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Senior Vice President

Graduated from Roanoke College in 1971.

Worked for Thomas Rutherfoord Bonding & Insurance in Roanoke, Virginia until 1976 when recruited by Gaston Caperton to join McDonough Caperton, Shepherd Goldsmith in Charleston, West Virginia.

Though multiple ownerships, been with the same company, now USI Insurance Service, LLC for 42 years.

Specializing in bonding and insuring contractors.

USI

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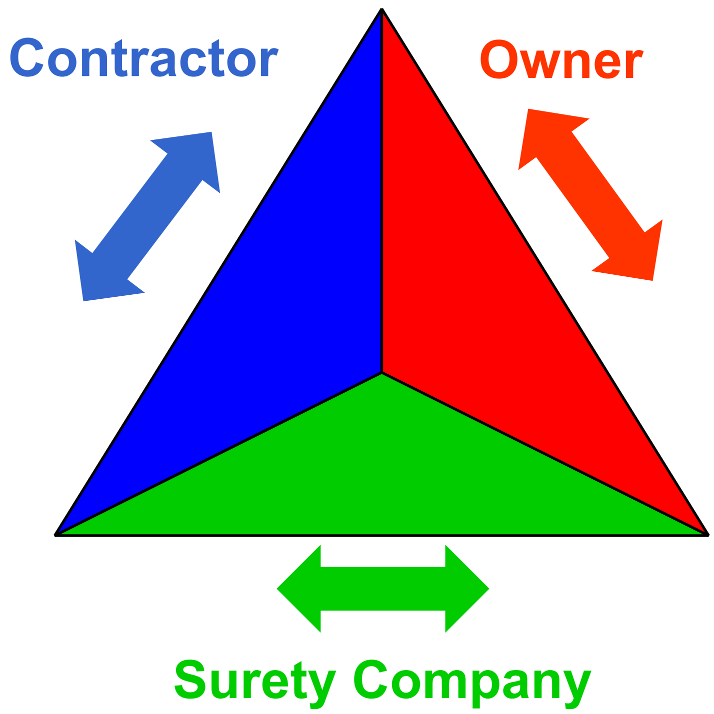
Survey Bonds 101

The Basics of Bonding

Surety Bonds

- A surety bond is an instrument under which one party guarantees to another that a third will perform a contract.
- Surety bonds used in construction are called contract bonds.

What is surety bonding?



3 Party Agreement

- Owner
- Contractor
- Surety Company

What is surety bonding?

A careful, rigorous, and professional process in which surety companies prequalify contractors and then assure project owners that these contractors will perform the contract according to its terms and conditions at the contracted price, deliver on schedule, and will pay certain laborers, subcontractors, and suppliers associated with the project.

The Bid Bond

Provides financial assurance that the bid has been submitted in good faith and that the contractor intends to enter into the contract at the price bid and provide the required performance and payment bonds.

The Performance Bond

Protects the oblige from financial loss should the contractor fail to perform the contract in accordance with the terms and conditions of the contract documents.

The Payment Bond

Guarantees that the contractor will pay certain subcontractors, laborers, and material suppliers associated with the project.

How does a surety provide the assurance that a contractor can perform?

PREQUALIFICATION

- An in-depth look at the contractor’s entire business operations
- PQ is done to determine contractor’s ability to meet current & future obligations

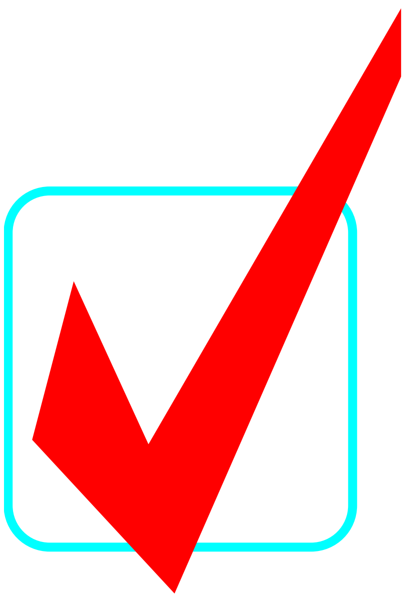
PREQUALIFICATION

A complete analysis of . . . .

- Capacity to perform
- Financial strength
- Track record & history of company
- Organizational structure & reporting
- Business continuation plans
- Trade references
- Analysis of *all* projects in progress

Surety Company's Checklist

Before issuing a bond, surety must be satisfied of contractor's



- Good character
- Experience matching requirements of contract
- Financial strength
- Excellent credit history
- Established banking relationship & line of credit
- Necessary Equipment

In short . . . .

The surety company's PREQUALIFICATION provides assurances that the contractor runs a well-managed, profitable enterprise, deals fairly, and performs obligations as agreed.

Benefits of Bonds

- Most comprehensive risk management tool addressing default
- Financial protection

Benefits of Bonds

- Payment protection for subcontractors, suppliers & laborers
  - May lower prices if they know they're protected by payment bond
  - Payment bonds are generally supplied at no additional cost when bought in conjunction with a performance bond

Bonds pay for themselves

Functions of Bonds

- Relieve owner from risk of financial loss arising from liens filed by unpaid subs & suppliers
- Smooth transition from construction to permanent financing by eliminating liens
- May lower cost of construction
- Support troubled contractor using a variety of techniques to keep project on schedule
- Arrange for project completion if contractor defaults

Cost of Surety Bonds

Premium is a fee for the surety's underwriting services.

"In theory, sound underwriting should result in no loss to the surety."

What is the cost of guaranteeing performance & project completion?

Typically, 0.5 % - 1% of the total contract price
(may be less for larger projects)

Examples of the Cost of Surety Bonds

Project Amount	Preferred Bond Premium	Standard Bond Premium	Percent of Contract Amount
$1 million	$7,770	$13,500	.77% to 1.35%
$5 million	$33,200	$47,250	.66% to .95%
$10 million	$56,950	$81,000	.57% to .81%
$20 million	$101,950	$146,000	.51% to .75%

Standard & Preferred Premium are approximate. Premium listed are from 2 of the nation's Top 10 sureties. NOTE: Some surety rates are lower than this example; rates vary company to company.

Understanding the Benefits of Surety Bonds

What are the FEATURES of Surety Bonds?

- Professional prequalification of contractor
- Protection against default

What are the BENEFITS of Surety Bonds?

- Verifies competency of contractor
- Owner has assurance of project completion
- Financial Security: cost savings benefit
- Risk transfer

Surety Bonds have *unique benefits* from its competition, the Letter of Credit

- Most comprehensive risk management device against default

- Financial protection

Primary Decision Makers

Those who require the bond!

- **Private Owners**
  - CEOs
  - CFOs
  - Risk Managers
- **Public Owners**
  - Government Officials
  - Procurement Officers
  - Legislators
- **Bankers**
  - Senior Bank officials
  - Construction Lending Officers

What is the Primary Benefit of Surety Bonds?

Transferring financial risk from owner to surety by assuring completion and contractor performance.

How Does a Surety Make the Guarantee of Performance to the Owner?

- Prequalification process
- Surety commits financial resources
- Surety's experience, expertise, & assistance to contractor throughout duration of contract
- Financial protection for subs, suppliers, & laborers

What Else Does a Surety Bond Provide?

- Cost effective protection against contractor default

- Through prequalification, owner knows contractor has been judged capable to complete the contract

Elements of contractor failure

Liberty Mutual. SURETY

In evaluating a sample of contract surety claim matters over a 10-year period, the following were identified as elements of contractor failure. Elements were identified at the time of the claim and are listed by frequency. There are many cases in which multiple elements were cited in any given instance.

53%
Market focus

- Geographic expansion
- Change in project owner sector
- Working for unfamiliar obligees
- Change in project type

47%
Internal controls capability

- Utilization of internal systems
- Capacity of internal systems
- Suitability for a contractor's application
- Training capacity

47%
Continuity of business operations

- Changes in management or key personnel
- Changes in ownership structure
- Lack of financial and operational continuity planning

32%
Overextension of business operations

- Operational growth exceeds balance sheet growth
- Increase in size of jobs

27%
Subcontractor risk management

- Subcontractor prequalification
- Management approach

Elements of contractor failure

Liberty Mutual. SURETY

Assess the impact of risk factors identified

Market focus

Has the company:

- Undertaken a project outside of its established geographical footprint?
- Undertaken work in a new sector?
- Undertaken work for new and/or unfamiliar obligees?
- Experienced significant changes in macroeconomic environment?

Continuity of business operations

- Has there been a change in a key leadership position such as CFO or operations manager?
- Is there a qualified person in place to fill the vacated position?
- Has there been a change in the company's ownership structure?
- Has the company developed a plan for operational or financial continuity?

Overextension of business operations

- Has the company demonstrated a pattern of undertaking larger and/or more complex projects?
- Do the most recent annual revenue growth rates exceed "established" growth rates over the past several years?
- Are increases in project contract values better explained by market forces such as cost of labor and materials, as opposed to a general appetite for larger projects?

Internal controls capability

- Do the company's internal control systems have the capacity to provide accurate, timely, and essential information to personnel?
- Is the company able to fully utilize the primary components of the internal control systems and are they able to fully utilize the expanded components?
- Is the company able to demonstrate proficiency with its internal controls systems? For example, can a project manager produce a progress report on a job on short notice?
- Learn more on this topic.

Subcontractor risk management

- Does the company use a risk-management process that's in line with the portion of work subcontracted?
- Is the company able to adequately prequalify key subcontractors? (e.g., subcontracts greater than X dollar amount or % of project value)
- Does the company employ adequate resources to manage subcontractors in the field?
- Does the company employ a subcontractor bonding policy? (e.g., subcontracts over a specified dollar threshold, etc.)

Elements of contractor failure

Emerging elements of contractor stress

Changes in the supply chain

- Methods of Procurement
- Supplier concentration
- Supplier geographic location(s)
- Documented delays
- Modes of transportation to final destination

Adequacy of skilled labor

- Potential impacts on:
  - Quality of work
  - Productivity
  - Labor costs used to estimate work
- Increased healthcare costs related to an aging workforce
- Impact of COVID-19

Contractual risk transfer

- Significance varies depending on proximity of the contract with the owner.
- Examples of potentially problematic clauses:
  - Extended warranties
  - Overly broad indemnification clauses
  - Conditional payment clauses ("pay when/if paid")
  - "No damage for delay" clauses
  - Onerous change order provisions
  - One-sided dispute resolution clauses

For More Information

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