

Surety Outlook 2015: It's Still About Cash Flow

By James P. Schabarum II, CPCU, AFSB

The surety industry reports fewer claims than expected in the last few years and remains optimistically braced for profitable results again in 2015.

During the recent post-recession recovery, many contractors have been able to put to rest their problems of the past and pursue more revenue volume opportunities. However, securing and collecting on acceptable profit margin work is still a challenge for the majority of contractors.

The most successful firms will adhere to the disciplined principles that got them through the toughest economic period in recent history. Although there are several factors that contribute to a contractor's success, one key element is consistent over all others: Cash Flow.

Surety Results

Results for the midyear 12-month comparison for 2Q 2013 and 2Q 2014 from the Surety and Fidelity Association of America (SFAA) Top 100 U.S writers of surety bonds showed a slight improvement of premiums and losses. As of 2Q 2014, the surety industry remained profitable, with more than \$2.658 billion in total direct premium written with an improved 17.3% loss ratio (the surety industry breakeven loss ratio is plus or minus 34%). Compared to the prior year 2Q 2013, the total direct premium written was \$2.541 billion and the loss ratio was 20.8%.

The modest improvement in total premiums and losses indicates we might be starting to see the long-anticipated growth out of the flat market results seen during the past few years. The noticeable increase in construction spending has not only been realized in the public arena, which contributes to about 75%-85% of the contract surety industry bond premiums, but also in the private commercial, mixed-use and residential subdivision markets. Although cautiously optimistic, for the right opportunities, sureties are once again "softening" in underwriting practices.

The industry remains top heavy. The top five largest surety companies (Travelers, Liberty Mutual, Zurich, CNA and Chubb), write 50% of all premiums and have a direct loss ratio of 8.6%. The top 10

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surety companies control 64.6% of the overall surety market. More alarming is that the top 15 sureties account for almost 3/4 (73%) of all premiums in the U.S. surety market, with a combined loss ratio of 13.2% -- nearly five points worse than the top five sureties. Regardless of the concentration, the U.S. surety marketplace remains very competitive for now, but concerns over future underwriting flexibility and claims handling conflicts remain.

Current Surety Market

Since the 1990s, consolidation has narrowed the surety market considerably. However, to offset any market availability concerns and support growing

capacity, the surety reinsurance market is a “buyers” delight. The record level of overall global reinsurance capital is peaking over \$3.54 trillion and seeing no stop to the continued inflow of funds. Surety reinsurers will continue to provide significant opportunities for reinsurance buyers (front-line sureties) to lower their cost of capital and enable growth into areas previously restricted. Share repurchases and other opportunities will improve sureties return on equity. Hopefully the ample availability of reinsurance and desire for premium growth will not erode the surety industry’s controlled approach to responsible underwriting and credit selection.

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**Top 100 Writers of Surety Bonds
United States & Territories, Canada & Aggregate Other Alien
Calendar Year 2014
2nd Quarter
(Year-to-Date Totals as of 6/30/2014)**

Group Name	Direct Premium Written	Losses Incurred	Direct Loss Ratio
1 TRAVELERS BOND	402,355,393	(64,294,359)	-16.9%
2 LIBERTY MUTUAL GROUP	372,266,718	86,876,874	24.0%
3 ZURICH INSURANCE GROUP	237,102,083	33,164,581	13.3%
4 CNA SURETY GROUP	208,241,891	54,788,591	27.7%
5 CHUBB & SON INC GROUP	110,646,211	3,783,490	3.5%
6 IFIC SURETY GROUP	85,894,129	13,831,547	17.0%
7 HARTFORD FIRE & CAS GROUP	83,259,873	22,830,158	28.5%
8 HCC SURETY GROUP	81,322,908	17,574,953	21.5%
9 ACE LTD GROUP	78,415,205	(4,610,655)	-6.3%
10 GREAT AMERICAN INSURANCE COMPANIES	58,751,380	11,865,804	21.5%
11 RLI INSURANCE GROUP	55,739,714	5,085,008	9.3%
12 LEXON/BONDSAFEGUARD INSURANCE COMPANIES	51,423,112	4,905,521	10.0%
13 NAS SURETY GROUP	40,600,397	5,123,943	11.6%
14 MERCHANTS BONDING CO GROUP	39,744,174	1,148,977	3.0%
15 THE HANOVER INSURANCE GROUP	36,552,818	2,872,662	7.9%

* Losses include IBNR
Source - SFAA

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Loss frequency will continue to be up for 2015. With more losses from smaller specialty trade contractors and, recently, a few large ENR firms, sureties will likely continue to see sporadic severe losses from larger general building and engineering contractors. Several years of performing low-margin work with tough contract terms are wearing down many contractors. Having low to no “net” cash and significant interest-bearing debt while failing to cut overhead over the last few years will undoubtedly be the death of some contractors.

A competing interest to the surety industry continues to be Subcontractor Default Insurance (SDI). SDI has taken a noticeable amount of surety premium and some losses away from the surety industry. The reduction of premiums has hindered the industry’s efficiency and frequently created adverse selection. More of a concern, SDI has shifted losses from sureties onto contractors that are often ill equipped to handle or manage the large deductible losses.

Sureties are very hungry for the best contractors and will compete aggressively on capacity, indemnity and rates. However, sureties are very tight on struggling contractors in the recovering construction market. Surety underwriters are now more concerned about project financing, contract terms (including warranty and efficiency guaranties), collection of account receivables (and retainage), approved and “unapproved” under-billings, access and use of bank debt, and exposure to subcontractor default. As a result, sureties will now want to meet with contractors and evaluate financials more frequently, look harder at the details, and confirm acceptable contract, bond form, and financing terms. Sureties now have a high standard expectation of risk assessment and risk transfer, including subcontractor bond-back policies and overall standard of conduct and reporting.

Risk Management Seminar Series

Sexual Harassment Prevention Training

Friday, December 5, 2014

7:30am Registration

8:00am - 10:00am Program

First Aid, CPR and AED Training - Get Certified and Be Prepared!

Friday, December 19, 2014

7:30am Registration

8:00am - 3:30pm Program

Reserve Early, Seating is Limited!

To register, click on the ‘register now’ button in the announcement email, or contact Bethany Mongold at mongold@cavnac.com or call 619-744-0540.

NOTE: Due to the popularity of our seminars and limited space available, we regret we cannot provide refunds or credits with less than 72 hours advance notice of cancellation.

Industry Trends

As the construction industry cycles into a growth mode, contractors should prepare for the pent-up demand that has been built up during the recession. While contractors must retrench during lean times, they also need to see the warning signs along the road and protect their core resources to be ready to capitalize on the real opportunities that will eventually return in the form of higher profit margin work. Some of the key current industry trends to look out for and harness are:

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- Public budget reductions, private lending restrictions and project delays are resulting in past work collections and schedule performance uncertainties
- Preference contracts for Disadvantage Business Enterprises (DBE) contractors are reducing work available to standard contractors
- Competition for less work has compressed margins below acceptable levels
- Fewer contractors are able to continue to produce multiple years of consecutive profitability
- Balance sheets have deteriorated
- Operating leverage has increased in total interest-bearing debt to net worth
- Working capital and liquidity have been adversely affected
- Hung receivables, unapproved change orders and REAs are teetering some contractors on bankruptcy
- Onerous contract and bond form terms and conditions have shifted risk
- Pressures are being felt from labor compliance and governmental regulations
- Firms must keep up with innovative technology in the form of integrated project delivery, BIM, sustainable construction and expansion of pre-fabrication

Success in 2015 and Beyond: Cash Flow

In order to survive and thrive, all contractors should accurately assess their own capabilities, balance sheet strength and ability to internally support cash flow. It is more important than ever to maintain a history of completing contracts profitably, and consistently producing net retained earnings. Create a flexible and realistic plan, examine all direct and indirect expenses and keep your hand on the throttle at all times. Complete, accurate, and timely job costing and financial reporting is an expected requirement, along with transparent and regular communication.

Today's environment and challenges require a stronger capital base that will allow contractors to control their own destiny. Cash continues to be the lifeblood of every construction operation. Contractors don't fail for lack of work or opportunities; they fail for lack of cash. The failure rate for contractors is two to three times greater during a recovery than during a downturn.



Cash management spans over all operations for the “best-in-class” contractors. It starts by seeking work with acceptable risk-reward balance, setting aggressive payment and retainage scheduling and terms, maintaining proactive billing and collection policies, having assertive change order and REA negotiations, utilizing all known cash management techniques and scrutinizing all expenses. Good cash management activities are essential to being a successful contractor.

Conclusion

2015 will be a good year for most contractors that have done their homework and have a good plan going into the New Year. A great business plan that will strategically maximize a contractor's strengths must include the ability to cash flow operations and take advantage of every opportunity to build its cash position. While contractors will continue to be tested on every front in the upcoming business cycles, it's indisputable that the world is still on the gold standard and “Cash is King.” ■

Are You Complying With the Recent Changes to the Public Contracting Code That Requires Public Works Prime Bidders to List Subcontractors License Numbers in Their Bids?

By Jase Hamilton, AFSB, Cavnac & Associates

Effective July 1st, 2014, a new revision to the California Subletting and Subcontracting Fair Practices Act Section 4100-4114 of the "Public" Contract Code is being enforced. The code now requires all prime bidders to provide the contractor license number of all listed subcontractors performing work equal to or greater than .5% (that's ½ of 1%) of the prime contractor's total bid. This requirement adds to all current mandates under the Act which requires the listing of all qualified subcontractors' names, places of business and portion of work to be performed in their bid. The failure of the prime bidder to disclose any of this information in their bid including the subcontractors' license numbers in accordance with this bill, will have their bids consider nonresponsive.

The revised Act does provide remedy to prime contractors who unintentionally list an incorrect license number. In this case, the new code allows the bidder to re-submit the correct license number(s) within 24 hours after bid opening. As long as the corrected license number corresponds to the subcontractor's name and location of business submitted with the bid, the error in the bid will not be grounds for filing a bid protest or considering the bid nonresponsive.

It is recommended that all prime contractors allocate sufficient time before the bid to conduct the necessary due diligence on subcontractors from which they have received sub-bids. All contractors' license numbers and contractor information can be found on the Contractors State License Board ("CSLB") website at <http://www.cslb.ca.gov>.

Any discrepancies between the information provided by the subcontractor and the information found on the CSLB website should immediately be addressed and resolved directly with the subcontractor.

Like all contracting issues, we recommend you engage the advice of an attorney.

To review the Subletting and Subcontracting Fair Practices Act in its entirety please reference the following link: http://leginfo.ca.gov/faces/codes_displayText.xhtml?lawCode=PCC&division=2.&title=&part=1.&chapter=4.&article=

PUBLIC CONTRACT CODE - PCC CHAPTER 4 Subletting and Subcontracting [4100 - 4114]
(Chapter 4 added by Stats. 1986, Ch. 195, Sec. 42.1.)

Any officer, department, board, or commission taking bids for the construction of any public work or improvement shall provide in the specifications prepared for the work or improvement or in the general conditions under which bids will be received for the doing of the work incident to the public work or improvement that any person making a bid or offer to perform the work, shall, in his or her bid or offer, set forth:

(a) (1) The name, the location of the place of business, and the California contractor license number of each subcontractor who will perform work or labor or render service to the prime contractor in or about the construction of the work or improvement, or a subcontractor licensed by the State of California who, under subcontract to the prime contractor, specially fabricates and installs a portion of the work or improvement according to detailed drawings contained in the plans and specifications, in an amount in excess of one-half of 1 percent of the prime contractor's total bid or, in the case of bids or offers for the construction of streets or highways, including bridges, in excess of one-half of 1 percent of the prime contractor's total bid or ten thousand dollars (\$10,000), whichever is greater.

(2) An inadvertent error in listing the California contractor license number provided pursuant to paragraph (1) shall not be grounds for filing a bid protest or grounds for considering the bid nonresponsive if the corrected contractor's license number is submitted to the public entity by the prime contractor within 24 hours after the bid opening and provided the corrected contractor's license number corresponds to the submitted name and location for that subcontractor.

(3) (A) Subject to subparagraph (B), any information requested by the officer, department, board, or commission concerning any subcontractor who the prime contractor is required to list under this subdivision, other than the subcontractor's name, location of business, and California contractor license number, may be submitted by the prime contractor up to 24 hours after the deadline established by the officer, department, board, or commission for receipt of bids by prime contractors.

(B) A state or local agency may implement subparagraph (A) at its option.

(b) The portion of the work that will be done by each subcontractor under this act. The prime contractor shall list only one subcontractor for each portion as is defined by the prime contractor in his or her bid.

(c) This section shall become operative on July 1, 2014.



A Healthier Thanksgiving

Thanksgiving meals usually include an abundance of unhealthy food options, making it easy to stray from proper nutrition until the start of the new year. But if you opt for a healthy Thanksgiving meal instead, it doesn't mean it can't also be enjoyable. With a few changes, you can make your "Turkey Day" an extension of your year-round commitment to good health.

Begin with the elephant in the room: food. You can probably stand to forgo a luxury or two come turkey time. But don't worry; you can still enjoy a delicious meal with the added bonus of feeling much better afterward. Plus, Thanksgiving is just the start of the holiday season, so there will be a lot of large meals to come.

Start by having breakfast. While many

Americans make it a habit to wait to eat until the holiday meal is set out, eating a small meal in the morning can give you more control over your appetite, allowing you to be more selective in your food and beverage choices later on. Keep in mind that you can always have leftovers the next day.

When moving on to Thanksgiving's centerpiece—the turkey—be sure to go skinless. Just 1 ounce of turkey skin contains 80 calories and 2 grams of fat. Also, be sure to use fat-free chicken broth to baste the turkey and to make the gravy.

Next, turn your attention to the side dishes. Substituting skim milk or half-and-half for whole milk and cream in recipes is an obvious choice, as is omitting bacon and cheese from

any casseroles, but how about complementing these sides or ignoring them altogether in favor of steamed or roasted vegetables and cornbread?

If you must have a holiday favorite, make sure it is just that, and not something you consume regularly during the year. And be sure to police your portions, since there are definite consequences to having too much of a good thing.

Once you've made smarter choices regarding your turkey and your side dishes, you may be wondering if there is anything else you can do. There is!

Take a walk early in the day and then again after dinner. It is a wonderful way for families to get some physical activity and to enjoy the holiday together. For those who have the day off after Thanksgiving, plan an additional workout. You will feel like your old self in no time, ready to manage your diet and exercise regimen right away, instead of waiting until Jan. 1.

Ebola is not a respiratory disease like the flu, so it is not transmitted through the air.

Ebola Outbreak Reaches U.S.

The recent deadly outbreak of Ebola in West Africa—the worst in history—has seized the world's attention, along with news that the virus has shown up in the United States.

Ebola is an acute viral illness characterized by the sudden onset of fever, debilitating weakness, muscle pain, headache and sore throat. People often confuse the illness' early symptoms with cold or flu symptoms.

Ebola is not a respiratory disease like the flu, so it is not transmitted through the air or through contaminated food or water. Ebola can only spread to other humans via contact with their bodily fluids, including saliva, sweat, blood and vomit, so people can only get Ebola from touching the bodily fluids of a person or animal that is sick with or has died from Ebola, or from exposure to contaminated objects, such as needles.

Though the Ebola outbreak has shown up in America, health officials have stressed repeatedly that the general public is at very low risk for contracting the virus, and they are instructing health workers on the proper precautions to take if they are called upon to treat an infected patient.

Provided by:
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Can You Really Boost Your Immunity?

As cold and flu season rolls around, there are a bevy of products you can turn to that purport to help boost your immunity. But how well do they actually work?

Since the function of the immune system is to react to challenges and develop new defenses, it can be improved. Every time you catch a cold or get vaccinated, your immune system builds a new army of killer T-cells, ready to fight off a future recurrence of the same pathogen.

But there is no nutritional supplement, superfood, or mind, body or spirit technique that will do this for you. Harvard Medical School has stated, “The concept of boosting immunity actually makes little sense scientifically. In fact, boosting the number of cells in your body—immune cells or others—is not necessarily a good thing,” and can lead to autoimmune disease in the case of your immune system.

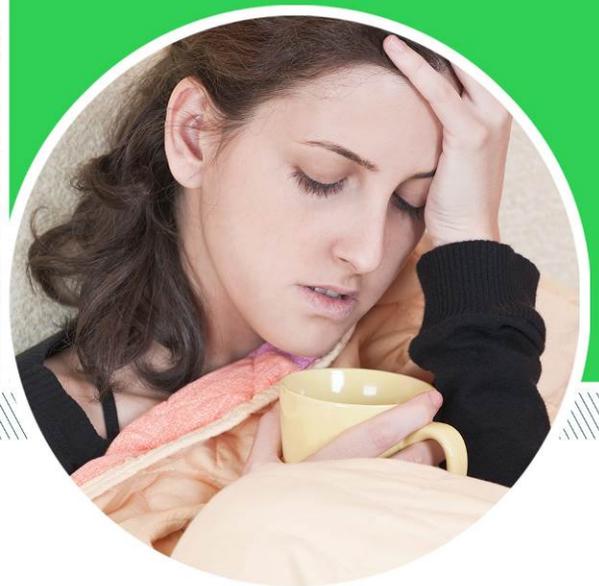
So while you can’t supercharge your immune system, you can take precautions to prevent getting sick. These include practicing good hygiene (like regular hand-washing), getting vaccinated (including flu shots), practicing food safety, being knowledgeable and vigilant when traveling to foreign countries, drinking clean water and practicing safe sex.

Lower Winter Fuel Costs



Budgeting money for the holidays is always important, but many people often forget about the increased energy costs associated with winter until they get hit with the bill. Use the following recommendations from the Department of Energy to keep your costs in check this year.

- Cover drafty windows with heavy-duty, clear plastic sheets, or tape clear plastic film to the inside of your window frames.
- Seal the air leaks around utility cut-throughs for pipes, in gaps around recessed lights in insulated ceilings and in unfinished spaces behind cupboards and closets.
- Maintain a regular service schedule for your heating systems. Replace filters once a month or as needed.
- Set your thermostat as low as is comfortable. Turning it back 10 degrees at night or before leaving your home can save around 10 percent of your heating bills.
- Finally, use LED holiday light strings to save on the price of seasonal decorations.



Sweet Potato Casserole

Skip the marshmallows this year. This five-ingredient sweet potato casserole is low in fat and rich in flavor, and makes for a perfect side to complement your Thanksgiving meal.

- 2 tbsp. low-fat milk
- 1½ tsp. brown sugar
- 1 tsp. ground cinnamon
- ¼ cup quick cooking oats, dry
- 1 can low-sodium sweet potatoes, drained and chopped

Preheat oven to 350° F. In a small bowl, combine milk, brown sugar, cinnamon and oatmeal. Mix well and set aside. In a medium-sized baking pan, add the sweet potatoes so they cover the bottom of the pan. Add the oatmeal mixture on top of the sweet potatoes. Bake for 20 minutes. Serve hot, or refrigerate and serve cold.

Yield: 6 servings. Each serving provides 94 calories, 0.5g of fat, 0g saturated fat, 0mg of cholesterol, 30mg of sodium, 5g of sugar and 3g of fiber.

Source: USDA

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SPOTLIGHT ON



Cavnac & Associates is proud to support local and non-profit civic organizations, including Mama's Kitchen.



Mission

At Mama's Kitchen they believe that everyone is entitled to the basic necessity of life — nutritious food. As a community-driven organization, they provide nutrition support to men, women, and children affected by AIDS or cancer who are vulnerable to hunger.

What They Do

Mama's Kitchen delivers three nutritional meals a day, seven days a week at no charge to men, women and children living with AIDS or cancer. Additionally, Mama's Kitchen provides pantry services (Mama's Pantry) and nutrition education to people affected by AIDS. Through these services, they are able to provide food, compassion and hope to over 1,400 people annually living throughout San Diego County.

For more information about Mama's Kitchen, go to www.mamaskitchen.org