CSBA

COMMERCIAL SURETY BOND AGENCY



Guide to Surety Bonds for Newer in Business Contractors

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Congratulations on starting your own construction business! Business ownership is one of the most challenging and rewarding things a person can do, and as a contractor, you are a critical part of keeping our communities functioning and beautiful to live in.

Depending on what type of construction work you do, surety bonds can play a huge part in your business. Bonding can open doors and bring your company to the next level or it can be a roadblock to your growth if you aren't prepared and set up with the right surety partners.

Whether you are still in the planning stages of your business, just got it off the ground, or are a few years in, this comprehensive guide will give you everything you need to set yourself up for success.

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Types of Surety Bonds

The first thing to understand is the surety bond types themselves, what they do, and what they are for.

Bid Bond

In the state of California, all public construction projects require a bid bond to be submitted along with the bid. While private projects aren't required by law to demand a bid bond, some privately owned projects do. General contractors also sometimes require bid bonds from their subcontractors. A bid bond protects the owner of a project or a general contractor during the bidding process, guaranteeing that the surety will compensate the project owner if the bidding contractor fails to enter the contract or does not provide the performance and payment bonds required.

To learn more about bid bonds in detail, we encourage you to read here.

Performance Bonds

Performance bonds guarantee that the contractor will complete the work and meet the contractual obligations outlined with the owner or general contractor on the project.

To learn more about performance bonds in detail, we encourage you to read here.

Payment Bond

A payment bond guarantees that subcontractors, laborers, and material suppliers are paid according to the terms of a contract and are standard requirements for both public projects and general contractors when qualifying subcontractors.

To learn more about payment bonds in detail, we encourage you to read here.

Where to Secure Construction Bonds

Many newer contractors go to their insurance agents for surety bonds. While an insurance agent can get a surety bond for you, it isn't always the best choice; it's similar to seeking a foot doctor for shoulder pain, they are both doctors but with different specialties. There are significant differences between a surety agent and an insurance agent that failing to appreciate, can cost a contractor opportunities to grow their new business and their bonding capacity.

Insurance Agent vs. Surety Specialist

The key differences between a surety specialist and an insurance agent include:

1. Professional background and approach: An insurance agent's education and experience is tied to insurance policy language and forms to protect against risks. Surety agents are more focused on construction accounting and financial benchmarks, which are an important part of the bonding process. Surety agents also have deep understanding of best practices related to job specific risks, which are areas insurance agents aren't intimately familiar with.

2. Industry relationships: Surety specialists have meaningful relationships with surety companies, which helps to match your bonding needs with an appropriate bond provider based on your unique needs. An insurance agent may only work with 8 or 10 sureties whereas a surety specialist can work with over 35 surety companies. More sureties equal more options.

There are several details and other information regarding why a contractor, especially a newer one, should seek out a surety specialist over an insurance agent. We strongly recommend you read here:

Difference Between Surety Specialist & Insurance Agent – CSBA

Bonding Process

When a contractor sets up a bond program with a surety, the surety will look to understand the following:

- The contractor's experience
- The financial strength of the business and owners
- The track record of the contractor
- The operational capabilities of the company

Applying for any surety bond typically follows these steps:

1. Find a quality surety expert, for information on how to determine the right surety agent to work with we encourage you to read here: 4 Ways to Determine if You Are Getting Top-Notch Service From Your Surety Agent
2. Gather the documentation and information required for the particular surety bond needed to begin the underwriting process
3. Fill out the bond application
4. Sign the Indemnity Agreement that states the principal (applicant) agrees to pay back the full amount of the bond if a claim is filed against it
5. Pay the premium for the surety bond
6. Submit the bond to the appropriate parties

How long does the approval process take?

Assuming the surety bond application was submitted with the required documentation and information, the turnaround time for the surety application is as little as 24 hours for bonds under $750,000. Larger bond programs can take a few days to a week, but the wait can be extended if the underwriter doesn't receive the right information.

There are ways a newer construction business can avoid common bumps in the road during the application process by working with a surety agent that has extensive experience with newer contractors.

We at CSBA are one of the few surety experts that work with newer contractors and take pride in helping them grow their businesses while educating them on the opportunities that increasing bonding capacity offers. To better help California contractors achieve their business goals, we've assembled this guide and provided information directed at contractors who've just begun their business. We encourage you to read through and discover the tools that can help you grow into the company you're working to become.

Qualifying for Larger Surety Bonds as a Start-Up

Newer contractors that have recently founded their own business can run into difficulties getting the surety bonds they need to secure construction projects that will fuel their growth. It can be a frustrating experience to want to build your start-up into an established business but not have the resources to be qualified for the surety bonds needed.

While it may appear that newer contractors have to slowly grow their bonding capacity, there are tactics you can use to help you jump to larger surety bonds without waiting years to do so.

In the following sections, we will discuss the common hurdles that startup contractors encounter in getting bonding, how surety companies determine bonding capacity, and specific actions that newer contractors can take to position themselves to maximize their bonding limits.

Hurdles a New Construction Business Faces

There are specific issues new construction businesses run into when applying for surety bonds as a result of the requirements and documentation needed:

- Some sureties won't provide a bond to a contractor until they've been in business for a certain amount of time.
- A line of credit is often a requirement for securing larger surety bonds.
- Sureties look at a contractor's experience of completing similar projects to help calculate the size of the bond they will qualify a contractor for, which is difficult to provide as a startup.
- Sureties want contractors to have sufficient capital to pull from in case a project goes beyond the estimate. If a start-up lacks sufficient cash to use in case of these instances, it can be difficult to be approved for a larger surety bond.

How Sureties Determine Bonding Capacity

To understand how to qualify for larger surety bonds as a start-up construction business, it's important to understand how sureties determine bonding capacity. Bonding capacity is the amount a surety will issue a bond for, whether it's a bid bond, performance bond, or payment bond. Before looking at how sureties determine a newer contractor's bonding capacity, first, you must understand the two types of bonding capacity:

1. **Single Bond Capacity:** When setting up a bond program for a contractor, surety companies establish what they refer to as a single project limit. Generally, they want to stick with bonding projects that are within 1.5 to 2 times the contractor's largest completed project, but there can be cases when they will consider larger jobs. With newer construction companies, surety companies have to use a combination of the contractor's experience under the current company and past projects they have completed for their prior employer.
2. **Aggregate Bond Capacity:** In addition to establishing a per-project bonding capacity, surety companies set a total bonding capacity for the contractor's entire backlog of work whether the work is bonded or unbonded. The reason for this is one of the most common factors for contractor failure is taking on too much work relative to the company's financial and operational resources. To learn more about how aggregate bonding capacity is calculated, we strongly encourage you to read this article:

   Aggregate Bonding Capacity: What is it and How is it Calculated? – CSBA

There are three main factors that surety companies evaluate to determine a contractors bonding capacity, often referred to as the "3 C's" of bonding:

1. **The Contractor's Character:** In the surety world, character is used to refer to how the owners and key employees of the company think and operate. When a surety bond company is evaluating character, they are looking to see if the contractor follows through on commitments and whether they are transparent in their communication. No one is perfect, but having strong character has proven to be the most important factor in surety underwriting. For this reason, you will want to work with a surety agent that takes the time to get to know you well, because that is the only way they can represent you properly to surety companies. In addition, you will want to investigate the surety agent's reputation, because if they don't have a strong reputation, that can negatively impact the way the surety looks at your construction company.
2. **Capacity:** When evaluating a construction company's capacity, a surety is looking to determine if the construction company's owner(s) and key personnel can perform the work. Does the contractor have the necessary estimators, project managers, superintendents, and office personnel, and are they seasoned people or new to construction or the organization? When looking at their experience, the surety company will examine their track record of being able to tackle specific types and sizes of projects successfully as well as running the organization's profitability as a whole. The surety will also want to see if the contractor either owns the equipment necessary or if they can rent it.

3. **Capital:** Here the surety is looking at what financial resources the company and owners have. There is a great emphasis on strong personal credit when it comes to start-ups because surety companies have to rely on the individual creditworthiness of the owners as there isn't as much of a track record as there is with established companies. The surety will also look at things like how much cash is there personally and in the company. Do the owners have equity in real estate and are there bank lines of credit available either for the company or personally with say a home equity line of credit?

How to Qualify for Larger Bonds as a Start-Up

The advice following will help a start-up construction business position themselves to secure surety bonds for bigger construction projects and continue to grow bonding capacity over time:

1. **Resume of Prior Experience:** This is one of the most important pieces of information you can provide to your surety agent as a newer contractor. Not only should you list your past employers and the roles you had, but you should also take the time to list some of the key projects you estimated or managed while at those companies. Organize them by year, list the project owner or general contractor's name, description of the work, profit if you have that information, and a reference the surety company can contact. This is one of the biggest tools your surety agent can use to demonstrate your experience and character.
2. **Key personnel:** The same applies to any of your key personnel. This is particularly helpful when multiple people that worked together previously start at the new construction company because it shows the depth of the organization extends back to the prior construction companies where everybody worked together.
3. **Initial capital:** The amount of initial capital you will need to start the company will largely depend on your operating needs and how much bonding capacity you'll require. You should talk with your surety agent to figure this out together.
4. **Equipment:** For construction companies that require equipment, it is generally best to rent as much as possible at the beginning to keep debt low and to maintain your cash, which will be critical for bonding purposes. There are times when equipment is necessary, and we typically encourage minimizing the down payment in the early years of your business.
5. **Financial statements:** If the company is brand new, surety companies will generally just get an internal balance sheet showing the amount of capital that was put into the company and a bank statement to verify the cash. If the company has been in business for more than a year, your surety agent will get your internal financial information including a balance sheet, profit & loss, and accounts receivable and accounts payable aging schedules for each year you have been in business, and then one for the current year. Some startup companies have a small loss or very minimal profit in the first year as they just get started building revenue. Don't worry if that's the case, as long as the subsequent years show progress toward profitability, the story will be easy to communicate for your surety bond agent.

6. **Setting Up Your Accounting:** Just as equipment can be the most important tool for contractors to get work done in the field, accounting is the most important tool for monitoring the profitability of that work and communicating it to the surety to qualify for bonding capacity. Many contractors view accounting as a burden and an expense. However, it can be one of the most important areas of your business, because when properly set up, it can show how strong your company performs, which can increase your bonding capacity and open doors to future project opportunities.

7. **Keep Work In Progress Schedules:** Work in progress schedules are somewhat unique to contractors, and they simply list the contractors' jobs showing the contract amount, estimated cost and profit, and the percentage complete for each job. They give the surety company a snapshot of the contractor's remaining backlog of work, how well the contractor is performing on each project, and whether there are any issues.

8. **Setting Up Your Banking:** Surety companies want contractors to have a line of credit as a safety net in case they run into an unexpected problem on a project. Having quick access to cash can make a difference to help you get through a challenging project and continue as a business. Many newer contractors think getting bank financing is out of reach because most banks will tell you that you have to be in business for three years to qualify for any loans. However, there are exceptions and ways to work around this. Some banks don't have these rigid rules, and it is a matter of finding the right banking partner. Other times, it makes more sense to use the equity you may have in personal properties to get home equity lines of credit. Surety companies will often treat this the same as a business line of credit for the first few years.

We at CSBA are one of the few surety experts that work with newer contractors and take pride in helping them grow their businesses while educating them on the opportunities that increasing bonding capacity offers. To better help California contractors achieve their business goals, we've assembled this guide and help you step-by-step by providing the resources. We have construction accounting experts that can help you set up your job costing, implement accounting software, and train your staff. They are available for the initial setup and on an ongoing basis if needed. We also work closely with several construction CPAs, and when your company is ready to take that step, we can guide you to these professional advisors.

SBA Bond Program

The SBA bonding program helps small contractors who are not likely to be approved by a surety bond company for a bond, which would prevent them from growing and securing government contracts at the federal, state, and local levels. The program provides a way for contractors who aren't likely to secure a surety bond to obtain a bonding line for projects up to a certain amount. The SBA would guarantee to the surety company for up to 90% of the liability on the contract, making the contractor a lesser risk to the bond provider.

Read through our SBA Surety Bond Program Guide to see if the SBA bonding program is the right option for you.

How Much Do Surety Bonds Cost?

Surety bond rates can be a mystery to contractors causing uncertainty of what contractors can expect and how to factor it into a budget ahead of time. Understanding how sureties calculate surety bond prices can help you prepare for the bonding process and position yourself for the lowest possible bond rates.

To help contractors with a new business learn the ins and outs of surety bonds and give them a leg up in securing the opportunities that can be provided for new businesses, we've put together this section that will help a new contractor navigate surety bond costs.

Surety Bond Premiums

Surety bond premiums are charged as a percentage of the contract. There are various factors that determine the percentage, which will be outlined further below, but the average cost of a surety bond ranges from 0.5% to 3% of the bond amount. It's important to note that the surety charges the premium at the time the bond is issued based on the initial contract price, but if the contract price goes up or down, there will be an adjustment to the premium at the end, meaning the contractor could owe an additional amount or be due a return premium. Thus, it is important for contractors to always include the cost of the bond in change orders.

Surety Bond Cost by Bond Type

Bid Bonds

Surety companies do not charge a premium for the bid bond itself, but a premium is charged if you are awarded the contract. Remember, that a bid bond protects the project owner if the contractor fails to enter into the contract or secure the other surety bonds needed. Therefore, you need to be aware of what the cost is for the performance and payments bonds, and factor that cost into your bid even though you won't be paying for the bid bond.

Performance Bonds & Payment Bonds

Sureties do not charge separately for performance and payment bonds, though some surety companies will charge a lower rate if only the payment bond is needed due to the lower risk for the surety company. For both performance and payment bonds, a surety provider will use the following factors to calculate your surety bond costs:

- **Contractor's credit and financial strength:** Contractors with good credit scores and good financial standing will generally receive rates that are lower.
- **The type of financial statements provided:** CPA-prepared financial statements will generally get lower rates than internally prepared financial statements.
- **A contractor's past performance on projects:** A solid performance record of completing past projects will often result in a lower rate.
- **The amount of work a contractor performs:** Contractors who do more bonded work will generally receive lower rates.
- **The type of work the contractor performs:** Sureties will consider the type of work a contractor generally performs when setting rates.

How Do I Know I'm Getting a Good Deal on Surety Bond Rates?

A contractor can take steps to reduce the cost of the surety bonds they need by:

- Taking steps to increase your personal credit score.
- The quality of financial statements cannot be understated. Investing in your internal financials can help secure the surety bonds needed and lower the rate, we highly recommend reading this article to learn how to invest in internal financials: How Investing in Quality Internal Financials can Increase Bonding Capacity – CSBA
- Have a CPA prepare your financial statements, this assures the surety company that your statements are accurate and prepared correctly.
- Strengthen your retained earnings and capital. A surety company will charge less and provide bigger bonds if they're confident you have assets to pull from if needed.
- Work with a surety expert. Having a surety agent guide you through the bonding process and help you prepare for it can help you pay the surety less for your bond, especially with the relationships they have with surety providers.

We at CSBA work with newer contractors and take pride in helping them grow their businesses while educating them on the opportunities that increasing bonding capacity offers. To better help California contractors achieve their business goals, we've assembled this guide and provided information directed at contractors who've just begun their business. We encourage you to read through and discover the tools that can help you grow into the company you're working to become.

How CSBA Helps Newer in Business Contractors

We are very proud to have a hand in guiding California contractors from their earliest days into strong companies. Our commitment is to help California contractors do more than just provide their surety bonds, but to help them build their company by guiding them on how to increase their bonding capacity, set up quality internal financials, and connect them with professionals such as CPA's, bankers, and attorneys that can help the company achieve its goals.

We invite you to explore the success stories of CSBA clients and see how our expertise in surety bonds and the construction industry helped shape their hard-earned success.

Explore California Contractor's Successes

Buhler Commercial wanted to break into public work construction and needed help to secure the required bid bonds. We helped them successfully apply to the Small Business Administration Bond Guarantee Program, and they now are able to bid on projects up to $12 million.
Buhler Commercial – CSBA

Dean Visosky Contractors needed guidance in establishing their bonding capacity. After meeting with them to understand their past experience and goals for their business, we provided the roadmap for the steps to take to achieve those goals and secure the bonding capacity needed.
Surety Success Story: Dean Visosky Contractors, Inc.

The owner of Force Demolition had decades of experience when starting his business, but he needed guidance on how to set their business up in a way to position it for success. We helped them select the appropriate accounting software, introduced them to a construction-oriented CPA, and partnered them with a surety company that was willing to put a lot of weight in their prior track record. They now have over a $25 million bonding capacity.
Surety Success Story: Force Demolition, Inc.

Marin Concrete was working with a surety agent to help them secure performance bonds they needed, but being dissatisfied with the limited-sized bonds the agent was getting them, they met with us. Quickly, we increased the performance bond limits to $2 million per project and worked on a plan to improve internal accounting to grow their bonding capacity. Today, it exceeds $25 million.
Surety Success Story: Marin Concrete

CSBA has a team of surety experts that can help you step-by-step through the bonding process, and we are passionate about helping newer construction companies grow. To find out how we can help you, contact us today.