Construction and Surety – Working Together

The tide is turning for the UK Construction Industry and as the industry sets sail for success, the UK Surety market has a vital role to play in helping Construction secure its future.

Paul Rowland, Senior Partner, Invictus Risk Solutions LLP

The UK Construction Sector appears to have put the past behind and finally climbed out of the recession (and its aftermath) of the 2009s. For many in the industry, the aftermath has continued to be felt well into last year, but with the surge in housebuilding at the back end of 2017, the construction sector could be said to be well on its way to a successful recovery.

Whilst commercial and civil engineering work is still contracting, the rise in residential construction has dragged optimism in the industry up from its recent five-year lows. Helped by the Governments Help-to-Buy equity loan programme, housebuilding has been a rare bright spot for the industry.

According to the latest Purchasing Managers' Index, an influential private sector survey compiled by IHS Markit, reported a rise of 50.3 from October to 53.1 in November 2017, while economists had forecast a reading of 51.0. With anything above 50 indicating expansion, the increase in house building work meant activity increased much faster than expected in Britain's challenged construction industry during November.

In some quarters of the financial press, the UK Construction industry is reported to be so maligned that it has the smell of a fish not in the best of health lying on a fishmonger's slab; hardly surprising given the external economic headwinds that continue to cause uncertainty for its financial viability and contract certainty.

In recent times, within the UK Construction industry, ten companies on average were failing on a daily basis with major failures including MJN Colston, John Doyle and Airedale Mechanical & Electrical. As a result, there continues to be a large number of payment incidents.

For instance, many Tier 1 Contractors will continue to insist upon longer payment terms from their suppliers beyond the industry average of 45–60 days. Government "pressure releasing" legislation and repeated calls by industry leaders will fall on deaf ears, because there is no sign that the UK Construction industry has the appetite or capacity to improve payments within its supply chain.

As this trend continues, smaller companies (Sub-Contractors) will become rooted in an increasingly perilous financial position; enforced payment terms beyond 60 and even 90 days means that they have in effect become a direct working capital funder for the larger and more powerful construction companies.

With the Press continuing to push the 'economic uncertainty and Brexit' story, pressure on the supply chain creates further payment delays. During my Fathers' career in the City at Rowbotham's and latterly Liberty Mutual, I remember him as being a highly respected, robust and dynamic professional, with the resilience and fighting prowess of a middle weight boxer and a laugh like a squadron of Wellington's cavalry troopers, charging over a tin bridge in pursuit of Napoleon after Waterloo.

One of his many pearls of wisdom that remain with me to this day is: "You cannot go by what the press says when they are having a go at somebody or a beleaguered industry; it is like Shakespeare, sounds good but does not mean a thing!"

So it is that I do not believe all of the doom and gloom!

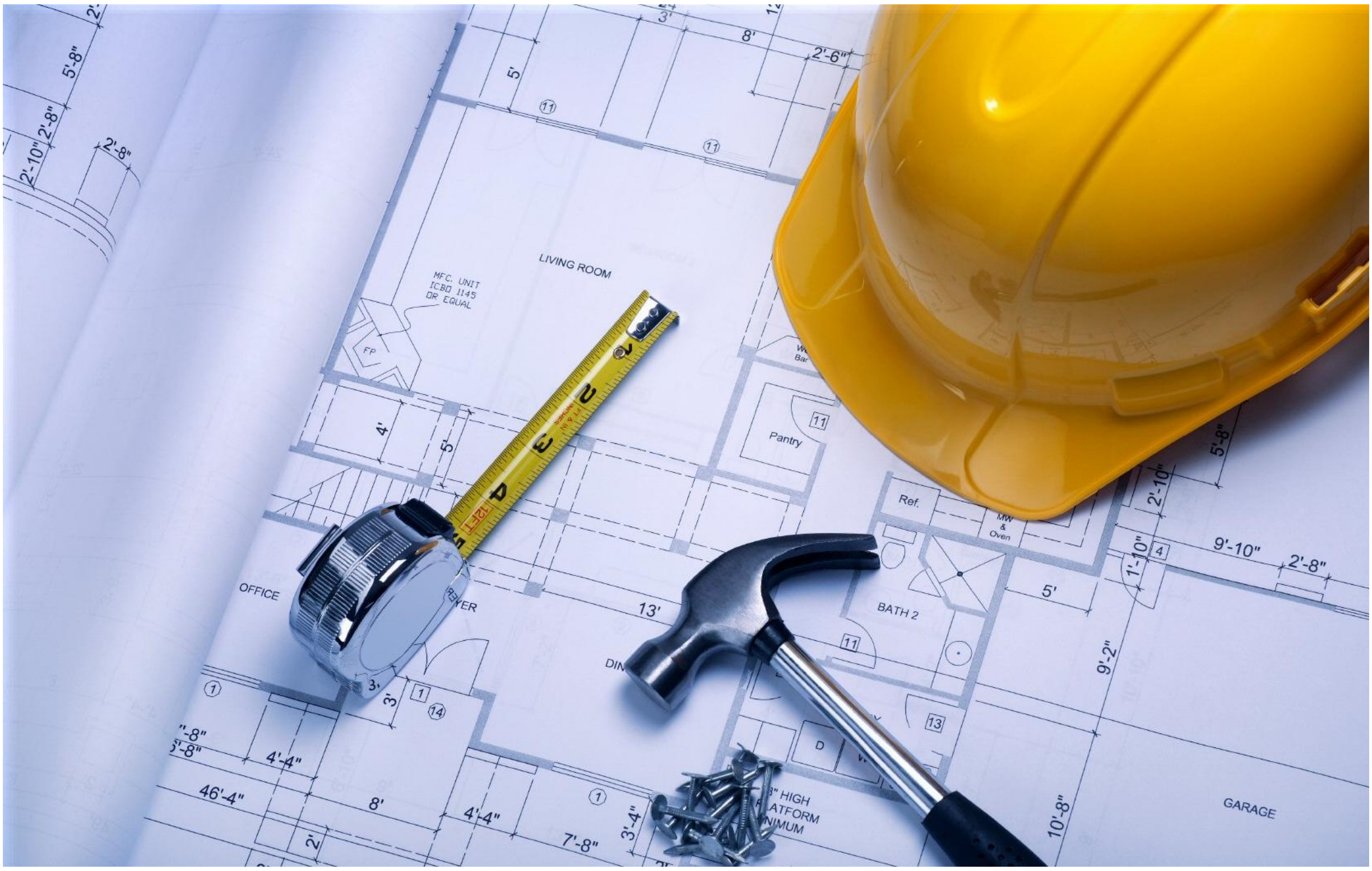
Today's political climate puts London and its property market in the spotlight. According to Deloitte's latest London Office Crane Survey Office construction is down 9% since the last survey and the last six months have seen the lowest volume of new space started since 2014.

However, this caution is somewhat mitigated by demolition levels hovering around 8m sq ft, indicating a desire to keep developing. In fact, there have been above average levels of completions and 2017 is on course to deliver a 13-year high of space. This is welcome news to a buoyant rental market in which 44% of space under construction is already let.

Eye catching buildings such as "The Shard", British Land's "The CheesEgrater" on Leadenhall Street and Land Securities' "The Walkie Talkie" on Fenchurch Street continue to dominate the City of London's skyline.

A little journey down Old Father Thames would bring you to the currently derelict, unfashionable and unloved 40 acres Convoys Wharf site at Deptford. However, there are plans afoot to invest £1 billion into a SPV led by Hutchison Whampoa's urban designer Sir Terry Farrell, to commence a decade long construction programme in 2018 and transform the area into a high end residential hub of 3,500 homes, three high rise towers up to 48 storeys tall, three new parks and a cultural centre, all with access to the waterfront.

I believe that there is a sense of renewed confidence occasioned by improving weather to allow catch up work across the summer after the normal appalling weather of December and January which often



prevents consistent and quality time on site. In addition, total construction output will continue to be bolstered by increasing levels of residential housing and a number of big ticket infrastructure projects strengthening an otherwise weak public sector order inflow.

The improvement in the PMI score should be seen as clear evidence that the industry's recent decline is coming to an end and that construction will lessen its negative "drag" influence on the UK's GDP in 2018. The only note of conservative caution being the fact that the behemoths of the UK Construction industry must maintain growth against a background of skills shortage, a low volume of Graduate level employees, high gearing, questionable quality of earnings and securing continued nationwide coverage, market penetration and control. At the same time, the Government must ensure that its scheme is processed under strict protocols less a damaging housing bubble be created unfettered.

Despite the continuing domestic UK and Eurozone economic concerns on the back of Brexit, London has continued to perform well and appears to remain an oasis of hope, sustainable development and refurbishment activity and increased tenant demand both in the City's Financial District and the West End.

So how can the UK Surety market support the recovery and needs of the UK Construction industry?

For those readers not accustomed to the vagaries of Surety, in simple terms it is an important mechanism to protect the contract conditions of the Employer (Beneficiary) whereby the Surety bond is a guarantee to pay the direct loss suffered as a result of a breach of contractual or legal obligations, or the Contractor (Applicant) becomes insolvent.

A Surety bond evidences the Contractor's ability to transfer the risks of default, non- performance or insolvency to a Surety, providing protection for the Employer under the contract. Once the Surety bond facility is in place, this will enable the Contractor to confirm during the initial contractual negotiations and through the tender documents that the Contractor has the technical ability and the financial capability to complete the works on offer.

It is important to highlight the fact that Surety bonds are not contracts of insurance; because of the way in which they operate, in the event that a bond is called and the Surety underwriter is required to pay, the Surety underwriter has a legal right of recourse back to the Contractor via a Counter Indemnity, and is entitled to seek reimbursement from the Contractor on whose behalf the bond has been issued.

A Surety contract is a sacred and wonderful thing but one must remember that it is an iron clad contract that if either applicant or beneficiary attempts to slide out of it they will be bitten to death by a wild pack of lawyers!

What is a bond strategy?

By obtaining up to date information and by hosting regular underwriter – Contractor discussions, a preferred underwriter will be able to make decisions that are accurate, timely and well informed.Each Contractor's needs are different, but there is a recurring theme of experience and expertise that underpins the current strategies being placed on behalf of several Invictus Risk Solutions LLP clients; we analyse the market and negotiate quality products available through identified underwriters; as there is not an abundance of individual underwriters to go to
(less than a dozen Corporate and Lloyd's markets in total), this narrow panel means that the integrity of our proposition will be founded upon a strong balance between the scope of coverage, clarity of terms and conditions, premium and continuity of service.

We will seek to encourage and persuade the underwriters to "validate" the Contractor as a well established, well managed company that possess a robust business model, strong market character, credible profile, sufficient capital and technical competence; our assessment process then determines the security required from the Contractor to ensure their contractual certainty and integrity going forward.

The above means that the Contractor's participation in projects will be far more attractive to investors, banks and employers and act as a stimulus to their appointment as the ability of Employers to trade safely and with confidence becomes of paramount importance.

Why consider a bond strategy?

Harold Geneen of the International Telephone & Telegraph Company wrote in 1934: "Business is many things. It is a fluid, ever changing, living thing, sometimes building to great peaks, sometimes falling to crumbled lumps. The soul of a business is a curious alchemy of needs, desires, greed and gratifications mixed together with selflessness, sacrifices and personal contributions far beyond material rewards."

Very gracious words for their time … however, this omits the most important element in the modern business era, the balance sheet.

The financial strength projected onto a successful applicant of a suite of Surety bonds and guarantees will allow solutions to be provided, even in the current difficult circumstances; the securitisation will increase banks' capacity to lend and will lessen the considerable amounts of valuable resource and time in trying to recover lost momentum.
From our interpretation of trends within the UK Construction industry, it is clear that Employers are becoming increasingly vigilant when selecting and engaging with a panel of preferred Contractors and Sub-Contractors and are seeking to view with absolute transparency the ability of these contracting partners to fulfil their obligations.

In view of the above, the assessment and placement of a protective blanket of Surety products should be viewed by all construction related parties as a "must" have purchase and will be seen as a huge positive by their Employers as they operate under increasingly strict banking covenants.

Poorly performing or financially damaged Contractors represent the biggest threat to the success of any project and pose a huge risk to their Employer's bottom line.

Accordingly, as a Contractor pre-qualifies and submits their tender documents, they should have their financial strength evaluated through stringent checks, executed by the underwriter as evidence that they can meet the financial obligations for the whole term of their participation in the project. Accordingly, the Contractor's ability to evidence its enhanced and stringent credit control procedures and financial strength to underpin a project's valuation and viability will become a huge "plus".

Conclusion

There are still those underwriters who when you introduce a new business opportunity to them will throw you the sort of filthy look they would usually reserve for a leper of whom they weren't particularly fond!

With the season of Ascot, Epsom, Goodwood and Newmarket soon to be upon us across the Spring and Summer, I offer up an equine analogy for our Surety brethren; a race horse that can run the same mile a few seconds faster than its competitor, is worth twice as much … that little extra proves to be the greatest value.

My belief is that as the economy strengthens and their balance sheets improve, the UK Construction industry will re-engage with the Surety market and wade into their capacity and support like thirsty camels arriving at an oasis after a long hard trek through the Sahara.

Money is king; both its creation and protection and as such Surety has developed from being a pure placement activity, to an important part of a developer's risk management programme. The appeal of Surety is no longer simply the assessment and placement of a standard policy product, but the information and transparency offered through access to the underwriters' refined and risk analytical disciplines, whereby clients instruct their brokers to create the corner stone of a complex financial and receivables management programme.

There is considerable doubt that a new player will enter the UK Surety market given the prohibitive start up costs required. In the past, established players have simply sought to consolidate their UK market position, namely, Euler Hermes, HCCI and RSA. Other high profile underwriters, such as ACE, AVIVA, Markel and QBE have all recruited very well, and others such as

AIG, Chubb, Travelers and Zurich appear to have re-positioned themselves to win bigger ticket market share on the back of a conservative assessment criteria and their powerful financial security, at a time when the Surety market continues to (correctly) harden its pricing and securitisation subjectivities, to lessen losses and attract more reinsurance.

At Invictus Risk Solutions, our clients want us to become an integral part of their risk management structure and as such we continue to work towards the creation of Surety strategies to complement their existing product portfolio of insurance, receivables management and financial securitisations.

The prevalence of internet driven on-line information systems enables clients to access high quality and up-to-date information in real time. However, we believe that UK and Global clients, in an increasingly fierce environment, will continue to attach a high priority to the nature of the relationship that we seek to establish through our policy management and negotiation skills. I firmly believe that today's modern CEOs/FDs/MDs are more likely to align themselves to us because we understand their needs and will provide a pro-active and prompt service, rather than beating the drum of "biggest is best."

The UK Construction industry should avoid those brokers or Consultants that save their Client just enough premium to pay them their fee, or come down from the hill to shoot the wounded only after the battle is over.

We will continue to engage our proven ability to understand the risk requirements and provide the right solutions through an attentive, knowledgeable, pro-active and professional service through our staff expertise, our market relationships and influence to identify and resolve unpalatable bond wordings and risks, our desire to act as a "risk manager" and not just a "price negotiator."

We will be sensitive and supportive as to where our Clients want to take their business and can offer practical, sensible and time sensitive advice and action, so that the proposed bond facility is arranged with the most suitable Surety underwriters.

As per David Gardner's pithy observation: "Success is getting what you want, happiness is wanting what you get."

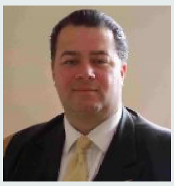
The goal of the surviving UK Construction industry is to re-energise and throw off the shackles of its inherent financial problems by operating and trading safely.

Confidence will increase exponentially as developers seek to mitigate the huge threat to their own balance sheets of non-performance or failure; the corner stone of the most effective solution will be a Surety programme built upon credible financial information and a dynamic broker relationship offering cultural sensitivity and understanding.

In closing, I offer up a poignant toast that I trust you find sits well next to my commentary regarding the UK Construction industry, its woes, its recovery and the relationships required to sustain it:

Do not walk in front of me, I may not follow.
Do not walk behind me, I may not lead. Walk beside me, and just be my friend.
May there always be work for your hands to do.
May your purse always hold a coin or two.
May the road rise to meet you.
May the wind be always at your back. May the sun shine warm upon your face.

[Albert Camus]



Paul C Rowland
Senior Partner
Invictus Risk Solutions

(m): + 44 (0) 77666 86565
(DDI): + 44 (0) 1473 836 930
(skype): pcrowland2012
paul.rowland@invictusrisksolutions.co.uk
www.invictusrisksolutions.co.uk

Paul C Rowland is a highly driven Broker and Client Advocate who holds a BA (Hons) degree in History and Law from Lancaster University. Paul is an accredited Lloyds of London broker and holds the ISO 9001 certification for excellent corporate compliance and governance. In addition, he has been awarded an MCIM in 2015 from the Chartered Institute of Marketing and an MCICM in 2016 from the Chartered Institute of Credit Management after independent assessment of a decade of his work at an operational and senior management level in both disciplines.

On Wednesday 19th July 2017 in the FinTech Awards conducted by Wealth & Finance INTL Invictus Risk Solutions LLP was awarded: "Best for Bespoke Corporate Funding Services - UK"

After 20 years broking and underwriting on behalf of some of the industry's leading practitioners, Paul has created his own company, Invictus Risk Solutions LLP (www.invictusrisksolutions.co.uk), with the goal of offering a single point of contact and a high level of bespoke, dynamic and intelligent service to clients across a range of areas of insurance and risk management expertise.

Offering a truly personal and pro-active service driven by his UK and International client's needs, Paul applies his in-depth knowledge of insurance products and underwriting markets to expand upon all existing and new relationships to create close ties between colleagues, customers and providers through a diverse range of transactions to manage their Commercial, Financial, Liability, Trade Credit, Political Risk, Surety and receivables management programmes.

*Paul is a regular contributor to **CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW**, and has published articles in Business Money, Insurance Times and Post Weekly.*

Paul has recently been the recipient of a number of domestic and international awards from his industry peers:

Wealth & Finance Intl FinTech Awards July 2017: Winner: "Bespoke Corporate Funding Services – UK"

Wealth & Finance Intl Global Excellence Awards January 2018: Winner: "Bespoke Corporate Funding Service Provider of the Year"

The CICM British Credit Awards February 2018: Finalist: "Risk Management Achievement of the Year"

The CIM Marketing Excellence Awards April 2018: Nominated: "Best Brand Building Campaign"