

Building a Solid Surety Relationship

By The Surety Association of America and the National Association of Surety Bond Producers.

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The contractor/surety partnership is essential to the growth and development of a contractor. In order to increase their workload and bid larger jobs, contractors need the backing of a financially sound surety company willing to extend the necessary surety credit. So your growth potential is inextricably bound to your surety relationship.

There are three basic stages to a healthy long-term surety relationship: meeting, maintaining, and maturing. This article looks at each of these stages and explains what steps can be taken to develop a mutually beneficial partnership with a surety company.

MEETING THE SURETY

Just as your business is constantly changing, so too is the surety's. In all likelihood, your business is dramatically different than it was just two years ago. Before making a determination in the amount of surety credit to extend, your underwriter needs to have a clear picture of your company today.

Surety underwriters may be requesting information they had not in the past. Underwriters want to know how the business is being run. They are becoming as concerned with resumes of key employees and comprehensive business plans as they are with your financial statements. It is important to know not only what the surety company needs, but also why it needs it.

Because things change so quickly, it is imperative that a meeting is scheduled with the surety underwriter and the producer (a.k.a. agent/broker) at least once a year to make sure everyone is on the same page. The best time to hold this meeting is shortly after the annual financial statement is available. It is a good idea to bring in your CPA and Chief Financial Officer/Comptroller to provide a clear picture of the company's financial condition.

The surety underwriter wants to know where the company is going and the plan to get there. Not only are underwriters interested in whether the financial statements are sound, but they also want the assurance that personnel is available to maintain your workload. The company's business plan for the next 12 to 24 months is an extremely important part of developing a surety relationship.



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The surety underwriter uses financial statements and business plans, among other factors, to determine the amount of surety credit the surety will extend.

MAINTAINING THE RELATIONSHIP

Open communication, timely financial statements, and no surprises are the keys to a good surety relationship. You've probably heard of the three Cs of surety underwriting (capital, capacity, and character). Capacity is easily quantifiable, either the personnel and equipment are available to take on a specified workload, or they aren't. Capital however is the great unknown. The surety underwriter and producer depend on timely and accurate financial information.

Maintaining a surety relationship requires open and honest communication with the surety bond producer and surety underwriter. All parties must say what they mean, do what they say, and show the results. There should be no surprises from the surety or the contractor. All parties must meet their obligations and remain accountable.

The primary conduit for communicating to the surety is through the job status report. The job status report is a snapshot of the business, and should be given to the producer on a bimonthly or quarterly basis to provide the surety with a clear picture of how the company is achieving its goals. The job status report should reflect all jobs undertaken, bonded and non-bonded, and provide consistent and conservative evaluations.

The surety underwriter analyzes each job status report and tracks a contractor's work history. The underwriter is looking for patterns and project management strategies. The surety realizes problems will occur on a job. The question is: "Is the surety notified when problems arise, or are they postponed in order to retain the surety line a few months longer?"

QUESTIONS THE SURETY WILL ASK

- 1. Are there large costs and earnings in excess of billings?** – If so, the surety will want to know:
 - Is the gross profit holding?
 - Has the owner failed to pay?
 - Have progress billings not been approved?
 - Have unapproved change orders been included in the costs?
 - If the job is complete, why hasn't it been fully billed?
- 2. Are billings in excess of costs?** – Overbillings may not be an issue provided the contractor recognizes that the project is overbilled. Substantial overbillings should reflect a strong cash balance. If not, you will need to explain this to the surety.



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3. Is the profit margin holding? – Sureties understand that some projects may experience profit fade. However, they get concerned when a contractor continually anticipates a high profit margin only to see it dwindle as the project moves on. There are several explanations for continuous profit fade including:

- Poor job cost procedures and inability to accurately determine cost to complete;
- Inability to accurately reevaluate problems on a job; or
- A contractor that is withholding information on problems with the project.

TRUST, RESPECT, AND ACCOUNTABILITY

A surety company would rather be informed immediately of problems. The surety should be provided with profit and loss statements based on percentage of completion. Realize that inflated profit and loss statements with significant profit fade by the end of the project raises a red flag.

Sureties can accept problems on a job; they see them every day. They understand your profit margins may shrink, but when it happens consistently, the surety becomes concerned with the business. These concerns could have a significant impact on how much surety credit they are willing to provide. However, open communication will gain their respect and confidence.

Maintaining the surety relationship requires trust, mutual respect, and accountability. To maintain and increase surety credit these qualities must be demonstrated over a long period of time. Provide the surety accurate, detailed, and consistent feedback on the business. Over time you will earn the trust and respect of the surety company, which is vital to the surety relationship. So, when increased bonding capacity is needed, the surety will support it because the financial results confirm your company's ability to maintain good margins on the current work program.

MATURING TO A GROWING PARTNERSHIP

Sometimes it may seem that the surety is only concerned with numbers on paper. The reality is that those numbers reflect more than the bottom line. They reflect character, management style, and commitment to foster a relationship with the surety. A lack of financial diligence is one of the biggest causes of surety credit problems.

Realize that surety companies are not looking for contractors to build a project, they are looking for sound businesspeople who run construction companies. Fulfilling contractual obligations is important, but you must also be able to generate income from those projects. The surety is not going to increase



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surety credit when your projects are just breaking even. They want to know that your company can continue to grow and generate revenue from the workload taken on.

The producer is the primary surety contact. The producer is the first person to speak with about a problem or concern. The producer will be able to communicate those concerns to the underwriter and help negotiate the best way to resolve them. The professional surety producer understands the surety underwriter's position and is best suited to help organize the business and communicate the plans to ensure a profitable, long-lasting relationship with the surety company. Do not rely solely on the producer to maintain the relationship with the underwriter though. Take the time to meet with the underwriter and build a strong working partnership.

An underwriter's primary goal is no default. If the underwriter is comfortable with your company's work program, he or she will have no problem providing surety credit. However, there may be a very good reason that the underwriter is unwilling to increase the credit line. In circumstances where there is disagreement as to whether the business can handle increased work capacity, listen to the underwriter's objections and address them specifically. The underwriter wants you to succeed. Trust that the underwriter's decision is made in your company's best interest and the relationship will be mutually beneficial.

Developing a relationship requires commitment, trust, and above all communication. Maintaining the relationship through open communication and timely reporting on the company's financial condition and job status reports shows character and builds trust with the surety. Maturing into a growing partnership requires teamwork and an organized effort between your company contact, the surety underwriter, and the surety bond producer.

There may be difficult times, and the surety may not always be willing to extend the level of surety credit your company would like. But by maintaining a relationship with the surety company, trust will be built and they will increase their commitment to your company over time. Following these guidelines will create the opportunity for a successful long-term relationship that will be mutually beneficial to your company and the surety.

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