

Bonding Basics



Basic Bond 101

- **What is a Surety Bond?** “Co-signer for Hire”
- ***Parties to a Bond include:***
 - The “Principal”, the party required to provide the bond
 - The “Obligee”, who the bond is in favor of (usually an Owner, GC or Govt Agency)
 - The “Surety”, the company guaranteeing the obligation under the bond per the contract
- ***Types of Bonds:***
 - Contract:** Includes Bid, Performance and Payment, Maintenance and Supply
 - Commercial Bonds:** Non-Construction contract, license and permit, court, janitorial, healthcare and so many more!
- ***Benefits of having a bond include transfer of risk, guarantee of contract performance, 3rd party verification of Contractor capability, protects taxpayer dollars on government projects.***

Understanding the Underwriting Process

The 3 Cs of Surety

“Capital, Capability, Character”

Financial Strength

Experience in the scope of contracted obligation

Credit Rating of Indemnitors

History of Paying Suppliers and Subs

Established Bank Relationship and Line of Credit

Experience of Key People

Financial Statement Quality

Bond Limits

Based on underwriting criteria such as:

Largest job completed

Available working capital

Surety Treasury Limits

Financial Statement Quality *based on current market trends

Internal statements (\$2MM)

CPA Compiled Statement (\$4MM)

CPA Reviewed Statement for bonds over \$2MM (Most bonding programs are provided at this level)

CPA Audited Statements for bonds and programs that exceed \$25 Million

Bond Costs

Costs range depending on type of bond and underwriting criteria

Bid Bonds – No Charge (in standard bonding program)

Performance and Payment Bonds – 1-5% of contract price*

Commercial and Misc. Bonds – generally 1-3% of bond penalty amount

Other factors that could influence overall cost is use of additional tools such as collateral, funds dispersal (fka Funds Control) and SBA Bonding Program. These apply to non-standard bonding programs

Where do I start?

<u>Gather your “A” Team</u>	<u>Plan to Fail</u>	<u>Get Sophisticated</u>
<ul style="list-style-type: none">• Banker• Obtain CPA specializing in your industry that understands surety• Retain Attorney specializing in your industry• Insurance Agent• Professional Bond Agent	<ul style="list-style-type: none">• Consult CPA BEFORE fiscal year end and obtain “Percentage of Completion” basis statement either on “Review” or “Audited” (depending on your needs, keep in mind a “3- year tail”)• Have your attorney review contracts PRIOR to signing• Obtain your bank lines of credit when you DON’T need them for as high as you can qualify.	<ul style="list-style-type: none">• Obtain an integrated accounting and job costing system• Knowledgeable bookkeeper/CFO• Maintain high quality, quarterly interims and job schedules• Maintain a system for collecting receivables on a timely basis

Roadblocks to Success

You are what you do, not what you say you'll do

DON'T

- Ineffective financial management system
- Maxed bank lines of credit
- Poor estimating/job costing
- No business plan
- Lack of communication
- Litigation/Notice of Non-Payments/Tax Liens
- Uncontrolled growth
- Venturing into unknown territory or scopes of work
- Signing contracts without reading or negotiating terms in advance – Be Sure to watch for onerous language!

DO

- Communicate openly with your “A” team
- Network, Network and Network some more! Build those relationships
- Join associations . Your competition can also be a partner.
- Reach out to local PTAC – find out about available certifications
- Remember there are two parties to the contract, negotiate fair terms for both parties
- Watch out for onerous language such as extended warranty provisions, high liquidated damages and especially “consequential damages” in your subcontracts. They can be a surety killer!

Other Current Market Hot Topics:

- Jumps in job size – contract costs have gone up along with inflation
- Bid Spreads – “Why does my surety ask for an explanation”
- Onerous Contract Language – things to consider BEFORE you sign the contract – Read the clauses!
- Job Start Delays – How does this affect the bonding?
- Geographic or Scope Expansion – “know before you go”

SBA Surety Bond Guarantee Program News

- Source – [Federalregister.gov](https://www.federalregister.gov) – February 15, 2024 -SBA announced new guidelines for small business qualification. These go into effect on March 18, 2024.
- Previous guidelines for contractor size – No more than \$15 Million in tangible net worth and not more than \$5 Million in average net income over 5 years.
- New guidelines state – No more than \$20 Million of tangible net worth and net income is \$6.5 Million over 5 years.
- Bonds Limits – New single contract limits up to \$9 Million and up to \$14 Million for federal contracts that are certified by the contracting.
- Caveat – Surety is still first line of underwriting, SBA re-insures the Surety

QUESTIONS?



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