

A surety thing

Preparing to bid on federal construction projects by obtaining a surety bond **Interviewed by Sue Ostrowski**

The construction industry has slowed along with the economy, but it won't be that way forever. And as things start to pick up, more projects will be at least partially funded by the federal government.

As a result, construction companies need to begin preparing now to be in a position to garner the surety bonds they will need in order to bid on public works and federal government projects, says Owen Brown, senior vice president at Millennium Corporate Solutions.

"The smart contractor will begin preparing today for the turnaround," says Brown. "With the economy as it is, some people are hesitant to do this now because they say there is no work. But now is the time to do it so that when there is work, you are ready. The companies that have done well over the years have done so because they prepared in the down times."

Smart Business spoke with Brown about why construction companies need to prepare themselves with a line of credit for surety bonds and how construction firms can position themselves for bond approval.

What is a surety bond?

Surety is different from insurance. The insurance company indemnifies the insured from losses for covered exposures specifically outlined in the insurance policy for a premium based upon the contractor's claim experience and potential exposure to loss.

The principal (contractor) who pays for the bond premium, which is based on his or her credit and financial strength, indemnifies the bonding company from loss. The bond forms, unlike the insurance policy, are often prepared by the government, municipality, or owner and make the contractor and surety company responsible for the bonded contract completion, lien free. All bills must be paid in full by the contractor and/or the bonding company before the bond is exonerated.

If the surety is served with a claim or lawsuit for unpaid bills or failure to complete the contract, the contractor, at his or her own expense, defends the surety from potential loss.

What can a company do to begin preparing to apply for a surety bond?

You need to establish a good solid outside management team. Identify a surety representative who has experience putting bonds together on federal projects, who knows what forms are needed and who knows the process of the federal government. In addition,



tion, you should have a CPA firm knowledgeable about construction contracts and familiar with surety company requirements. The financial report — its format and method of preparation — is a very big part of the presentation to the surety and the surety's decision to go forward with the contractor. You should also have an insurance agent who knows what insurance exposures you have when you undertake work for federal reservations and for cities and counties. Finally, you should have an attorney to consult with because, as these contracts grow, they become more complex.

Does a company need to provide a lot of information to a surety representative?

Yes, because he or she must determine if you have the experience and financial strength to do the work. The construction company will need to provide the resume of the owner and information on projects that the company has completed, including the project owners' references. The surety representative will also need a list of key personnel, because if you are dealing in construction and you want to grow, you need good, experienced people. Obtaining a bond is a credit operation. Financial strength is important and the contractor will be asked for financial statements from past years as well as current financial reports, including a personal balance sheet.

You will also need to provide information about your insurance program, simply because the representative wants to make sure

your family is taken care of if something happens to you. Last is a bank line of credit — how much the company can borrow. There can be hiccups in any construction project, and a bank line of credit can help you get through a crisis or a slow pay situation.

A line of credit for surety bonds can be established within a reasonable time frame if the construction firm is prepared. Preparation prior to a bond requirement is best for the contractor and the surety.

Is the process expensive?

Everything that the surety representative does to build the file and acquaint the surety with the company's operations is done at no cost. The only time there's a charge is when the representative writes a performance bond or payment bond on a contract. When you're bidding a job, if there is a bid bond required, there is no charge for that. Only when you get the contract do you pay.

What would you say to a contractor who has no interest in pursuing federal contracts and says he will never need a surety bond?

Contractors, especially in tough times, have to be able to make adjustments. If you've been building houses for the last 10 years, and suddenly there are no houses to build, you need to stop looking for houses to build.

With the way the economy is being restructured, most of the state contracts that we're seeing, such as public works for streets, roads and highways, are partially or completely federally funded, which means federal regulations will rule. As the state of California struggles, it is relying more on federal funds, and the federal government is getting more involved in state and local contracts. Some contractors say they don't want to work for the federal government, but no matter who they work for, they've got to realize that the federal government holds the purse strings for a lot of contracts, and it requires bonds.

Additionally, people are asking for bonds that they may not have asked for in good times. Banks previously would loan money on a construction project with no bond required. Now, when they are loaning money to an owner, they tell that owner that he or she needs to get a bond from the contractor.

By getting things in order now, you'll be prepared to bid on contracts requiring bonds. <<

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