



## Small Business Administration Surety Bond Guarantee Program: Viable Options for Small, Emerging or Challenged Contractors

Liberty Thought Leaders

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### Program History

The Small Business Administration (SBA) Surety Bond Guarantee Program began in 1971. It's designed to increase small businesses' access to federal, state, and local government contracting, as well as to private-sector contracting, by guaranteeing bid, performance, payment, and specified ancillary bonds. The program primarily serves contractors that cannot obtain bonding through traditional commercial channels, such as small and emerging contractors and those new in business.

The program guarantees individual contracts of up to \$6.5 million and may consider up to \$10 million for federal contracts if a federal contracting officer certifies that such a guarantee is necessary. Periodically, the \$6.5 million limit is adjusted for inflation. The SBA's guarantee currently ranges from 80% to 90% of the surety's loss if a default occurs.

In FY2018, the SBA guaranteed 10,800 bid and final surety bonds with a total contract value of nearly \$6.5 billion. While total industry information is difficult to ascertain, estimates based on the total amount of premiums collected by the private sector in recent years suggest the SBA's Surety Bond Guarantee Program represents only 3% - 6% of the total value of all bonds issued in the marketplace.

### SBA Prior Approval Program (Plan A) vs. the Preferred Program (Plan B)

When the Surety Bond Guarantee Program began in 1971, the agency offered one plan, the Prior Approval Program (Plan A). At its inception, Plan A required every surety bond application be reviewed by one of only two SBA offices. The process proved to be rather onerous on all participants, requiring significant paperwork and processing time. Today, Plan A is significantly more streamlined. It includes approximately 30 participating sureties and operates more efficiently than during its early years.

In the 1980s, based upon feedback from the industry, including multiple standard sureties, the SBA, in conjunction with the U.S. Congress, authorized the creation of the Preferred Surety Bond Guarantee (Plan B). Plan B permits "preferred sureties," meaning those that meet specific criteria, to issue SBA guaranteed surety bonds. To be approved to participate, sureties must demonstrate specific underwriting and administrative standards, and must agree to periodic review and audits of SBA bonds. In exchange for assuming the underwriting and decision making, participating sureties accept a 70% guarantee against losses (compared to the 80%-90% guarantee offered by Plan A).

### Eligibility Standards and Program Requirements

Below are the most basic requirements of small businesses to participate in the SBA programs.

- The small business/contractor together with its affiliates, must meet the SBA's size standard for the primary industry in which it is engaged.

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- The SBA uses the North American Industry Classification System (NAICS) to determine size standards, historically using the last three years of average annual sales/revenue as the determination. As of January 6, 2020, the SBA determines size based on the last five years of average annual revenues. However, businesses may use three- or five-year figures through January 6, 2022, at which point the five-year figure will be required.
  - There is an actual bond requirement.
  - The applicant is unable to obtain such bond on reasonable terms and conditions without a guarantee.
  - There is a reasonable expectation that the applicant will perform the provisions and conditions of the contract, and the terms and conditions of the bond are reasonable, considering the risks involved and the extent of the surety's participation.

Additionally, according to the Code of Federal Regulations (CFR)<sup>i</sup>, applicants must “possess good character and reputation” as demonstrated by (1) not being under indictment, being convicted of a felony, or having a final civil judgment stating that the applicant has committed a breach of trust or has violated a law or regulation protecting the integrity of business transactions or business relationships; (2) not having a regulatory authority revoke, cancel, or suspend a license held by the applicant, which is necessary to perform the contract; and (3) never having obtained a bond guarantee by fraud or material misrepresentation.

Other eligibility standards include:

- Applicants must certify the percentage of work under the contract to be subcontracted. The SBA guards against guarantees for “paper” contractors or applicants that are primarily brokers or have effectively transferred control over the project to one or more subcontractors. Typically, applicants should be self-performing at least 10%-15% of the contract.
  - Single-size contract limit is \$6.5 million (\$10 million for federal contracts). There is no specific limit to the number of bonds that can be guaranteed for any one contractor.
  - There are no restrictions on the length of time a principal/contractor can participate in the SBA bond guarantee program.
  - The SBA guarantees up to 90% of losses incurred and paid by a surety if the contract is \$100,000 or less, or if the bond is issued on behalf of a socially and economically disadvantaged-owned and controlled small business, a qualified HUBZone small business, a veteran-owned and controlled small business, or a service-disabled veteran-owned and controlled small business. Otherwise, the guarantee percentage is 80%.
  - The SBA does not charge principals application fees or bid bond guarantee fees. However, if the SBA guarantees a final bond, the principal must pay a contractor fee equal to a percentage of the contract amount, which is determined by the SBA. The contractor fee is currently 0.6% of the contract price.
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- In exchange for the SBA guarantee, the surety must cede 20% of the bond premium collected to the SBA.

### **Benefits of using the SBA Surety Bond Guarantee Program**

#### **Program benefits for contractors**

- Viable option for new, small or emerging contractors seeking their first bond
- Viable option for start-up companies
- Potential for contractors to increase capacity
- Desirable for contractors with limited financial resources
- Good option for contractors lacking CPA-prepared financial statements and/or present financial reporting challenges
- Options for those with prior history of credit challenges (business or personal)
- Potential for eliminating or reducing the need for further risk mitigation
- Only one additional SBA form is now required in most cases (significantly less than in the past)

#### **Eligible contract and project types**

- Sticks and bricks construction projects
  - Supply contracts
  - Service contracts
  - Joint-venture projects
  - Design-build projects
  - Timber sale contracts
  - Multi-year contracts
  - Task order and/or IDIQ contracts
  - Private construction work
  - Tribal contracts
  - Maintenance bonds
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## Conclusion

While the SBA Surety Bond Guarantee program has experienced growth in recent years, it is still an under-utilized government program. The government funding allocated to the program in recent years has far exceeded the total value of guaranteed bonds. Due in part to efforts to streamlining the application process, reducing paperwork, and improving response times, the program continues to become more relevant and utilized.

The SBA bond guarantee program is a viable option for more contractors than may be understood, even by those in the industry. It's also a valuable option for agents to have in their toolbox. It is a useful option to assist contractors, whether they're just starting their business, or facing a challenging situation.

*DISCLAIMER: This article should not be considered legal advice by Liberty Mutual in any way. The statements contained here are merely the Company's perspective on the SBA Surety Bond Guarantee Program.*

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<sup>1</sup> Code of Federal Regulations. Specifically, 13 C.F.R. §115.13(a)(2).

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