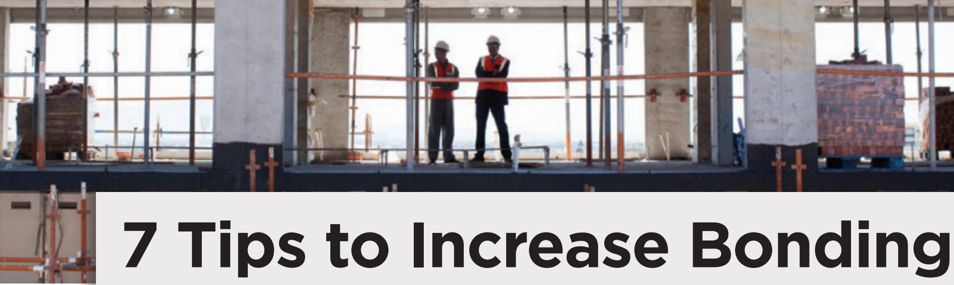

7 Tips to Increase Bonding Capacity

By **Dan Huckabay**, President, Commercial Surety Bond Agency

As the construction market continues to improve, we are seeing more contractors needing increased bonding capacity. For some contractors this means wanting the ability to bid larger projects and for others, it's a matter of more overall bonding capacity to support their growing backlog. Here are seven ways contractors can potentially increase their bonding capacity.

Retain earnings in the company

While retaining profits in the company may seem obvious, there can often be conflicting objectives facing owners of construction companies. There can be a strong temptation to take money from the company to do things like purchase a home or invest in other assets. Those things are important; however, it's critical to remember that the biggest investment you can make as an owner is in yourself and your business. Supplying the golden goose with the needed capital will normally far outweigh any return in an outside investment.

Beyond simply retaining profits, you need to be able to provide financial statements to your surety reflecting the additional retained earnings. As market improvement accelerates, providing quarterly internal financial updates can be really helpful, as it allows your surety to increase your bonding capacity on a more frequent basis than every six months with the typical financial reporting time frames.

Use personal cash to boost equity

For owners that have cash personally or have access to a home equity line of credit, cash can be put in the business either as paid-in capital or as a shareholder loan. Shareholder loans are advantageous, because they can easily be repaid when no longer needed, but many sureties will require the loan to be subordinated before the cash infusion can be treated as capital. This essentially means the owner agrees not to pay themselves back until the surety approves it. If you don't have the cash resources yourself, but a family member or friend is willing to loan money to the company and subordinate it to the surety that can potentially add equity to the company from the surety's perspective.

Limit fixed asset purchases

In times of growth, other investments in the company besides building capital are usually needed, such as for purchasing equipment. Equipment purchases should be weighed against the need for working capital (= current assets – current liabilities) to support the company's bond program. Every $1 used to purchase a fixed asset like equipment will lower working capital by $1. This can equate to reducing your overall bonding capacity by $10-$20.

Using long-term debt can help, but make sure you aren't loading up on too much debt because that creates concerns for sureties as well.

Increase bank line of credit and/or get a home equity line

According to numerous studies, more contractors fail during an economic expansion than during a recession, and one of the major reasons is that they run out of cash. That being the case, increasing your access to cash at a time when your backlog is growing can help a surety get comfortable with stretching your bonding capacity. While a traditional bank line of credit for the company is best, home equity lines can help as well, because it still allows you to have access to cash that can be put in the business in the event of a crunch.

SBA program

When most contractors know about the SBA bond program, they generally think it's for small start-up companies. While that is certainly one great use for the program, the SBA program can bond individual contracts up to $6.5 million and contractors can access revenue of up to $36 million (depending on the type of work). Because the program is designed to help "smaller" contractors gain access to increased bonding capacity, the underwriting guidelines enable them to offer more than double the bonding capacity compared to what most standard sureties will allow.

Bond subcontractors

There are many good reasons for prime contractors to bond their subcontractors in today's market. The obvious reasons are protection from subcontractor default, which is becoming more common as subs get extended beyond their abilities, and protection against unpaid wages and penalties, which is also becoming more prevalent.

Another very good reason is to allow your surety to stretch on a particular job or potentially even on your overall bond program if you have a consistent policy to bond subs. Bonding a sub does not mean your surety will not count that sub's portion of work against your bond capacity, but it does allow your surety to be more liberal in the capacity they provide to you.

Use personal assets to your advantage

There are many contractors that have a significant personal net worth with substantial equity in assets like real estate or stock portfolios that don't like to keep too much idle money in the company. There are a handful of sureties that will base a contractor's bond program heavily on personal assets rather than requiring all the capital to be in the company.

Some sureties will even accept collateral by using real estate or stock portfolios to either stretch on a job or provide a larger bond program so the contractor doesn't have to put all the assets in the company.

There are many ways to increase your bond capacity, but the first key ingredient is to communicate your needs to your agent and go over the potential options that fit your specific situation.

Your agent can help you figure out if you're with the right surety and set a plan in motion to work towards the overall objective you need. Just don't delay, because the more time you allow for planning, the more options that are generally available, or as Richard C. Cushing put it, "Plan ahead. It wasn't raining when Noah built the ark."

Dan Huckabay can be reached at 714-351-8080 or at Dan@commercialsurety.com.