Introduction to Bonding

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Advantages of Bonding

- Bonded firms have more job opportunities
- A bond helps grow a business more profitably
- Firms that are bonded stay in business longer (due to secondary oversight on projects)
- Large prime contractors and agencies will understand that your firm has the capacity to complete projects successfully

What is Bonding

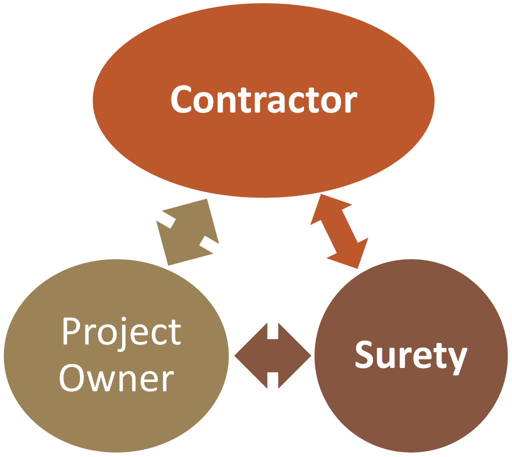
A **Surety Bond** is a three party contract:

- **The Contractor** promises to do the work;
- **The Surety** guarantees that the Contractor can do the work, and steps in to complete the work if the Contractor cannot; and
- **The Project Owner** pays for the bond in exchange for this guarantee

What is Bonding

A bond is an instrument of **pre-qualification:**

The **surety** tells the agency/prime/**project owner** that the **contractor** has been examined and found to be qualified to complete the **project**.



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Qualifying for Bonding

- To apply for bonding you must complete a detailed Application.
- First impressions are important – how you present your firm in the application is the first qualifying step.
- Depending on the size of your firm, a great deal of additional information may be required to qualify for bonding.

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Qualifying for Bonding

Underwriters look at the 3 C's when evaluating an application:

- Is the principal trustworthy, reputable and of good **character**?
- Does the principal have the **capacity** to complete the work guaranteed by the surety bond?
- Does the principal have adequate **capital** to finance and complete the work that is to be bonded?

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Qualifying for Bonding

An Unofficial "4th C is just as important:

- **<u>Cooperation</u>** is required to qualify for bonding and to maintain a strong relationship with your bonding company.

- This means that your application should be complete (no unanswered questions), honest and neat. All requests for additional information should be answered immediately.

- **<u>Don't be afraid to ask your broker for help. If your broker wont help, seek a broker dedicated to working with small contractors!</u>**

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Bonding vs. Traditional Insurance

- To secure business auto insurance, the contractor completes an application, submits it to the broker/agent and secures a quote.

- To qualify for bonding, the contractor must prepare an in-depth submission. This often requires the firm to create documents they may not have, and establish systems they may not understand.

- When a claim is made on an auto policy, the adjuster assesses the loss and a check is cut to pay for repairs exceeding the deductible. The premium may go up, but the insurance company does not ask the policy holder to repay it for the cost of repairs.

Bonding vs. Traditional Insurance

When a claim is made against a surety bond, the surety replaces the contractor and finishes the project within the scope of the terms of the contract at no additional cost to the owner.

- The surety, relying on the General Indemnity Agreement, holds the contracting business and the owners personally liable for all costs exceeding the contract amount.
- All sureties require the business owner to assume personal liability for losses if the business cannot pay.
- In other words, the contractor must pay the surety back for the money and services it has advanced on its behalf.
- It is crucial to be well prepared for any project you bid!

Requirements for Bonding

Requirements for bonding vary based on the size of the contractor:

1. Under $ 500,000 in revenue
2. Over $ 500,000 in revenue
3. Over $5,000,000 in revenue

Each tier has different requirements for an underwriting submission, with the under $500,000 tier able to submit the "fast and easy" applications that rely heavily on the business owner's personal credit score.

Starting at $500,000 in annual revenues, firms begin to require more in-depth or "full" submissions. These requirements are laid out in the next slides.

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Contractors under $400,000

Limited Bond Line

- Various bonding ranges capped but most are capped at $400,000
- Document Requirements must be able to furnish some financial statements to qualify for bonding

Fast Qualification Process

- Based mostly on Credit Score
- 1- 2 day Approval

Project Limitations

•Projects that last longer than 12 months do not qualify
•Projects that require work near or on water are not eligible
•Projects excluded include any contract that has asbestos, mold, lead or other environmental hazards
•Cannot subcontract more than 50% of project cost

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On-Line Bond Submission (<$500m)

- Largely based on your credit scores
- One or two financial statements or tax returns are required
- Bank statement (working capital) must be verified

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Full Submission for Contractors over $500,000 in Revenue

Documents Required:

- Questionnaire – 5 pages
- CPA Financial Statements (3 years preferred)
- Tax returns
- Resumes of Key employees
- Bank letter and statements
- Proof of Insurance
- Personal Financial Statement of owner(s) and spouse(s)
- Work in Progress schedule
- Accounts Receivable aging schedules
- Organizational chart (sometimes required)
- Job references – completed projects

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Bonding Capacity

What a contractor **BELIEVES** should be their bonding capacity may not be what the surety is willing to support.

A firm must **QUALIFY** for a bond or bond line. Examples:

- An underwriter will not grant a bond for a $1mil project if the largest completed contract was $500,000
- An underwriter will not grant a bond to a GC for a plumbing contract – it is outside of their regular scope of work
- A rule of thumb is that a surety will not bond a project that is more than 1 ½ times the size of your largest recent project.

How to Begin the Process

- Most bonding companies require that you apply through broker.
- Contractors with less than $500,000 in revenue can apply to some sureties directly by completing online applications.
- Not all insurance brokers understand bonding. You need a specialist.
- Not all bond brokers work with small contractors. Make sure to ask your broker if they handle contractors that are your size and if they have access to markets focused on small firms.

Ask your local small business resource center for help finding a surety bond broker in your area.

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THANK YOU

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