"Without bonds, small firms can't come to the government-work party."

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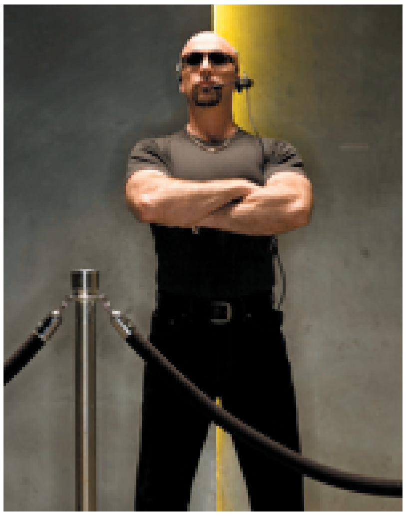
"CONSTANTLY STUCK between a rock and a hard place," is how Dominic Dunlap describes his business, DCG Roofing Solutions. Finding work isn't the problem: There are all kinds of government contracts to be grabbed near his Des Plaines, Ill., headquarters. The problem is getting a bond to qualify as a bidder for the contracts. If you can't get a so-called surety bond—the insurance that covers the government if something goes wrong—you aren't invited to the party.

There's a lot of jawboning about giving more government work to small businesses, the firms most vulnerable to the slowdown. But a government project worth more than $150,000 almost always requires a bond. "Bonding is always an issue for small business," says Joe Flynn, program director for Tennessee's Procurement Technical Assistance Center, one of the country's 300 centers established to help local businesses qualify for government work.

The federal government asks its agencies to set aside 23 percent of their contract work for small businesses. But for many firms, it's a helping hand they can't reach. "I hear this over and over from every small contractor," says Mark Yarbrough, a city council member in Perris, Calif., who has a small automotive business. Bond issuers, meanwhile, "are looking to draw blood, looking to disqualify you," adds Dunlap.

Surety bonds are issued by specialty businesses that do pretty much nothing else. But before such lenders give a small business a bond, they'll usually insist that the business show that it can also qualify for loans or a



line of credit from a traditional bank. Small firms—especially start-ups—have struggled to get that capital since the crash, explains Lenore Marema of the Surety & Fidelity Association, a trade group. Those companies either wind up getting nothing or paying much more for what they get.

Obtaining a bond costs 2 to 3 percent of a project's value if you're a well-established Monolith Inc. But young businesses like Dunlap's, without long credit histories or huge assets, can't dream of getting that rate. So they have to go to what amounts to the subprime lenders of the surety world, getting a so-called nonstandard bond that costs anywhere from 4 to 10 percent of a job. For the kind of $400,000 roof job that Dunlap typically does, that's the difference between an up-front payment of $8,000 and as much as $40,000.

$98 bil.
Federal contracts awarded to small firms in 2010

It gets worse. A small-business owner like Dunlap could once put up his house as collateral, but since the housing market crashed, the lower-tier bond companies are more likely to demand cash in addition to the up-front bond payment. In 2007, when Dunlap was just starting out, the surety lenders typically wanted 10 percent of a job in collateral. In 2008, that rose to 30 to 50 percent. (It didn't help matters that while starting his business, Dunlap took on extra debt and missed a mortgage payment, dinging his credit score.) So for one $80,000 construction job, Dunlap says, he was asked to put aside $40,000—money he couldn't touch until months after the work was completed. Terms like those put many jobs out of reach. "Stimulus money? Let me tell you, the little guy ain't getting it," says Dunlap.

There are some tiny ripples of help on the way, as various state and local

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governments try to make the bond process less onerous. And some bonding companies have decided that they're willing to eliminate some of the hurdles for entrepreneurs. Dunlap, for example, found his way to Ox Bonding, owned by Cinium Financial, of Rock Hill, N.Y. Ox told Dunlap it didn't care about his credit score, wouldn't ask for heavy collateral and was willing to write bonds based on his business record—the jobs he had completed and whether his clients were happy. (They were.) "We have to get back to judging people by character not some mathematical formula," says Robert Berman, Cinium's CEO. Berman's motivation, he says, comes from the fact that despite a spotless work history, his dad's construction firm couldn't get bonded back in the 1970s.

Berman has a heart, but he also gets paid for taking the risks. His company receives and controls the government payments, taking its own cut before paying the borrower; Ox sends checks to suppliers and essentially monitors the business. Dunlap doesn't mind the extra hand-holding because, he says, "we're staying afloat."

There are still a lot of hoops to jump through, but looser rules can bring in more competition—and, in turn, governments can often get work done more cheaply. Stacy and Devin Bair, of Bairco, a Lovell, Wyo., construction firm, wanted to bid on a $250,000 to $500,000 contract to build a creek barrier, but they couldn't get a bond. Ultimately, their savior was a middleman; an agent fought for them in negotiations with surety companies, and Bairco got the bond, Stacy says, "by the hair of my chinny chin chin." She says the firm's creative solution for building the barrier—without the use of helicopters—saved the government a bundle. As for her business, Stacy adds, "If we didn't get that project, we wouldn't be here today." Ⓢ

OUT OF BONDAGE

Some efforts are afoot to help small companies get surety bonds more easily:

▶ **Making Jobs Smaller.** State and local governments are breaking jobs up, to enable companies to qualify with smaller, easier-to-get bonds.

▶ **Calling All Middlemen.** Certain specialized agents can match up small firms with bond issuers.

▶ **Bond-Free Jobs.** The state of Virginia recently raised the bond threshold for state jobs to $500,000, from $100,000, and Pennsylvania is also working on reducing bonding requirements.