

# STRAIGHT FORWARD FACTS ABOUT BONDS

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## **Factors Involved in the Surety Companies' Credit Decision**

The surety performs an independent investigation of an organization (company) to determine its degree of credit worthiness.

Key factors involved in a surety's decision:

- Integrity of management
- Financial position and presentation
- Adequate financing on project(s)
- Cash flow
- Relationship and trust between agent and surety
- Ability of agent to understand risk and to effectively communicate to the surety company

If the surety can obtain a comfort level with the developer and agrees to provide bonds, the surety is guaranteeing to the municipality that the site improvements will be completed according to municipal ordinances. The primary responsibility to satisfy the obligation is the developer's, however, if they fail to satisfy their obligations, the surety may be responsible to complete the site improvements.

The areas of interest to the surety include prior experience, financial wherewithal, cash flow, development philosophy, and degree of speculation.

## **Performance Bond**

The developer (primary) and surety (secondary) guarantee the performance of the required site improvements to the owner. The surety stays in the background unless the municipality brings in the surety to perform. Any surety involvement would be due to the failure or default of the developer to satisfy their obligations.

## **Rating**

Premiums for performance bonds are based on the bond amount. The initial charge is for two (2) years. If the improvements are not completed within two years, an additional charge is assessed on an annual basis. The rate is reduced on the third year and again is charged utilizing the bond amount at the time. It is important to request a reduction several months prior to the two year anniversary of the bond to reduce the cost.

## **Indemnity**

The developer is the primary party and responsible for the performance of the obligation. If the developer defaults on their obligation, the surety will then be responsible to satisfy the outstanding obligations.

However, it is important that the developer understand that the surety has subrogation rights. Specifically, the surety will pursue recovery of all monies expended to satisfy the developer's obligations, expenses to investigate claims and the cost of litigation, etc.

The surety's recovery is derived from the remaining corporate assets and assets of any third party indemnitor(s). (i.e. individuals) The developer is responsible for all costs incurred by the surety. It is usually more economical in the long run for the developer to use his resources to fulfill the outstanding obligations, rather than have the surety satisfy the outstanding obligations of the developer. Please keep in mind that if the surety is kept abreast of a problem, they may be in a position to provide financing to get through the problem. This option is only available if a true relationship is developed between all parties (surety, developer, and agent) and the request is made within a reasonable time frame, allowing the surety time to investigate.

### **Information**

The primary factors in maintaining and maximizing surety credit are to provide updated, timely information and the establishment of a relationship with the surety. The quality, frequency and timeliness of information all play a major factor in the amount of credit extended, conditions, and rates. It is imperative that you obtain a list of the information necessary to support the bond facility to avoid problems with obtaining bonds on desired projects. If you have any questions on the relevance of information requested, ask your agent or the surety for an explanation. There should be a purpose for all of the information requested.

It is also suggested that you establish a true relationship with your surety. At minimum, you should sit down with your surety once or twice a year. Office or social meetings can both be positive investments.

### **Financial Statement**

The financial statement plays an important role in the surety's willingness to extend bond credit. The financial presentation and format, quality of statement (compilation, review or audit), frequency (annual, semi-annual quarterly) and timeliness (time frame in which a statement is received) are all critical to obtaining and maintaining credit. Provided the above is accomplished, the financial strength carries much more weight and provides additional surety credit.

### **Bond Requests**

In order to keep your bond line intact and obtain the bonds required, make sure the surety has all outstanding information. It is important that you, the developer, carefully review the specific bond requirements and advise the surety accordingly.

The developer should provide ample time for the surety to review the information, evaluate the individual job prospect and execute and deliver the necessary bond. You must remember that sureties handle a large number of accounts and all requests cannot be handled on a "last minute basis". It is important to approach your surety as early as possible.

### **Overview**

It is important that you align yourself with an agent and surety company that understands your world. It makes for a successful partnership, necessary in any business relationship.

We hope this article is informative and enhances the relationship between yourself and the surety.

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