Opportunities Grow, but Contractors Find Challenges with **Sureties**

BY DOUG RIEDER
PRESIDENT AND PRINCIPAL
STERLING RISK ADVISORS

IN THE CONSTRUCTION BUSINESS, COMPANIES REQUIRE surety bonding to secure projects, ensuring that a project will be completed should the contractor default for any reason. It appears we've reached an inflection point in our economic recovery cycle in this regard. Contractors are finally starting to see new opportunities with healthy profit margins. Unfortunately, many are coming off three to five years of losses or near-losses, making them a less attractive candidate for bonding.

Conversely, sureties — the companies that provide that bonding — have taken significant losses since the downturn, so there is a tendency on their part to be tighter with the credit the contractors need to pursue these attractive new projects.

Contractors whose sureties are balking on providing deals have several options for improving their outcome. They may be able to renegotiate, or it may be time to look for a new provider. If you choose to pursue the latter course of action, make sure you are an "attractive" surety client by running through this preparedness checklist before approaching your current provider (or a new one) about securing new coverage or expanding what you have currently.

CHECK YOUR BANK LINE OF CREDIT — IS IT ENOUGH?

Is your bank line of credit adequately sized for your work program? If you typically work on $20 million projects and have a $1.25 million line of credit that may be an appropriate number. But if you decide to pursue significantly larger projects ($40 - $60 million for example), the credit line likely needs to be significantly higher. Larger projects also involve the need to finance larger invoices to the owner (these monthly "draws" could easily hit $5 million in our example). Slow payment for any reason could put your company in a real bind. Sureties like to see their clients have appropriately sized facilities.

BUILD A DETAILED FINANCIAL MODEL

Over the years construction companies have become very sophisticated. However, many companies still only provide historical information to their credit partners. Financial reports like income statements, balance sheets and the like are backward looking by their nature. While these are very important, contractors should develop their own financial models of their business.

Ideally, companies should consider modeling their backlog and its "burn rate," the income that flows from that and the impact it has on a balance sheet over a year to 18 months. This places expectations into context and is much better than letting credit partners make their own assumptions and draw their own conclusions. This technique can be very helpful in getting creditors to stretch, which is very important when bouncing back from a recession.

Another key consideration is the type and quality of your internal systems, like accounting, project management and scheduling. Many contractors tend to view these as overhead items and not the investments in the business that they are. The ability to report results and demonstrate the ability to manage and schedule your work is vital to a company's effort to instill confidence in their credit partners. If you are using lower-grade entry level systems, consider investing in this business infrastructure as these investments will pay big returns when trying to grow your business with the help of credit, whether bank or surety credit.

Here are some other basic steps that every contractor can take: Make every effort to get paid timely through your contract terms and by ensuring that invoices are complete and to the owner's specification; negotiate retainage terms if possible and time cash inflows to outflows whenever possible.

Lastly, try to front-end load the "schedule of values" (a detailed statement furnished by the contractor, outlining the portions of the contract sum; it allocates values for the various parts of the work and is also used as the basis for submitting and reviewing progress payments) where possible or negotiate mobilization funding. Front-end loading a construction billing schedule will enable you to get more billings out on the front end of the job and help to ensure that the project will finance itself. A reasonable amount of this "overbilling" will help to present a more liquid, healthier balance sheet, which has positive implications for bank credit and bonding.

TAKE STEPS TO MAXIMIZE SAFETY

Finally, providing a safe worksite is the right thing to do for several reasons, and one of those is that safety is simply good business. There is no doubt that the best performing contractors tend to have better-than-average safety results. This is one reason that many owners use the Experience Modification Rating (EMR) as a prequalifying factor when selecting contractors. The EMR is a ratio of past losses with actuarially expected losses adjusted for relative business size. EMRs less than 1.0 are indicative of superior performance while EMRs over 1.0 indicate less than average performance. Even though it is specifically used in the calculation of workmen's compensation premiums, it is highly correlated to general safety. Being a safe workplace opens more doors, keeps your costs down and avoids the opportunity cost of lost time. ◆

Doug Rieder is president and principal with Sterling Risk Advisors, a full-service surety and insurance brokerage firm. He has served as an instructor, guest lecturer and panel member on surety and construction insurance topics for the Associated General Contractors Young Leader Program. He can be reached at drieder@sterlingriskadvisors.com.