



The University of Texas System Bonding and Technical Assistance Program



Applying For Surety Bonds: Tips For Small and Emerging Contractors

Applying for the first time for a Surety bond is often a frustrating experience for small and emerging contractors. It is frustrating not only because of the depth and breadth of paper that has to be provided – tax returns, financial statements, certificates of insurance, resumes, forms to be completed, etc. But often after the documents are reviewed by the surety agent, he will come back with additional requests for information, clarification, or may even ask some of the documents to be revised. The good side of the experience is once a contractor has struggled his way through the process, he often recognizes the value of the experience, and puts in place new policies and procedures that will improve the financial and administrative management of the business. What follows below are some tips of things you can do upfront to smooth the bond application process.

The Roles of the Surety Agent and Surety Company

There are two key parties involved in the surety bonds process: the surety agent and the surety company. The surety company provides the bonds, providing a financial guaranty that it will make sure the project is completed and bills paid if the contractor fails to meet its obligations. But they distribute the bonds usually through independent surety agents.

Surety agents typically work with several different surety companies that vary widely in the type of contractors they are interested in serving. The surety agent's role is to evaluate your bonding needs and capacity through the application process, and to submit your application to the surety company that best meets your needs, and is most interested in contractors that fit your profile.

Steps for Applying For Bond

The first step in preparing to apply for a surety bond is making sure you have all the documents that will be requested readily available. Make sure you keep the originals and provide copies to the surety agents. The key documents you should have are:

1. The last two years of business tax returns – *The surety uses the tax returns to verify profits or losses being reported to the IRS*
2. The last two years of personal tax returns of the owners (anyone with 10 percent or more ownership) of the firm – *The tax returns are reviewed to verify household income*
3. The last three years (the surety may want up to 5 years if the results have not been good in recent years) of income statements (a/k/a profit and loss statement) and balance sheets on the business, and a current income statement and balance sheet that is no more than 60 days old on the date of submission of the application. – *Most Sureties prefer compiled financial statements prepared on a percentage of completion basis by a certified public accountant experienced with the construction industry. You should review them with your accountant and be prepared to explain any areas of weakness or negative trends and what is being done to improve. In addition, for contracts of \$300,000 or more, the Surety may require reviewed or audited financial statements done in the percentage of completion method by a certified public accountant.*
4. Aging of accounts receivables and payables – *This report will let a surety know if your customers are paying in a timely fashion and if you are paying your creditors in a timely fashion*
5. Certificate of insurance – *The surety wants to make sure you have general liability, workers compensation, and other insurance policies in place that match the requirements of the contract you want bonded*
6. Copy of contract – *Contract language is reviewed for provisions that are particularly onerous to the contractor*
7. Copy of bond requirements from the request for proposal or invitation to bid – *Many contracts require that the surety company be U.S. Treasury listed and/or have a certain rating from AM Best. Both of these entities evaluate the financial soundness of surety companies.*
8. Resumes of owner and key personnel – *The Surety reviews the resumes to insure the personnel have the right set of skills and experience to successfully manage the scope of work of the contract.*

The following are documents the agent typically provides to you to complete:

1. Contractor questionnaire – *Its purpose is to gather detailed information on the firm and its principals and also to reveal any problem areas or risks*
2. Status of contracts – *The surety reviews this to determine your current and future work load and whether the current jobs are profitable*
3. A performance and payment bond request form – *This form provides key information on the construction project and contract for which you are seeking a bond*
4. Job cost breakdown – *This will include not only materials and labor, but should also include overhead*
5. Personal financial statement on owners – *Evaluated to determine the financial condition of owner(s). The surety company usually requires the owner (s) to personally guaranty the bond.*

In addition to the above information, the surety agent will ask for references from your:

1. Bank – *your bank may be required to complete a form providing information on average balances of your accounts, your payment performance on any loans or lines of credit you have or had with them*
2. Creditors – *your suppliers will be called and/or sent a form to complete assessing your payment history,*
3. Customers – *your customers will be asked if you performed your work according to specs and on time. In addition they may also be asked if you submit your pay requests and other paperwork in a timely and accurate fashion.*

The surety company will also obtain a personal credit report on all the owners of the business. Companies with owners with credit score below 650 are often considered marginal. Prepare written explanations for credit problems if your credit score is below 650. Marginal credit scores are one of the primary reasons for bond application denial.

If your company does not meet the traditional guidelines for approval, the agent may attempt to place you with a surety company that offers programs for contractors considered higher risk. These programs include:

1. Collateral – *The surety company requires collateral equivalent to 10 to 20 percent of the contract size. Often the collateral required is cash or a letter of credit.*
2. Funds control – *In this program a third party (or the surety may do it themselves through an affiliate entity) manages the receipt and disbursement of all funds for the contract bonded, charging a fee for the service.*
3. SBA Guaranty – *The SBA guarantees bonds for participating surety companies and agents. The SBA charges a fee for the guaranty and requires completion of its bond guaranty application*

In many ways applying for a bond is like applying for a business loan: A surety company analyzes a contractor's personal and business financial condition to see if the contractor has a good track record of meeting financial obligations in a timely manner, and the financial wherewithal to pay suppliers, labor, and subcontractors for the new contract and any other projects in progress. Also surety companies look for contractors to lines of credit that will enable them to meet financial obligations while waiting to be paid.

Obtaining a performance and payment bond for the first time can be tough, but through proper preparation, one can make the process go a lot smoother.

For assistance with applying for surety bonds contact:

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