To our Surety Clients:

Many of our clients have received SBA loans through the Paycheck Protection Program (“PPP”) loans under the CARES Act.

We understand many clients may now be unclear on the structure of the PPP loans including the obligation on the borrower to certify their need from an operational standpoint for the loan itself. One such certification, is that the borrower must confirm the impact of the “current economic uncertainty” that makes the loan request “necessary to support the ongoing operations” and that the loan request considers “current business activity” and “access to other sources of liquidity.” The foreseeable issue with such a certification, is the level of subjectivity and the interpretation of what is deemed necessary to support ongoing operations in these uncertain times is still unknown.

As a surety bond user, the ability to qualify for surety credit is paramount to your business. A key factor in determining the level of credit you can obtain is based on the financial strength of your company both from a short-term and long-term perspective. Many surety companies utilize credit models and assess the level of credit to extend based on profitability, equity, working capital, cash flows and debt leverage, among other criteria.

We know the recent pandemic may have a negative impact on many clients’ financial performance. Due to the unprecedented disruption, many projects have been delayed and/or stopped, and many new projects have been canceled, creating additional uncertainty for the foreseeable future. As a result, many clients’ backlogs and projections have been altered and many may find it difficult to refill their backlogs causing doubt of ongoing operations. This is why we are heavy proponents to surety clients obtaining PPP loans as a method to access and maintain adequate liquidity to cover any potential problems and cash flow concerns surrounding ongoing operations caused by the COVID-19 Pandemic.

For many of our clients, current business activity such as the collection of accounts receivable and underbillings represent a large part of their current assets and in turn working capital, which is a key factor for a surety company when evaluating the amount of surety credit to extend to a client. Due to the COVID-19 pandemic, it may be more difficult for our clients to bill and collect from their clients. This will have a direct impact on the availability to cashflow operations and their ability to obtain surety bonds. As a result, the access to a PPP loan and additional liquidity is not only a prudent business decision but, in many cases, essential to continue ongoing operations.

Another concern from our clients is the ability to access their bank line of credit as an alternate source of liquidity. Surety companies encourage their clients to secure a Bank Line of Credit to provide access to additional working capital. However, it is generally viewed that any borrowing on the line of credit should be as a last resort and not used as a liquidity solution for day-to-day operating expenses such as payroll, rent, utilities and other common operational expenses. Borrowing on the line of credit for day-to-day operational expenses can be potentially problematic, as it will increase debt-ratios and impact a contractor’s ability to obtain surety credit. Therefore, it is in our opinion, the bank line should not be considered another source of liquidity to support ongoing operations.

In conclusion, the surety and construction industries are dynamic. The level of uncertainty presented by current economic conditions, make it difficult to predict future cashflow needs and access to liquidity. Therefore, we believe obtaining PPP loans is not only a necessary option to continue operations but it also provides additional assurance to our surety partners and helps support the ability to obtain surety credit and continue operations for our clients.