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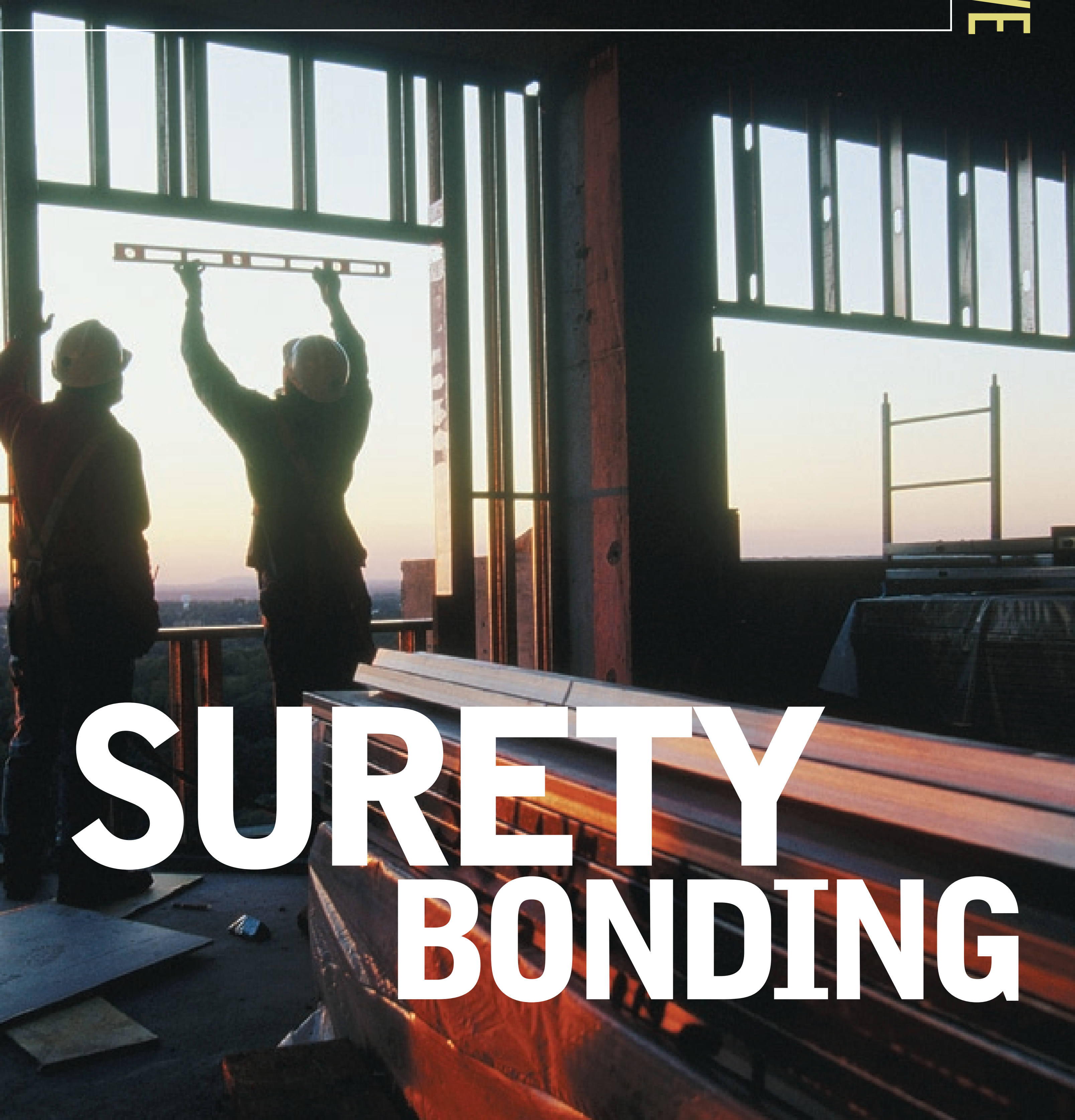

SURETY BONDING

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EDITOR-IN-CHIEF
Lisa A. Nardone

ASSISTANT EDITOR
Lauren Pinch

STAFF WRITER
Joanna Masterson

CONTRIBUTING EDITORS
Marla McIntyre
Surety Information Office

Marc Ramsey
Surety Information Office

DESIGN AND PRODUCTION
The Magazine Group

ADVERTISING INFORMATION
Donald R. Berry,
National Sales Manager, (908) 852-7466
dberry@constructionexec.com

Stephen B. Donohue,
Regional Sales Manager, (609) 654-4568
sdonohue@constructionexec.com

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2006 SURETY MARKET OVERVIEW

SURETY INDUSTRY EMBRACES 21ST CENTURY CONSTRUCTION BOOM

BY MARC RAMSEY

In the late 1800s, "boom" described cattle towns that sprung up overnight along railroad routes. Today, the term boom is thrown around more readily. The Internet boom. A boom market. A booming economy. Baby boomers.

Is today's current construction industry really booming? Is a modern day Gold Rush taking place? Surety executives say they see an explosion in today's construction environment. And some believe "boom" may be an understatement.

Executives who work in all regions and construction markets across the country say the industry has been in a boom for at least six months, and it's likely to continue for some time.

CONSTRUCTION ENVIRONMENT

"The marketplace from a primary construction standpoint is growing faster than I've seen in my 33-year career in the surety industry," says Terry Lukow, executive vice president, Travelers Bond, Construction Services. "On average, our construction clients' backlogs are growing 20 to 25 percent, and that's across all disciplines in the marketplace."

Health care, manufacturing, power, lodging, office, amusement and recreation, highway and street, transportation, government-funded infrastructure—the entire construction marketplace is booming. Factor in the rebuilding of the Gulf Coast region and school, retail and environmental construction, and contractors see tremendous opportunities. "In our view, it is unrivaled by past economic performance by the industry," Lukow says.

Stephen Cory, president of the National Association of Surety Bond Producers (NASBP) and president of Cory, Tucker, & Larrowe Inc., adds, "When you look at the Gulf Coast and the overall health of the economy, there absolutely is a boom in the making. There's more to come. The only cautious point is overextension."

availability continuing to drive owners to look at all conceivable methods to control costs including labor.

"There are so many large projects and so much work available," says William Cheatham, president, Zurich North America Surety, "but that doesn't make the surety or construction markets easier. It changes the risk factors. There's a real balance trying to manage a commercial construction economic cycle that's booming."

So, how long will this construction boom last? Surety executives say at least a year and possibly as long as 24 to 30 months. "The read we get from our contractors is they are confident that their opportunities in the next 12 months will be similar to what they have acquired in the current year," says Dennis Perler, president, Liberty Mutual Surety.

Construction activity has been strong so far this year. Many contractors are running at or near full capacity. The U.S. Census Bureau of the Department of Commerce reported that through August, the value of non-single family residential construction put in place was up 17.1 percent.

"There should be some additional questions regarding labor, supervision and commodity prices, such as fuel, copper and cement," says NASBP's Cory. "All will play into construction in the future as inflation creeps in."

According to James Lee, president and CEO, Old Republic Surety Company, open shop contractors will remain a strong force in the construction equation, especially with cost escalation due to materials

CAPACITY AND AVAILABILITY

Surety executives agree plenty of surety capacity is available to handle the construction boom. Henry Nozko Jr., president, ACSTAR Insurance Co., says, "Most sureties are probably using less than their capacity. The sureties are being careful how they dole out that capacity."

For example, sureties are looking more closely at contract terms and conditions, such as onerous language, consequential damages, delay damages and hold-harmless obligations. "If owners and/or prime contractors have those provisions in the contract," Nozko says, "it will be a tough contract to bond. If they have a fair contract with fair conditions, they will have no problem drawing plenty of capacity."

Sureties continue to employ disciplined underwriting because the industry is still recovering from record losses. Michael Greer, vice president, surety, Pennsylvania National Mutual Casualty Insurance Co., says, "Surety industry losses from several years ago were due in part to contractors obtaining too much surety capacity relative to their financial strength and organizational capability."

The surety industry returned to profitability in 2005 and should be profitable this year. The key for the industry's long-term health, though, will be whether the industry as a whole can sustain the discipline to maintain profitability over time.

Contractors with strong, established backlogs have ample profits to cover overhead, so prudent expansion of well-run operations will be supported through 2007, Liberty Mutual's Perler says.

However, growing too fast, as well as supervisory and labor shortages, are bigger concerns for contractors than capacity. "The real weakness is contractors need skilled professional support around them to grow the business," Zurich's Cheatham says. "Contractors need to pick their surety not for the short term, but for the long term, just like they select skilled professionals."

Because the marketplace is so robust, any commercial contractor can grow. Contractors should look for a surety that can help them grow in a disciplined manner. A professional surety bond producer and underwriter are strategic advisers in today's marketplace when it comes to risk and risk management.

Michael Cusack, senior vice president and managing director of surety, Aon Construction Services Group, says, "As contractors position their firms in this boom era, surety capacity decisions—beyond balance sheet analysis—will be based on the surety's comfort level with contractors' experience, project management capabilities, tolerance and management of contractual risk, and subcontractor procurement/risk management. As additional capacity is extended to support larger work programs, bonding companies will expect contractors to drive margins and improve profitability in this vibrant market."

Mary Jeanne Anderson, vice president, Arch Insurance Group, adds, "Profitability is the hallmark of a successful contractor. The job progress and trends reflected in the work-in-progress schedule provide a glance at the past, present and future profitability of a contractor, and this is a key component in the underwriting process."

The availability of timely and accurate financial information is often as important as the financial data itself. "It can be the difference between a well-run company and one that really does not know where it stands financially," she says.

SMALL-MARKET CONTRACTORS

Expect solid opportunities for the small construction segment—under $10 million—to obtain work at reasonable profits. The key for these contractors, surety executives say, is to accept only work for which they have good managers.

Opinions vary on surety availability for small contractors. Most say more than enough capacity exists to satisfy the demand in this marketplace, while some say underwriting for this segment is easing. Others indicate smaller or emerging contractors may continue to have difficulties entering the surety market and point to more frequent loss activity involving these contractors.

"Fundamental underwriting characteristics in this sector, such as capital adequacy in relation to the work program, will become more stringent," Aon's Cusack says.

Some executives suggest the surety industry will demand smaller contractors become more sophisticated and produce higher quality information on a timely basis. This means using a construction-oriented CPA firm that can prepare a percentage-of-completion financial statement for year-end, and having well thought-out business plans and continuity agreements funded by life insurance.

"Surety companies will insist on having upscale submissions with an overall tendency to shy away from in-house financial statements when considering bonding capacity," says Karen Barbour, president, The Barbour Group.

Bonding assistance and support programs are available to emerging contractors as part of the surety industry's commitment to this segment. "Because bonds are generally a product of statutory requirements, a contractor's ability to bid public work is severely hindered if it can't secure bonds," Old Republic's Lee says. "Our agents assist contractors in providing counsel and advice to enable them to approach markets that will consider bonding."

"Small and emerging contractors of today are the large and successful contractors of tomorrow," adds Gary T. Dunbar, chair, The Surety & Fidelity Association of America (SFAA), and divisional president, Bond Division, Great American Insurance Companies, Cincinnati, Ohio. "Many small and emerging contractors are owned by individuals who satisfy participation goals established by the government on many public projects. By helping small and emerging contractors, the surety industry is also helping many large, established contractors meet their participation goals."

MIDDLE-MARKET CONTRACTORS

The middle market—around $100 million—may be the most competitive. "Capacity is readily available for qualified contractors, as there are many sureties in this arena," says Terrance Cavanaugh, chief operating officer, Chubb Surety. "[If] surety companies maintain their underwriting discipline, which has restored profits, competition should remain strong."

Middle-market contractors, ACSTAR's Nozko suggests, are large enough to have sophisticated operations and don't have the high-risk profile associated with small or specialized contractors. As these firms grow, they must transition and develop their accounting, cost controls, field management and business planning to meet their increasing financial targets.

Barbour adds, "The surety industry may require some contractors to guarantee a certain gross profit percentage on jobs in excess of $50 million to provide a stronger comfort level when seeking support from reinsurers. It is becoming apparent that these contractors will need to at least guarantee a 4 percent gross profit margin for such projects to be bonded."

And, according to William Marino, chairman and CEO, Allied North America, "Quality professional support from construction industry-focused accountants, attorneys and surety brokers is expected, and a strong risk-management protocol, joint venture partners and historic project performance are necessities."

JUMBO-MARKET CONTRACTORS

While the jumbo marketplace historically referred to projects exceeding $250 million, in a relatively short time it increased to highs of $500 million and $750 million. "For the right contractors, the numbers seem to be pushing $1 billion," says Old Republic's Lee.

While this market has fewer players, surety executives insist adequate capacity exists. These contractors have to be more strategically focused to create the kind of surety capacity they need.

"Although there seems to be an increase in markets that will support this level of project and program," explains Chubb's Cavanaugh, "aggregate capacity is still selective on deciding which contractors qualify for surety capacity."

John Stanchina, senior vice president and division manager, Rutherfoord Companies, an Assurex Global Partner, says, "Joint ventures and co-surety arrangements used in the 1970s are again being utilized on larger projects and programs."

Michael Murphy, executive vice president, Bush, Cotton & Scott, A Hub International Company, agrees. "Recent industry results and expanding reinsurance capacity are sufficient to meet the surety needs of a very strong construction economy, with large work programs in excess of $500 million and very large single projects continuing to require co-surety arrangements in many cases," he says.

Even with strong joint ventures, sureties may struggle to assemble the capacity necessary to provide 100 percent performance and 100 percent payment bonds. "On projects with contract values greater than $750 million, owners have to evaluate the possibility of accepting reduced penalty bonds," says Allied's Marino. "This presents a significant challenge on public projects where an act of legislature is generally required to proceed."

Murphy adds, "The large contractor market continues to be the most restrictive in terms of flexible underwriting criteria and available reinsurance capacity."

Larger, well-capitalized contractors with operational discipline are generating tremendous margins in this market. Surety executives attribute improved profitability to shorter bid lists, more discipline in the deployment of surety capacity and higher margin expectations. In fact, surety executives say larger construction franchises have embraced this surety capacity environment, and most firms view the detailed underwriting analysis, close surety scrutiny and disciplined extension of capacity as a healthy process.

Top 10 Writers of Surety Bonds
2005 (Preliminary)

	Direct Premium Written (millions $)
1. Travelers Bond	$885
2. CNA Insurance Group	$382
3. Zurich Insurance Group	$368
4. Safeco Insurance Group	$309.5
5. Chubb & Son Inc.	$234
6. Liberty Mutual Insurance Group	$210
7. Hartford Fire & Casualty Group	$181
8. Arch Capital Group	$109
9. HCC Surety Group	$103
10. International Fidelity Insurance Co.	$86.6
Total All Surety (Top 10)	$2,870
Total All Surety	$4,528

Source: The Surety & Fidelity Association of America (SFAA), "Top 100 Writers of Surety Bonds—United States," 2005 (preliminary, including contract and commercial surety). Detailed statistical reports are available for purchase at www.surety.org. SFAA now offers a subscriber service to non-members that includes a newsletter; statistical reports; *Binder of SFAA Standard Fidelity Forms*; *SFAA Manual of Rules, Procedures and Classifications for Fidelity, Forgery and Surety Bonds*; a web listing; and reduced rates on other publications and special data requests. For more information, contact Barbara Finnegan Reiff at breiff@surety.org.

SURETY OUTLOOK

The outlook for the surety industry over the next 12 to 24 months will hinge on a number of factors, including the economy, disciplined underwriting and available surety capacity in the market.

"We have seen significant inflation in construction over the past three years," says Rutherfoord's Stanchina. "Continued material and labor inflation may become an issue as the cost of construction has the potential to outgrow the equity and liquidity that contractors retain through traditional operating earnings. This has the potential to put pressure on the surety program leverage and force contractors to look for additional capital from shareholders or other outside sources to support surety capital requirements."

Doug Hinkle, chief underwriting officer, CNA Surety, is optimistic about the next few years for the surety industry. "Primarily through consolidation, the top 10 sureties now write more than 60 percent of all the surety business. Second, most sureties seem to have a greater focus on their capital allocation and the need for adequate return on that capital. Finally, there has been a movement toward greater underwriting sophistication," Hinkle says. "Traditional economics suggest that fewer players in the market, greater focus on return on capital and greater underwriting control would lead to longer-term market stability."

Timothy Mikolajewski, senior vice president, Safeco Surety, adds, "Absolutely, 2005 was a good year for the surety industry, and 2006 looks to be an excellent year. With continued sound underwriting discipline and pricing, the outlook for the surety industry over the next several years in the small, middle and jumbo markets looks good."

Ramsey is communications manager of the Surety Information Office, Washington, D.C. For more information, call (202) 686-7463 or email sio@sio.org.

EXECUTIVE INSIGHTS

SURETY INDUSTRY LEADERS OFFER VIEWS, EXPERTISE

COMPILED BY MARC RAMSEY

Terry Lukow
Executive Vice President
Travelers Bond, Construction Services

Today's economic climate is totally different from the very competitive, dog-eat-dog world a lot of construction organizations have seen before. Now more than ever, the industry is focused on managing both opportunities and growth. Contractors should ask themselves: Where can I capitalize in a given market considering my organization, my capabilities and my experience in a way that will allow me to gain the highest and best economic returns?

For an organization to be successful in today's marketplace, contractors should approach the construction industry with a strategic view rather than a transactional view. It's more than a strategic financial structure; it's a view composed of a business plan structure, risk appetite and relationships. Contractors must manage for the long term, not the short term, because long-term management will keep them in business while short-term management will only increase their risks.

A surety company looks for more than just a contractor's financial structure. It asks, "What is the strategic business plan?" and "How will contractors manage this economic boom in the marketplace?"

Doug Hinkle
Chief Underwriting Officer
CNA Surety

The construction industry represents great opportunity and risk, and it's important to have open communication and a strong relationship with your surety.

The surety's contribution to a contractor's growth plan is through the surety capacity that it provides, both on a single job basis and through an aggregate work program. Three key characteristics of a bondable contractor include good cash flow, reasonable funded debt load and a track record of performance.

The primary reasons for contractor default change little over time. Defaults often involve—independently or in combination—excessive growth, expansion into unfamiliar territory or expansion into areas of work without the necessary expertise.

A contractor should ask questions that confirm whether the surety understands and supports the business plan. A contractor should confirm the producer has the necessary surety expertise to bring value to the relationship and contribute to the success of a contractor operation.

William Cheatham
President
Zurich North America Surety

Zurich develops a total profile on every customer/account—organizational structure, financial history, business philosophy, management experience, etc. We balance the pros against the cons. Then we credit rate the contractor from our own proprietary credit scoring model and decide whether the contractor qualifies for surety credit, and at what limits (i.e., job size and program).

We constantly try to strengthen our underwriting to enhance our customer selection process, and the most recent change is the credit-scoring model that helps identify financial characteristics. If you deal in surety bonding, you can expect credit-scoring models to be adapted in some form, and these models will become an accepted practice.

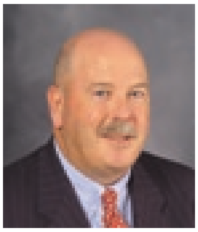
My advice to emerging contractors is to learn from a position of strength. Find partners that will be mentors. Look for historical success and find a way to grab on. Ask yourself: What are my personal goals? What type of training will I require? What kind of personal commitment am I willing to make?

Timothy Mikolajewski
Senior Vice President
Safeco Surety

With due diligence, a surety underwriter can determine the true strengths and weaknesses of a contractor. The result is knowing the appropriate types and sizes of projects a contractor can complete successfully. With updated and current information from contractors, surety underwriters can respond to the contractors' positive financial trends and be in the best position to maximize surety support.

We work with our clients to prevent a default by identifying the problem early. All parties can review the options and come up with a unified plan to prevent a default. Often, contractors wait too long to let their surety know a problem exists, resulting in few viable solutions. Drivers for contractor failure include working out of one's normal territory, relying on claims or underbillings to come through and having substantial debt or a substantial overhead burden.

Terrance Cavanaugh
Chief Operating Officer
Chubb Surety



Strong construction operations will be provided the necessary surety support to match their operational capacity, financial strength and business plan. Companies that have managed their business and balance sheet will have no difficulty securing the necessary surety bonding.

A critical issue is whether an individual construction company is ready to take on this current boom. The construction industry faces shortages in both the supervisory and labor pools. The shortage of available human resources will impact the abilities of a contractor to execute in a growing market.

On the other hand, contractors with strong human resources and a well-disciplined strategy will have an opportunity to take advantage of a tight market and generate better gross margins.

Adhere to a focused business plan, surround yourself with professional advisers and partners, engage a strong surety producer and consistently communicate the opportunities and challenges of your business to your surety.

Dennis Perler
President
Liberty Mutual Surety

Many contractor failures occur during rapid economic expansion. They are either undercapitalized, don't have the working capital or don't have the personnel in place. However, several contractors appear to have ample profit margins in their work.

One or two years of profitability, however, does not define a strong business, and the credit business demands that sureties generate a string of consistent earnings. That's what attracts capacity and capital to the business.

The challenge for the surety business is to not become complacent and overly pleased with results. The surety industry needs to have a long-term view of profitability and growing earnings, not just the top line. We've gone through periods of reckless underwriting, but I'm hopeful that we've all learned lessons from the earlier part of this decade.

Mary Jeanne Anderson
Vice President, Surety
Arch Insurance Group

The biggest challenge is the high level of inflation of construction material and labor costs. This situation, combined with owners' tendencies to bundle smaller contracts into one large contract, creates a significant increase in job and overall program size without the benefit of a commensurate increase in the contractors' balance sheets.

Usually a combination of factors contribute to contractor default—tough project owners, adverse contract and bond terms and undertaking work beyond the contractor's experience and resources.

All contractors should investigate the claims handling philosophy of their bonding company and meet their claims professionals prior to the development of any claims.

Stephen Cory
President, National Association of Surety Bond Producers
President, Cory, Tucker, & Larrowe Inc.

As contractors gear up to handle the massive rebuilding in the Gulf Coast region, they need a plan for when the work slows down in three to five years. Contractors have an opportunity to make above-average profits, and it would be a wise move to fix any current balance sheet issues that might affect surety capacity. Contractors should not over-extend themselves based strictly on the availability of work. They should continue to measure capabilities against opportunities while remaining cautious and preparing for the next downturn.

Your surety agent and company should be part of your strategic team. Being part of the planning process will give them insight into your game plan and provide you with objective feedback. They should bring value to the process in terms of industry and market overview, as well as experience and service.

James Lee
President & CEO
Old Republic Surety Company

Sureties consider a number of criteria when determining a contractor's bondability, including character—how the contractor has reacted to adversity; continuity—whether the contractor is backed by proper legal documents and life insurance; and references—having outstanding operations and being well-regarded by customers, peers, creditors, owners, architects and engineers.

Sureties also look at a contractor's business plan, key employees, job radius from home, bidding history, relationship with suppliers and price commitment ability, bonding subcontractors, on-time completion and penalties involved, ability to provide uncompleted/completed work-in-progress schedules on a timely basis, tracking profit and loss of projects, labor contract expirations, contract forms preferred and utilized, hazardous waste portions of the job, equipment sufficiency and proper insurance.

A contractor also should have clean credit reports and sufficient credit with suppliers. The contractor should take advantage of supplier discounts when offered, have a banking relationship and backup banking relationship and have a capital spending program. A contractor also needs capital, net quick assets, net worth and profitability.

Henry Nozko Jr.
President
ACSTAR Insurance Co.

In terms of underwriting, ACSTAR may distinguish between classifications of work when providing surety bonds. For example, we view marine contractors, underground piping and structural steel contractors as a higher risk than acoustical ceiling, finishing carpentry and plumbing contractors. We also assess high risk and low risk in terms of geography. A contractor in Bangor, Maine, has a lower risk profile than a contractor in one of the Borroughs in New York City, which probably is the most difficult geographic landscape in the country. Los Angeles, Chicago and New Orleans are difficult, but don't come close in comparison to New York City.

Michael Greer
Vice President, Surety
Pennsylvania National Mutual Casualty Insurance Co.

Well-managed contractors take advantage of opportunities, but they also need to know when enough is enough. A contractor with a "relationship-based surety" should be confident the surety will be available to provide additional capacity when necessary. However, a contractor should not roll out of bed one day and decide the company should be three or four times bigger in the coming year. Growth needs to be planned, and above all it needs to be controlled.

There always will be good contractors and good surety companies. The key to both is consistency. Just like a surety looks for a contractor with consistent earnings, a contractor should look for a surety with consistency in its approach to providing surety bonding.

William Marino
Chairman & CEO
Allied North America

Contractors looking to capitalize on the current construction climate need to show their surety they have adequate human resources and financial capacity to pursue these opportunities. Credibility is crucial.

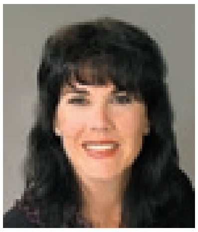
The surety underwriting process constantly compares estimates to actual performance. Contractors always should present information to their surety partner that is both tested and conservative. Failure to consistently perform as projected will have a negative impact on any surety relationship.

Contractors must clearly understand the factors that contribute to the expansion of their work programs. There is a direct correlation between balance sheet growth, successful completion of bonded projects, a clearly defined business plan and the expansion of a surety work program. The role of the surety broker is to work with the contractor on understanding the surety's expectations and regularly communicating with the carrier to assure the information used to arrive at decisions is accurate and complete.

Karen Barbour
President
The Barbour Group

The surety industry is well positioned to handle the construction explosion with more than 100 sureties looking to grow their market shares. To maintain overall profitability, sureties will be conservative in their underwriting with many choosing not to take risks on small or startup companies. But, some sureties geared toward small business accounts are expanding their offices and hiring staff to absorb the surety void for small businesses.

Contractors must know the strengths and weaknesses of their key employees, learn their market and their strengths in it and, above all, have the utmost confidence in their abilities before applying for their first bond.



The top three characteristics we look for in a bondable contractor are a positive attitude, trade experience and willingness to listen and heed advice. The top three items on a financial statement include timely receivables, reasonable over/under billings and low debt to overall net worth. A bonding agent needs to be a strategic advocate to put in place benchmarks and steps so the contractor has a clearly defined path to follow.

Michael Murphy
Executive Vice President
Bush, Cotton & Scott, A Hub International Company

Environmental contractors continue to have very limited market choice and capacity due to exposure to potential long-term liability and lack of reinsurance. Aside from environmental construction, the Pacific Northwest shows few restrictions in terms of market competition or capacity.

As has historically been the case, underwriting standards are much stricter for most subcontracting trades. Contractors need to carefully balance the opportunities created by a strong construction economy with controlled and well-managed growth and geographic spread. It is critical to maintain a lean but flexible organization—both cost-wise and in terms of expertise—which can react quickly to economic downturns or significant and sudden changes in market conditions.

Three of the most important financial characteristics sureties look for in a contractor are adequate liquidity, lack of bank dependence and leverage, and a reasonable level of flexible overhead.

Peter Hammett

Vice President
Parker Smith & Feek, An Assurex Global Partner

The construction boom has hit the Pacific Northwest. Building is at an all-time high, and the surety industry seems to be keeping up very well. The question is whether the construction industry can keep up with adequate manpower. The surety industry looks objectively at financial strength and experience when determining levels of surety credit availability for every contractor.

Contractors should select a surety underwriting company based on the underwriting company's experience in their type of business. Each surety company has particular areas in which they are comfortable and succeed. Surety bond producers can help contractors grow by providing advice on issues such as perpetuation and market focus, and selecting other advisers such as CPAs, attorneys and bankers. Underwriters also listen carefully to contractors' plans and use their experience in seeing where others have stumbled or excelled to help contractors set a clear goal.

John Stanchina

Senior Vice President and Division Manager
Rutherfoord Companies, An Assurex Global Partner

This is a great time for the construction and surety industries. For anyone who is adequately capitalized and has a solid business strategy, excellent controls in place and proven management, capacity will not be an issue. This will be the case whether you are in the small, middle-market or jumbo segments.

Align yourself early with a group of professionals who understand and specialize in construction, including a professional surety and insurance agent/broker, CPA, banker and attorney. Find a surety with an underwriting philosophy that matches your business plan. Make sure you have open and honest dialogue with your agent and report problems immediately. Surety professionals have tremendous resources that can assist a contractor in a tough situation.

Be realistic, and don't be penny wise and pound foolish. Long-term strategies prevail over short-term gains.

The key items on a balance sheet are cash, equity in relationship to debt and the amount of underbillings as a percentage of working capital and equity. Sureties want to ensure underbillings and receivables turn into cash. Some sureties tend to consider an underbilling either as unrecognized profit fade or unapproved change orders, and will quickly discount underbillings in their credit modeling.

Michael Cusack

Senior Vice President—Managing Director, Surety, and Operations Board Member
Aon Construction Services Group

What has developed in the bonding market over the past four to five years in terms of underwriting discipline will continue for the foreseeable future. With exception to certain regions—most notably the New England states—the majority of the U.S. construction industry is enjoying one of its strongest economic periods ever.

The convergence of new project opportunities, a static supply of competent trade labor and restricted surety credit has forced contractors to be more selective in the pursuit and acquisition of new work. In responding to market conditions, contractors have been more thoughtful in the deployment of their bonding capacity and, as a result, have been more disciplined in setting margins on new projects.

The trend toward shorter bid lists and higher margins will continue as the surety industry is expected to adhere to sound underwriting fundamentals in the near-term, with underwriters continuing to be selective in the acquisition/development of new contractor relationships.

Robert Meade

Senior Vice President
American Arbitration Association

The strong economic climate for construction services reinforces the need for construction executives to consider contract terms that enhance performance and reduce risks of project delays. When consulting with owners and contractors, sureties should discuss plans for managing disputes throughout the life of the construction project. Conflict avoidance processes help construction partners resolve disputes before they escalate and delay construction. Partnering is a commitment by all stakeholders to achieve goals and objectives—including processes to control and address obstacles and disputes.

Dispute management options include a dispute resolution board—typically a panel of three neutrals appointed by the parties that become part of the project team, attend periodic meetings, review essential project documents and assist in the identification and resolution of issues and potential problems.

However, even with strong conflict avoidance procedures in place, sureties should encourage contractors to include in their contracts clear, well-devised dispute resolution clauses that incorporate procedures, such as mediation, to resolve disputes as early and efficiently as possible.

Steven Raffuel

Surety Practice Leader
Commerce Banc Insurance Services

The surety market continues to be firm for all contractors. Bond capacity is available for well-managed companies in all geographic regions. Steady as she goes is the mantra of the industry right now, meaning that the glass is full. I don't expect any significant changes in the marketplace over the next few years, unless some considerable new capacity becomes available. As for the differing market segments, $10 million to $100 million contractors will do just fine because they are manageable exposures that generate good premium activity for their surety. Perhaps the single most valuable asset a professional surety agent or underwriter brings is their history of looking at the experiences of hundreds of contractors over time. We've seen the successes and failures, and can provide insight to contractors to help them get past operational hurdles, or avoid the many trap doors along the path to growth.

Ramsey is communications manager of the Surety Information Office, Washington, D.C. For more information, call (202) 686-7463 or email sio@sio.org.

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.

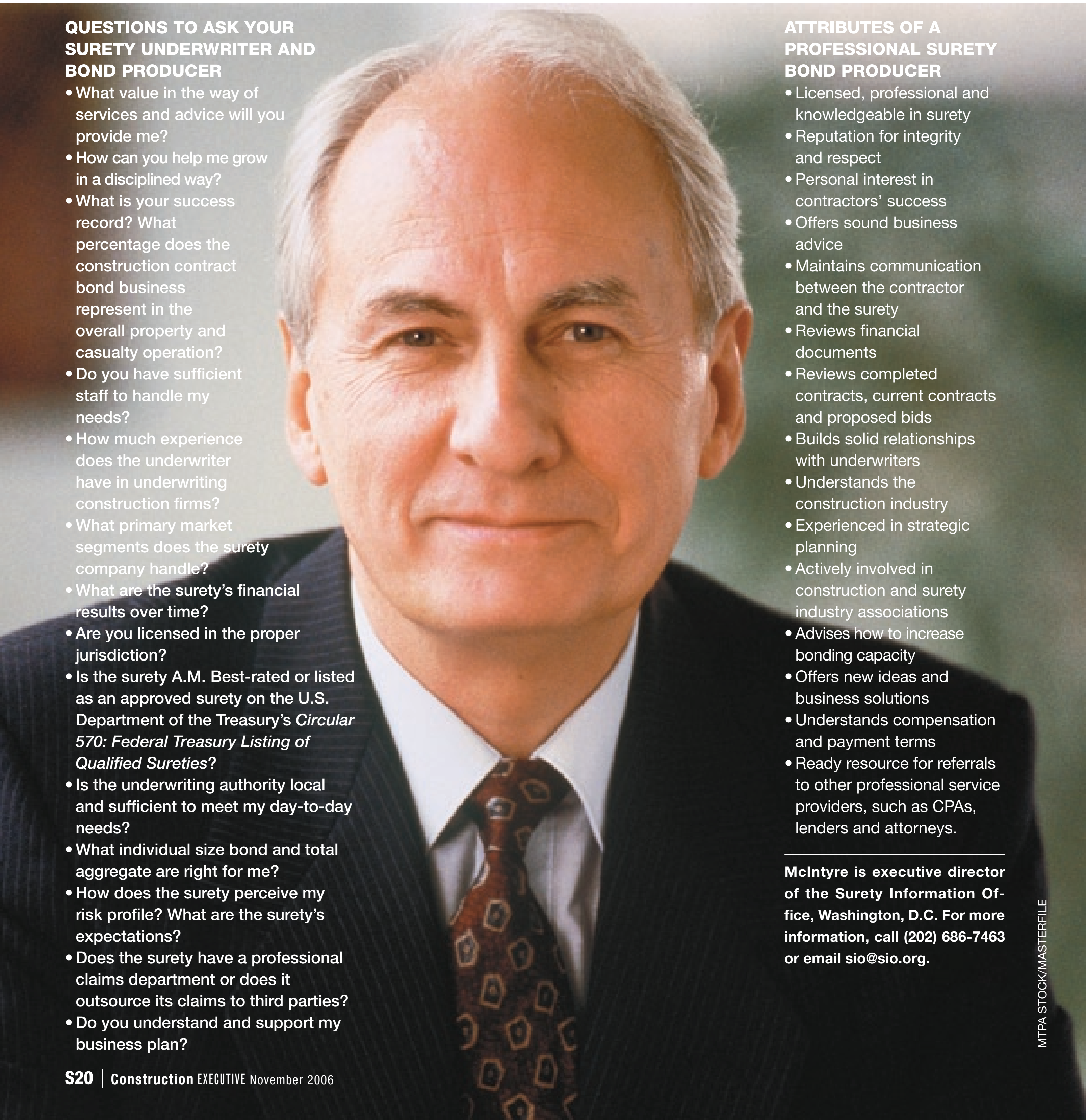
SURETY UNDERWRITERS LOOK FOR:

- 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.

THE SURETY RELATIONSHIP

BY MARLA McINTYRE



MTPA STOCK/MASTERFILE

QUESTIONS TO ASK YOUR SURETY UNDERWRITER AND BOND PRODUCER

- What value in the way of services and advice will you provide me?
- How can you help me grow in a disciplined way?
- What is your success record? What percentage does the construction contract bond business represent in the overall property and casualty operation?
- Do you have sufficient staff to handle my needs?
- How much experience does the underwriter have in underwriting construction firms?
- What primary market segments does the surety company handle?
- What are the surety's financial results over time?
- Are you licensed in the proper jurisdiction?
- Is the surety A.M. Best-rated or listed as an approved surety on the U.S. Department of the Treasury's *Circular 570: Federal Treasury Listing of Qualified Sureties*?
- Is the underwriting authority local and sufficient to meet my day-to-day needs?
- What individual size bond and total aggregate are right for me?
- How does the surety perceive my risk profile? What are the surety's expectations?
- Does the surety have a professional claims department or does it outsource its claims to third parties?
- Do you understand and support my business plan?

ATTRIBUTES OF A PROFESSIONAL SURETY BOND PRODUCER

- Licensed, professional and knowledgeable in surety
- Reputation for integrity and respect
- Personal interest in contractors' success
- Offers sound business advice
- Maintains communication between the contractor and the surety
- Reviews financial documents
- Reviews completed contracts, current contracts and proposed bids
- Builds solid relationships with underwriters
- Understands the construction industry
- Experienced in strategic planning
- Actively involved in construction and surety industry associations
- Advises how to increase bonding capacity
- Offers new ideas and business solutions
- Understands compensation and payment terms
- Ready resource for referrals to other professional service providers, such as CPAs, lenders and attorneys.

McIntyre is executive director of the Surety Information Office, Washington, D.C. For more information, call (202) 686-7463 or email sio@sio.org.

WHY ARE FINANCIALS SO IMPORTANT TO YOUR SURETY?

BY CHRIS MURPHY

The mission of surety underwriting is to determine whether a contractor has the financial resources to pay its bills today and to forecast if the contractor could continue paying them if faced with adversity in the future.

Many factors determine the long-term success of a construction company: thoughtful and experienced leadership, skilled people in the field and in the office, a sound business plan, luck and more. But financial analysis tends to get the most attention when it comes to surety underwriting.

Most underwriters agree that a contractor's strengths and weaknesses are reflected in the company's financial statements in some way. Most underwriters also believe that without a face-to-face meeting, they can't really get to know a contractor.

The business community generally understands financial terms and measurements. What most contractors want to know is: "What do these financial measurements mean to surety underwriters, and what business strategies can ensure our company is in the most favorable position in these terms?"

In the final analysis, there are no absolutes. Each company needs to be managed according to its own circumstances. For example, an underwriter often views a contractor's balance sheet with minimal interest-bearing debt quite favorably. Not having to service debt in a future that may or may not be sufficiently profitable clearly lowers risk and improves financial flexibility. So one might conclude that borrowing money is a bad idea if impressing the underwriter is the goal. But, a business manager who avoids all risk also may avoid the possibility of meaningful returns.

Contractors should have trusted advisers (a professional surety bond producer, underwriter, CPA, etc.) who can provide feedback on their plans, but only hindsight will determine whether the plan was a good one.

FINANCIAL STATEMENT

The income (or profit and loss) statement is simply a report card of how much activity (revenue) was performed during the period, how profitable that activity was (gross profit/loss), and what it cost the contractor to run the business (overhead). The underwriter examines these carefully against industry and geographical norms. Importantly, the underwriter focuses on the trend of these measures over several years.

- For example, if the trend reveals 30 percent revenue growth every year, the immediate concern is the speed of that growth. While revenue growth in a technology company may make its stock price surge, in construction it creates questions about whether pricing was sacrificed to create revenue growth, whether the contractor has the people or systems resources to manage the growth without things falling through the cracks, and whether the contractor has the cash to finance larger receivables.
- If overhead seems higher than a contractor's peers, the underwriter will question whether the business is being run to maximize profitability and financial strength, or to finance expensive personal lifestyles. Clearly, some companies are mature and have built superior financial strength over time, and therefore minimize the need to retain significant profits going forward. But in general, overhead analysis can be the underwriter's window to the contractor's true priorities.

BALANCE SHEET

The balance sheet demonstrates what the contractor has (assets) and what the company owes against those assets (liabilities). The difference is the net worth of the business. Net worth is significant to the surety because it measures the long-term staying power of the business. But short-term staying power is important, too. Payroll, accounts payable and debt payments all need to be paid regularly—in cash.

- Underwriters analyze working capital to assess the contractor's ability to finance these requirements. Any interruption of cash coming in—a disputed receivable or change order, unprofitable projects, etc.—can place unbearable pressure on the contractor's ability to meet obligations. The underwriter analyzes the balance sheet in the context of "what if." Could the company survive, and for how long, if adversity strikes? Contractors that maintain their balance sheet to support only normal circumstances may not be enthusiastically supported by their surety. Rainy-day capitalization (or risk capital) can be critical to obtaining the desired level of surety support.

- Leverage is an important area of focus as well. Taking on debt may be the best thing for the contractor's business, but contractors should carefully question whether buying a piece of equipment or a building (and taking on debt to pay for it) is the best move at the time. Especially if the contractor's overall financial strength is modest, renting equipment or putting off other asset purchases until financial strength improves may be the best course of action. Also, overdependence on an operating line of credit to finance cash flow may indicate undercapitalization. These are areas where a contractor should solicit the counsel of trusted advisers.

STATUS OF PROJECTS

A surety also looks closely at the financial status and trends of individual projects via the work in progress (WIP) schedule. Analysis of the estimated cost to complete the backlog may indicate how heavily the contractor's resources are being utilized and measure the contractor's capacity. The estimated gross profit in the backlog gives an idea of future profitability, assuming the estimates hold up over time. The WIP also shows whether a project is underbilled or overbilled.

- An underbilling suggests the contractor is financing the project for the owner in some way. It also may be a sign that the contractor has prematurely counted the revenue of a change order to which the owner has yet to formally agree. Or, it may simply indicate the contractor has not revised cost estimates on the project. Rather than acknowledging that costs have exceeded budget, resulting in a lower gross profit, an underbilling occurs. Gross profit decreases on jobs are often disguised as underbillings, so substantial underbillings are subject to scrutiny by the underwriter.
- Also significant is the underwriter's ability to view WIPs over several periods and track the estimated gross profit on a job over time. Steady margins that hold up through completion are a sign the contractor likely produced a solid estimate before beginning construction and was able to execute in the field according to the estimate. This is an extremely favorable indicator of the contracting firm's overall quality. Contractors that conservatively report their estimated gross profit during construction, and then consistently report an increase on completion, are held in high esteem not just for their ability to execute, but also for their conservatism. On the flip side, WIP trends that show project gross profits regularly slipping from start to completion tell the underwriter there is a problem in estimating, in execution, or both.

Not all underwriters have the same perspective on the business or on financial analysis. Construction executives should discuss the financial analysis with a professional surety agent and an underwriter to ensure a meaningful relationship.

Murphy is the underwriting director for Travelers Bond, Construction Services, Hartford, Conn. For more information, call (860) 277-9354 or email cmurphy4@travelers.com.

HOW A GOOD CONSTRUCTION CPA CAN HELP CONTRACTORS OBTAIN MORE SURETY CREDIT

BY EMILIO ALVAREZ

Sureties are almost always the largest extenders of credit to construction contractors. This credit—always open-ended, and in many cases unsecured—is reserved for those who meet certain criteria, such as presenting complete and accurate financial information on a timely basis.

FINANCIAL STATEMENTS

A contractor's financial statements should be prepared in compliance with the American Institute of Certified Public Accountants' Statement of Position 81-1 and should include job schedules for completed and in-progress contracts.

These financial statements are only as good as the credibility and reputation the preparer has with the surety with regard to honesty in presentation, knowledge of the construction industry and the Generally Accepted Accounting Principles for construction contractors. This additional level of competence is the greatest contribution a good construction CPA makes to clients in the process of obtaining surety credit.

BONDING DISCIPLINE

Along with the financial statements, a CPA can help a contractor increase surety capacity by emphasizing bonding discipline. It is not very popular to tell a contractor to leave the profits in the company or to refrain from pursuing endeavors that sureties feel may be conducive to problems. Even more difficult is telling a contractor not to make purchases that would consume badly needed working capital.

For example, in a 5 percent bonding scenario, $1 of profit left in the company (as opposed to distributing it to the stockholder) produces $20 of additional bonding availability that, if moved one and a half times in a year, produces $30 of additional work. At 10 percent gross profit, this produces an additional $3 of profit.

Nowhere can a contractor get a better deal than in the opportunity to invest in and triple the money in a year.

CASH FLOW

Cash flow is king. Accordingly, a CPA should advise a contractor on cash flow issues, from the collection of receivables to the advantages of a schedule of values that allows for money to flow in faster. Poor cash flow usually signals the beginning of trouble.

The issue of cash flow ties directly to underbillings, and a CPA's assistance in detecting and understanding the possible causes of the underbillings, their effect on cash flow and the available solutions, is invaluable. And, the proper presentation of the underbilled situation is extremely important to the surety in its underwriting efforts.

Contractors that need large amounts of equipment find themselves in the situation in which renting the equipment may not make financial sense and purchasing it uses up working capital that forms the foundation for bonding capacity. Advice and guidance on how to finance this transaction so the largest portion possible is long-term debt and not part of the computation of working capital is another instance when CPAs are instrumental in assisting their clients in obtaining more surety capacity. This is true not just in the purchasing of new equipment, but also in the refinancing of existing equipment to convert the equity in the equipment into working capital.

Although the goals of the contractor's bank and surety may sometimes appear mutually exclusive, providing detailed information to both parties and disseminating information on a contractor's financial statements increase the probability of more adequate lines of credit which, in turn, facilitates more surety capacity.

TAXES

Another area of opportunity for a CPA to assist a contractor in obtaining additional surety capacity is taxes. Under certain circumstances, contractors can use methods of revenue recognition that allow companies to postpone paying income taxes while maintaining the percentage-of-completion method of revenue recognition for financial statement purposes. This postponement can provide additional, although temporary, cash flow and provide the basis for some additional surety credit.

CONTINUITY PLAN

Sureties also need the reassurance that, if anything happens to the owner who is indemnifying them, then a plan of continuity exists whereby others complete all the work in progress without any interruptions. Construction CPAs, working with the contractor's attorney, get involved in the production of the continuity plan.

In the end, successful contractors treat their sureties as partners, and the CPAs that play a role in the process help their clients obtain the maximum surety credit.

Alvarez is president and managing director of E.F. Alvarez & Company PA, Miami. For more information, call (800) 272-5332 or email ealvarez@efacpa.com.

SAFETY PERFORMANCE AFFECTS CONTRACTORS' ABILITY TO OBTAIN A Bond

BY MICHAEL YOUNGBLUT

The safety function in a construction company touches nearly every segment of operations, including a contractor's ability to hire qualified workers. Employee safety, public safety and preservation of equipment and property are enormous responsibilities that extend well beyond the jobsite. Other than a lesson learned, nothing good comes from an accident. No matter who is involved or what the circumstances are, any accident is a setback for a project and a company.

No construction company is immune from discontinuance. Statistics show that construction business failures are spread fairly evenly among emerging firms, growth-mode companies—those that have been operating for 10 years—and well-established, multigenerational construction companies.

AN UNDERWRITING CONSIDERATION

Many factors threaten the success of a construction company, including material shortages, weather delays, labor/worker difficulties and economic downturn. However, safety performance is within a contractor's control. Accidents happen, but being proactive and having company leaders instill and demonstrate a corporate culture that places a priority on safety often minimizes the ill effects of the occasional mishap when a company is being reviewed for surety bonding. A strong safety program built on sound safety policies and practices can minimize damage or loss by allowing contractors to respond quickly and take appropriate action.

A contractor's safety performance is an underwriting consideration, and poor performance can show up in many areas of the underwriting process. Before a surety company will issue a bond, it must be satisfied the company is well managed and that all threats in the form of risk are being addressed, monitored and measured. The surety company has a keen interest in a contractor's ability to maintain a steady and productive workforce, operate a profitable enterprise, generate respect in the construction community and fulfill obligations as an employer.

The underwriting or prequalification process is fairly exhaustive. A firm's financial position is thoroughly examined, including the potential impact of pending claims. Its capacity is evaluated in terms of trained personnel, proper and safe equipment, and the experience to perform the type of work being considered. Finally, its reputation and relationships in the marketplace are appraised.

IMPACT ON FINANCIAL POSITION

Poor safety performance can affect a construction firm's financial position—in particular a company's net worth and liquidity, capacity to perform and reputation in the surrounding marketplace.

> "When employees operate under a comprehensive safety and health program, incidents of injury, illness and fatalities go down, insurance goes down and workers' compensation payments go down."
>
> —EDWIN G. FOULKE JR., OCCUPATIONAL SAFETY AND HEALTH ADMINISTRATION (OSHA)

- Stressed systems—Rapid growth is rarely a planned event. When the construction economy heats up, the natural reaction is to optimize the situation and ride the wave until the market cools. During these periods of good economic opportunity, systems are stressed, including safety management. The need for an influx of workers to handle the growing backlog can cause shortcuts. Proper procedures are skirted, jeopardizing the project and everyone onsite.
- Inadequate training—Working outside the company's core competency by venturing into a different type of work or into an unknown geographic area could result in personnel not being adequately trained for the required tasks or unfamiliarity with the area roads and local weather conditions. Insufficient or improper worker training is a leading cause of personal injury and project delay, and could result in profit fade.
- Insufficient insurance—Safety is a cornerstone in any risk management function. It is not uncommon for a company to be underinsured. Suppose some workers fail to properly execute a safety policy to secure jobsite materials, resulting in the death of a third party walking by the jobsite. This failure could reach far beyond the contract's specified limits of insurance and appear on the contractor's financial statement (e.g., high legal/professional fees and penalties and fines).
- Reputation—A contractor wants to hire the best, most productive people pos-

sible for every "audience." One audience a contractor wants to impress is owners. Another audience is prospective employees. If the company has a bad reputation as an employer—one where jobsites are unkempt and jobsite accidents are reported in the local newspaper—it will have a more difficult time recruiting and retaining a top-notch workforce.

PRODUCTIVITY AND SAVINGS

"It is a proven fact that when employees operate under a comprehensive safety and health program, incidents of injury, illness and fatalities go down, insurance goes down and workers' compensation payments go down," says Assistant Secretary of Labor Edwin G. Foulke Jr. of the Occupational Safety and Health Administration (OSHA). "At the same time, employee morale goes up, productivity goes up, competitiveness goes up and profits go up."

Foulke continues, "It costs a company far less to institute preventative measures than to wait for the inevitable, expensive consequences of a workplace illness, accident or fatality. The savings and increased productivity that an employer realizes by investing in workplace safety can help a company survive."

Practical Tips

1] **Follow strict hiring protocols**—Benchmark the competition to stay one step ahead in hiring and retention practices as they relate to safety.

2] **Understand company finance**—Make sure management understands the basic concepts of construction company finance. Studies show that a common misunderstanding exists among key employees that companies make 30 percent net profit. Everyone needs to know how decisions and actions affect the bottom line.

3] **Beware of being under-insured**—General liability claims can be the most costly. Make sure insurance limits, including excess liability, match up adequately with exposure. Consider the trade off of higher retentions against the additional premium for higher limits.

COMMITMENT TO SAFETY

Higher than average insurance costs, profit fade from lackluster jobsite productivity, outstanding claims and disputes, above-average legal expenses, OSHA fines and related litigation, poorly maintained equipment and a below-average expense ratio for employee safety training are just a few of the red flags raised in the mind of a surety underwriter. They indicate a contractor's lack of commitment to safety excellence.

Poor safety performance can cripple a company's net worth and liquidity and damage a company's well-crafted reputation. It can impede a contractor's performance by limiting the company's ability to recruit and train a highly effective workforce.

Owners know there is a price for everything and must decide if it's worth paying for a firm with poor safety performance.

Youngblut is vice president—national surety practice, Hess Egan Hagerty & L'Hommedieu, Chevy Chase, Md. For more information, call (301) 654-3600 or email myoungblut@hessegan.com.

BONDING PRIVATE PROJECTS OPENS DOORS

CONTRACTORS CAN ACQUIRE MORE WORK, GENERATE MORE REVENUE

BY MARC RAMSEY

More and more contractors realize the benefits of obtaining surety bonds on private projects. In addition to building contractors' credibility and confirming their ability to perform the job, bonding provides a competitive edge and enhances their ability to acquire work.

"The surety's prequalification of the contractor validates its experiential and financial soundness and enhances its ability to bid private and public work," says Dennis Perler, president, Liberty Mutual Surety.

Doug Hinkle, chief underwriting officer, CNA Surety, adds, "The ability to bond is independent validation of the contractor's capabilities and is viewed favorably by banks as lending partners and private owners as potential customers. Bonding involves a prequalification process that, upon bond issuance, tacitly declares the contractor has the ability to complete the work in accordance with the given plans and specifications."

So, what are the advantages to contractors?

- **Qualifications**—In today's bonding market, the value of prequalification is high. Not all contractors qualify for bonds. The fact that a contractor has a relationship and bonding capacity with a surety company is a strong indication of its qualifications.
- **Relationships**—The contractor should use the relationship with a surety bond producer and underwriter to the company's advantage. Contractors should view bonding capacity as a special type of credit. Just as contractors use bank lines of credit to finance an expansion of the business, a surety bond assists the contractor in generating new business by opening doors to new project opportunities. The contractor should hold out its bonding capacity as a "seal of approval" to encourage project owners to enter into relationships.
- **Credibility with owners**—Bonding builds a level of credibility with the project owner by giving the owner greater certainty and comfort in the contractor's ability.
- **Self-confidence**—A bond demonstrates the contractor is confident enough in its ability to secure its performance. The contractor also is making a sound risk-management recommendation to the owner, indicating that the contractor has a high interest in protecting the owner.
- **Financial strength**—During the prequalification process, the contractor's financial strength and ability to support a viable business are assessed. This includes an analysis of corporate financial statements, personal financial statements of construction company owners and work-in-process schedules.
- **Experience**—The contractor's resources, expertise and experience also are assessed

during the prequalification process. This involves a review of the contractor's largest jobs completed and its organizational chart with the résumés of key personnel.

- **Character**—A contractor's character also is analyzed by checking references and credit reports.

While most contractors equate bonding with public contracts, bonds are just as essential in private construction as a risk-management tool.

"Contractors should view surety as a marketing tool," says Henry Nozko Jr., president, ACSTAR Insurance Co. "Once you have a surety bond, it provides you with a clear, distinctive advantage over your competition that may not have a bond. Small contractors can bid to larger contractors that require all of their subcontractors to be bonded."

"Sureties," Nozko continues, "provide contractors the prequalification that will get them into doors they otherwise would not get into without a bond."

Ramsey is communications manager of the Surety Information Office, Washington, D.C. For more information, call (202) 686-7463 or email sio@sio.org.

Benefits of Surety Bonding

1] Provides contractors with a competitive advantage.

2] Validates a contractor's financial strength, capabilities and qualifications.

3] Provides contractors with value-added services.

4] Generates new business opportunities.

5] Builds credibility and trust with project owners.

CONTRACT SURETY BONDS OR BANK LETTERS OF CREDIT?

This chart highlights the differences between surety bonds and bank letters of credit.

By Marla McIntyre

CONTRACT SURETY BOND	BANK LETTER OF CREDIT
Definitions	
• A three-party agreement where the surety assures the obligee (the project owner) that the principal (the contractor) is capable of performing the contract in accordance with the contract documents.	• A cash guarantee to the owner. The owner can call on the letter of credit on demand. The letter of credit then converts to a payment to the owner and an interest-bearing loan for the contractor.
Prequalification	
• Capital • Capacity • Character	• Quality and liquidity of collateral
Borrowing Capacity	
• Often issued on an unsecured basis • No direct effect on bank line of credit • Credit enhancement	• Assets used as collateral • Diminish existing line of credit • Can affect cash flow
Duration	
• Duration of contract • Maintenance period	• Date specific—usually one year • Evergreen clauses for renewal
How to Obtain	
• Issued through surety bond producers	• Issued through banking or lending institution
Cost	
• –2 percent of contract price • Includes performance and payment bond and warranty period • Included in bid price	• Generally 1 percent of specified percentage of contract amount • Included in bid price
Coverage	
• Performance bond in 100 percent of contract amount • Payment bond in 100 percent of contract amount	• Typically 5 percent to 10 percent of contract amount • No protection for unpaid subcontractors
Claims	
• Surety investigates claim of default • Surety pays rightful claims of certain parties (payment bond)	• Payable upon demand • Owner determines validity of claims by subcontractors and suppliers

McIntyre is executive director of the Surety Information Office, Washington, D.C. For more information, call (202) 686-7463 or email mmcintyre@sio.org.

AVOIDING THE BIG 'D'

PREVENTING DEFAULT STARTS EARLY

GREAT SURETY PRODUCERS AND UNDERWRITERS MAKE CONTRACTORS STRONGER

BY MARC RAMSEY

A surety company does more than prequalify contractors. It also helps nurture and foster profitability and success.

For example, Pennsylvania National Mutual Casualty Insurance Co. recently had the opportunity to work with a construction company in business 23 years. However, Penn National's client made a couple of job mistakes that led to losses, and it was readily apparent from the financial statements the company was not following proper management practices. The company also didn't have a cost system detailed enough to show what was really going on.

After a frank conversation, Penn National resolved that if the contractor implemented certain recommendations—including bringing in a nationally known construction consultant—the surety would provide a planned, step-by-step bonding program. Once certain improvements had been made, Penn National extended more bonding capacity until all of the identified problems were corrected and the contractor was back to making a solid profit.

"Difficult times can be the best thing that ever happens to a contractor—assuming it survives," says Michael Greer, vice president of surety, Penn National. "You have to be willing to take a hard look in the mirror and figure out where you went wrong and stop doing that. It is amazing the number of times companies make the same mistake over and over again.

"Not every owner has the stamina to have someone point out their blemishes," Greer adds. These types of scenarios require a considerable amount of time and effort on the part of both the agent and the surety. Given the extra time and cost involved, there has to be a very straightforward agreement of what will and won't be done."

"Contractors are like any other business in that their ultimate success or failure is largely determined by the skill of management," explains Doug Hinkle, chief underwriting officer, CNA Surety. "Low profit managers, high overhead and poor estimating are examples of symptoms that generally point to a more fundamental problem within management."

> "Contractors need to make a sufficient profit margin on their projects and should learn to say 'no' to jobs that don't meet these margins."
>
> —TERRENCE CAVANAUGH, CHUBB SURETY

It's times like these that a good relationship with a surety bond producer and underwriter pays off—and it starts with communication. The most important thing a contractor can do is keep the surety informed when problems arise. This means communicating good and bad news to the surety bond producer and underwriter if or when problems begin. If possible, many sureties will work with the contractor to help it through the problem.

In addition to maintaining open communication, industry experts recommend contractors stay within their capabilities. In other words, think twice before working outside known geographical areas and scope of work.

Practical Tips

1] Don't take on more work than you can manage.

2] Grow your balance sheet in relation to your work program.

3] Keep your debt as low as possible.

4] Work to develop a strong relationship with your surety and provide full disclosure.

5] Understand the contract and make sure it defines default.

Contractors need to manage growth and control overhead. This includes maintaining accurate and current financial records and documenting change orders, disputes, claims and back charges.

"Construction is an amazingly complex business where many factors can drive success or failure," says Dennis S. Perler, president, Liberty Mutual Surety. "Frequently, contractor difficulties stem from rapid growth, under-capitalization, inadequate liquidity, weak internal controls and poor project oversight."

Contractors need to understand the contract—and risk variables such as financing, schedule and scope—and look for effective and equitable contract language that spells out the responsibilities of the owner, contractor and design professionals. Furthermore, the contract should define circumstances constituting default. Contractors should adhere to contract requirements, including scheduling, and comply with notice requirements.

If a project isn't right or the contract language is onerous, experts recommend declining the job. Adjust overhead instead of accepting a job merely to keep employees busy. "Contractors need to make a sufficient profit margin on their projects and should learn to say 'no' to jobs that don't meet these margins," says Terrence Cavanaugh, chief operating officer, Chubb Surety.

Michael J. Cusack, senior vice president and managing director of surety, Aon Construction Services Group, agrees margin discipline and contract language are two issues that dictate the long-term success of many construction franchises. "These are fundamental issues in the industry and both are within the contractor's control," he says. "Over the long term, the more successful contractors are generally the firms that demonstrate more discipline in applying appropriate margins to the risk profile of work and refuse to accept unreasonable and inequitable risk in construction contracts."

Finally, developing and maintaining a lasting surety relationship is essential, especially in times of economic uncertainty. The contractor, professional surety bond producer and underwriter are the key players on this strategic business team.

Advises Greer: "People who don't know you are not going to support you when you need them most."

Advice for Preventing Failure

- Use a construction-oriented accountant;
- Learn causes and warning signs of contractor failure;
- Have a bank line of credit available to support the company's business plan;
- Conserve capital;
- Bond subcontractors, especially when they represent a key trade, a significant portion or sole source of the work, or there are questions on their availability, capacity, ability or financial strength;
- Qualify the surety;
- Read and understand the bond forms;
- Understand the surety's rights and responsibilities toward the contractor and owner; and
- Qualify the owner. Is there sufficient financing? Beware of owners with a track record of litigation.

Ramsey is communications manager of the Surety Information Office, Washington, D.C. For more information, call (202) 686-7463 or email sio@sio.org.

WHY CONTRACTORS FAIL

BY HUGH RICE

Construction involves more risks than other industries, and the company failure rate is higher as well. Successful contractors must learn to manage risk. The following are the top 10 reasons contractors fail, as identified by FMI, a construction consulting firm based in Raleigh, N.C., in conjunction with the Construction Users Roundtable:

1. Overexpansion/flawed strategy;
2. Volume obsession;
3. Poor project selection, onerous contracts, unrealistic commitments and risk concentration;
4. Insufficient "real" capital or profits;
5. Poor business acumen;
6. Poor leadership and succession;
7. Poor field performance;
8. Problem owners;
9. Economic volatility; and
10. Credit market changes.

Most of these problems are seldom recognized until it is too late to save the company.

STRATEGIC ISSUES

One of the most common flawed strategies is overexpansion. Growing too fast and beyond the financial and human resources capabilities of the firm is a classic reason for contractor failure. Eternal optimism frequently leads to over-committing the firm. Instead, having a rational, sustainable business strategy is key to survival and success.

Unfortunately, revenue and sales volume are not always related to profitability.

Like overexpansion, volume obsession can blind a contractor to underlying problems and remove the necessary financial cushion to soften the blow when problems arise.

Poor project selection, onerous contracts, unrealistic commitments and risk concentration all can lead to rapid business failure. Contractors anxious to fill their backlogs seldom think they have a choice of owners to work with, so they sign contracts without considering all of the risks and make commitments they are unlikely to keep. Often contractors think:

- We have to keep our employees busy.
- We'll make it up on changes.
- We need to put our money to work.
- We're right, and we'll win in court.
- We'll figure out how to staff it once we get the job.
- That won't affect our market.
- I'm not sure where our work will come from next month, much less next year.

Sometimes a contractor's best job is the one it does not get. One bad project can put a contractor out of business. While there are times to take risks—for instance, entering new markets, working with new owners or taking on larger projects than normal—those risks should be part of a broader strategy. Spreading risk through diversification can help avoid catastrophic failure.

ORGANIZATIONAL ISSUES

People, processes and management errors represent a breakdown in the system. Insufficient "real" capital or profit indicates the accounting system produces insufficient information for decision-making.

Construction company financial statements are notoriously suspect because of the large number of estimates used to prepare them. Frequently, a substantial portion of a contractor's equity is based on percentage-of-completion estimates of projects, and the actual results are not known until the projects are complete. Phantom profits or equity can disappear and leave the firm in financial distress.

Another organizational issue is a lack of business acumen. Many good builders may not be skilled businesspeople. Financial management capability, marketing knowledge, business strategy and risk management skills may be lacking in the management of construction companies.

Construction firms often fail when moving into the next generation, whether the company is a family business, partnership or publicly owned. If the success of the firm revolves around a single, strong leader, it also may be in a position to fail if that leader can no longer lead. If the construction firm does not have a leadership succession plan in place, the business is at risk. Leadership succession is not only a question for top executives, but for those throughout the firm.

Great execution can overcome a poor strategy, and the wrong project manager or superintendent—or high turnover in these positions—can make a good strategy go bad. Adequate project control systems are critical to identifying problems early and making mid-course corrections. Even good project managers may not perform well if the systems for success are not in place.

Working with a difficult owner is a frequent reason cited for contractor failure. A poorly financed owner may cause slow pay or no pay and create liquidity problems. Disputes resulting in claims, litigation and unsigned change orders can leave the contractor in a poor negotiating position, with substantial cash tied up in a project susceptible to bankruptcy.

UNCONTROLLABLE ISSUES

Contractors can control strategic and organizational issues, but economic volatility and changes in the credit market are out of their hands. Downturns in construction tend to be sudden and severe, and can catch an unprepared firm with too much overhead or precipitate taking very low-margin work. To avoid crashing, contractors should monitor economic trends and prepare contingency strategies.

Credit markets, including surety bonding and banking credit, are the lifeblood of the contractor. Changes in the underwriting standards, like those that occurred after 2001, can create difficulties for contractors pressing the outer limits of their credit availability. In fact, several firms have sold or downsized in the past few years due to changes in the credit markets.

Firms can be more successful by studying past failures. Understanding the reasons contractors fail will help improve the industry's reputation and the credit market response, leading to a better industry for all.

Rice is chairman of FMI, Denver, Colo. For more information, call (303) 398-7223 or email hrice@fminet.com.

ELECTRONIC SURETY BONDS IMPROVE COSTS, EFFICIENCY

With the enactment of the Uniform Electronic Transactions Act in 46 states and the Electronic Signatures in Global and National Commerce Act at the federal level, electronic documents and signatures have legal standing. The electronic execution of contracts, including surety bonds, has become a reality for the construction industry.

Electronic bonding replicates the bond execution process that exists today—the signing of the bond form by the principal and surety and delivering the form to the obligee electronically through the Internet or other electronic medium, or within a web-based environment.

The National Association of Surety Bond Producers (NASBP) and The Surety & Fidelity Association of America (SFAA) strongly support the electronic execution and filing of surety bonds. The electronic filing of surety bonds reduces processing costs and increases efficiency for everyone involved in the bonding process: government agencies and other obligees, contractors and other bond principals, surety bond producers and surety companies.

ELECTRONIC BIDDING AND BONDING TODAY

State Departments of Transportation (DOTs) have been the leaders in adopting electronic bidding. Electronic bonding is being used with electronic bidding systems that fully automate the bid submission process for DOT construction projects. By using an electronic bidding system, the contractor can enter its bid data—such as name of contractor, contractor license number, project number and line item prices—directly into the DOT system through the DOT website.

Many of these bidding systems work with bond authentication systems. One of the data elements the contractor enters into the bidding system is the bid bond authentication number. With the authentication number, the bidding system can access the bid bond data. Currently, 31 DOTs have implemented, or are in the process of implementing, an electronic bidding solution. And, the Pennsylvania Department of Transportation has implemented an electronic solution for the final bonds.

Some DOTs still rely on paper bonds. Others seem willing to rely on the bond data included in the bond authentication system (name of surety, obligee, description of project, bond amount, execution date, description of bond form used, etc.).

Technology exists today to permit the delivery of an electronic bond that is signed by the contractor and surety in a secure manner. Private Key Infrastructure technology provides a secure means to use digital signatures that are verifiable and cannot be repudiated.

THE FUTURE OF ELECTRONIC BONDING

As technology matures and the use of electronic bonding expands beyond DOTs, two important principles need to be kept at the forefront. First, an electronic bond form signed by the principal and surety should be able to fully integrate into the obligee's systems. Second, as obligees consider different technologies and methods for electronic bond execution, some stan-

Who's Using Electronic Bidding/Bonding?

Department of Transportation*	Info Tech (BidExpress)	InSure Vision Technologies	Surety 2000	Custom System
Alabama	In Use	Interfaces with BidExpress	In Use	
Arizona	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Colorado	Testing	Testing		
Florida	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Georgia	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Illinois			Stand-alone solution	
Indiana	Testing			
Iowa	In Use			
Kansas	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Louisiana	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Maine	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Maryland DGS*		Interfaces with eMaryland Marketplace	Interfaces with eMaryland Marketplace	eMaryland Marketplace
Massachusetts	Testing			
Michigan	In Use			
Minnesota	In Use	In Process	Interfaces with BidExpress	
Mississippi				MDOT Bid System
Missouri	Testing	Testing		
Montana	In Use	In Process	Interfaces with BidExpress	
Nebraska	In Use		In Use	
New Jersey	In Use	Interfaces with BidExpress	In Use	
New Mexico	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
North Carolina	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
North Dakota	In Use			
Ohio	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Oklahoma	In Use	In Process	Interfaces with BidExpress	
Pennsylvania				ECMS (final bonds)
PA Turnpike*		Testing	Testing	
South Carolina	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Tennessee	In Use	Interfaces with BidExpress	In Use	
Utah		Stand-alone solution	Stand-alone solution	
Vermont	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Virginia	In Use	Interfaces with BidExpress	Interfaces with BidExpress	
Wisconsin	In Use			
Wyoming		In Process	Stand-alone solution	

*Except where noted. Note: Blair Business Systems and Workgroup Technology Partners are working with a number of DOTs, but their information was not available at press time.

dardization should be developed, and electronic bonding should present no barriers to the electronic procurement process.

If each obligee develops a system or requires the use of a proprietary system or service, sureties and producers can be forced to adapt to an array of systems and technologies, raising the cost of automation for surety bond producers, surety companies, contractors and ultimately the obligee.

Any technology adopted for the electronic execution of bonds should be open to all participants with little or no barriers, assure the validity and authenticity of all contracting parties, deliver a binding and legally enforceable document from one location to another, and be able to fully integrate the data from one system to another.

Contributed by the NASBP/SFAA Joint Automation Committee, a joint effort of the NASBP Automation and Technology Committee and the SFAA eBusiness Advisory Committee. For more information, visit www.nasbp.org or www.surety.org.

BONDING FOR SMALL AND EMERGING CONTRACTORS

WHAT WORKS AND WHAT DOESN'T?

BY LENORE MAREMA

Bonding for small and emerging contractors was a key issue in the 2006 state legislative sessions, and in several different contexts. Some states sought to increase the state bond threshold under the theory that small and emerging contractors could do bigger jobs for the state without bonding and grow their businesses.

In Indiana, a $500,000 bond threshold in Senate Bill 360 was defeated. The Utah Administrative Services Office considered, but decided against, increasing the state bond threshold from $50,000 to $100,000. State bond threshold legislation also failed to pass in 2006 in Iowa, Kansas, Missouri and Washington.

In Virginia, however, House Bill 64 raised the bond threshold from $100,000 to $250,000 for state Department of Transportation projects. As originally drafted, the bill would have increased the state threshold to $500,000 for all public projects.

This issue also arose in legislation to permit individual sureties to write bonds. The thinking was that if insurance companies did not bond small and emerging contractors, these contractors should have the option of individual backing. Individual sureties claim to pledge assets to the state to back the bonds they issue. State procurement officers have the substantial burden of determining the authenticity of the documentation of the assets pledged and verifying that pledged assets actually exist and are sufficient.

Maryland enacted House Bill 169, which now allows individual sureties to write surety bonds without being licensed as a surety or subject to regulation by any state agency. The Louisiana Senate passed Resolution 158, which calls for a study of the feasibility of permitting individual sureties to provide surety bonds on public works projects, with the possibility of legislation there in 2007. In North Carolina, House Bill 1723, which was enacted, contains a list of the items the state legislative research council is permitted to study.

Recently, small and minority contractors expressed concern about the home services contractors bonding bill (AB-

3048) still pending in the New Jersey legislature.

WHY DOESN'T THIS LEGISLATION WORK?

This type of legislation does not help small and emerging contractors because it is not aimed at them. Raising the state bond thresholds does not guarantee small and emerging contractors will get any or all of the state projects under the higher threshold, and permitting individual sureties to issue bonds does not mean they will focus their efforts on these contractors.

Even more important is whom this legislation harms. Laborers, subcontractors and suppliers on public projects must rely on a general contractor's payment bond for protection because they cannot assert mechanics liens against public property. If no payment bond is required, these parties are left with no means to collect for their services and supplies if the contractor is unable or unwilling to pay them. Small and emerging contractors are more likely to start their businesses as subcontractors, so when state bond thresholds are raised, the most vulnerable companies are deprived of payment protection.

Increasing the bond threshold may mean that all contractors will be able to bid on bigger projects without providing payment bond protection, and these may include financially unstable contractors from other states that cannot get bonded.

Similarly, if individual sureties pledge assets that don't exist, are difficult to verify or are not readily convertible into cash, everyone on the project is left unprotected. Significant abuses and fraud occurred in the past when individual sureties were permitted to issue bonds.

If individual sureties can write bonds in unlimited amounts, they could be the surety on multiple large state contracts. If the assets pledged to support the bonds are uncollectible, any or all of the contractors bonded could default and go into bankruptcy, and the public owners would be left with huge unfunded expenses to complete the construction projects.

WHAT DOES WORK?

Bonding requirements exist to provide vital safeguards for those who work on public projects and the taxpayers who pay for them. Programs currently are in place to assist small and emerging contractors in obtaining surety bonds. The Surety Bond Guarantee Program of the U.S. Small Business Administration is one example.

Members of The Surety & Fidelity Association of America (SFAA) and National Association of Surety Bond Producers are committed to making surety bonds available and accessible to all qualified contractors. They also are committed to increasing the number of small, minority and women-owned contractors that are bondable. SFAA has developed a Model Contractor Development Program to assist the local surety associations and their respective contractor communities in furthering these goals.

The relationship between a surety and its client is one of mutual help. The surety wants the contractor to succeed and grow, and the surety prospers only when the contractor succeeds.

Marema is vice president of government affairs for SFAA, Washington, D.C. For more information, call (202) 778-3637 or email lmarema@surety.org.

CULTIVATING EMERGING CONTRACTORS

BY SAM CARRADINE

A businessman from the New Orleans area expanded his real estate/property development business last year to include a demolition company to help his neighbors with the overwhelming cleanup effort following Hurricane Katrina. The contractor has razed and cleared more than 650 private residences declared irreparable by homeowners' insurance companies. Now the contractor has his eye on some of the demolition work funded by the U.S. Army Corps of Engineers. These projects, which involve direct public funding, require contract surety bonds.

A surety professional can help assess what this contractor and other emerging contractors need to do to obtain a first bond to perform some of the $200 billion in anticipated work in the Gulf Coast.

Other communities also are looking for ways to include more emerging contractors in expanding public and private construction opportunities. For example, city officials in Savannah, Ga., and Hillsborough County, Fla., want to increase minority participation on downtown renovation and revitalization projects. High Point, N.C. plans to increase the legislated bond threshold, but to date it has not resulted in greater participation by small and minority businesses in public contracting.

MODEL CONTRACTOR DEVELOPMENT PROGRAM

The Surety & Fidelity Association of America (SFAA) Chair Gary Dunbar, divisional president, bond division, Great American Insurance Companies, Cincinnati, Ohio, says SFAA has a better solution than increasing bond thresholds. "SFAA has designed an instructional program to be presented to disadvantaged contractors. It provides direction on how to become bondable, where to find resources like the Small Business Administration (SBA) and how to receive help from other professionals, such as CPAs and bankers," he says.

Originally launched in 2001, the Model Contractor Development Program (MCDP) is a comprehensive program of bonding awareness, education and support. Its objectives are to:

• educate emerging contractors about

SFAA Collaboration Efforts

The Surety & Fidelity Association of America (SFAA) has been working in a number of jurisdictions nationwide to help emerging contractors become bondable or increase their bonding capacity. SFAA members, staff and local surety associations have provided technical assistance or guidance to these jurisdictions in framing their programs:

- California Department of Transportation;
- U.S. Department of Commerce's Minority Business Development Agency;
- New Jersey Economic Development Authority;
- State of Ohio Bond Guarantee Program;
- Tennessee Department of Transportation Bond Guarantee Program for Small and Disadvantaged Business Enterprises;
- U.S. Department of Transportation Bonding Assistance Program;
- Economic Development Corporation of Prince George's County, Md.;
- National Veterans Business Development Corporation;
- City of New Orleans;
- Prince George's County, Md., Economic Development Corporation Small Business Initiative;
- Suffolk County, N.Y.; and
- Other local governments and organizations in states ranging from Texas to Massachusetts.

surety bonds and assist them in becoming bondable;
- identify resources, such as the SBA Surety Bond Guarantee Program and similar state and local programs, for obtaining a first bond;
- provide assistance and referrals for accounting, project management and financing expertise; and
- help increase a company's bonding capacity.

EDUCATION AND BOND READINESS

The MCDP consists of two interrelated components—educational workshops and bond readiness. Educational workshops help local emerging contractors access bonding and technical assistance tailored to fit their needs.

The Construction Financial Management Association is assisting SFAA with a construction accounting and financial management workshop, while Associated Builders and Contractors is responsible for a business and project management workshop.

Meanwhile, the bond-readiness component focuses on networking and outreach, capability and capacity assessments, resource identification and referral, and assistance in the bonding process. SFAA is working closely with a network of 47 local surety associations around the country that advises emerging contractors and reviews bonding prequalification requirements; assesses their capability and capacity; and develops strategies, such as recommending specialized project management, accounting or financial assistance.

OPPORTUNITIES IN THE GULF COAST

Nowhere is the need for bonding support more apparent than in the Gulf Coast region. Efforts to reconstruct the damaged infrastructure and rebuild the areas devastated by Hurricane Katrina can provide unique opportunities for local emerging contractor participation.

Dunbar cites the need for creative approaches to address access to bonding. "The surety industry needs to transform the lack of bonding for disadvantaged companies from a problem into an opportunity," he says. "We have the opportunity to help create great future contractors by pulling together groups of interested professionals who can mentor disadvantaged companies on their way to becoming great contractors."

"The surety industry needs to transform the lack of bonding for disadvantaged companies from a problem into an opportunity."

—GARY DUNBAR, SFAA CHAIR

SFAA staff has met with Gulf Coast contractors, as well as Mississippi's director for small and minority business, Louisiana's head of procurement and New Orleans' director of economic development to discuss strategies for bonding assistance for emerging contractors in the area.

SFAA continues to work closely with the City of New Orleans and the New Orleans Regional Black Chamber of Commerce to provide emerging contractors with the skills and access to bonding and financing to participate in current and future contracting opportunities as the Gulf region rebuilds.

Dunbar says, "How can the surety industry fulfill obligations to protect taxpayers, project owners and lenders, and laborers and suppliers on construction projects, while addressing the political and social issue of more bonds for disadvantaged contractors?" The answer, he says, is "a well-written, detailed roadmap, as prepared by a diverse group of interested professionals on how hard-working and well-intended individuals can become great contractors."

Carradine is director of development and diversity for SFAA, Washington, D.C. For more information, call (202) 463-0600 or email scarradine@surety.org.

SURETY INFORMATION OFFICE: THE INFORMATION RESOURCE ON CONTRACT SURETY BONDS

Established in 1993, the Surety Information Office (SIO) is the information source on contract surety bonds in public and private construction. SIO responds to thousands of requests and distributes tens of thousands of complimentary brochures, CDs and other materials on contract surety bonds every year. The following is a sampling of contractors' frequently asked questions.

Where can I find contract documents and standardized bond forms?
SIO lists links to several resources on contract documents and bond forms on its website, www.sio.org. These resources include Associated General Contractors of America, American Institute of Architects, Engineers Joint Contract Documents Committee, General Services Administration, Construction Management Association of America, Design-Build Institute of America, Surety & Fidelity Association of America (SFAA) and the National Association of Surety Bond Producers (NASBP).

How do I know I'm dealing with a reputable surety company?
Most large property and casualty insurance companies have surety departments. In addition, surety bonds make up all or most of the business for some companies. In either case, for a company to write a surety bond in the United States, it must be licensed by the insurance department of one or more states. Although some exceptions exist, generally a surety company must be licensed in the state in which it is doing business or by the state where the obligation guaranteed by the bond is being performed.

Visit SIO's website to download or order a free copy of *Surety Companies: What They Are and How to Find Out About Them*, or for links to state insurance departments, the U.S. Department of Treasury, SFAA's Bond Authenticity Program, NASBP and several rating organizations.

What is the Treasury List, or T-list, and how can I get a copy?
Circular 570: Federal Treasury Listing of Qualified Sureties, also known as the T-list, provides a list of all surety companies qualified to write bonds on federal contracts. Access the T-list online at www.fms.treas.gov/c570/c570.html.

How can emerging or minority contractors obtain bonds?
SIO's brochure, *Helping Contractors Grow: Surety Bonding for New & Emerging Contractors*, provides information on bonding assistance and support programs, mentor-protégé programs and the U.S. Small Business Administration's Surety Bond Guarantee Program. Visit the SFAA website for information on its Model Contractor Development Program.

Where can I get information on subcontractor bonding?
NASBP offers *The Basic Bond Book* and *Understanding Surety Bonding: A Guide for Subcontractors* for a fee by calling (202) 686-3700. Another valuable resource, *Subcontractor Bonds—Needless Expense or Needed Protection*, is available via SFAA's website.

SIO is supported by SFAA and NASBP. SFAA is a Washington, D.C.-based non-profit corporation that represents members engaged in the business of suretyship. Member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is licensed as a rating or advisory organization in all states, as well as in the District of Columbia and Puerto Rico, and it has been designated by state insurance departments as a statistical agent for reporting fidelity and surety experience. SFAA represents its member companies in matters of common interest before various federal, state and local government agencies.

NASBP is the international organization of professional surety bond producers and brokers. NASBP represents more than 5,000 personnel who specialize in surety bonding, provide performance and payment bonds for the construction industry, and issue other types of surety bonds such as license and permit bonds for guaranteeing performance. NASBP's mission is to strengthen professionalism, expertise and innovation in surety and to advocate its use worldwide.

For more information, visit SIO's online FAQs at www.sio.org.

SIO

Surety Information Office (SIO)
1828 L St. NW, #720
Washington, D.C. 20036
(202) 686-7463
(202) 686-3656 Fax
www.sio.org
sio@sio.org

The Surety & Fidelity Association of America (SFAA)
1101 Connecticut Ave. NW, #800
Washington, D.C. 20036
(202) 463-0600
(202) 463-0606 Fax
www.surety.org
information@surety.org

NASBP

National Association of Surety Bond Producers (NASBP)
1828 L St. NW, #720
Washington, D.C. 20036
(202) 686-3700
(202) 686-3656 Fax
www.nasbp.org
info@nasbp.org

NECESSITIES FOR EVERY CONTRACTOR'S TOOLBOX

SIO RESOURCES HELP YOU BUILD YOUR BUSINESS

The Surety Information Office (SIO) is committed to helping contractors and subcontractors grow through contract surety bonding and the valuable relationships with producers and underwriters that surety bonding provides. SIO offers a number of free resources so contractors and subcontractors can gain a better understanding of contract surety bonds.

- *How to Obtain Surety Bonds*—Provides an overview of the bonding process, from finding a producer to undergoing the prequalification process.
- *Importance of Surety Bonds in Construction*—Provides an overview of the value and benefits of contract surety bonds.
- *Surety Companies: What They Are and How to Find Out About Them*—Explains how to qualify a surety company through readily available resources.
- *Helping Contractors Grow: Surety Bonds for New & Emerging Contractors*—Provides information about bonding assistance and support programs, bond guarantee programs and mentor-protégé programs for new and emerging contractors.
- *Surety Bonds Versus Bank Letters of Credit*—Explains the key differences between letters of credit and surety bonds.
- *An Overview of the Contract Surety Bonds Claims Process*—Addresses performance bond default situations, payment bond claims and project-owner expectations.
- *Surety Bonds: A Guide for Contractors*—Contains narrated presentations and publications on an interactive CD.

For more information, visit the SIO website at www.sio.org.

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