To Bond or Not to Bond

Many contractors have discovered that working on projects requiring bonding can be extremely profitable. These are typically Public Works and Commercial Projects. Contractors have found the higher the level of bonding they obtain, the less bidding competition they encounter. Going after jobs that require bonding is not for all contractors; but if it is something your company might pursue, I recommend getting your company bondable *before* you need a bond.

What is a bond?

A bond is a guarantee. The surety provides a guarantee to the project owner that a particular project will be completed and the bills paid. The surety is *not* guaranteeing the contractor will complete the project, just that the project will be completed by someone.

Types of bonds used in construction

There are three types of bonds we want to consider for now:

- **Bid Bond** – The bid bond serves to pre-qualify the contractor's ability to supply a performance bond and payment bond if the contractor is awarded the contract.
- **Performance Bond** – The performance bond is the surety's guarantee to the owner that the work will be completed under the contract.
- **Payment Bond** – A payment bond is the surety's guarantee to the owner that the contractor will pay the subcontractors, suppliers, and laborers used on the job. Payment bond serves to protect second-tier subcontractors and suppliers, thus assuring the owner the job will not be shut down by subcontractors or suppliers who have not been paid.

How bonds differ from insurance policies

One misconception contractors might have about surety bonding is that sureties are just like insurance companies, and bonding is another form of insurance like property and casualty insurance. No true. Although many insurance companies provide bonds, a surety is more like a credit grantor (similar to a bank) than an insurance company. Casualty underwriters (insurance companies) anticipate some losses. Sureties do *not* write bonds with the anticipation of incurring losses. The surety bond cannot be canceled during the period of the contract, insurance policies can be cancelled.

Obtaining a Bond

The surety analyzes a substantial amount of information prior to granting or increasing bonding lines. Presenting the contractor's financial statements is a most critical factor when it comes to becoming bondable.

The Sureties analyze contractors by Capability, Character and Creditworthiness.

- **Capability**. The surety must determine if the contractor is capable of performing the work. The surety focuses on both the principal's individual experience as well as the company and key employees to determine the capability to perform the work. The surety also evaluates the contractor's company operations. This includes evaluating estimating, administration, technical experience, project management and cost accounting to make a determination of the bonding ability of the contractor.
- **Character.** The surety will consider the reputation of the contractor for paying subcontractors and suppliers. Who does the contractor use as professional advisors? Are credit references reliable? Are job references trustworthy? Is there a litigation history?
- **Creditworthiness**. The surety will typically request reviewed financial statements, prepared by a C.P.A. These records include (but are not limited to) the following: Income Statement; Balance Sheet; Aged accounts receivable; Aged accounts payable; Statement of cash flows; Work-in-process schedule; Completed-contracts schedule; Schedule of general and administrative expenses; Direct and indirect costs; Fixed-asset and equipment lists; Personal financial statements on the owners of the contracting business; Income tax returns for the business and its owners; Current year interim financial statements, and, Current financial budgets and forecasts.

Is a surety bond worth the effort?

A contractor's ability to secure surety bonding has a dramatic influence on the company's ability to bid and win projects, and to attract high quality, reputable subcontractors who have reputations for completing projects. While you might be thinking that becoming bondable is a daunting task, there is an undeniable link between winning larger, more profitable projects and being bonded.

So, as with most worthwhile endeavors, taking one step at a time makes the overwhelming doable. And, in the long run, winning some of those big projects can be well worth the effort.

-Donna Caswell, President, On Track Business Management, Inc. On Track provides a full-slate of financial services that have helped contractors meet their financial goals for 20 years.

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