally, when considering an average industry expense ratio of nearly 50 percent, the industry is not covering its risk-adjusted cost of capital.

If the loss ratio continues to increase, less capital may be allocated to the surety industry, leaving contactors with too little surety capacity to support their business plans. Contractors in this environment may face different challenges, each leading to different strategies.

- For a contractor that is struggling and may be the source of a surety claim, communicate early and openly with your surety about the source and depth of the problem. Business problems seldom get better with time, and first options are often your best options.
- For a contractor that has bonded a struggling subcontractor, notify the subcontractor's surety early. Help them understand and figure out ways that might solve the problem with minimal disruption to your job and your company.
- For healthy contractors that expect to need more surety capacity as the economy recovers, choose a surety with a portfolio that is healthy and loss ratios that have remained low throughout the business cycle. These are the ones best able to make and keep commitments to support your business.

STEVE DORENKAMP

Vice President, Claims Manager

Merchants Bonding Company (Mutual)

The overall economic downturn of the past five years has not led to the loss cycle that many predicted. While there always has been surety capacity for the small to middle-sized contractors, we have seen the surety industry implement sound underwriting principles in anticipation of this downturn. One factor contributing to this avoidance of major claim activity may be due to the fact that a number of contractors failed because of lack of work. With major government budget reductions, the amount of work available was limited. Thus, contractors were forced to compete among a large pool of available bidders and trim margins to a dangerous level. When there was a contractor failure, the large backlog was not present.

It is not only essential for the contractor to communicate with the surety during the claims process, but also to include its professional bond producer in this process. In today's fast-paced environment—with the advancement of technology and more complex construction projects—open communication is expected as the new norm. This open communication may even allow the surety to assist prior to a declaration of default or termination. The surety has an obligation to multiple parties, but has tremendous resources available to mitigate damages, including financial support to provide relief to a stressed contractor.

LAWRENCE F. McMAHON

Executive Vice President and Surety Manager

Alliant Insurance Services, Inc.

President

National Association of Surety Bond Producers

Due to the length and severity of this financial slump, our industry has been bracing for contractor failures. For several years, we have been saying that the losses are coming, but we have not seen the frequency or the failures we expected. The losses have been smaller than we anticipated for both general contractors and subcontractors. In most cases, they have just run out of work. There have been payment claims and small performance claims; however, this has not been to the extent we expected. Several major sureties have been cleaning up the reserves they set in the middle to late 2000s, so that impacts the numbers, as well as the fact that other sureties are using Incurred But Not Reported Reserves (IBNR) to do the same thing. Each surety has its own philosophy on this.

With most economic downturns, the failures and surety losses will come when firms are climbing out. As work becomes available, the margins for the next year or two will still be lower than normal because contractors will be aggressive about trying to build their backlog. The issue with this is that they will need cash or bank support to finance that work, and without that, they could experience cash flow issues. The survivors of this period have cut expenses and costs, and they will need to continue to be patient and disciplined as the economy recovers. Once the aggressive bidding cools down, contractors' margins and profits will increase.

STEPHEN RUSCHAK

Chief Operating Officer & Senior Vice President

The Guarantee Company of North America

Overall, we have not seen an increase in claims activity in 2013. While profit margins have not increased across much of the country, we are starting to see pockets of improvement. Most contractors deserving of bonding support have largely avoided the various obstacles that can negatively impact their operations and balance sheets.

The earlier a contractor can advise its surety of a potential claim situation, the more alternatives the surety can offer. Contractors also should understand that sureties must follow regulatory requirements regarding claim investigations. A collaborative relationship between the contractor and surety can help both parties resolve tough claims situations more efficiently.

MICHAEL J. MITCHELL

Vice Chairman

The Graham Company

We have seen an increase this year and I believe most sureties have as well. As a result of this increase in claims, there is certainly an added administrative workload that is required of the contractor. This can be burdensome for contractors that might not be anticipating the surety's requests for detailed information. Contractors must be patient with their surety and should remember that surety companies are required by law to handle claims using "good faith" principals. As a result, they are forced to collect as much information as possible so they can defend their contractor clients without concern for "bad faith" allegations. This is today's protocol, and the contractor must accept this as standard operating procedure. Contractors will have a greater chance for success with their surety if they are prepared to share detailed documentation and information.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ROBERT THOMAS

President – Surety

The Hanover Insurance Group, Inc.

We haven't seen dramatic changes in frequency. However, in this uncertain economic environment, claims are surfacing that have challenging elements but that can be mitigated by a proactive and thorough partnership approach among the contractor, its surety and the agent.

Three key things improve a contractor's chances of a successful outcome:

- a financially strong insurer with surety expertise in both underwriting and claims;
- a contractor committed to comprehensive management practices; and
- an agent or broker possessing surety experience and expertise.

Know the surety carrier well. Contractors should feel satisfied that their surety possesses in-house expertise and does not follow a cookie-cutter approach. Seek an experienced surety carrier that will treat you uniquely and wants a long relationship. Following are more tips based on more than 100 years of working with contractors.

- Carefully document affirmative and defensive claim matters at least weekly. Be aware that an owner or general contractor is likely doing the same. Make sure your documentation is solid. Most outcomes are driven by documentation, not the alleged facts.
- Provide timely transparency. Raise issues to your agent or broker and surety early; have command of the issues involved and a strategy for addressing them.
- Collaborate with your agent or broker and your surety carrier's underwriting and claims teams so everyone understands the issues and is prepared to address them. This is important for smaller matters as well as larger issues.

MELISSA CURRENT

Surety & Fidelity Manager

First Insurance Company of Hawaii, LTD

Both performance and payment bond claims have significantly increased during the last 12 months due to a decline in the effectiveness of the contractor's internal controls and lack of ability to adjust to the economic hardships of the last few years; a decrease in project awards; and significant payment delays—from both the project owners and general contractors/prime contractors.

Contractors should involve their sureties immediately in all claims and potential claim situations. Once it has become clear to the key staff of the operation that the financial structure of the company has been negatively impacted, or there is a breakdown in communications with the obligee, subcontractors, suppliers and/or laborers, the contractor should advise the surety agent and surety. Involving the surety as early as possible ensures the most effective mitigation of contractor loss possible. While the surety is not a construction company, it is well-versed in the construction industry and has the ability to intercede and help restore effective communication between the parties and exponentially decrease the potential of large claims by addressing the financial aspect of completing bonded projects.

MICHAEL D. SPECHT

Vice President

INSURICA

Bond underwriters seem to agree that losses have continued from 2012 into 2013. Subcontractors and suppliers are quicker to file bond claims during these tougher times. There is increased claim activity; the majority of them are disputes that get resolved and not full-blown contractor failures.

If you are a prime contractor and you are aware that a subcontractor or supplier will be filing a claim, notify your bond professional. Sureties do not like surprises, so a heads up about the matter and a game plan for resolving it will go a long way with the bonding company.

If the claim is more serious, notify your bond professional as soon as possible so the surety's claims personnel can assist. Most claims professionals are experts in performance and payment challenges, so their prior experiences will be of assistance in working through claims. I have experienced situations in which bonding companies successfully assisted contractors through significant bond claim situations and the contractors are still in business today.

MICHAEL HERROD

Executive Vice President

National Surety Director

Aon Risk Solutions

At Aon, we have seen an increase in claims activity through the first nine months of 2013. While surety companies understand that claims will arise during the course of construction, they rely on open communication and detailed documentation from their clients in order to properly administer their claims handling processes. Contractors should have consistent processes and procedures in place for dealing with claims and should share these with their surety providers on a routine basis. Once a claim arises, contractors should ensure they communicate the nature of the claim and the steps being taken to properly deal with the situation with their broker and surety company and provide all relevant documentation. Transparency and a consistent approach to claims handling will serve all contractors well and ensure they are properly aligned with their surety providers when claims arise. Contractors also should align themselves with experienced claims counsel, and can utilize their surety to provide recommendations on qualified claims attorneys throughout the country.

CONSTANTIN POINDEXTER

MGA, Chief Underwriter

Surety One, Inc.

There are many vital decisions to be made when presented with a claim. The quality and timeliness of those decisions and the actions taken based on those decisions can be severely crippled by a lack of clear information. Honest, detailed and correct situation reports must be obtained from the parties to the bond and the underlying contract.

Interpersonal communication is an art in many ways. Not everyone responds positively to a particular claims specialist's manner. Specialists should be aware of this and, when necessary, vary their approach. Obviously the goal is to acquire a profound understanding of the underlying problem, but you can't get there by offending the parties from whom you require cooperation. Attitudinal and cultural barriers can effectively end a conversation if not handled properly, and, in many cases, definitively close the door to further cooperation

from a contractor in working through a remediation.

The adage, "treat others as you wish to be treated," is appropriate to remember during the claim investigation. Throughout the timeline of a claim, quality communication always dictates the success or failure of the process.

EDWARD TITUS
Senior Vice President, Surety Division
Philadelphia Insurance Companies

We believe all successful businesses design and maintain thorough business plans and strategies for the current year and following fiscal periods. The plan should reflect the types and size of projects on which the company is focused, as well as the resources required to profitably prosecute that work. Generally, projects should characteristically be within the scope of prior projects where the company has a track record of success. Contractors should target owners and general contractors they believe will be fair and equitable in their approach to project management and expectations of performance. A combination of a sound business plan and strategy with a positive track record will be very valuable in developing an excellent banking and surety relationship.

Project management and risk assessments are areas that require continuous improvement. Initially, place strong emphasis on the value of good project estimating. Here's an area where good contractors invest in time, talent and systems to avoid "buying a job." Perform a detailed contract review and overall scope assessment. Focus on key terms and conditions, including payment, liquidated damages, default and warranty provisions. Set definitive goals and expected results and consistently measure performance as the job progresses.

Maintaining appropriate cost levels requires monthly review of your operations. Stay focused on your plan and adjust it as required to maintain appropriate margins. Identify underperforming assets and selectively sell or lease them.

JACK A. CALLAHAN
Partner/Construction Industry Practice Leader
CohnReznick

Despite the economic downturn of the past several years, it seems like many contractors have been holding their own. However, research shows that construction contractors are three times more likely to fail in a recovery than in a recession. The reason: In a recovery, many contractors overextend themselves financially while taking on too much risk as they look to rebuild their businesses.

For this reason, we recommend that contractors keep a tight watch on the bottom line and put a system of controls in place to help ensure they don't fail during this recovery. For contractors that find themselves in a claim situation, we can't reiterate enough the importance of early and regular communication with your surety company. Contacting your surety claims personnel at the onset of a claims situation can provide them with the opportunity to assist you in putting together a project recovery plan or in looking for ways to help you get the project back on track with as little time lost as possible.

Each circumstance entails its own set of challenges that require time and expert advice in order to complete. Depending on the potential implications of the claim, it may be beneficial to enlist the guidance of an outside advisor in the accounting or legal field.

During this process, as taxing as it may be, the key is to keep the big picture in mind. In the end, it will benefit everyone to find as clear and sensible a resolution as possible.

ELIZABETH DORFMAN
Partner
Watt, Tieder, Hoffar & Fitzgerald

We have not seen an increase in claims this year. With regard to how contractors should work with sureties in claims situations, the interest of the surety and contractor usually are aligned. With regard to subcontractor claims on a payment bond, the surety obviously only wants to pay a claim to the extent it is meritorious. The contractor should provide the surety with the relevant information to properly investigate and make a determination on the bond claim. Similarly, with regard to performance bond claims, the surety needs the pertinent information from the contractor to investigate and determine the merits of any claim and relatedly appropriate defenses.

To the extent the contractor has affirmative claims against an obligee, again both the surety and contractor benefit from ensuring the claim is appropriately considered by the owner/obligee. The contractor should be mindful of its obligations under the indemnity agreement, and from the outset take steps to mitigate the exposure to both the surety and the contractor. In the end, the contractor will be better served if it cooperates and forges a good working relationship with the surety.

WHAT ARE YOU SEEING IN TERMS OF CONSTRUCTION/ECONOMIC ACTIVITY FOR 2014 AND WHAT IMPACT COULD THAT HAVE ON SURETY?

WHIT McGRAW
Americas Market Leader
S&P Capital IQ

Gathering information from S&P Capital IQ, S&P Ratings, McGraw-Hill Construction and S&P Equity Research, we are generally seeing an uptick in new construction projects, specifically in the transportation sector. This trend suggests demand for surety bonds in 2014.

New projects across the country are fuelling this, including the Washington, D.C., area's $6.8 billion Metro Silver Line project, with phase one service commencing next year; the $2.5 billion LaGuardia Terminal replacement project; Florida's I-4 project; and many more.

Maintenance funding also is a large part of construction going forward. Putting it into perspective, there are roughly 4,000 to 5,000 miles of toll roads in the United States, accounting for only about 10 percent of all roads in the country. The rest must be funded in order to be maintained. This may provide an opportunity for surety producers. Another positive indicator is there are roughly twice as many public-private partnerships than there were in 2009. And given the long lead time of major construction projects, the current economic conditions, like rising interest rates, are not likely to change the 2014 outlook.

In closing, new construction projects coming online could bode well for the surety marketplace in the coming year.

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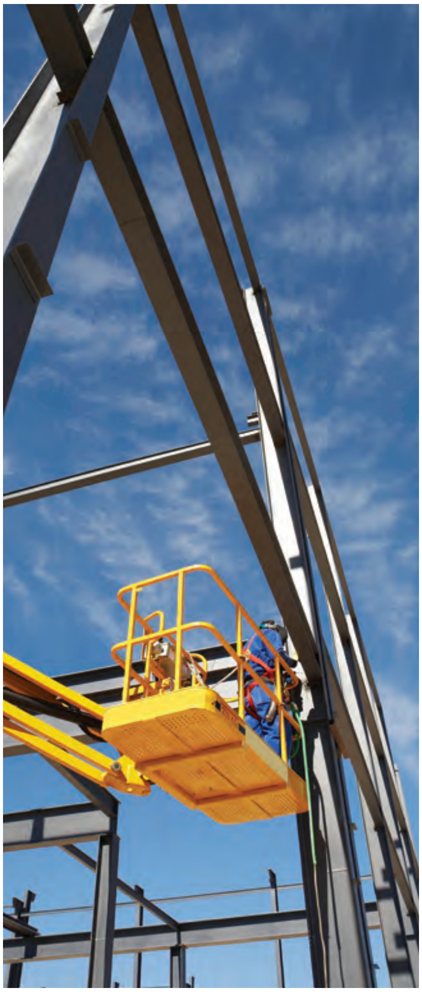

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- Our domestic U.S. operations provide industry-leading capacity for well-capitalized and liquid construction, manufacturing, and supply risks.
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Liberty Mutual Surety works closely with Liberty International Underwriters (LIU), Liberty Mutual Insurance's specialty lines insurer. LIU brings knowledge that's unmatched in the industry – allowing us to focus on complex projects. We collaborate across product lines, resulting in superior service.

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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 www.hanover.com 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 should 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.

The Hanover is a leading surety writer in the United States. Backed by its 100-year history of writing contract surety and its "A" rated financial strength, The Hanover adds value by offering one of the most experienced and talented underwriting teams in the business.

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 15 locations nationwide who can respond quickly to both commercial and contract surety needs.

The Hanover's underwriters can provide a surety program tailored to a contractor's needs. Hanover Contract Surety will help guarantee performance with a comprehensive contract surety bond.

AN AGENT THAT ADDS VALUE

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.

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.

The Hanover is a leading surety writer in the United States. Backed by its 100-year history of writing contract surety and its "A" rated financial strength, The Hanover adds value by offering one of the most experienced and talented underwriting teams in the business.

FIRST-TIMER'S GUIDE

To Being Bond Ready

BY MELISSA CURRENT

While surety bonds have been required by federal, state and local governments on construction projects for decades, today's economic climate is driving the private sector to require performance and payment bonds, as well as compelling general contractors to require bonds from their subcontractors. As such, it's important for unbonded contractors to start the bonding process well in advance so they don't miss out on an opportunity to bid on a bonded job in the future.

BONDING BASICS

Project owners, general contractors and prime contractors (obligees) require surety bonds on construction projects to protect against contractor failure. The surety underwrites the character (reputation), capacity (experience) and capital (financial structure) of the contractor in conjunction with the particulars of the project in question. By providing a bond, the surety is stating its opinion that the contractor has the respect of the construction industry, as well as the experience and financial structure to execute the project being bonded. The surety is promising that if the contractor fails to execute a bonded project according to contract terms and conditions, the surety will protect the obligee by:

- completing the project;
- finding another contractor to complete the project for the obligee; or
- paying the obligee the difference between the remaining contract funds and the cost to complete the project.

The surety works with the contractor as a business partner. The surety provides bid bonds that enable the contractor to compete for construction projects requiring bonding and final bonds (performance and payment) to meet project award requirements. The surety also reviews contract terms and conditions and works with the obligee to address any onerous language in bonded construction contracts. Additionally, the surety can provide the contractor with advice on business practices that result in a profitable and viable operation and information about what causes contractor failure.

The contractor, insurance/surety agent and surety form a business partnership. The insurance/surety agent is key to building and maintaining the surety relationship, as the agent will know the characteristics of both parties—pairing the contractor with the surety that will best meet the contractor's needs (e.g., the size of bonds and overall bond program required) and personality.

INFORMATION GATHERING

The information a surety will require from the contractor is exactly what a contractor would require from a potential business partner: a complete understanding of the overall business operation; details regarding internal controls (accounting and estimating software, processes and procedures regarding accounts payable and accounts receivable, job costing detail and review, etc.); financial reporting (internal and CPA); and completed projects (size, scope, estimate as compared to final contract price and profit, project owner/general contractor/prime review of project, etc.). Simply put, the surety will assess that the contractor has:

- a strong, respectable reputation in the construction industry;

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- the experience, equipment and labor force to execute the full scope of work under contract or the ability to manage subcontractors and suppliers; and
- the financial structure to cash flow the project being considered.

To begin the underwriting process, it is recommended that the contractor provide the surety:

- credible business and personal financial statements (current and for the last three fiscal years);
- a list of references from general contractors, subcontractors, suppliers, architects or project owners;
- a formal business plan, including the current and projected direction of operations, the size and scope of projects on the horizon, and future goals;
- a formal continuity plan that lays out who will be responsible for completing open projects should key management be unable to operate the business, as well as how this individual or entity will be financially compensated and whether the operation will run in perpetuity or be shut down once all open projects are completed; and
- surety program expectations, including the largest possible size of a single contract wherein a bond may be required in the next 12 months and total backlog the contractor may possibly have in the next 12 months.

RELATIONSHIP BUILDING

To become bond-ready, begin by talking with an insurance/surety agent. If the company's insurance agent is not well-versed in surety, the agent will provide an introduction to an agent that will focus solely on the firm's surety needs, while the original agent continues to handle its insurance needs. The surety agent will work to understand the company and its business plan, as well as help anticipate possible surety needs. The agent will help prepare the information required by the surety, and will know which surety will be the best fit for the company.

Next, talk with the company's CPA. Most construction-savvy CPAs know the surety industry and the financial information required by the surety company. The CPA will help assemble a complete financial package for the surety, one prepared internally and one by the CPA. The CPA also can advise on any changes that may be required to the company's current financial structure.

Finally, talk to industry peers to gain other contractors' perspectives on the surety relationship. Contractors that typically perform public works projects have an established surety relationship in place. A local general contractor or prime contractor with which the company has an established relationship would be a good resource on experience with surety bonding and all it entails. Following are some questions to begin the discussion.

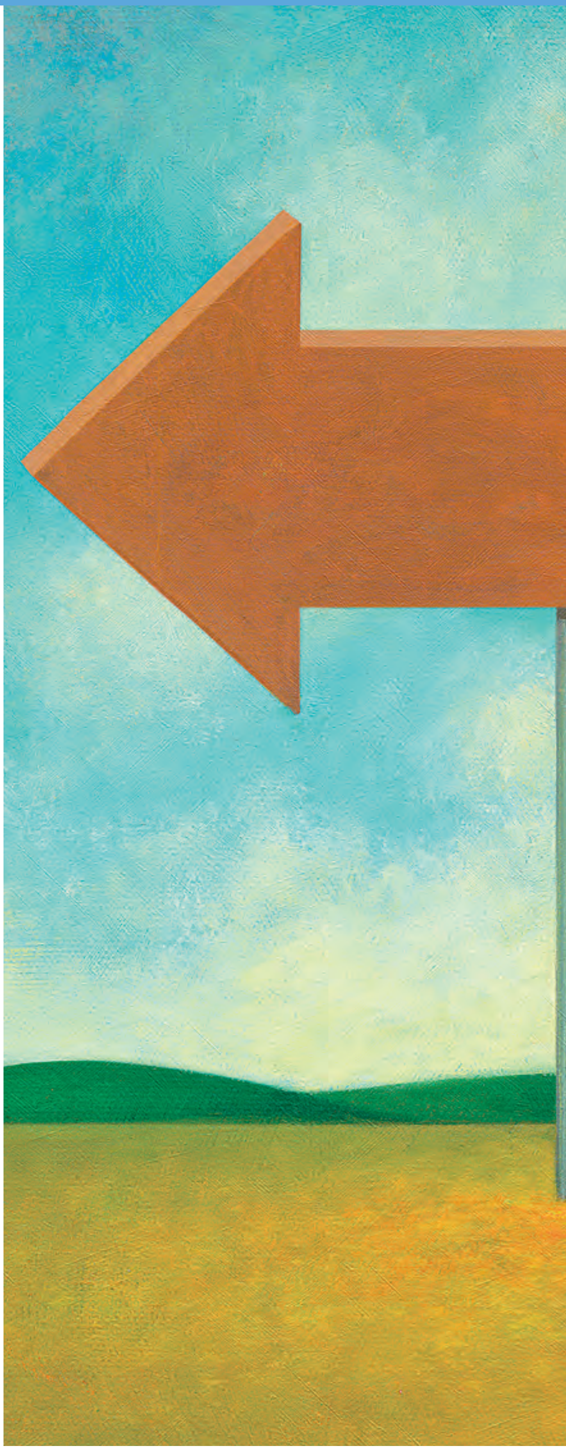
- How long have you been with your surety?
- What type of information do you have to provide each year?
- How often do you meet with your surety?

While establishing a surety relationship is neither quick nor easy, maintaining it is simple: Treat the surety as a valued business partner and the company will have the surety support it needs to grow, remain viable and be profitable.

Melissa Current is surety & fidelity manager at First Insurance Company of Hawaii. For more information, email melissa.current@ficoh.com.

KEYS TO *Improving Small Contractors'* SURETY CREDIT

BY KATHY HOFFMAN



GEORGE SCHILL/ILLUSTRATION SOURCE

"Being in business today is not any easier than it was in the past, and some would say it is more difficult, but securing surety bonds for small contractors can be done relatively easily presuming they have good personal and corporate credit," says Erle Benton, bond department manager at Cretcher Heartland, LLC, Overland Park, Kan.

Small contractors can take the following steps to obtain or improve their surety credit and ultimately qualify to compete on more projects.

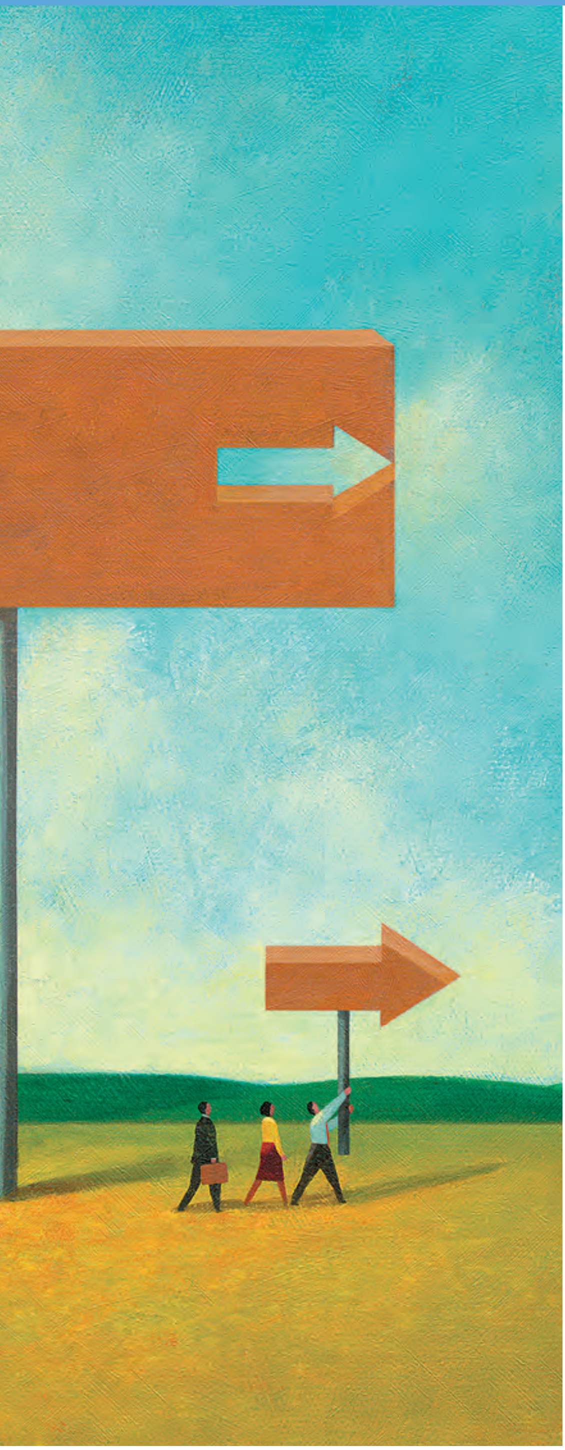
BUILD A TEAM OF SURETY PARTNERS

It's important to build a team of trusted surety partners that includes a construction CPA, surety bond producer, banker and attorney. "You must surround yourself with professionals who you can trust and who are looking out for your best interest," Benton says.

Working with a construction CPA helps assure the construction company has quality financials. "If you want to be successful and maximize your surety bonding capacity, you should establish a relationship with a good construction CPA," says Todd P. Loehnert, managing director for Pinnacle Surety of Kentucky, Louisville.

A construction CPA also will help monitor projects. "The obvious benefits of being represented by a good, quality construction-oriented CPA are the credibility with the surety and good business guidance and direction. But equally important is that a CPA helps you implement the appropriate job cost accounting system that will enable you to know where you are on each project to identify issues and adjust quickly to affect positive change," says Susan Hecker, area executive vice president at Gallagher Construction Services, San Francisco.

Additionally, choose a trusted, professional surety bond producer. "A professional surety agent does more than provide bonds; the agent is a trusted advisor who can help with various aspects of your



business, such as providing reference checks on general contractors, project owners and subcontractors; assisting in managing the company balance sheet to meet the surety's expectations; and recommending a construction CPA, banker or attorney that fits your company's needs," Benton says.

LEARN HOW SURETIES CALCULATE CAPACITY

Contractors should be familiar with how surety companies assess capacity and prequalify.

"Small contractors need to be aware that if they pay cash for fixed assets, it will impact their surety credit," says Jim Phillips, Jr., a CPA at Phillips & Associates, Lubbock, Texas. "The idea of being debt free is great, but if it also means not having any working capital, it can be disastrous to the company."

IMPROVE THE COMPANY'S FINANCIAL PRESENTATION

Another step a small contractor can take to obtain or enhance its surety credit is to improve the construction company's financial documentation and presentation.

"Improved internal and external accounting procedures and presentations can have a significant impact on one's surety bond credit," says Chad Martin, bond agent at TIS Construction Division, Knoxville, Tenn.

Adds Loehnert: "The CPA can help you prepare throughout the year so your presentation maximizes your bondability."

Carl Dohn, Jr., president of Dohn & Maher Associates, Palatine, Ill., recommends upgrading from a compilation to a review or from a review to an audited fiscal year-end statement. "Be on a percentage-of-completion basis with full supporting schedules, especially cash flow, work in process and completed contract schedules," he says.

Additionally, prepare internal financial statements with under/overbillings. "Most small businesses operate on a cash or accrual basis without the knowledge that under/overbillings can help a contractor's statement look significantly better," says Joshua A. Etemadi, sales manager with Construction Bonds, Inc.—a division of Murray Securus, Herndon, Va.

BOOST THE COMPANY'S WORKING CAPITAL

"During times like these, every job is important, so having as much working capital as possible is vital," Etemadi says. "If you have maxed out your bank line of credit and are having a hard time paying it down, consider converting it to a long-term loan. By terming out the loan, you will be able to free up a significant amount of working capital on your balance sheet."

If a firm doesn't have a bank line of credit, it should obtain one. "Some markets allow you to stretch on deals with the knowledge you have a bank line; the U.S. Small Business Administration can count it as additional working capital," Etemadi says.

Lourdes Landa, surety manager and assistant vice president at BB&T Insurance Services of California, Inc., Fullerton, also suggests contractors "obtain a home equity line of credit for emergency capital and maintain good personal credit."

According to Lawrence F. McMahon, executive vice president/surety manager of San Diego-based Alliant Insurance Services, Inc., going after larger work hurts because it eats up working capital when starting the job. Instead, he suggests seeking smaller projects that can be completed over a shorter period of time for solvent owners. "Bill at least how much you've earned or more, as this will help decrease underbilling and could increase overbillings to the point where the work finances itself," McMahon says.

REINVEST IN THE BUSINESS

Once contractors are profitable, they should reinvest in the company.

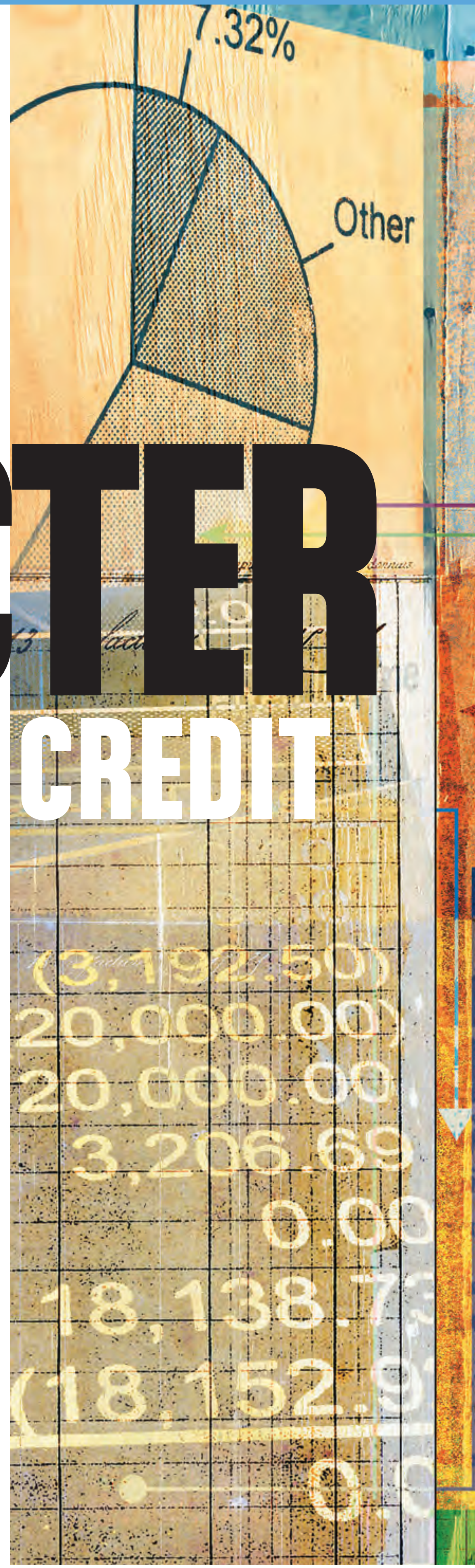
"Many contractors reward themselves with big salaries and pull money out of the business," Hecker says. "Contractors that resist the temptation for a big payday and retain the profits in the business will be the companies sureties will stretch for when new opportunities arise to grow the business."

In addition, reserve funds to address larger problems. "Bigger projects have bigger problems, so prepare for them," Hecker says. "Smart contractors will build their loss-paying power in the business to ensure they will be able to work their way through the issues inherent to the construction business."

Kathy Hoffman is director of communications at the National Association of Surety Bond Producers. For more information, visit www.nasbp.org.

To find a surety bond producer, visit the "NASBP Find a Producer Directory" at www.nasbp.org. To find a construction CPA, visit the "NASBP Find an Associate Directory" at www.nasbp.org or go to the Construction Industry CPAs/Consultants Association (CICPAC) website at www.cicpac.com.

HOW CHARACTER IMPACTS SURETY CREDIT



BY GEOFF DELISIO

Forming a fact-based assessment of the character and capacity of a contractor's leadership team is one of the most challenging areas of surety underwriting. These highly nuanced characteristics are difficult to assess with daily interaction, much less during an annual two- or three-hour meeting. Due to this limited window of interaction between the surety and contractor, even minor points can grow to carry meaning beyond their actual weight. However, a contractor can highlight several areas that will be helpful to the surety's assessment.

ROY SCOTT/ILLUSTRATION SOURCE

Presenting a thoughtful business plan at an underwriting meeting is a key way to give the surety underwriter a greater level of insight into the contractor's character and capacity. The business plan does not need to include a PowerPoint presentation with graphics and charts. It can be as simple as a conversation outlining the contractor's approach to the marketplace, its response to challenges in the firm's operating territory and a high-level view of financial goals for the upcoming year. Following are key items on which an underwriter will focus.

- **Reasonableness of strategy.** Construction is a challenging business that requires a certain level of optimism for success. However, a firm's business plan should be realistic and take into account how market conditions may affect its business in the future. Specific economic trends (e.g., interest rates, government spending or housing starts) that impact the contractor should be assessed in the plan. The surety will assess its overall reasonableness in conjunction with the contractor's marketplace. A business plan calling for 40 percent revenue growth in a constricted market may be aspirational, but most likely should not be part of the current year business plan. For a contractor that has a large amount of business with a state's Department of Transportation, the firm's strategy should take into account the upcoming funding cycle.
- **Alignment of business operations and the business plan.** If the contractor is engaged in highly competitive work, such as public school construction, then the firm's operations likely should be aligned around a competitive cost structure. In the case of a contractor that is in a position to be selected for several jobs in the upcoming year, thereby increasing its revenue, there should be a discussion of resources (cash and equipment) needed to start the projects. In short, the surety will assess if the pieces of the puzzle fit together to support the overall plan.
- **Thoughtful expansion into new markets.** Diversification through geographic and market expansion can provide long-term benefits if contractors take a thoughtful approach to this strategy. The same diversification strategy that is executed poorly and focused on the short term can lead to financial ruin. The surety underwriter will look to see if the expansion plans include learning about owners and subcontractors in the new area, the competitive landscape and the operational controls needed. The underwriter will have concerns if the first project in a new geographic area or market is the contractor's largest to date, or if it will be run by a new employee.

Another way a contractor can meaningfully impact the surety's assessment of the company is by following the simple adage "do what you say and say what you have done." When assessing a contractor's character, the underwriter focuses on honesty and integrity, as well the commitments the leadership team makes during a meeting. The commitment may be related to an action a contractor can take to reduce overhead or that a project will hold its current profit level during completion. In both examples, the contractor may be overly optimistic and unrealistic, which will make the meeting with the underwriter positive, but guarantees the next several meetings will be challenging. A more advantageous approach would be for the contractor to discuss the potential outcomes, drivers of those outcomes and items that depend on those outcomes. The contractor can use these opportunities to build trust and creditability with its underwriter.

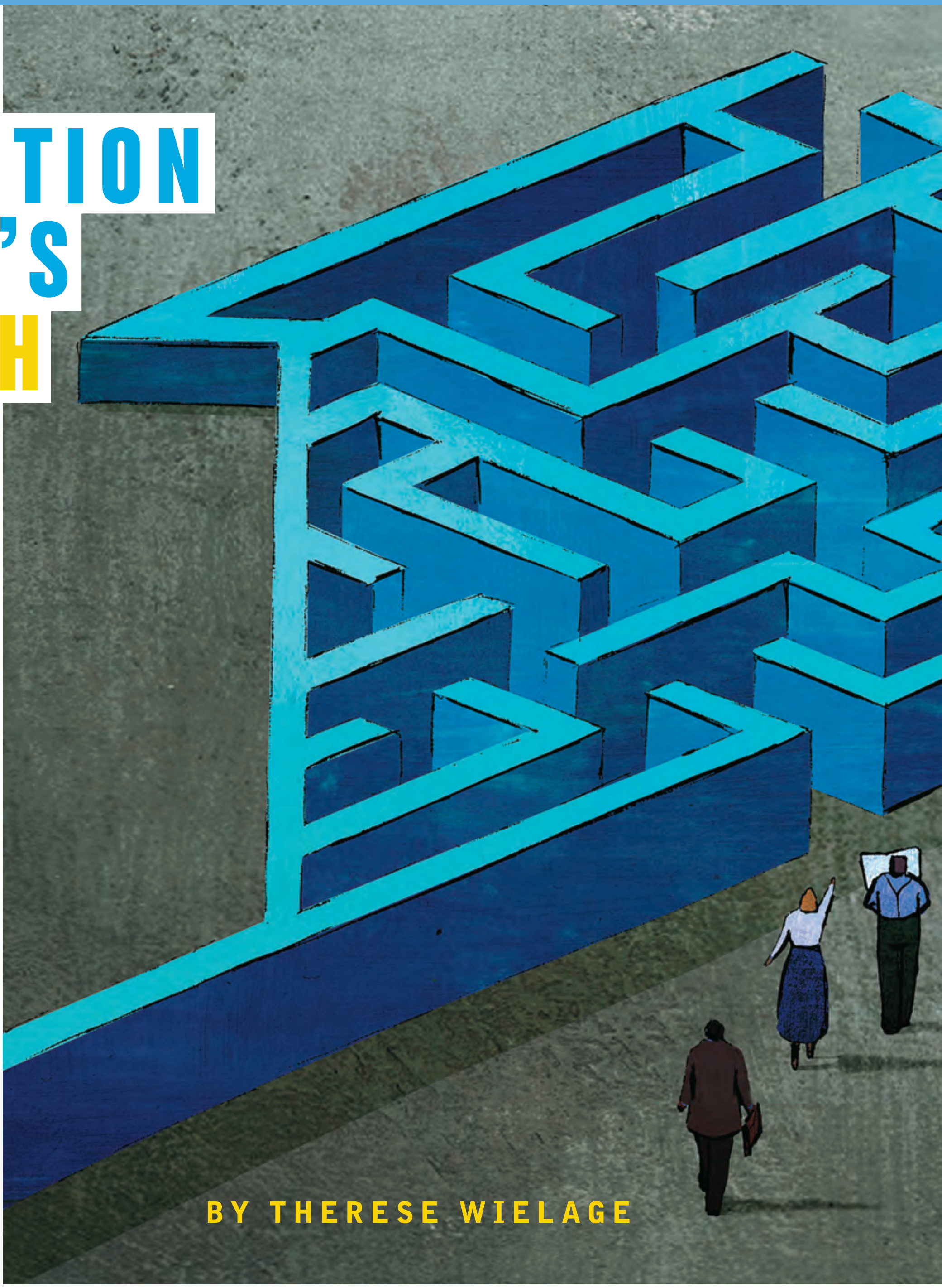
When assessing a contractor's character, the underwriter focuses on honesty and integrity.

Having direct and open communications regarding the contractor's business plan and following through on commitments are two of the best ways to enhance a firm's surety program.

Geoff Delisio is senior vice president of Zurich Surety. For more information, email geoff.delisio@zurichna.com.

THE CONSTRUCTION RECOVERY'S LABYRINTH OF RISK:

FORECASTING, FINANCING AND FINDING QUALIFIED LABOR



BY THERESE WIELAGE

Public sector contractors that survived the recession face a new set of risks. The worst risk is the forecasted shortage of work in public construction. According to industry economists, school and public works opportunities will continue to slide as the federal government caps spending of all types and state and local governments devote more of their revenue to other priorities such as Medicaid and underfunded public employee pension plans. The recovery for private nonresidential construction is mixed, with some rebound in manufacturing and projects related to drilling, transportation and the use of domestic natural gas and oil, but little change in retail, office or hospital construction.

The extremely slow pace of the recovery already has contractors bidding aggressively. Add in a gloomy construction forecast and financing can become a problem for even healthy companies. The response from banks has been uncertain; while financing might be somewhat more available than it was a year ago, construction watchdogs say banks aren't particularly enamored with the construction industry and are more tight-fisted than before the recession. Industry expert Thomas Schleifer points out credit

ART VALERI/ILLUSTRATION SOURCE

lines already are stretched and assets are pledged. Similar to the banks, sureties rely on the financial strength of an enterprise to extend or increase bond credit.

Schleifer says concerns also surround volatility in materials availability and cost. Although materials capacity exists now, unfortunately it's because demand in the United States has gone down. Diesel fuel will continue to be the most volatile input cost with which contractors must cope.

Tangled up with the worries about having enough profitable work while bidding with razor-thin margins is the forecasted lack of skilled labor. A recent nationwide survey from Associated General Contractors found 74 percent of construction firms across the country are having trouble finding qualified craft professionals. It's impossible to make money on aggressively bid work without skilled crafts professionals making sure the job is done right.

Of the survey's 686 respondents, 81 percent said their firms were having difficulty filling at least some professional or craft positions, 74 percent report challenges filling craftworker positions and 53 percent are having a hard time filling at least some professional positions. Among firms struggling to fill professional positions, 49 percent report challenges filling project manager/supervisor spots, while 35 percent report having a hard time filling estimator positions. Meanwhile, construction firms are having the hardest time finding the following types of craft professionals: laborers (35 percent), carpenters (34 percent) and equipment operators (31 percent).

One study calls this assessment into question, claiming market data does not forecast a skilled labor shortage in the next two years. Michigan State University Professor Dale L. Belman's study states there is a large pool of experienced workers available to the construction industry who are either not working or have found work in other industries due to the recession. Using data on job openings, the report also found there are 10 individuals actively seeking employment for each construction job advertised. As the construction industry slowly recovers, Belman contends the national demand for construction labor will not outpace supply; however, there may be geographic and skill-specific shortages.

Going forward, the question is whether construction professionals will return to the industry when the demand for their skills increases. Construction industry leaders aren't willing to take that chance, and they are urging elected officials across the country to make sure construction skills are included in high school and community college curriculums. Additionally, Belman notes construction stakeholders will need to offer competitive wages and benefits, as well as provide formal and on-the-job training, to attract future employees tempted by other employment opportunities.

The advice from surety professionals is to work with agents and underwriters to be prepared to address these risks. Being aware of the risks and remaining disciplined about best practices could be the difference between surviving or succumbing to the long, slow recovery.

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



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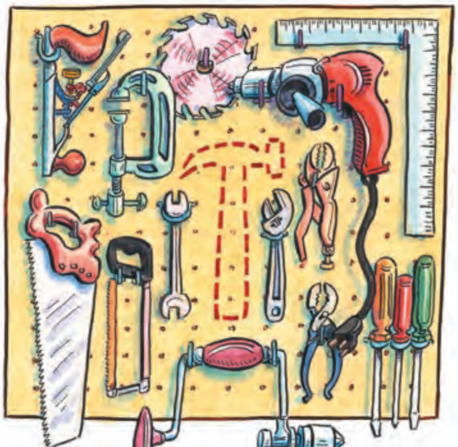
MANAGING AGAINST SUBCONTRACTOR DEFAULT

BY BOB RANEY

The economic downturn clearly has taken a toll on the construction industry during the past five years. Client interactions reveal that general contractors and construction managers have been forced to look much harder at subcontractor risk mitigation. Depending on the size of the contractor, multiple tools can effectively manage subcontractor risk. How those tools are implemented can be critical to how successfully a firm manages its way out of the downturn and through a recovery.



To mitigate risk, many companies use a combination of referencing and prequalification, joint checking and bonding subcontractors. The failure of one or more subcontractors can cause significant business interruption, including having to secure replacement subcontractors, which can severely delay a project and lead to administrative, accounting and financial issues.

One of the keys to successfully implementing any of these risk mitigation methods is to put adequate resources toward managing the process and staying on top of subcontractors across an entire backlog of work. Bonding subcontractors is a time-tested way to mitigate execution and financial risk for any contractor. Second to acquiring that next project, subcontractor risk arguably carries the most potential to impact an organization negatively. Bonding subcontractors is an effective risk management tool that enhances the stability of any project.

A key benefit of subcontractor bonding includes assurance that subcontractors have been prequalified by a professional surety company, which points to the subcontractors' ability to meet rigorous standards and limit their exposures to delays. Additionally, subcontractor bonds allow the general contractor or construction manager to focus exclusively on delivering the best project by not asking construction and estimating teams to assume other roles.

Subcontractor bonds also prevent owners' concern that subcontractor default insurance (SDI) creates an incentive for a construction manager to seek only the financially strongest subcontractors so it can benefit from the preservation of its SDI retentions. Using only the strongest subcontractors may unnecessarily add to the overall project cost and cause a misalignment of the interest of the owner and construction manager, as well as eliminate opportunities for small disadvantaged businesses.

Subcontractor bond forms are now available that permit the general contractor or construction manager to continue the construction process while a surety conducts its investigation and allows the general contractor or construction manager to recover reasonable costs incurred to do so. Another benefit is leverage: No subcontractor wants to hear its surety has been put on notice for a problem, and sureties often have robust security agreements that make it difficult for a subcontractor to abandon a project.

In today's marketplace, no single solution exists to effective risk mitigation; it depends on the type of client and may involve a variety of approaches that best fit the firm. A clearly developed policy that includes subcontractor bonding provides the general contractor with many benefits aimed at ensuring it can complete a project profitably.

Bob Raney is executive vice president of construction services, bond & financial products at Travelers. For more information, email rlraney@travelers.com.

PETER BONO/ILLUSTRATION SOURCE

THE HIDDEN DANGERS OF EXPANDING MARKETS

BY GREGORY S. HORNE

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An expanding waistline is a sign of prosperity and wealth in some cultures. However, medical science indicates unseen threats are often proportionate to a person's girth. An expanding construction market is also a sign of prosperity, but just like a waistline, hidden dangers can affect the health of a contractor.

When the economic collapse occurred, many contractors had a solid backlog that was bid and acquired during good times. Consequently, they survived the first year or two without significant problems by feeding off that backlog. As the good margin work completed, many contractors implemented a strategy of acquiring low-margin work to maintain cash flow, believing the downturn would be short and the market would improve soon.

Unfortunately, the market did not allow contractors to maintain volume or margin; as a result, cash flows were insufficient to cover obligations. Firms that did not react quickly to reduce the burden often lacked bank support and needed additional cash. Contractor business failures began in the underground and civil market, primarily because of the heavy debt loads needed to fund expensive equipment. Business failures then moved to the vertical market, as general contractors with stretched balance sheets were not able to absorb a problem job, or an owner or subcontractor failure.

Subcontractors absorbed most of the financial burden from 2009 to 2011, suffering unprecedented balance sheet and margin erosion. In addition to the market collapse, they funded the brunt of owner failures via pay when/if paid contracts.

A sample of electrical contractors that survived saw their operating margin decrease by more than half to 2.5 percent,

with a corresponding 62 percent decrease in operating cash flow. A sample of mechanical contractors incurred similar results, with operating margins dropping by half to 2.6 percent and operating cash flow decreasing 45 percent. Mechanical contractors funded the stress with borrowings, as bank debt increased 147 percent. Non-MEP contractors were hit hardest. In a financial aggregation sample of 122 non-MEP subcontractors, operating margin dropped from 4.56 percent to 0.30 percent. Net cash decreased from $18 million to a deficit of $357 million. While all subcontractor groups saw some improvement in 2012, the trends continued to be negative.

As the economy recovers, these depleted subcontractor balance sheets will be required to support working capital through the expansion, making subcontractor selection even more critical. Prudent contractors will use a subcontractor risk management system consisting of:

- subcontractor prequalification, including financial, aggregate backlog and résumé review;
- contract language to address any concerns with the subcontractor's potential performance;

Long-term subcontractor relationships can complicate decision-making.

- risk mitigation strategies for a failing contractor (e.g., credit enhancements, funds control and management oversight);
- subcontractor bonds, which are available to any obligee and provide an independent prequalification and total risk transfer; and
- a forum for information-sharing among sales, estimating and production staff. A disastrous error can occur if sales or estimating relies on a competitive bid from a subcontractor only to learn that production is struggling with that subcontractor's performance on a current project.

As the market improves, some subcontractors will gorge themselves on work, not appreciating the working capital required to fund those projects. Early warning signs a contractor is suffering include delays in providing prequalification information or a bond, excessive bid spreads, early manpower issues, vendor notices and negative feedback from other subcontractors. Discipline is essential as the market expands.

Subcontractor relationships are born from successful results. Consequently, the decision to use a specific subcontractor incorporates current financial aspects, reputation, technical capability and historic working relationships.

Long-term subcontractor relationships can complicate decision-making. Carefully developed and documented processes and procedures should govern the process, minimizing subjectivity in emotional situations. Use a subcontractor risk management system to generate healthy discussion between staff and the decision-maker, and to provide the framework for objectively selecting and managing subcontractors, especially if a long-time partner is suspected of having problems.

Gregory S. Horne is AVP, contract underwriting officer at Liberty Mutual Surety. For more information, email gregory.horne@libertymutual.com.

SFAA BONDING ASSISTANCE PROGRAM SPURS ABC WEBINAR SERIES

TOPICS ARE GEARED TOWARD SMALL AND EMERGING CONTRACTORS

BY SAM CARRADINE

Since 2001, The Surety & Fidelity Association of America (SFAA) has been represented on Associated Builders and Contractors' (ABC) National Diversity Committee, which develops resources and tools to assist ABC members and chapters in working with America's diverse workforce. Committee initiatives range from developing a diversity value proposition for the construction industry to publishing an *Employer Guide to Diversity and Inclusion* and funding diversity awards for ABC chapters. These efforts embody both organizations' belief that embracing diversity through education, awareness and business practices is an empowering competitive advantage for their respective member companies and chapters.

Also in 2001, SFAA started developing the Model Contractor Development Program (MCDP®), which aims to increase small and emerging contractors' access to bonding. Begun as a way to assist Local Surety Associations (LSAs) in their efforts to provide bonding for small contractors in their areas, the MCDP® has evolved into a comprehensive program of bonding awareness, education and support. Based on best practices in the surety industry, the program now is a formal process of educational workshops and bond readiness activities that have resulted in hundreds of contractors becoming bondable for the first time. Additionally, the program is the SFAA's primary vehicle for achieving the dual goal of greater access to bonding and increased contractor capability and capacity.

The MCDP® has been implemented in several state and local jurisdictions throughout the country, where it has been highly successful in qualifying contractors for the public construction bidding process. To date, more than 1,500 contractors have participated in various program initiatives, and more than $400 million in bonding can be attributed directly to the implementation of the program. In addition to a national program with the U.S. Department of Transportation that began in 2010, major MCDP® bonding assistance efforts have occurred in New York, Mississippi, Texas, Rhode Island, New Jersey, Ohio, Indiana, Maryland and the District of Columbia.


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When designing the educational workshop component of the MCDP®, SFAA looked to ABC and other trade association partners for curricula development and presentation materials. In particular, SFAA used part of ABC's Emerging Contractor Reference Manual, first published in 2000, to develop several of its eight workshop modules. Since that time, the workshops have been updated, expanded and enhanced, and now serve as the basis for a number of non-MCDP® bonding education and assistance programs nationwide.

In 2008, SFAA and ABC signed a Memorandum of Understanding (MOU) to increase small and emerging contractor expertise and participation in the construction industry, as well as to make ABC's programs available to this segment of contractors. Specific provisions of the MOU include:

- encouraging and helping facilitate joint educational and training programs for small and emerging contractors among ABC chapters, local surety associations, and other local trade associations and organizations;
- developing and implementing bonding assistance programs, such as SFAA's MCDP®, to help small and emerging contractors increase their subcontracting and joint venture opportunities with ABC construction firms, as well as become stronger general contractors in their own right; and
- supporting the use of mentor-protégé programs to expose small and emerging contractors to skills, techniques and resources that enhance their capability and capacity.

Another webinar series is being planned for 2014.

This MOU brought the SFAA-ABC relationship full circle. In March 2012, ABC embarked on a webinar series aimed at small and emerging contractors that covered topics such as business planning, construction accounting, banking and financing, bonding, estimating and bidding, project management and field operations, marketing and growth management. The content for these webinars was adapted from the educational component of SFAA's MCDP®. More than 1,100 contractors attended the eight webinars.

In 2013, the series was expanded to include 19 webinars, with new topics including fringe benefit compliance, contract clauses and change order management, the fundamentals of green building and how to use social media as a small business. To date, 12 webinars have attracted nearly 1,200 contractors. All of the webinars are archived on www.abc.org under the Academy for Construction Ethics, Compliance and Best Practices. Another webinar series is being planned for 2014.

Sam Carradine oversees The Surety & Fidelity Association of America's Diversity and Model Contractor Development Program. For more information, email scarradine@surety.org or visit www.surety.org.

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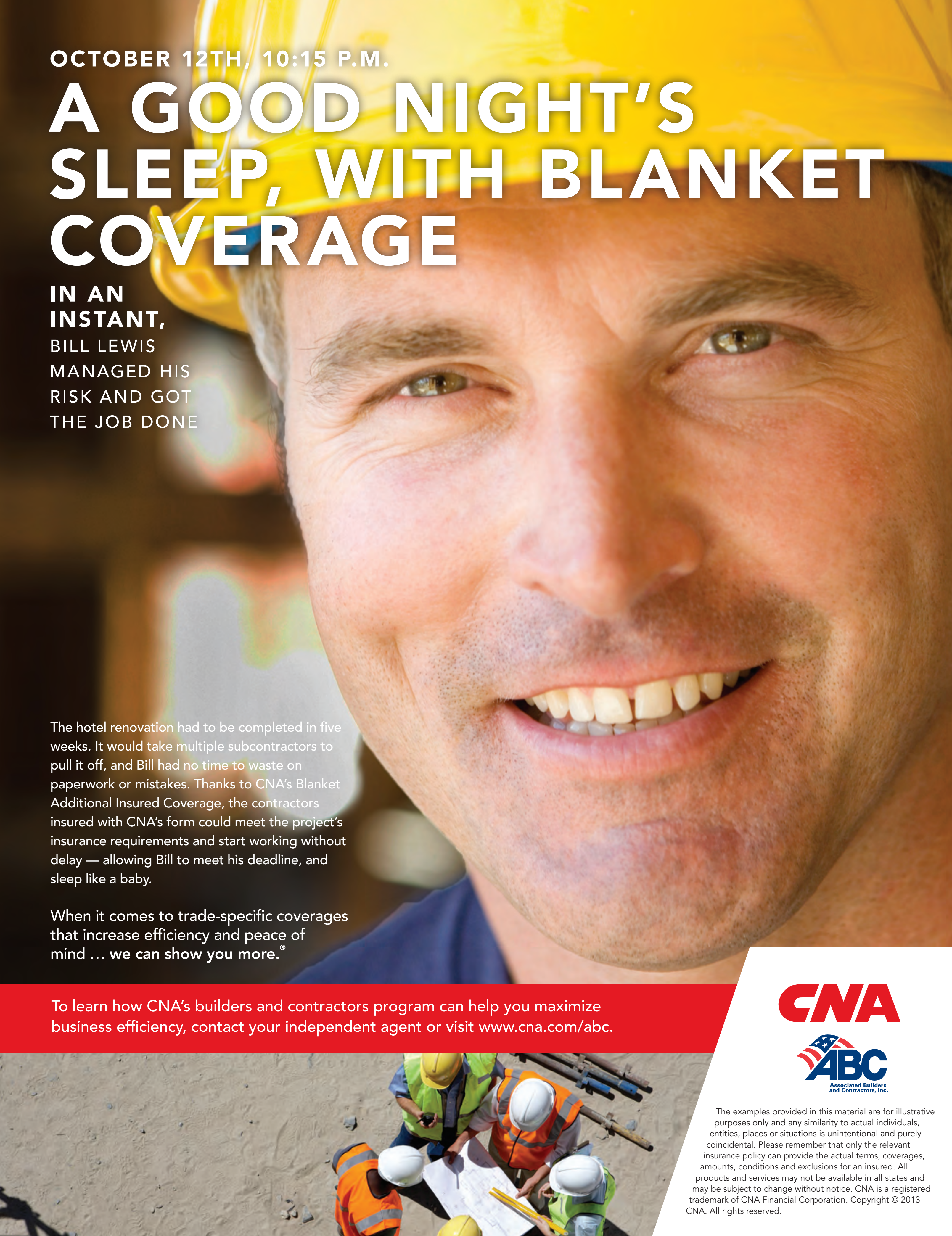
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