

Narrative

My name is Shawn Blume. I am a surety bond agent with Pinnacle Surety in Costa Mesa. Pinnacle Surety is an agency that almost exclusively provides performance and payment bonds to contractors. I have been in the surety bond business since graduating from College in 1985. My first 9 years I was an underwriter with two different surety companies here in Los Angeles. I have been a surety bond agent in So. California for the past 25 years. I have worked with general builders, engineering contractors, and most specialty trades over the past 34 years.

1). I have separated my presentation into four main areas. First, I would briefly like to talk about the need for surety bonds. Secondly, I would like to talk about the selection of a surety agent. Then, I would like to address the contractors reporting requirements to the surety. I would like for you to understand what the surety does with this information. If you understand what they are doing with this information it makes it easier for you to help them understand your business, which should be a goal of yours. And finally, I would like to talk a little about the surety submission process.

2). Contractors need to provide a surety bond on all public works projects because public owners only want to pay once for a project. If you are awarded a \$1,000,000 contract to construct a federal building. Then it is the government's thought that they will only spend \$1,000,000 for that building.

If a contractor were to default on a project like this, and there were no performance and payment bonds provided, then in all likelihood the government would not have enough contract proceeds left to pay the completion contractor as well as the unpaid subs and suppliers. The financial impact of these two items would be rather substantial.

It is worth noting that a contractor cannot buy a bond. Rather a contractor qualifies for bonds through the underwriting process.

3). When applying for a bond for the first time, the first step is to select a surety agent. The agent will **submit** your qualifications as a builder to the surety company. The agent's **ability** to convey the contractor's qualifications will have a direct impact on the level of surety support you will receive.

That being the case, you should not simply hand this task over to just any one. The agent will have a large **influence** on how successful you will be in developing a relationship with a surety company so it is appropriate that you interview them. I believe you should take the same care in selecting a surety agent that you do when hiring trusted employees. I would even say it is appropriate to ask for a copy of their resume as well as referrals.

Here are some questions I think you should consider asking.

- Ask them to tell you about their surety background.
- Ask them to tell you about the types of construction businesses they have worked with in the past.
- Ask them the sureties they have worked with the most. Who they prefers and why. Specific answer ---. The manner in which they answer will shows their knowledge of the business and the number of relationships they have.
- Ask them what they think is a reasonable surety line for you, and why.

- Ask them what they think are reasonable increases in your surety line of credit once you have completed larger job and larger work programs.
- Ask them if they have any referrals.
- Then ask your CPA, attorney, banker, insurance agent, and competitors, if they have any knowledge of the agent.

One thing to keep in mind is that surety underwriting has little resemblance to insurance underwriting. So a contractor most likely will not be well served by an insurance agent who only occasionally places surety bonds.

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Moving on, I will talk about the primary reporting requirements to the surety companies and point out that they are virtually the same whether you obtain your bonds through standard market or by way of the SBA Program

The first two items are financial statements. Almost across the board sureties feel as if 12 months is too long to go without a financial update, so virtually all sureties in almost all situations require a 6 month update. The six month update usually does not need to be of the same quality of the year end financial statement, but you do need to be prepared to show the surety companies how well you are performing financially both at six months and year end.

An in-house personal financial statement will be asked for once a year.

Contractors Questionnaire. Typically 4-5 pages in length and simply provides some particulars about your business. It is a good idea that this is in an editable format so that you can easily update it as larger jobs are completed, and as you add key employees to your payroll.

References are usually required, and although resumes are usually not required, they are more than a nice thing to have, and everyone should think strongly about having one, for both their business and key personnel. Resumes will go a long way in increasing your level of bonding.

Quarterly Work In Progress reports are required by the SBA, but in the standard market, if you have your year end and 6 months statement prepared timely, you can most likely get by with the Work In Progress reports that should already be a part of these financial statements. The preparation of Work In Progress reports on a quarterly basis is the only thing I can think of that is different between the standard markets and bonds provided with SBA support.

Although not a requirement for surety credit, if you have a bank line of credit, the documentation outlining this should be provided.

These are the big items. There may be smaller items requested, but nothing I can think of any significance. I think most everyone will agree that the most difficult items are the financial statements. You would serve yourself well to find a CPA who will take the time to understand your internal systems. If the CPA understands your internal systems and has confidence in them, then his preparation of your statement should go much more smoothly.

On my website, which I have provided on the last slide, I do have sample financial statements both in-house and CPA prepared. Your CPA's statement does not need to mirror my sample statement perfectly, however if the CPA is having trouble preparing a statement in a similar format, then you really should consider changing CPA's.

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Lastly is putting together your surety submission. This is where the agent demonstrates to the surety all of your qualifications, and then makes a recommendation on the single and aggregate limits. The single is the largest size

project that the agent will in all likelihood recommend for you, and the aggregate is the sum value of all jobs in progress that he will recommend. A poorly prepared submission is one where the agent simply gathers the information and then forwards it on to the underwriter without any narrative. The underwriter wants a narrative where the agent shares his thoughts and comment. The underwriter wants to feel as if the agent understands the contractor and his business. That is a major part of the job of the agent.

Everything that is discussed, or underwritten, about the contractor falls within the following three categories, which maybe you have seen or heard many times: Capital, character, and capacity.

Capital refers to the financial resources you have at your disposal. The agent, at the least, should be able to calculate working capital and tangible net worth. The agent should be aware of the value of equipment which may be overly depreciated on the balance sheet. The same is true of undervalued real estate. The agent should be aware of your borrowing ability and any covenants to those agreements. And the agent should be aware of your personal resources and the ability to use those assets for the operations of the business.

Character. References are one tool used to evaluate Character. References are what Projects owners have to say about you. References are also provided by subcontractors and suppliers. Your business and personal credit report speaks to how you have handled past credit obligations. And lastly, sureties expect to write bonds, and for the most part never have to deal with complaints. Sureties do understand that disputes will occur, but you should work hard in keeping them to a minimum and when they do arise settling them as quickly as possible.

Capacity is everything else. Capacity has to do with the knowledge and ability of your key people. Capacity also has to do with project management systems and accounting systems. Capacity has to do with all of the tools and non-financial resources at your disposal to do your work. Capacity is the most over looked item and it should not be.

If I could have you remember three things from this presentation they would be the following: 1). Have an appreciation for the need for surety bonds, 2). Take the selection process of an agent seriously, and finally 3). Understand that you have some responsibility in making sureties comfortable in providing you with bonds.

I have provided my e-mail address at the bottom of this last slide. Feel free to e-mail me and I will e-mail you the power point slides as well as my narrative of this presentation. I have also included by website address. You can see sample financial statements there. Both CPA prepared as well as internal statements. I also have a library of contractor risk topics and white papers written on those various topics.

Thank you. Kevin now has some comments on the SBA program.