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Above: Underground Solutions, Inc. uses air excavation and vacuum rigs to find underground utilities.
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Left: ACE Pipeline has found its niche, inspecting and cleaning storm drain and sewer systems
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The Surety Report

Michael R. Strahan

Turning Opportunities into Reality

By Michael R. Strahan,
CCFP, Surety Account Executive

From time to time, contractors experience the thrill of encountering a unique job opportunity that makes them want to roll up their sleeves and go after it.

The project may be larger than anything they've attempted before, peak their backlog to an all-time high, spread their business to a new geographic area, or vary in scope from their traditional "bread and butter" work. However, something about the job tells the contractor, "This is the project we need to pursue!"

When such a job opportunity presents itself, contractors need to gain their surety underwriter's support. As contractors may know, surety companies keep profiles on construction firms with regard to routine job size, backlog levels, geographic reach, and scope of work.

When surety companies are requested to go outside those parameters, underwriters need to understand "Why now?" and, "Why this job?" before they can justify extending bonding credit. Contractors must be able to explain the complexities of the project, how it fits within the firm's abilities, and why their firm has a competitive advantage.

They should focus on these areas when presenting the job to the surety underwriter(s).

• Who are the competitors for the project?

Although contractors probably won't know all the competitors on the project, being able to identify the main competitors and explain why the firm has an advantage over the competition is vital for both the contractors and their surety company(ies). Advantages can include geographic location, special relationships with key subcontractors/suppliers, the current backlog levels of the competitors and their ability to absorb additional work.

• Do they have the management and supervisory capacity and manpower for the project?

The firm's ability to man the project with qualified supervisors will not only be a key factor in gaining surety underwriter's support, but it will also determine the ultimate success with the project. Does the firm have enough expertise at project management and supervisory levels to tackle such a project? Are the necessary people currently available? If not, will they be available when it's time to start the job?

• In addition to management and supervisory personnel, is there access to a labor pool that is both qualified and substantial enough to handle such a project?

• What is the cash flow projection for the job?

Contractors will need a cash flow analysis for the project in order to forecast its impact on the overall operation of the firm. If the job will be larger than normal, or if it will require a larger volume of material/supplies, they'll need to analyze and predict differing cash flow needs:

1. Can they handle the mobilization costs associated with the project?
2. Are these costs larger than the firm is capable of handling internally?
3. Will the size and timing of retention release relative to profit margins cause them to experience any cash flow shortfalls?
4. Will they occasionally require outside sources of cash to maintain ongoing operations?

Be ready to discuss the financial arrangements with the surety underwriter. If analysis shows that the firm will need outside financing at some point, it's wise to discuss the project with a banker and involve him/her in the planning process from the beginning. Gaining the bank's approval for either a separate project-specific credit line or a larger line of credit are issues that should be resolved before pursuing the project.

• How will the contractor mitigate subcontractor and specialized material supplier risk?

If the project is larger or varied in scope, will the contractors be able to use familiar subcontractors and suppliers, or will they have to start new working relationships? If entering into new relationships, how will they pre-qualify the subcontractors? What is their philosophy on subcontractors and specialized supplier bonding? From a contractual standpoint, the contractor should have legal counsel review the contracts to ensure enforceability.

• Will there be enough profit on the job to make it worthwhile?

Does the projected profit on the project make sense relative to risk, duration, opportunity, costs, etc? If the project is going to take up a substantial amount of capacity for the organization for an extended period of time, will the profits generated be enough to meet the necessary return on equity for the business? For example, if a $20 million job is scheduled for 18 months' duration, and the contractor plans to make a gross profit of 3 percent, simple math indicates that they should average $33,333 of gross profit per month.

Outside of this project, how much other gross profit will the operation be generating until they have the capacity to take on new work? Is this an acceptable return of equity?

• What can happen if the project doesn't go as planned?

If the project doesn't make the anticipated profit margins, or worse, loses money, how badly will the company be impacted? Is this an "all your eggs in one basket" type of job, or will the company just get a financial "black eye?" Also consider whether it's possible that the concentration of risk with one owner may take the contractor out of touch with their other business relationships.

• Have you taken care of the surety basics?

Once they've answered the questions above, contractors should take two steps back to make sure the basics have

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Lost Wages: Water-quality protection in San Diego is a high-stakes game

By Karen Henry,
Deputy Director
and Marnell Gibson,
Senior Civil Engineer
for the City of San Diego

Beating the odds is not anything new to contractors. To stay in business, they are competitive by nature. Public bidding requires them to compile detailed information, solicit quotes and make educated guesses at what it will cost to complete a project. They juggle schedules and changing conditions daily. Risk assessment is a key element of every construction project.

The California Regional Water Quality Control Board, San Diego Region, has recently upped the ante with the issuance of fines in excess of $1 million to builders for "violations of California Water Code section 13376, Order No.99-08-DWQ, National Pollutant Discharge Elimination System (NPDES) General Permit for Storm Water Discharges Associated with Construction Activity (General Permit)." Or in layman's terms, dirt left the site.

During the past few years, there has been an increase in the number of storm water Best Management Practices (BMPs) installed on construction sites. However, BMPs just for show will not function when it rains.

Regulators are out in force to call your bluff. A rain gauge on your site is not an ace up your sleeve. Storm water BMPs must be effective in order to avoid stiff penalties, even if we get a repeat of this past year, the third wettest year on record.

Legal challenges have not evened the odds, but rather, have reinforced that the odds are with the house.

As a result, the cost of doing business in the future is expected to increase. Builders today must take into account the cost and implementation of storm water BMPs. This includes erosion and sediment controls, good housekeeping/ materials management, and record keeping.

To keep your seat at the table, players need to:

- Plan ahead
- Know your site
- Have trained personnel
- Monitor BMP effectiveness and adjust as necessary

Remember, folding is not an option in this game!

SURETY REPORT

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been covered:

1. Has the balance sheet been managed in a way that's attractive to the surety company?

2. Is there an appropriate amount of equity, working capital, debt-to-equity ratio, and cash to support the desired project and potential backlog?

3. Do they have a quality CPA that produces timely information and does more than merely generate compliant financial statements?

4. Are they capable of producing timely and accurate internal financials using the "percentage of completion" method of accounting? These should contain all expected supplementary schedules.

5. Do they have a construction-oriented attorney who reviews contracts (both those they sign and those others sign)?

6. Have they proactively managed the business credit so that "slow-pays" and other potential problems don't creep into the equation?

In many cases, if contractors are presented with an opportunity that makes sense, and if they've done their homework by evaluating the risk and find it to be acceptable, they'll be able to gain surety support.

However, proper presentation of the attributes of the project to the surety underwriter in a manner that is well thought out, clear, and professional will also go a long way toward obtaining the approval desired.

A professional, knowledgeable surety bond broker is vital to a contractor's success. Make sure the broker has the qualities, experience and surety markets to make dream projects become realities.

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This article is provided for information purposes and is solely the product of the author. Michael Strahan is surety account executive at EGCA Affiliate Member Cavignac & Associates, a commercial insurance brokerage firm providing a broad range of insurance and expertise to design and construction firms, as well as law firms and the general business community. More information can be found at www.cavignac.com.