

# Surety Credit

The surety basics you need to understand.

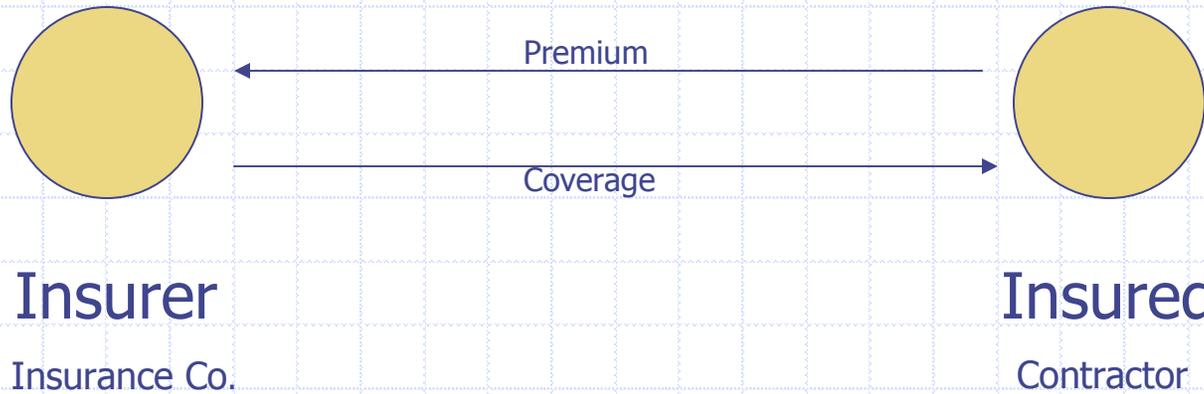
# Surety Credit vs. Insurance

Surety Credit vs. Insurance

Surety Credit vs. Bank Credit

# Insurance

## Insurance - Two Party Relationship



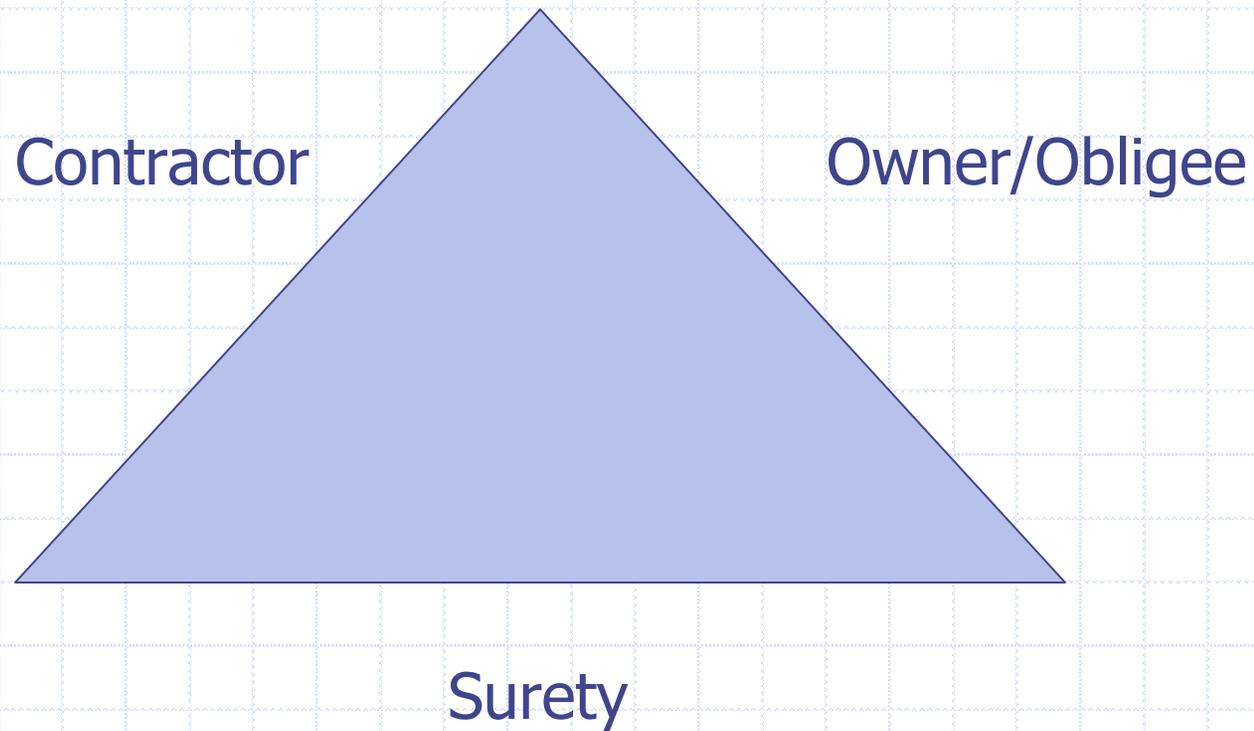
# Insurance

- ◆ Premium based on law of large numbers.
- ◆ Reimburse for covered losses.
- ◆ Spread of risk.
- ◆ Insurers expect losses.
- ◆ Premiums fund losses.
- ◆ Attempt to underwrite to a specific loss ratio.
- ◆ Risk management techniques to control/minimize losses.

# Bank Credit

- ◆ Two party relationship.
- ◆ Expect no losses. Repayment is expected.
- ◆ Charges a fee (interest) for use of funds.
- ◆ Secured creditor - collateral.
- ◆ UCC Filings.
- ◆ Corporate and personal guarantees.
- ◆ Current borrowing rates.

# Surety Credit - Three Party Relationship



# What is a Surety Bond?

- ◆ A three-party agreement.
- ◆ Surety assures project owner (obligee) that the contractor (principal) will perform according to contract documents.

# Surety Credit

- ◆ Suretyship is an ancient practice, with the first written record appearing on a clay tablet from Mesopotamia in 2750 B.C.
- ◆ Contract surety bonds protect approximately \$350 billion of construction each year.

# Surety Credit

- ◆ Provides performance and payment guarantee to owner/obligee.
- ◆ Guarantee terms & conditions of contract.
- ◆ Bid bond provides prequalification.
- ◆ Expect **zero** losses.
- ◆ Extension of credit.
- ◆ Unsecured creditor.
- ◆ Corporate and personal guarantees. GAI.
- ◆ Regulated by state insurance departments.
- ◆ Rate or premium does not contemplate losses.

# Obligations of Each Party

- ◆ Principal (Contractor).
  - Duty to owner/obligee to perform according to contract terms.
- ◆ Surety.
  - Duty to Obligee to take action if the principal/contractor defaults.
- ◆ Owner/Obligee.
  - Must abide by contract terms.
  - Compensate Principal and Surety.

# Types of Contract Surety Bonds

- ◆ **Bid Bond**-Assures the owner that the contractor has been pre-qualified.
- ◆ **Performance Bond**-Protects the owner from financial loss should contractor fail to perform.
- ◆ **Payment Bond**-Assures that the owner will pay subs, suppliers & laborers.

# Prequalification Checklist

- ◆ An organization chart.
- ◆ Detailed resumes of owner & key employees.
- ◆ A Business plan.
- ◆ Continuity plan.
- ◆ Bank credit relationship.
- ◆ Letters of recommendation.
- ◆ Relevant experience.

# Financial Statements

- ◆ CPA Opinion Page.
- ◆ Balance sheet.
- ◆ Income Statement.
- ◆ Statements of Cash Flows.
- ◆ Work in process and completed contract job schedules.
- ◆ Explanatory Notes

# Quality of Financial Statements

- ◆ **Audit**-Comprehensive financial assurance and disclosure.
- ◆ **Review**-Far less comprehensive than an Audit. Limited to inquiries.
- ◆ **Compilation**-No assurance or very limited assurance as to credibility of figures presented.

# Laws that Require Bonding

- ◆ Miller Act of 1935.
  - All Federal contracts in excess of \$100,000.
- ◆ States Little Miller Act.
  - All state contracts in excess of \$100,000.
- ◆ State Statutes.
- ◆ Municipal Ordinances and Codes.
- ◆ Private Owners.
- ◆ Prime Contractors.

# Bankruptcy Pecking Order

- ◆ Secured Creditors.
- ◆ Expenses of administering the bankruptcy.
- ◆ Expenses incurred after the bankruptcy petition is filed and before a trustee is appointed.
- ◆ Wages in 3 months before bankruptcy (\$2,000 per employee).
- ◆ Contributions to benefit plans (up to \$2,000 per employee).
- ◆ Customer deposits (up to \$900 each).
- ◆ Taxes owed to federal, state and local governments.
- ◆ Unsecured Creditors.
- ◆ Preferred Stockholders.
- ◆ Common Stockholders.

# Cost of Surety Credit

## Surety Rates.

- Less than 1.5% - Preferred Rate.
- 1.5% – 2.0% - Competitive Rate.
- Job cost.

# Surety Underwriting

- ◆ Quality financial statements with good notes disclosure with work in process and completed contract job schedules.
- ◆ Internal accounting. Job cost reporting.
- ◆ Business plan/strategy going forward.
- ◆ Succession planning.

# Maintaining Strong Surety Relationship

Strong Relationships Require Open Communication.

- Say what you mean.
- Do what you say.
- Show results.
- No surprises.
- Meet obligations.
- Be accountable.

# Problems that cause contractors to go broke

- ◆ Grow too fast.
- ◆ Take on work in new territory.
- ◆ Take on unfamiliar work.
- ◆ Loss of leadership or key people.
- ◆ No formal continuity succession plans.
- ◆ Death of major stockholder or key people.
- ◆ Bad luck, weather, strikes, bankrupt subs or owners, volatile material prices.
- ◆ Incompetent estimators or field managers.
- ◆ Rely on bad information or poor MIS.
- ◆ Follow a flawed strategy too long.

# SBA Eligibility

- ◆ Contract amount must be \$2 million or less.
- ◆ Business must be independently owned and operated and qualify as a small business.
- ◆ Average annual receipts for last three fiscal years cannot exceed \$6,000,000.
- ◆ See SBA website: <http://sba.gov.osg>

# Indianapolis SBA Office

Michael L. Hasler

US Small Business Administration

8500 Keystone Crossing, Suite 400

Indianapolis, IN 46240

317-226-7272 Ext. 241

[Michael.hasler@sba.gov](mailto:Michael.hasler@sba.gov)

# Other Resources

◆ National Association  
of Surety Bond  
Producers (NASBP)

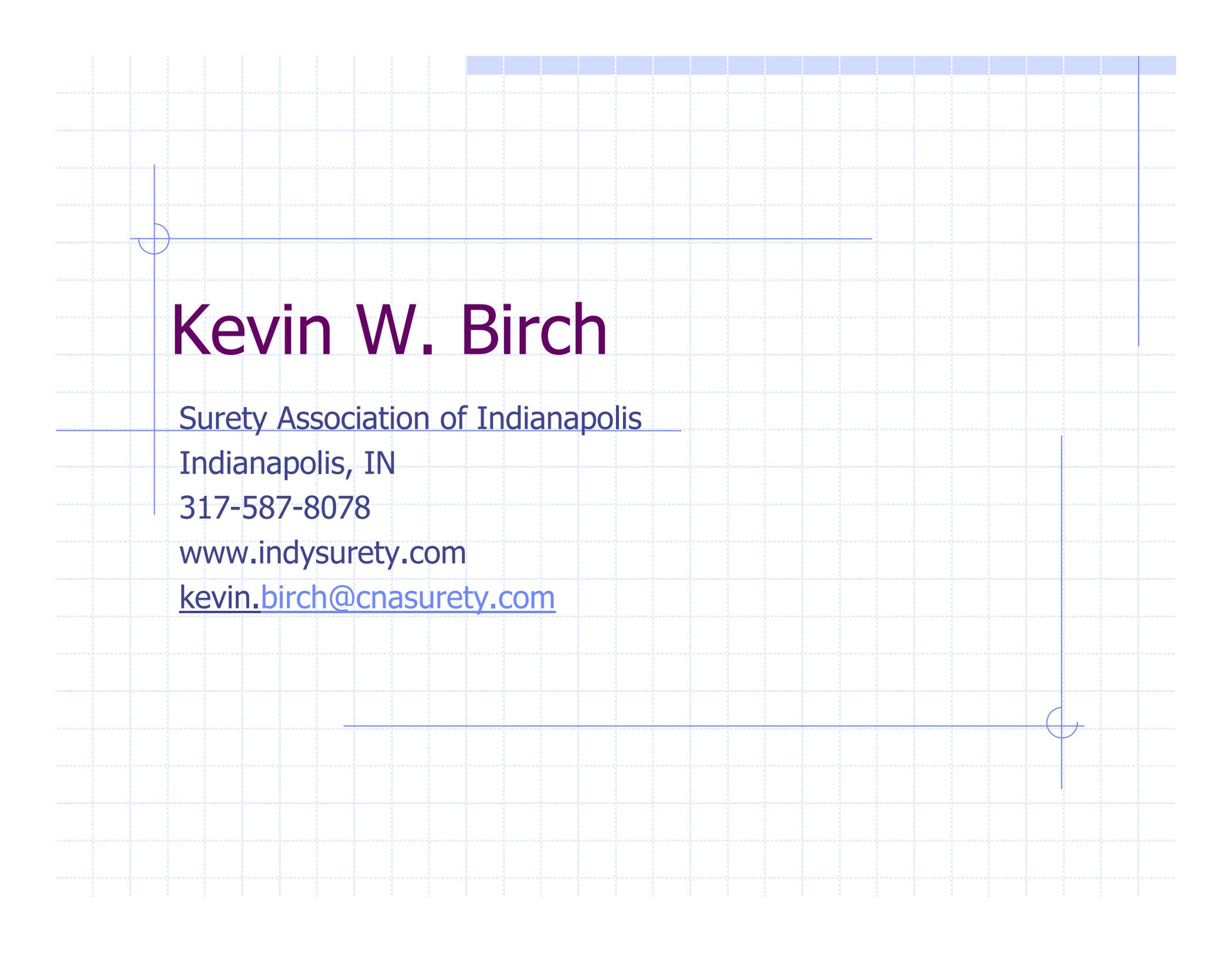
[www.nasbp.org](http://www.nasbp.org)

◆ Surety Information  
Office

[www.sio.org](http://www.sio.org)

◆ The Surety  
Association of  
America

[www.surety.org](http://www.surety.org)



# Kevin W. Birch

Surety Association of Indianapolis

Indianapolis, IN

317-587-8078

[www.indysurety.com](http://www.indysurety.com)

[kevin.birch@cnasurety.com](mailto:kevin.birch@cnasurety.com)