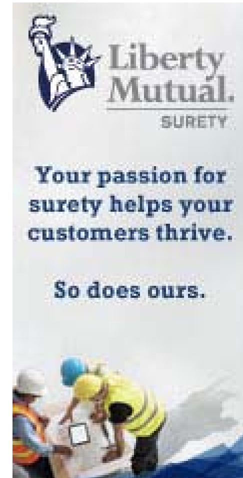
Sign in

The Business of Non-Construction Surety Bonds

Since the passage of the Heard Act in 1893, the federal government has required construction contractors to obtain bonds for federal public works projects to assure performance of the contract. Superseding the Heard Act in 1935 the Miller Act mandated performance bonds and payment bonds on federal projects over a certain threshold amount. Most states and local jurisdictions have similar legislation, commonly referred to as “Little Miller Acts,” which vary greatly from jurisdiction to jurisdiction. The surety bond concept is a risk transfer mechanism where the surety company assures the obligee, “the government entity issuing the contract,” that the principal, the entity hired to fulfill the work, will perform the contract.

The surety industry that grew out of this government legislation of more than a century ago has protected the funds spent for performance on contracts for construction projects of all kinds, protecting thousands of billions of dollars in taxpayer money. In underwriting public works' contractors, surety companies extensively prequalify those businesses to confirm that they have the capital, capacity, experience and character to perform the specific contract. But, public funds are spent on a lot of other products and services beyond construction. Private Industry has always provided goods and services to our government entities. Supply and service contract awards make up a significant portion of governmental budgets across the country.

Supply type accounts can include: Office/School Supplies, Flooring/Counters, Fencing, Modular Buildings, Work Trailers, Landscape, Portable Restrooms, Cabinets, Printers, Computer/Electronic Equipment, Irrigation Equipment, Boiler/Generators, Low Voltage Wiring, Software, Wireless Installations, Specialized Vehicles, Concrete Piping and many more.



Service type work can include; Guard / Security, Transportation/Bus, Janitorial, Entertainment, Landscape, Photography, Window Washing, Pest Control, Food Service, Wireless Networking, Street Sweeping, Boiler/Generator Retrofit, Tower Maintenance, IT Support, Medicaid Management, Social Services, Educational Testing, Waste Hauling, Debt Collecting and much more.

Recognizing that non-construction contracts were quite different from the construction contracts that created the corporate surety world, the surety industry gave Supply and Service Contract Bonds their own class code (Class Code 500) in 2004. Many contracts that could fall into this class are possibly still being reported as construction type contracts. Even with that said, the growth in the reported direct written premium over the years on record is very impressive starting with $15,077,697 reported in 2005 to the $104,999,990 reported in 2015.

are you having difficulty getting your client bonded?
Contact ACSTAR Today!
Minimum security required
Resolve NOW!
ACSTAR INSURANCE COMPANY

Although with this large growth trend, class code 500's $105 million in 2015 is still minuscule when compared to the $3 billion of written premium for construction surety bonds and the $5 billion of written premium for all surety bonds written in 2015. The cause for this relatively low reported number could be attributable to the continuing misclassification on some supply and service contracts as a construction type exposure and the circumstance that many public entities don't follow the spirit of the law and continue to not require surety bonds on non-construction contracts.

That being said, the trend of a 66% average annual growth in written premium is not bad, but it can be better. Over the last decade many surety companies have recognized that analyzing and underwriting this sector of contract surety is very different than the parameters used in processing sticks and bricks construction surety. A number of surety's have expanded their commercial bond departments to include underwriters that understand and seek non-construction contract business. You will find within these departments that they have developed underwriting factors that look a lot closer at the actual risk related to the various types of contracts supported, correlated to the financials presented. Old school "If it makes sense underwriting" is very much alive in non-stick-and-brick contract surety.

In today's economy many public entities are also looking to private industry as a method to reduce their internal costs and budgets by outsourcing a number of services and duties. It is important for all publicly funded organizations to understand that surety is a risk transfer tool that has been used extensively and successfully to bond all types of commercial contractual arrangements. The use of a bond ensures that it is a qualified vendor that bids on outsourced public work, that public entities and taxpayer dollars are protected in the event that the outsourcing provider (or principal) is unable to perform (or fulfill) its obligations under the contract, and that there is not an interruption in the delivery of vital public projects, services, and resources. Additionally, surety bonds provide assurance that the outsourcing provider's subcontractors and employees will be paid in a timely fashion, alleviating potential risk and burden to suppliers down the chain.

The lower risk associated with many service type contracts has allowed government agencies to bond only a portion of the entire gross contract amount. They determine what the perceived monetary exposure and costs would be at any one time to replace a contractor/vendor during the contractual period. Often that number comes in at one to two months of the monthly billing rate as compared to the full gross contract billings. The surety industry has recognized and agreed that there is a lesser risk and has determined that, unlike construction contracts surety bonds that are always charged based upon the full contract value no matter the size of the bond, class code 500 surety bonds charge on the size of the actual bond liability.

Also, many service contracts are multi-year agreements. The government organizations do this to reduce the inherent costs associated with putting the service agreement out to bid each year. Historically, sureties have great difficulty in providing surety bond guarantees that go out much more than two or three years. This is due to the nature of the risk and the need to verify that the contractor/vendor still meets the required qualifications. The surety industry has addressed this issue with the creation of an annually renewable surety bond document that allows for continuing coverage, time for review, and adequate notice for the contractor/vendor to get another bond or the serviced entity to bring in another contractor/vendor.

The bottom line is that more and more public entities are realizing that having a surety partner taking all performance and payment risk on contractual services is a good thing. With an average cost factor of 1% to 3% of the bond amount, surety coverage is more than reasonable and cost effective.

Requiring our government agencies to use surety bond protection for all types and sizes of supply/install and service contracts not only protects taxpayer money, but also helps spur the local economy. Often, many of our government procurers are reluctant to contract out to smaller firms because of the lack of resources to verify their capability. Surety eliminates that concern.

The underwriting process, while extensive, does not exclude small and emerging companies from qualifying to perform work. In many ways, the process educates them and prepares them to be more successful business owners by introducing them to a comprehensive view of their companies. The surety industry has enacted a number of programs to be inclusive of small and emerging companies in their customer base. This puts a great number of local businesses in

position to bid and win lucrative contracts with local government agencies, resulting in local communities growing and supporting their local small businesses.

The use of surety bonds guarantees that our governmental agencies will get the supplies and services that are contracted for. Surety bonds protect public dollars and promote the use of local businesses. The surety industry exists to make sure projects and services are properly managed, performed and completed. The use of surety bonding has proven over more than a century that it can be relied upon to be an inexpensive method for our government to get the best products and services for its money.

*This article includes statistics and information sourced through the National Association of Surety Bond Producers and the Surety & Fidelity Association of America.

Steven Swartz is President and CEO of South Coast Surety, an agency he established in 1995 and built into a nationwide wholesale surety agency with more than 20 employees who support insurance brokers and direct accounts across the country. He is the primary Contract Surety Underwriter and special commercial programs underwriter. Swartz has continuously been in the credit/financial field since 1971 and a pioneer, creating a wide spectrum of surety programs specifically tailored toward specialty contractors. Swartz serves as a member of the NASBP Professional Development Committee and on the Surety Forms Working Group.

Privacy Policy

Copyright © Pipeline. All rights reserved.

Powered by Higher Logic