DISCLAIMER

Electronic versions of the exhibits in these minutes may not be complete.

This information is supplied as an informational service only and should not be relied upon as an official record.

Original exhibits are on file at the Legislative Counsel Bureau Research Library in Carson City.

Contact the Library at (775) 684-6827 or library@lcb.state.nv.us.

My name is Angela Ziel. I work for Kaercher Insurance Agency in the Surety Bond Department. I am also on the Board of Directors of the Surety Association of Nevada. The Surety Association of Nevada is part of the Surety Association of America. The Surety Association of America promotes the use of surety bonds and educates various industries regarding the use and application of surety bonds.

My goal today is to describe how excessive retentions and additional withholdings held by the Public Works Department are having an adverse effect on a contractor's ability to obtain surety bonds. This will ultimately cause the cost of public works projects to increase due to lack of competition and ultimately cost the tax payers more money.

When a contractor is awarded a Public Works Job they post Performance and Payments Bonds. A Performance Bond is a guarantee by the surety company and the contractor to the Public Works Department that the contractor will fully and faithfully perform all of the obligations required in the contract. If the contractor does not perform the surety company will either find another contractor to complete the work, pay the Public Works Department the bond amount so they can pay another contractor to complete the work or in some cases the surety will provide financing to the contractor and help them manage the completion of the project. The Payment Bond is a guarantee the contractor will pay their subcontractors and suppliers. If the contractor does not pay the subcontractors or suppliers then the surety company will pay them. The Performance Bond also contains a standard one year Maintenance Guarantee, which covers the contractual maintenance or warranty obligations for defective material and faulty workmanship found after the project is completed.

Because surety is more like an extension of credit rather then an insurance policy a surety company will look at several things when they are considering providing surety bonds for a contractor. There are three main areas the surety companies will investigate, The Contractor's Character, The Contractor's Capability and The Contractor's Capacity/financial strength. It is the Contractor's Capacity that is being affected most by the Public Work's Department excessive retentions and additional withholdings.

One of the things a surety company looks at when they evaluate a contractor's capacity is backlog. The larger the backlog the less bonding capacity a surety may provide. The definition of backlog in it's simplest form is how much work the contractor has to complete The surety company will look at how long it will take to complete all of the current projects and the period of time over which remaining revenues and gross profits will be recognized. The excessive retentions and additional with holdings create a larger backlog and decrease the contractor's ability to obtain bonds.

Another key item a surety company will look at when evaluating a contactor's capacity is the contractors working capital. This is the contractor's current assets less the contractor's liabilities. Due to the excessive retentions and additional withholdings being held by the public work department contractors are using the cash they have in the bank to buy supplies for a project and pay their laborers, subcontractors and suppliers. Or even worse many contractor's are borrowing against a bank line for these items. This causes a decrease in the contractor's assets. But it causes and even bigger increase in liabilities because now they have to repay the bank with interest. This decrease in working capital causes a great concern for a surety company due to the uncertainty of the contractors future ability to fund the costs associated with a new project.

After a surety company completes it's evaluation they will assign a contractor with a maximum single bonded job limit and an aggregate limit for all outstanding bonded work.

The excessive retentions and additional withholdings by the public works department has caused some contractor's to stop bidding on public works because they were unable to successfully fund the project while the retentions and additional withholdings were being held. It has also caused other contractors to have much lower bond limit for public works then for any other bonded jobs. For example one surety company assigned a contractor a single bonded limit of $30 million and an aggregate bonded limit of $50 million except for their public works jobs. For their public works jobs they were assigned a single limit of $5 million and an aggregate limit of $15 million.

Over the course of the next year it is expected that the surety companies will be reducing contractors single and aggregate bond limits even further. The reasons for this is that over the last few years several bonding companies such as Amwest, Frontier, Connecticut Surety have filed bankruptcy and gone out of business. Other companies who once provided millions of dollars in surety bonds for public works projects such as American International Group are pulling out of the surety bond market. And others have been down graded by AM Best and they no longer qualify to write bonds for public works. Two such examples are Kemper and Hanover. Lastly, many surety companies are finding it increasingly difficult to obtain reinsurance.

This has caused the companies that are still willing to write surety bonds to be very careful not make the same mistakes the other companies have made. This means they are being more strict when they assign single and aggregate limits. Also due to the decreased number of carriers willing or able to write surety bonds they are in a position to "pick and chose" which contractors the want to write bonds for.

By having reduced bonding lines more contractors will reach their bonding limit much quicker and they will not be able to bid additional work until their current bonded projects are completed. This will cause a reduction in bids and will lead to those few who are bidding to increase their price due to the decrease in competition.

Also the contractors may raise the price they bid on a job to make a little more profit on this job because they may need to fund the project and repay interest to the bank. Also, they may be unsure if they will have the necessary bonding limits available to bid the next job.

By decreasing the excessive retentions and additional withholdings the contractors backlog will decrease and his working capital will increase. This will allow the contractor to obtain the bonding capacity necessary to carry on operations. Without this change the contractors will need to raise their prices which will increase the cost of public works projects. A cost that will ultimately be passed onto the taxpayer.