THE BONDING CRISIS

Sureties Are Bonding Fewer and Fewer Contractors

Having been requested to address the present and future state of the construction bonding industry, I must pronounce at the outset, to put the matter in proper perspective, that 1986 finds the surety bonding business, like much of the construction industry, in dire circumstances.

The final figures for 1984 showed that year to be the worst ever in terms of underwriting losses, in the long history of the surety bonding business.

Preliminary figures for calendar year 1985 indicate that approximately $750 million in contract bond (construction bonding) premiums were written, with combined 1985 losses (actual paid losses plus all expenses) amounting to some $1.1 billion.

There are no indicators that point to 1986 as being a much better year for the surety business, and one thing is a certainty: virtually all bonding companies are becoming more selective in choosing the contractors they are willing to bond.

Obviously this is very disturbing news for those contractors who deal primarily in public work or on jobs requiring bonds, and who do not have an established and reliable bonding connection.

Bonding Sources Available . . .

Before proceeding further, I think it is important to establish one significant fact about contractors and bonding.

By Bruce T. Wallace
Executive Vice President
National Association of Surety Bond Producers

The majority of established, experienced and well-managed construction firms in America, whether general contractors or subcontractors, do have a source for obtaining the surety bonds necessary to prosecute the work programs they wish to undertake.

It is those contractors who are not sufficiently well organized, well managed and adequately financed who are experiencing severe difficulties in obtaining the bonding credit necessary to perform projects or subcontracts on which bonds are required.

We know that many members of our association, The National Association of Surety Bond Producers, are bonding agents for AWCI members who have been and continue to prosper in their construction field. However, our members and many other agents and bonding companies also have considerable exposure to those many contracting and subcontracting firms that really are not prepared or qualified for the construction programs they wish to undertake.

There is absolutely no question in anyone’s mind that there is a substantial overcapacity in the ranks of nearly all types of construction firms in the U.S. today. This excess of capacity exists in virtually every contracting discipline.

Declining Number of Surety Companies . . .

On the other side of the coin, the available bonding capacity in the United States, that is, the number of surety companies continuing to provide contract suretyship to contractors, has declined and is likely to continue to decline during the remainder of 1986.

A number of surety companies have left the contract bond field in the last two or three years, including some substantial writers of surety bonds. Some of these companies have left the field voluntarily because their managements did not foresee a reasonable opportunity to earn a profit from writing surety bonds. Others left the field involuntarily due to heavy losses.
from their bond underwriting operations, particularly in 1984 and 1985. The net result of this is that there is significantly less bonding capacity available throughout the country today than there was a year ago, and those sureties that are still writing contract bonds, as mentioned earlier, are becoming ever more selective in determining contractors for whom they are willing to provide bonds.

Dramatic Premium Increases . . .

The problem of contractors obtaining the bonds necessary to pursue a successful work program in 1986 has been further exacerbated by the additional factor of unavailable and/or unaffordable liability insurance to cover their contracts. Since last year, as I’m sure every reader of this article is painfully aware, virtually every insurance company in the country, and foreign insurers as well, have drastically increased their premium levels, on basically all lines of insurance, in an effort to effect a return to underwriting profitability after several years of the worst bottom line results the commercial insurance industry has ever experienced.

In addition to these dramatic premium increases, most insurers have also determined that they are not going to continue to write certain lines and classes of insurance, at any price. Further, many insurance companies have resorted to the drastic, and unwarranted, in my opinion, action of cancelling many insurance contracts in mid-term and either refusing to rewrite them at a higher premium level or rewriting them for such an inflated premium that the coverage becomes, in many cases, unaffordable, for all intents and purposes.

The bonding companies are becoming increasingly concerned with the problem of liability insurance unavailability or unaffordability for those contractors for whom they are still writing bonds or on whom they still have bonds outstanding on uncompleted projects.

Inasmuch as contract bonds guarantee the terms of the construction contract, if a contractor is unable to procure the liability insurance required by the contract, his bonding company is fearful that if the contractor has a third party insurance claim or lawsuit, the surety will have to respond to the loss in the absence of the required, but unavailable, insurance.

Financial Jeopardy . . .

Even when the necessary liability insurance is available to a contractor to cover a particular project, the premium, especially annual renewal premiums on a project lasting 1½ or 2 years or longer, is often so inflated and so much above the cost levels the contractor had originally figured in his bid, that it puts the contractor in financial jeopardy in simply paying for the required liability insurance for the contract.

We are also witnessing many more instances of banks cutting off or not renewing unsecured lines of credit for contractors because of the contractors’ inability to secure liability insurance. Bankers are very afraid of the prospect of loaning money to contractors who are “going bare” or operating without adequate liability insurance.

For all the reasons heretofore discussed in this article, the present time, and the foreseeable future, has got to be one of the most difficult times ever for contractors needing surety bonds.

Securing Bonding . . .

There are steps to be taken however that can greatly reduce the difficulties many contractors experience in securing bond credit:

1. Deal with an agent who is experienced in surety bonding and in working with contractors, and who represents several quality surety companies.

2. Engage a competent CPA. Ideally, this should be a CPA who is also experienced in the construction field. Most sureties now require an audited financial statement at least once a year, including detailed spread sheets outlining the status of all projects on hand and uncompleted.

3. Install a system of job cost accounting that will provide you with immediate and continuous information regarding costs, and profits or losses, associated with each project on hand. Only by doing this can a contractor take timely action to correct a problem on any job where a problem may develop.
(4) Be prepared to adjust overhead costs quickly to match the workload you have on hand at any given time. A lot of contractors have gone down the tubes from an overhead expense structure that they could not cut back sufficiently in times of reduced construction activity.

In closing, I’ll reiterate my steadfast belief that those contracting firms that are well-managed, sufficiently well-financed and experienced in their field of construction, will continue to be able to get the surety credit necessary to successfully pursue their work programs.

Increasingly, as time goes on, those contracting companies that are seen by sureties as being marginal or less than properly managed, financed or inadequately equipped for the type and size of project they wish to undertake, are not going to be able to secure the bonding they need.

Although painful for some contractors, this process of nonqualification for surety credit will be one of the ways by which the excess capacity which now exists in the construction field will be “wrung-out”, thus creating in the future, a better balance between available work and the number of contractors available to perform that work successfully and profitable.

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**Academy Opens its Doors in Scottsdale**

AWCI’s Academy ’86 will be held November 20-24 in Scottsdale, Arizona, under the direction of Academy Council Chairman Mike Kennedy, an AWCI member from Birmingham, Alabama.

Each year, Academy is the wall and ceiling industry’s premier educational marketplace, filled with dozens of new ideas, opportunities, and solutions to a contractor’s toughest challenges. This one-of-a-kind educational marketplace has been bringing contractors, suppliers, and their key employees together in an intensive learning environment for nearly a decade.

Among the areas to be examined on this year’s agenda are fireproofing, bonding, sound control, risk management, caulking and sealants, ASTM/UL ratings, business continuity, and much more.

AWCI’s instructors are in a class by themselves. Most of them are contractors/suppliers, and will deliver hands-on information, not theory. The knowledge you’ll gain at Academy ’86 can be put to use immediately upon returning to your company.

These three days will present you with a unique opportunity to exchange ideas with your peers in the wall and ceiling industry and increase your technical and managerial knowledge. The goal of the Academy is simple—to help you operate more profitably. The atmosphere at Academy ’86 is purposely informal in order to stimulate a free flow of new ideas between all participants.

This conference has been designed to allow you to customize your own learning experience. At any given time, there are several educational sessions being conducted concurrently and you should feel free to attend any one of them that interests you. Spouses are welcomed to attend all of the scheduled social functions, and the Opening General Session as well.

In today’s contracting environment, it’s not enough to learn about all the new developments in the industry—you have to use them! And you just can’t find the kind of specific, quality programming offered at Academy locally. Invest in your company’s future and register yourself and your key people today!

You can save more than 30 percent by taking advantage of the multiple registrant discount and the early-bird registration discount, which apply to registrations received before October 20, 1986.

Just call Terry Childers at AWCI, (202) 783-2924, for additional information or to register by phone. You can even charge your registration to your Visa or Mastercard. Or, watch your mail for AWCI’s Academy ’86 brochure. Either way, we want to see you in Scottsdale this November!

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**Testimonials like these attest to the value of Academy:**

“The quality of AWCI’s Academy is outstanding. The main benefits of attending are new ideas and industry contacts, as well as being inspired and rejuvenated. It really makes you feel good about where the wall and ceiling industry is headed.”

—Harry J. Vernetti
Mid-States Construction Systems
Rockford, IL

“The Academy is the best vehicle for improving management and exchanging information AWCI offers. I am continually impressed with the results of the Academy.”

—James E. Biddle
Mader Construction Corp.
Buffalo, NY

“This was my fifth Academy. Every year they just keep getting better and better, and from the looks of it, more popular too. You can bet I’ll be at Academy again next November.”

—Bill Gargano, Jr.
“Bill” Gargano, Inc.
Endicott, NY