



Bonds and Bonding Capacity 101

Executive Summary. If you've ever wondered how bonding capacity is earned and calculated, it may be a bit fuzzier than you think. But it does rely on numbers. Read on for the basics.



What is bonding? You've heard people say "The job is bonded." or "How much can they bond?" or "They'll call the bond". This begs the understanding of what exactly a bond is. A bond is an insurance. It's an insurance for, usually, a Project Owner.

A bond is a piece of paper that says "If the contractor fails, the company named on this piece of paper will step in and fix all of the problems caused by the contractor." Usually that company named to fix the problem(s) is a name you've heard: Liberty Mutual, Travelers, Hartford, Zurich, AIG, et cetera.

Let's just pick Liberty Mutual for my examples below.

What are the types of bonds in construction? There are three common types of bonds in construction: bid bond, performance and payment bond, and labor and material bond. As stated above, if there is any problem with the bid, the contract performance or payment to subcontractors, or labor and material payments, Liberty Mutual will step in and hire a new general contractor and/or make payments, or whatever cures the issue.

Is it like auto insurance? If your question is "Since bonding is an insurance, is there a deductible for the general contractor and certain rules on coverage?" The answer: nope, not even close. There is no deductible. The Owner simply calls up Liberty Mutual and says "My project's general contractor is in trouble, please come out and fix my problem." The next step is Liberty Mutual places a call to the general contractor and if there is no immediate resolution, Liberty Mutual starts paying bills or hiring a new contractor, or both.

How do I get bonding? There's a saying in the bonding world that bonding capacity is based on the Three C's: character, capacity, and capital. It's very true. Character will get you the initial meetings with the sureties (surety and bond are



basically synonymous), capacity has to do with the controls a contractor has in place and if they can handle the additional work, and lastly capital is pretty much just cash.

How is bonding capacity calculated? Once you have the character and capacity established as described in the prior paragraph, then it comes down to capital, or cash. It's a balance sheet calculation. A contractor's balance sheet is a financial document prepared by your accountant which shows the company's financial conditional at a moment in time. Below are Granite Construction's year over year balance sheets from Yahoo! Finance:

Granite Construction Incorporated (GVA)
NYSE - Nasdaq Real Time Price. Currency in USD

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35.37 +0.48 (+1.36%)

As of 11:28AM EST. Market open.

Balance Sheet

All numbers in thousands

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Breakdown	12/31/2021	12/31/2020	12/31/2019	12/31/2018
▼ Total Assets	2,494,927	2,379,996	2,502,088	2,476,601
> Current Assets	1,827,399	1,455,246	1,376,941	1,415,389
> Total non-current assets	667,528	924,750	1,125,147	1,061,212
▼ Total Liabilities Net Minority Int...	1,499,364	1,388,386	1,323,672	1,078,967
> Current Liabilities	1,069,318	943,256	842,056	677,842
> Total Non Current Liabilities ...	430,046	445,130	481,616	401,125
> Total Equity Gross Minority Inte...	995,563	991,610	1,178,416	1,397,634
Total Capitalization	1,298,873	1,306,186	1,497,579	1,686,752
Common Stock Equity	967,682	975,664	1,141,471	1,351,633
Capital Lease Obligations	32,928	46,769	58,618	-
Net Tangible Assets	904,467	825,850	830,135	1,026,447
Working Capital	758,081	511,990	534,885	737,547

Scott Jennings, P.E., is the President of [SJ Construction Consulting, LLC](#) (808) 271-5150, sj@sjcivil.com. He is the former owner of a heavy/civil construction company and now provides cost estimating and training, litigation support, construction management, and efficiency advice to contractors. He is also the author of numerous construction childrens' books at [www.amazon.com!](#)



Bonding capacity as calculated by a surety is usually done in one of two ways: by working capital or by net worth.

If by working capital, then the working capital is calculated and then multiplied by a number, like 10 or 20. So, taking the balance sheet above (and let's assume that the balance sheet is NOT in thousands), the working capital is calculated:

Current Assets	\$1,827,399
Current Liabilities	<u>\$1,069,318</u>
Working Capital	\$758,081
[Working Capital = Current Assets – Current Liabilities]	

Working Capital * 15	\$11,371,215
Bonding Capacity	\$11,371,215

There is no exact science to any of this. The Three C's and the calculation above (the working capital, the multiplier of 15, et cetera) are all done on "feel" by the surety based on your surety agent's opinion of you and his/her ability to "sell you" to the surety.

If you do a net worth calculation (instead of the working capital one), the process is similar. Above, the net worth is Total Assets minus Total Liabilities, or \$995,563. Again, another multiplier is chosen.



How do I get bonding capacity for my new construction business? If you're just starting out your construction business, it's pretty simple. You need to get an introduction to a surety agent and then you need to have cash. Cash solves a lot of problems.

My story. I was a project manager for a growing construction business and I

always talked with their surety agent. So, when I went out on my own I had a surety contact. Then I gathered money from my parents and my own savings account and threw it in a business bank account. Voila! Bonding capacity!

Work safe!