Bonding Overview

Presented

by

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Why is bonding important?

- Almost all public construction work in US (Federal, State, and local) is bonded
- More general contractors are using bonding capacity to assist in the prequalification of subcontractors even if they ultimately do not require the sub to provide a bond.
- Bonding required for private construction work is increasing
- Being bonded provides a contractor with opportunities for a more diverse revenue stream
- Bonded contractors can bid public construction on a prime basis
- BONDING = EMPOWERMENT and OPPORTUNITY

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Heard Act of 1894

- Established a single performance and payment bond for federal contracts but was fraught with limitations.

Miller Act of 1935

- Enacted by Congress in 1935.
- Requires prime contractors on most federal government projects to post bonds to guarantee performance of heir contract and payment to their subcontractors.
- Protects first and second tier subcontractors and suppliers.
- Most states have enacted a "Little Miller Act" which defines bond requirements for state work. These differ from state to state.

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What Is A Surety Bond?

- A three-party agreement whereby one party (the Surety) becomes obligated to a second party (the Obligee) to perform the obligations of a third party (the Principal) in the event the third party fails to fulfill the obligation.
- Biblical references to surety. Proverbs 11:15 "He who is surety for a stranger shall smart for it, and he that hateth suretyship is sure" (safe).
- Prior to recognition of corporate sureties, obligations were guaranteed by individuals.

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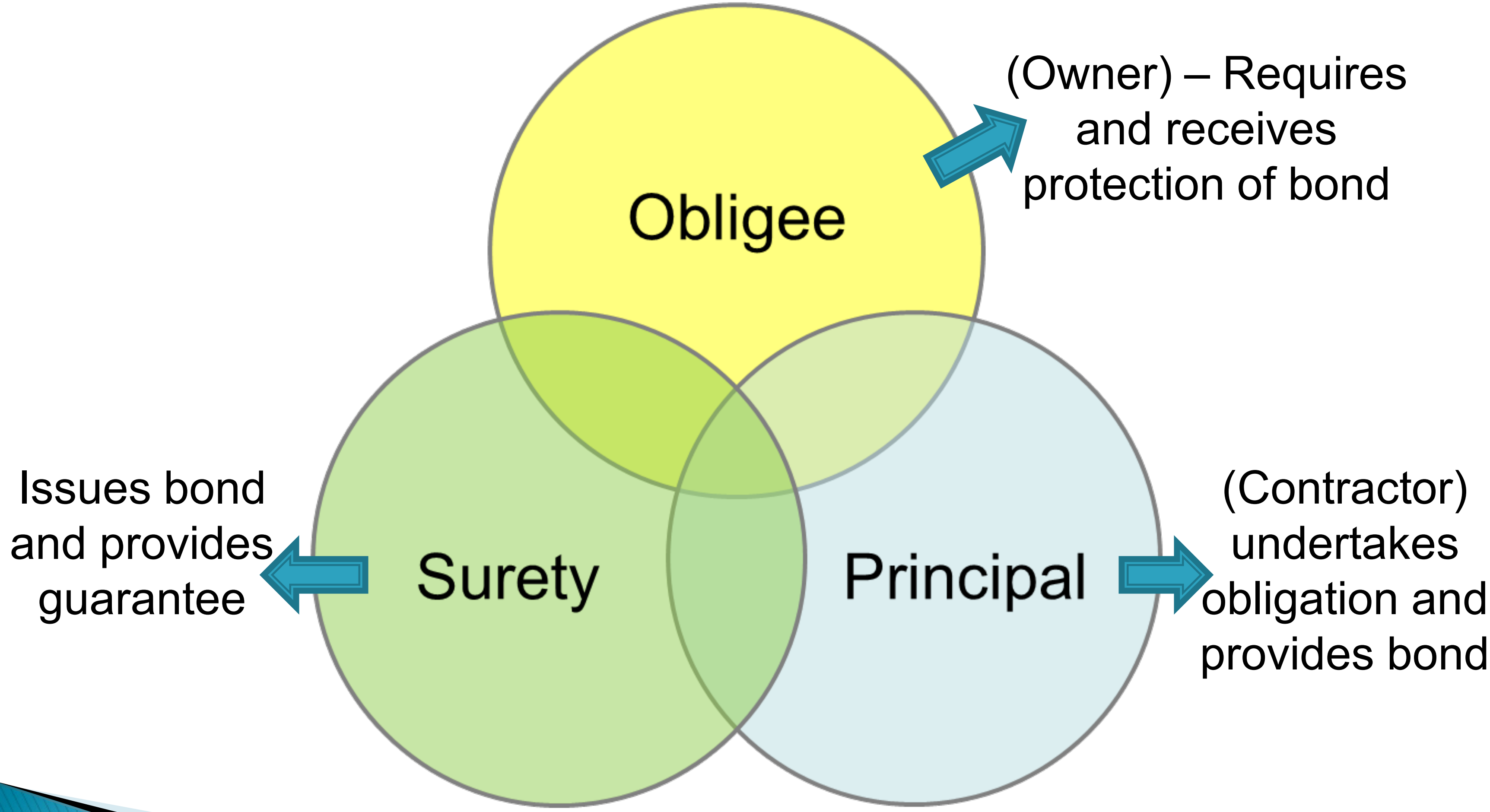
Parties to a Surety Bond



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Unique Characteristics of a Surety Bond

- Surety bonds guarantee up to 100% of the contract amount.
- Surety bonds are not insurance, but are a third-party guarantee
- Surety bonds are more like bank credit than insurance
- Surety bonds are written on a "no-loss" assumption
- Surety bonding is a 3-party agreement, not 2-party like insurance
- Obligee (owner) is the "protected" party, not the Principal (contractor)
- Contractor/Principal is ultimately liable for all losses (through the indemnity agreement)
- Prequalification is key – not every contractor will qualify for bonding

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Types of Surety Bonds

- Commercial Surety bonds
  - Wage and Welfare
  - Court
  - License and Permit
- Contract Surety Bonds
  - Bid Bond
  - Performance Bond
  - Payment Bond
  - Maintenance Bond

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Surety Underwriting

- The 3 C’s
  - Character
  - Capital
  - Capacity

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The 3 C's

- Character
  - Reputation in the community
  - Personal credit history
  - Bill paying habits
  - Deals with owners, subs, suppliers, employees fairly
  - Resolves disputes amicably
  - Avoids litigation

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The 3 C's

- Capital
  - Equity (net worth)
  - Working Capital
  - Debt Structure
  - Liquidity
  - Leverage
  - Available Bank Credit

The 3 C's

- Capacity
  - Technical Skill
  - Depth of Management
  - Qualifications of Personnel
  - Employee Retention
  - Experience with type and size projects for which surety credit is being sought

Traditional Bonding Company Requirements

- In business for 3 years with profitable results.
- Provide CPA Review year-end financial statements.
- Have working capital and net worth equal to 10% of maximum backlog
- Have line of credit from bank.
- These requirements can be more or less depending on current market conditions.

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Bond Markets

Market/Program	Cost	Comments
Quick Issue Bonds	3%	Limited to $500,000 single bonds. Underwriting is based on credit score of owners. No financial statements required. Good market for infrequent bidder.
Collateral/Funds Control	3%+	Surety secures itself with collateral (irrevocable letter of credit) an/or funds control (escrow)
Small Business Administration Bond Guarantee Program	3.1%	Must be considered a Small Business by the SBA according to NAICS. Single bonds up to $10M. Very flexible underwriting.
Standard Markets	0.5 to 2.5%	Company personnel are usually more skilled and experienced. Lower overall cost and ease of doing business. Higher underwriting standards

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SBA Bond Guarantee Program

- Created in 1971 to provide guarantees to bonding companies willing to provide bonding to contractors who are unable to obtain bonding in the standard surety market.
- Guarantee to surety company can be as much as 90%.
- SBA can provide guarantee for single bonds up to $6.5 million. Can go as high as $10,000,000 at request of Contracting Officer.
- SBA Quick Bond Program can provide single bond guarantees of $400,000 with no financial statements.

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SBA Bond Guarantee Program

- Underwriting methods are unique and "relaxed" allowing for a greater amount of surety credit to be granted to a contractor than would be available in the standard market.
- Fee to contractor for an SBA guarantee is 0.6% of the contract amount.
- Fee to the surety for an SBA guarantee is 20% of the contract amount.

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SBA Bond Guarantee Program

- Many agents listed on SBA web site as participating in SBA Bond Guarantee Program, but few actually do. It is important to understand the nuances of the program to be successful for your customers.
- The Fedeli Group is the 7th largest agent in US for 2021 and was named Agency of the Year by SBA in 2018.

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Who is a Candidate for SBA Bond Guarantees?

- Must be defined as a small business by the SBA. Size standards are determined by North American Industry Classification System (NAICS). Link is https://www.sba.gov/document/support-table-size-standards
- Average annual sales last 5 years determines size.
- $39.5 million for general contractors. $16.5 million for specialty trade contractors.
- New Companies (in business less than 3 years)
- Companies with limited or no equity or working capital.
- Companies experiencing fast growth who cannot get the amount of surety capacity needed from the standard market.
- Companies who suffered recent losses and need a place to go while they are regaining their financial footing.

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Federal Contracting

- Federal government establishes formal goals to ensure small businesses get fair share of work
- All federal government purchases between $10,000 and $250,000 is automatically set aside for small businesses
- Other contracts set-aside for small businesses meeting certain qualifications

Federal Contracting

- 8 (a) Business Development
  - Be at least 51% owned and controlled by U.S. citizens who are economically and socially disadvantaged
  - Be owned by someone whose personal net worth is $750,000 or less
  - Be owned by someone whose average adjusted gross income of $350,000 or less
  - Be owned by someone with $6 million or less in assets
  - Have the owner manage day-to-day operations and also make long-term decisions
  - Have all its principals demonstrate good character
  - Show potential for success and be able to perform successfully on contracts

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Federal Contracting

- **Historically Underutilized Business Zone Small Businesses (HUBZone)**

  - 51% or more of my business is owned, controlled, and primarily managed by U.S. citizens, a Community Development Corporation, an agricultural cooperative, a Native Hawaiian organization, or an Indian tribe
  - Certified business is "small" in its primary industry in accordance with SBA size standards for that industry
  - Have its principal office located in a HUBZone
  - Have at least 35% of its employees live in a HUBZone

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Federal Contracting

- **Service-Disabled Veteran-Owned Small Businesses**
  - I am a service-disabled veteran (SDV) or a caregiver and I own and control 51% or more of my business
  - As an SDV, I hold the highest officer position in my company
  - I have a service-connected disability that has been determined by the Department of Veterans Affairs (VA) or Department of Defense (DoD)
  - My SDVOSB is assigned a small North American Industry Classification System (NAICS) code for procurement

Cost of Surety Bonds

Bid Bond	No charge
Performance Bond	½ - 3% of contract price
Payment Bond	Price included with performance bond
Maintenance Bond	1st Year included with P&P bond. 0.25% per year on amount of bond thereafter.

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