

Change

The One Thing You Can Count On

by Shannon Klein

Having recovered from the dark days of the dot-com bust and the softening surety market at the turn of the century, surety companies have remained profitable despite little premium growth. Fewer losses have occurred over the past several years and contractors have benefited from the favorable surety industry.

Change is coming

There is concern, however, that contractor losses in late 2009 and 2010 may begin to accumulate as the result of a sharp decline in the demand for construction—creating a more competitive environment and lower margins that could force some contractors out of their niches or even out of business.

We can expect to see increased bonding requirements from lending institutions or owners seeking to protect the money in private projects.

Also, general contractors may increase subcontractor bonding requirements in order to protect their companies from subcontractor default. With a cautious eye toward the prevailing market, sureties could require that more subcontractors be bonded before projects are approved.

Growing concerns

Because the construction economy typically lags behind the overall economy, there is concern about the economic crisis throughout 2009 and into 2010, as contractors complete their profitable work on hand and replace it with newer, less lucrative work. In addition, since the surety claims cycle is long, bonding companies will not likely feel the full impact of contractor losses until 2010 or possibly 2011.

Put your house in order

Lenders of all types are still writing business for clients who are in good standing to the same extent they had been before

the economic crisis. As insurance companies begin to analyze all lines of business to ensure profitability, every business unit will be scrutinized. Surety departments may be pushed to underwrite contractors even more closely to avoid suffering additional losses. Now is the time for construction executives to step up and take inventory. Tough questions must be asked and difficult decisions must be made and acted upon.

The point is to be more prepared than you are right now, so that you can answer the tough questions. In addition, don't underestimate the amount of work it will take to supply your underwriters with proper documentation.

Be prepared

Currently, sureties are becoming stricter regarding documentation on private work, as well as requesting other information not previously required. Bonding companies generally want to analyze the balance sheet, income statements, cash flow, receivables and the schedule of work in progress. While you may think this is unnecessary, being unprepared is just not worth the risk. For example, if a large project comes along and you push your company's aggregate bonding limits because of the spike, what will happen if your underwriter can't respond because you haven't provided the required information?

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The ever-growing bid list

A weak economy creates more competition—and contractors are more competitive now than ever before. With the decrease in available work, the days of having only three or four bidders for a job are long past. The reality today is ten to fifteen bidders for every available job. To find work in a reduced market, some contractors are stepping outside their fields of expertise to bid jobs they would not ordinarily consider.

Everyone needs some advice from time to time

In this time of financial uncertainty, sureties offer contractors the following bits of advice:

1. Make sure you have a sound business plan
2. Analyze and reduce overhead, with emphasis on the ability to downsize, assuming that only lean contractors will survive
3. Contractors should not venture into new types of work

Remember that a good relationship with your surety is vital during an economic downturn. Treat your surety as a resource and business partner. Seek advice as needed and, most importantly, keep your underwriters informed of your company's financial condition and give them plenty of lead time to approve your bond requests.

