

# Surety Bond Quarterly

AN OFFICIAL PUBLICATION OF  
THE NATIONAL ASSOCIATION OF  
SURETY BOND PRODUCERS

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## DOLLARS and SENSE OUTLOOK

TARIFFS, TAXES and the WORKFORCE  
DURING a TIME of GROWTH

**State of the Surety  
Industry 2018 Report**

**Robert Shaw—Sharing the  
NASBP Experience**

**Musings of a U.S. Economist**

**Leading a Multigenerational  
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**ACORD Exec:  
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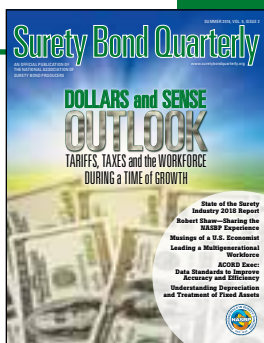
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### ON THE COVER

#### SUMMER 2018

A growing economy means growing the surety industry, and just as bond producers predict a growing industry, the new tax law is sure to create opportunities for new investment and tax savings. But there are downsides: growth makes it harder to recruit talent and the new tax law will actually increase taxes in some locations. We've covered all the angles in this issue of *Surety Bond Quarterly*.

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# NASBP Upcoming Meetings & Events

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July 29-August 3, 2018  
West Palm Beach, FL

## **COMMERCIAL SURETY SCHOOL**

August 2-3, 2018  
West Palm Beach, FL

## **REGIONS 1, 2 & 3 MEETING**

September 12-14, 2018  
Coeur d'Alene, ID

## **REGIONS 8, 9, 10 & 11 MEETING**

September 16-18, 2018  
Charleston, SC

## **LEADERSHIP WORKSHOP**

September 19, 2018  
Charleston, SC

## **SALES WORKSHOP**

October 2-3, 2018  
New Orleans, LA

## **REGIONS 4, 5, 6 & 7 MEETING**

October 3-5, 2018  
New Orleans, LA

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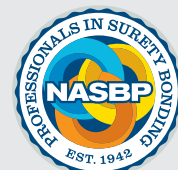
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From the CEO

# Satiating Curiosity: Worthwhile Information for Now and for Your Future



We humans are said to be curious by nature. We wish to explore constantly, and we want to understand those things which will impact us now and well into the future. We are gifted with the capacity to learn throughout our lives, and learning new skills and knowledge lets us cast off boredom and keeps us relevant in the ever-changing, complex environment of

our careers and lives. We literally have a “love of learning.” One commentator has coined a term for us as “informavores” to denote our search for and consumption of information. We are incentivized in this behavior, as those better informed and with superior knowledge tend to reap benefits such as better pay and other resources. At the crux of it is that maintaining curiosity and accumulating knowledge is our means of personal survival.

How am I doing and what is around the corner? Those are questions you no doubt ask yourself about your own performance and that of the industry to which you devote your time, attention, and energy. Any information that leads to answers is critical. For years, NASBP has sought to provide answers in the form of the State of the Surety Industry presentation, the end product of personal interviews and written survey results annually. This year, 2018, we did something different; we discarded the presentation at the Annual Meeting in favor of the distribution of a written summary report, which has been included in this issue of the *Surety Bond Quarterly*. This “snapshot” report, intended as a quick read, profiles the surety market in 2017 and in the first-quarter of 2018. It unveils strong optimism about performance in the current market but also growing concerns regarding industry challenges, such as a continuing soft market and attracting and retaining talent and integrating new employees into a disparate, multigenerational company workforce. The report also takes note of the preferences of younger professionals for greater technology utilization.

**HOW AM I DOING AND WHAT IS AROUND THE CORNER? THOSE ARE QUESTIONS YOU NO DOUBT ASK YOURSELF ABOUT YOUR OWN PERFORMANCE AND THAT OF THE INDUSTRY TO WHICH YOU DEVOTE YOUR TIME, ATTENTION, AND ENERGY.**

These identified industry challenges are illuminated further in different articles in this issue of the *Surety Bond Quarterly*. Alan Pakiela, Director of Program Development for New Haven Consulting Group, Inc., in Shelton, CT, discusses the critical points to consider in leading a multigenerational workforce. New Haven Consulting Group also will be involved in the in-person leadership skills workshop on September 19 that is immediately after the Regions 8, 9, 10 & 11 Meeting at the Belmond Charleston Place Hotel in Charleston, SC. ACORD Executive Malou August, on the other hand, describes the importance of technology innovation, specifically in the form of uniform data standards, to generate greater efficiencies in the operations of bond producers and surety underwriters.

This issue also looks at the impacts of the recent tax reform effort, both at macro and micro levels. Economist Dr. Chris Kuehl takes a high-level view of the tax reform effort, the application of tariffs, and implications of trade wars on the U.S. economy and on the construction sector. Certified Public Accountant Jack Callahan of the firm of Cohn Reznick, LLP relates the top 10 focus areas for contractors with respect to The Tax Cuts and Jobs Act, while CPA Cara Benningfield of the firm of BKD provides a web-exclusive article at [www.suretybondquarterly.org](http://www.suretybondquarterly.org) on how tax reform will impact ESOPs.

I hope the information in this issue of the *Surety Bond Quarterly* sparks your curiosity, because knowing such information likely will help hone your competitiveness and differentiate you in this spirited marketplace.

Warmest regards,

**Mark H. McCallum**  
NASBP CEO



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# National Association of Surety Bond Producers State of the Surety Industry 2018 Report

**NASBP ANNUALLY SURVEYS** its affiliate membership of surety companies to gain an understanding of the state of the surety industry over the prior calendar year, together with a snapshot of the affiliates' expectations of and experiences in the first quarter of the year in which the survey is conducted. Survey information is gathered through a written survey instrument and is complemented with information gathered through in-person discussions with selected company executives. Typically, 30 to 40 companies, representing all surety market segments, provide information for the survey, though exact respondent counts vary year to year. All information gathered is treated as confidential, with only aggregated information reported. The following summary report of survey results is divided by topic, with headlines reflecting the major findings and trends.

## **Company Performance: Profitable Growth and Solid Results**

Respondents to the 2018 State of the Surety Industry Survey\* (hereinafter, "Survey") overwhelmingly indicated that 2017 company performance was superior to 2016 performance. This result continues a trend in recent years in which more than 80% of sureties have indicated that their present performance has exceeded their prior year's performance. In 2017, 81% of respondents indicated that their company had experienced an increase in profits over the prior year (19% reported a decrease in profits). In 2016, 86% of respondents saw an increase in profits (5% saw no change, and 9% saw

**GENERAL OPTIMISM FOR 2018  
COMPANY PERFORMANCE  
WAS REFLECTED IN WRITTEN  
SURVEY COMMENTS, WHICH  
CITED THE "CONTINUED GOOD  
ECONOMY"/"HEALTHY ECONOMY" AS A  
DRIVER FOR POSITIVE PERFORMANCE.**

decrease). Sixty-nine (69%) of respondents also indicated that their 2017 performance beat their 2017 budget. This is down from the survey results in 2016, in which 85% indicated that their performance exceeded their budget, which may reflect better incorporation in 2017 budget assumptions for continued performance increases. Not surprisingly, however, continued solid performance corresponded with expansion of surety company branches, with 80% of respondents indicating that they had expanded in 2017 and that they had similar plans for 2018.

General optimism for 2018 company performance was reflected in written Survey comments, which cited the "continued good economy"/"healthy economy" as a driver for positive performance. When asked about accomplishments and challenges in 2017, respondents reported that "continued excellent results" and "profitable growth" were both an "accomplishment" and a "surprise" coming out of 2017. Sureties indicated that they did not see a reason to depart from optimism of performance in 2018,

## EIGHTY PERCENT (80%) OF RESPONDENTS ANTICIPATED THAT CONTRACT SURETY UNDERWRITING PRACTICES WILL SOFTEN IN 2018, FOR SUCH REASONS AS “MANY NEW COMPETITORS” AND “RESULTS ARE GOOD AND MEMORIES ARE SHORT.”

with one providing perhaps the ultimate self-expression of optimism, “We da bomb.” Respondents expected the construction economy to continue to experience growth in 2018.

### **Company Underwriting: Softening in the Short-term**

Despite espousing general optimism regarding performance, respondents cited “overcapacity” and “aggressive competition” as conditions that would ensure that both contract and commercial surety markets remained soft or would soften further in 2018. Eighty percent (80%) of respondents anticipated that contract surety underwriting practices will soften in 2018, for such reasons as “many new competitors” and “results are good and memories are short.” Some respondents also remarked on how producer behavior is further softening the market. One stated that many producers “are reluctant to ask questions and quick to take the path of least resistance.” Remarking that “the producer’s helpfulness [in the underwriting process] continues to degrade,” another respondent offered that “rate and capacity seem to be the only measures of success.” On the other hand, a number of respondents related that their business plans are predicated on trusting relationships with “the professional bond producer,” which permits growth the “right way” and are critically important to continued success.

In terms of the commercial surety market, 47% of respondents indicated that the market would soften, while the majority, 53%, indicated that the market would remain the same. A comment given may explain the majority view that the commercial surety market will remain the same, as “it can’t get any softer in commercial,” which echoes a similar statement that the commercial surety market “is free money” made in last year’s survey.

Regardless of the type of surety market, respondents related that such markets were not likely to tighten without the occurrence of an economic downturn and/or the advent of a loss cycle.

### **Company Challenges: Managing Contractual Risks**

Among the significant challenges facing sureties in the current environment is managing contractual risks, an answer given by 87% of respondents when asked to identify top

challenges and opportunities for surety companies. One respondent framed this challenge in the following terms: “sureties need to make sure that they are not taking on contractual risk that they can’t handle.” This finding is further reinforced by the sureties’ assessment of top challenges for contractors, whereby 73% of respondents listed “difficult owner contract language” that places additional risk on projects where profit margins remain thin. Certain emerging circumstances, such as those presented in the context of public-private partnerships, also require that sureties be ever mindful of the contractual risks that they are underwriting, reasoned a respondent.

Respondents identified other challenges being faced by construction contractors, noting that, beyond difficult owner language, contractors are contending with subcontractor competency issues, qualified workforce issues, and cash management issues.

## RESPONDENTS EMPHASIZED THE IMPORTANCE OF PRODUCER INTEGRITY IN THE CURRENT MARKET AND STATED THAT PRODUCERS HAVE A CRITICAL ROLE TO PLAY IN EVALUATING SURETIES AND IN DOING BUSINESS WITH THOSE THAT “WILL STAND BEHIND THE PRODUCT.”

### **Company Challenges: Talent**

As a shortage of talent/skilled workers is a significant issue for construction companies in the present labor environment, so too is it an issue for surety companies, as indicated by 80% of respondents. Seventy-three (73%) of respondents related that they plan to hire more underwriters in 2018 to fill either existing positions or newly created ones. How can they accomplish this goal when there is a shortage of talent? Nearly all respondents indicated that they had plans to hire talent away from competitors, underscoring the meaning of the phrase “war for talent.”

Working with persons of the millennial generation also is very much on the minds of respondents in 2018, particularly with respect to bridging generational differences among employees. Some respondents disclosed that they are trying to increase employee engagement and interaction. Among the means of accomplishing that is by pairing employees of different generations and experience levels in mentoring groups. Respondents also revealed that technology use is becoming more important as a result of the influx of millennials in corporate culture. Respondents, however, related that “developing people skills” may be more of a challenge and a need for some millennial employees.



### Company Challenges: Maintaining Underwriting Discipline

Respondents reported that, in view of excess capacity, soft market conditions, and considerable competition, maintaining underwriting discipline is of great concern. Eighty percent (80%) of Survey respondents pointed out that “excess capacity” was a significant challenge in today’s surety market. Many cited “deteriorating” terms and conditions or “dilution” of underwriting terms and conditions as difficult present challenges and emphasized that continued soft markets would put added pressure on maintaining underwriting discipline in 2018 and beyond.

Respondents emphasized the importance of producer integrity in the current market and stated that producers have a critical role to play in evaluating sureties and in doing business with those that “will stand behind the product.” One respondent offered that producers can do the best job possible when evaluating sureties by evaluating their business plan, their claims philosophy, their underwriting consistency, and their support from senior management.

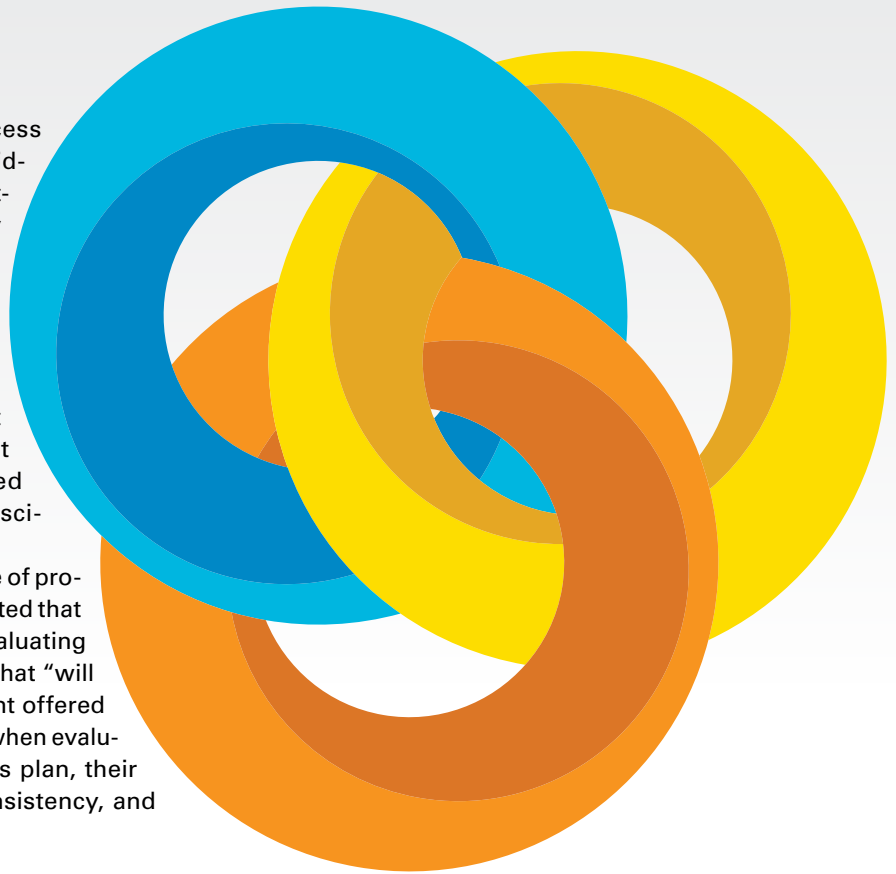
### Company Claims Experience: Activity, Frequency, and Severity not Expected to Rise

Survey responses indicated that, as a whole, surety companies do not foresee significant claims activity in the near term. When asked, “Are you seeing a rise in the frequency and/or severity in your claims department?” 71% selected “no” and 29% selected “yes.” When asked to predict claims activity in 2018 relative to that in 2017, 64% believed that claims activity would remain the same, 7% believed that it would decline, and 29% believed that it would increase.

### Company Claims Handling: Solid and Improving

As in past surveys, this Survey asked respondents to grade the industry’s claims handling on a scale of 1 to 10, with a rating of 10 being the highest. The average of the ratings came in just under a rating of 7 (6.8), the highest average rating since 2012. When asked how to further improve claims handling, many respondents related the importance of frequent communication with claimants. Other suggestions for improvements were investing in claims staff, paying proper claims promptly, and creating

**NEARLY ALL RESPONDENTS INDICATED THAT THEY HAD PLANS TO HIRE TALENT AWAY FROM COMPETITORS, UNDERSCORING THE MEANING OF THE PHRASE “WAR FOR TALENT.”**



transparency of process. Producers can help too, added a respondent, by not taking bonds from those with a poor history of handling claims.

### Industry Image: Mystery to Many; Education and Outreach Needed

A common refrain of Survey respondents on industry image was the need for the surety community to promote the value of surety bonds. To paraphrase a respondent, surety bonding cannot remain “a mystery to many outside of our immediate industry” if we are to improve surety’s image. Delivering message points to decision-makers that bonds save taxpayers money on defaulted contracts, provide contractors with the ability to grow responsibly, and provide ongoing jobs for construction workers are important, added the respondent. Other respondents identified image opportunities as “telling the story of how surety bonds helped obligees get their projects completed” and “linking successful project completion with the presence of a bond.” To that end, NASBP and the surety community must continue to be “proactive with advertising” and with “building relationships.” ●

### End Note

\*The information contained herein was compiled through the efforts of NASBP leadership and staff, with NASBP CEO Mark McCallum being the primary author of the report, published April 2018.



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# Robert Shaw

## Sharing the NASBP Experience

**ROBERT SHAW, PRESIDENT** and founding partner of Skillings Shaw & Associates in Lewiston, Maine, has a passion for teaching others about the surety bond business; he's been an instructor at the NASBP William J. Angell Surety School for almost 30 years. Shaw himself has learned a lot about the industry since he interviewed for a job with Maine Bonding and Casualty Company (Fidelity & Deposit of Maryland) back in 1978. When David Fossett, the company president, asked him if he'd like to work in the bond department, Shaw's response was "savings bonds?"

Fortunately for him, and for the surety industry, Shaw got the job anyway. Now, after a 40-year career, Shaw is serving as NASBP President for 2018-2019.

After graduating from the University of Southern Maine, Shaw spent almost a decade learning about the company side of the business, first with Fidelity & Deposit in Maine, San Diego, and Boston and then back in San Diego with Industrial Indemnity.

In 1985 he joined the Robert F. Driver Company and began working with Jack Warnock as a surety account executive. "That was my entry into the agency business," Shaw said. "I got great experience there. It was a straight commission job, and I learned a lot about sales, about customer service, and about life.

"I loved it," he added. "It was so exciting. The surety industry is great anyway, because each account is unique and every day is different. Being on the agency side is really the front line. You have to go out and develop your reputation, you have to go out and prospect and beat the bushes and find opportunities. You never find easy opportunities; you always find challenges, which you get to make into an opportunity." Helping a contractor resolve problems can be the beginning of a long-term relationship that benefits the producer, the contractor, and the surety.

Shaw returned to Maine in 1987 to take a job with the Dunlap Agency in Auburn. He worked with David Skillings, the agency's



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The 2018-2019 NASBP Officers were elected at the Annual Meeting.

Vice President of Surety, for several years before the pair founded their own agency in 1994. Skillings, a former NASBP President, retired in 2002.

Today Skillings Shaw & Associates handles every type of bond, including contract, commercial, fidelity, and licensing. He has clients throughout New England and some national accounts as well.

"In a small market economy like northern New England, you have to be able to adapt, so you have to sometimes be creative," he said. "I handle small, medium, and large-sized accounts, specialty accounts, and distressed accounts. We also do brokerage business where we handle some surety accounts for agents who either don't have the expertise in surety or the markets." The good relationships he's formed with independent insurance agents have given him a fairly broad penetration into that market.

Like all small business owners, Shaw was conscious of a need for continuity of his business. In 2012 he sold the company to Woodrow W. Cross Agency. He retains the title of Company President and runs the agency with the same dedicated team just as he had previously. "It's worked out really well. Royce Cross has been a solid partner, and we've continued to grow every year; we even had to move to a larger building."

### NASBP Aids Growth

Shaw said his greatest professional accomplishment has been founding Skillings Shaw & Associates and making it a success. He's proud that he's created a reputation as a well-run and solid agency among contractors and the surety marketplace

in New England. He values the long-term relationships he's formed with customers; some started working with him in the late 1980s and have remained with him to this day, through generation and ownership changes.

"It's been very rewarding to be part of their business growth," Shaw said. "At the same time, I've had employees who have been with me for 10 or 15 years. I've been able to provide a stable workplace so they've been able to finish their college education, buy houses, get married, and put their kids through college."

NASBP has been a big factor in his success. "NASBP has allowed me to have access to resources beyond a small Maine insurance agency, to be able to network with other members around the country and around the world," he said. "I've been able to help some of my customers when they've had questions or had needs outside of my territory. I've been able to work with members, like myself, who have been more than happy to countersign a bond or provide me information."

"Being part of NASBP is an important part of my relationship with my companies," he added. "They view NASBP members as best-in-class, and as part of that they want to partner with you."

Shaw's first experiences with NASBP came when he was at The Driver Company and began working with SuretyTech, NASBP's underwriting program. When he joined the Dunlap Agency, both Steve Dunlap, the Company President, and David Skillings were active members of the association. They suggested that he develop a sales module for the NASBP Surety School. He taught that course in 1989 and has been a teacher at the William J. Angell Surety School and the Angell-Curtin Advanced Surety School for both Winter and Summer Sessions ever since. He teaches the underwriting basics, WIP and submissions, with Jim Lareau from Travelers Insurance.

"Every year, when I go out and teach at the School, I feel like I get so much more than I give. I interact with the other instructors—we like to bounce things off each other—and interact with the students. I learn something new

every time," he said. He always comes back from these sessions energized.

Shaw has also served on several other NASBP committees, including Membership, Ethics, Government Relations, State Government Affairs, and Industry Relations. He's been a member of the Surety Industry Forms Working group as well.

In addition, Shaw is active in the Maine chapters of several construction industry associations: Associated General Contractors, Associated Builders and Contractors, Construction Financial Management Association, and Maine Better Transportation Association.

### Year Ahead: Marketing and Networking

Shaw intends to continue a new initiative that was started by Howard Cowan during his 2017-2018 term as NASBP President.

It is a communications campaign that will provide tools and materials to members to assist them in marketing the importance of surety to construction businesses, private owners, and architects.

"There are always some disruptors in the marketplace, such as subcontractor default insurance, bank guarantees, or private owners not requiring a bond because they don't understand the value that a bond adds and all that the product actually does," said Shaw. "The campaign is a long-term commitment and a pretty big financial commitment, but we know it's important to do this."

Shaw also has planned an outreach to membership, the "NASBP Roadshow—Bonding with Bob."

"NASBP has been a phenomenal experience for me; the meetings are fantastic and the networking opportunities are key," he said. "I've always wanted to have more people enjoy that kind of experience, but the time and the travel and the cost can be prohibitive. Agencies and companies can only send so many people."

So this year the association will try to reach many more people with six small meetings around the country:

- July 17, 2018 - Villanova University Conference Center, Villanova, PA





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Bob Shaw's wife, Kelly, has been integral to his success.

- July 19, 2018 - The Lyceum, Hartford, CT
  - November 2018 - Des Moines, IA & Kansas City, MO (locations and dates TBD)
  - February 2019 - Southern California & Denver, CO (locations and dates TBD)
- For more information, go to: <http://www.nasbp.org/2018-2019roadshow/home>.

The half-day event will start with lunch, followed by a NASBP update. Then come the "Bob Talks."

"They will be a surety version of Ted Talks; we'll have three or four people give 10- to 15-minute pieces about an industry related topic," Shaw explained. After a break, participants will hear a final speaker or panel discussion. An hour-long networking/social session will end the program around 4 p.m. in the afternoon.

Shaw hopes that both agencies and companies within a three- to four-hour travel circle will bring not just the principal or key people to these meetings but also support staff like surety and administrative assistants. That will give them the opportunity to gain additional knowledge and to network with their peers.

"I would like for new people to have the NASBP experience through the road show and to develop some NASBP friendships and relationships on a moving-forward basis," he added. "That will be good for all of us."

#### A Great Choice of Career

Shaw says his wife, Kelly, has been key to his successful career. She supported his decisions to become a commission-only agent and to start his own agency

and has served as Skillings Shaw & Associates' CFO from its early days.

"We've been married since 1980, and she's been a true partner all my life," he says.

They have two sons. Benjamin, the older, has worked with his father for three years, and Cameron has worked in the entertainment industry (he's a writer) and is also involved in property management.

Shaw and his wife live on a 100-acre property on a small lake in Auburn, ME.

They enjoy outdoor activities like snowshoeing, paddle boarding, and hiking with their dogs, Gus and Emmett. "A tired dog is a good dog," Shaw said.

He feels very fortunate that he accepted that first job in the surety business. "When I get together with my NASBP friends, we look at each other and say, 'Can you believe we get paid to do this?' I've had so many different experiences that I had no inkling were possible when I was young and idealistic and going to school." ●

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# The Musings of a U.S. Economist— Be Careful What You Wish For:

## Implications of the Tax Reform Effort, Tariffs, and Trade Wars



BY CHRISTOPHER KUEHL

**WHAT WAS THE** old Chinese curse? “May you be born in interesting times”? We are most certainly seeing those interesting times, and few sectors have been as affected as construction—housing, commercial activity, and public sector building. These are important parts of any nation’s economy, but in the U.S. the impact is especially profound. Home ownership has been promoted more in the U.S. than anywhere else in the world. For years many have asserted that home ownership creates social stability and economic growth. To that end, there have been programs to underwrite home buying and tax benefits to encourage that ownership. The bulk of the growth that has been noted in terms of capital investment has been in commercial development, nearly twice what is spent on new equipment. The public sector has been neglected for years, and we have been paying the price with deteriorating roads and bridges as well as antiquated airports, seaports, and all types of public structures.







## Impact of U.S. Tax Reform on Real Estate, Construction

The tax reform plan that finally emerged from Congress earlier this year was typical of any large and complex piece of legislation. It was a far cry from what was intended in the beginning, and it has any number of flaws that presumably will be addressed in the years to come. Many of the provisions that most worried the real estate and housing sectors did not survive the final adjustments, but some did; and they will likely alter the markets in both subtle and significant ways.

Before getting specific, consider the efficacy of the whole plan. Most economists have harbored dubious feelings about the long-term benefits of the Tax Cuts and Jobs Act due to the timing of the plan. It is not unusual for the government to cut taxes during a recession or even a downturn. These tax cuts were not the largest the U.S. has seen in recent memory; both of the Reagan cuts were bigger, and so were the Kennedy tax cuts. These past tax cuts came in the middle of an economic reversal and did roughly what they were supposed to do, boost growth by getting more money in the hands of business and the consumer.

I cannot help but think that the recent tax cuts come as the economy already has improved. The growth rates have been over 3% since the second quarter of last year, and the unemployment rate is 4.1%. It is arguable the economy needed no more stimulating, and the Federal Reserve has said as much, as it now talks of higher interest rates through 2018; and it has ended all the other programs designed to push more money into the system. In the face of this apparent recovery, we get massive tax cuts; and we have already seen the downside of this move.



This must be what it feels like to be that person at the wild party who stands in the corner and keeps reminding the revelers that they are going to regret all this bacchanalia in the morning. Right now the economy is booming despite a slew of headwinds that would normally have been expected to have slowed things by now. The gross domestic product numbers look good, joblessness has rarely been this low, manufacturing indicators are up, the inflation threat remains distant and

mild. The business community has been enjoying those tax cuts, and even the consumer seems to have gotten into the swim of things lately. Why would someone want to bring up the hangover that is almost certain to follow? No, scratch that—it is not almost certain—it is certain in the world of economics. The fact is that debt and deficit is getting worse as far as the U.S. is concerned, and we are well beyond the point that remote easy fixes are available. The debt and deficit

issue will cause real pain, and bringing either of them back to reality will hurt as much or more.

Companies and individuals have largely behaved as they were expected to after the tax cuts. They are spending. Companies are investing in machinery, and they are paying bonuses, and they are hiring, and they are expanding their operations physically. Consumers are buying and no longer fear hauling out that credit card. This has prompted some very real fears of inflation, and everybody knows what the response to inflation will be, even higher interest rates. Much of the motivation for the return of stock market volatility has been the fear of inflation and the subsequent Federal Reserve response. The era of easy money has come to a screeching halt.

There is no guarantee of high inflation, as many factors will have to come together; and at the moment there is simply not that much inflation to worry about. This has started to change, however. The latest jobs report showed that wages are now going up at a 2.9% annual rate as employers are being required to pay those new hires more. Even more importantly, employers have to pay their existing staff more to keep them from being poached by other hungry employers. This is still a pretty anemic pace, but it is faster than it has been in the last four or five years. The price per barrel of oil has not returned to the bad old days of \$100, but it has gone up by more than 50% in just the last several months. This has already led to fuel surcharges in the trucking and rail sectors, and the airlines are starting to hike fares in response. You can see where this is going.

Where will construction fit into all this? The federal funds rate doesn't immediately impact mortgage rates as these tend to follow long-term bonds more closely, but those bonds react to what the Federal Reserve does and that does mean higher mortgage rates in the not distant future. In the last year there has been constant reference to the "headwinds" affecting the housing market. It was expected that mortgage rates would

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climb, it has been noticed that home prices are up, and in some markets the rise has been dramatic. There has even been concern about the slow pace of wage gains. Now there are changes taking place. Those mortgage rates are going up and prices are as well. At the same time the consumer has more to work with—higher wages and lower taxes—and the vast majority of the population is now gainfully employed. It is a bit of a tug-of-war between factors that encourage buying a house and those that suggest not buying.

This brings us back to the provisions of the tax reform. Can it still be asserted that the U.S. wants people to buy homes as opposed to renting? Yes, but the incentives took a hit, fortunately, not as severely as had been anticipated at one time. One of the key conversations was over the mortgage interest deduction. This has been attacked by many economists as a benefit primarily for the wealthy as the more one spends on a mortgage loan the higher the interest payment and the bigger the tax write-off. The flaw in this logic has been that home prices vary dramatically from one part of the country to another. One million dollars buys quite a nice little mansion in Kansas City and a two-bedroom bungalow somewhere near the beach in California or a modest dwelling in New York City. The threat to eliminate the deduction was held off, and there was a modification that limited how much deduction could be claimed for expensive homes. There was also a grandfather clause that protected previous home buyers.

There was also a reversal of the original provision that would have required people to live in their home five of the last eight years to reap capital gains benefits but that was dropped and the existing law stands. All in all, the threats to real estate were blunted to some degree; but there has been enough subtle change that it will take some time to understand what this will mean for a market that has been driving the whole of the U.S. economy for the last two to three years.

### **Possible Trade War Between U.S. and China**

Now we have the arrival of steel tariffs and the impending prospect of a trade war. This is not something that can be taken lightly. The looming possibility of a trade war between the U.S. and China has created a lot of tension in those communities that will be most affected by the imposition of trillions of dollars of tariffs from both the U.S. and China. Trade disputes are common enough, and in the past there

has generally been a pattern. It starts off with fulmination and bravado on both sides: “you need me more than I need you.” Most of the rhetoric is for domestic consumption, as the only reason there is a trade dispute in the first place is that some industry sector in the country wants some protection or other advantage over a foreign competitor. It is no accident that most trade quarrels coincide with elections as this kind of talk is good for motivating voters. Behind

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the scenes it is a far different story as negotiators try to accommodate the needs of both parties. Access is always the goal, and there are always parts of the other country's economy that business wants access to; and the goal is to give up something of less importance to the national economy in return for that access.

This time the patterns are somewhat harder to identify as the key actors are much harder to pin down. President Trump shifts from a negotiating position at lightning speed. At this point there is very little that can be relied on as far as the public statements are concerned. A hard-fought compromise may blow up over some Twitter rant or fit of pique. Xi Jinping seems far more stable on the surface, but this is a different kind of Chinese leader than the U.S. has seen previously. He is unchallenged in his leadership and has arranged to be in charge for life. There are no other leaders that can balance his opinions, and he has made it clear he has ambitions for China and will not risk compromising those aims. There is no sense that either man is going to back down regardless of the domestic costs. President Trump has now acknowledged this trade fight will hurt farmers and has made vague promises to help them out, but losing the

Chinese as a customer will devastate a community that has been clinging to the edge for years already. Xi knows that cutting access to the U.S. hurts his exporters badly, and he has been utterly cavalier about that damage.

The latest speech from Xi was anti-climactic, a re-hash of what had been stated before at the World Economic Forum in Davos, Switzerland, and in speeches before Chinese delegations with promises to provide better access for U.S. companies seeking to invest in China but precious few specifics. This has always been the criticism of China: the rhetoric is always right on-point, but there is never much follow through. This may all be smoke and mirrors as the real negotiations take place, but there is enough mystery to all this to create some real consternation in markets that have been dependent on trade between the two countries.

#### **Economies of U.S. and China Intertwined**

The U.S. and China are now locked in a ferocious diplomatic battle over trade, and it is going to be hard to get a sense of what is at stake as both sides fire their best shots at one another. This is a conflict that means a great deal to both nations, and neither has a real "leg-up." China

needs the world's greatest consumer nation to buy the output that streams from Chinese manufacturers, and the world's most dedicated consumers want those low-priced goods. The economies are intertwined and mutually dependent, and every threatening gesture hits both the adversary and the folks at home. There is that old adage stating that, when two elephants fight, the loser is the mice. That is what is happening to the U.S. consumer and Chinese producer. To make the situation even more complex, there will be considerable political capital expended on both sides; and both President Trump and Xi have a lot to lose.

For many years it was fairly clear that China was in clear violation of numerous trade rules, informal and formal. They were engaged in dumping, defined as selling a product for less than it cost to produce. They were engaged in currency manipulation, which is defined as deliberately managing one's currency downward to favor exports. It can be argued that China does neither of things now. The fact is that costs of production are lower in China, and China does not have to delve below what it costs to produce to be competitive. The yuan now floats as a normal currency would, and China is not guiltier of manipulation than is Japan or Europe or even the U.S. The techniques used to promote exports are subtler or more thoroughly ingrained into the system.

At the very heart of the tension between the U.S. and China is a drastic difference in systems of economics and politics. China is a command economy and a totalitarian state. The vast majority of Chinese business is either owned outright by the state or is heavily influenced by the government—all the major banks, major manufacturers, and so on. The U.S. is a private sector economy where government control is indirect and weak. Decisions are made at the highest political level and may or may not have anything to do with business or profitability. In the U.S., consumer demand determines what companies survive and prosper, while in China it is the political





purpose the Chinese companies serve. A country of 1.5 billion people puts a lot of emphasis on jobs, and operations will be kept going for decades just so that people have work.

The Chinese have been manipulating trade to suit their interests for decades, and now is no different. The U.S. is not the only nation that is irritated with China. This year, Japan, South Korea, and Europe attempted to push back. Over time almost every country that has done business with China has rebelled to some degree. The U.S. plan is to find a way to reset the relationship, but that will not be simple as China knows where it has leverage and is not shy about using it. Someone observed that, while the press continues to verge on the apoplectic when it comes to Russian meddling, the press seems to give the Chinese a pass despite their very upfront targeting of sensitive electoral areas with their tariff policies. China knows full well who its friends are in the U.S. and has been working overtime to get them ramped up.

The good news for the U.S. business community is that there is reason to negotiate for both the U.S. and China. Realistically, neither nation can simply walk away; and there is room to compromise for both sides. Whether this is possible will depend as much on domestic politics as on economics, making the next six months very interesting, indeed.

To purchase a recording of the April 4 and 24 NASBP Virtual Seminars on this topic, go here: <http://nasbp.formstack.com/forms/VSccontentlicenseagreement>. ●

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# LEADING A MULTIGENERATIONAL WORKFORCE

BY ALAN PAKIELA

**ACCORDING TO A** McKinsey & Co. report, it is estimated that up to 25% of independent agents and brokers will turn over in the next few years.\* One fourth of your organization needs to be replaced and typically will be replaced with a “millennial generation” employee.

And to add to that challenge, millennials do not have a particularly positive view of the insurance and surety industries as a whole. Many of them do not see how these industries meet their needs and aspirations.

These two factors will place many organizations in jeopardy of increasing revenues and market share. So, what’s a company to do? To paraphrase Albert Einstein, “You can’t solve the problem with the same thinking that caused it.” It might be time to understand what the incoming generation is looking for

in an employer. It might be time to take a closer look as how surety professionals view generations in the workplace.

Each generation seems to think the incoming one is just a younger version of themselves. This perspective tends to create a conflicting dynamic between these generations, which often leads to deep misunderstanding, resentment, conflict and, in the case of companies, turnover.

In fact, the generations present in the workplace today have vastly different life experiences that have shaped how they view themselves and the world around them.

The generations view working in very different ways. Boomers (born 1943–1960) see their work as a “career” and have been labeled “workaholics.” Xers (born 1961–1981) see work as “necessary.” Millennials

(born 1982–2004) see work and life as integrated.

We all know that these generalizations do not apply to everyone in the group, but the characteristics, experiences, and views will affect how these generations interact with one another. As the boomers continue to retire and the Xers move into higher positions of authority and responsibility, potential gaps in understanding between the generations will only continue to grow unless both sides listen to what the other needs.

Research conducted by LifeCourse Associates shows that over 72% of insurance agents and brokers feel that “Yes, sometimes/often real differences between younger and older generations pose challenges in the workplace,” as compared to the national benchmark of 54%.



The survey further reveals that both boomers and Xers have a fairly negative view of the younger generation. Only 5% of boomers and 9% of Xers have a very favorable view of millennials. Interestingly, millennials held a much more favorable view of boomers and Xers at 20% and 10%, respectively.

The survey also asked questions around coaching and feedback, two key areas almost all employees rate as a critical need for advancement. While it may make sense that coaching and feedback become less “important” the longer you are working, the need for these activities still remains high even for the boomer and Xer employees.

In responding to the statement “I like my supervisor to provide me with hands-on guidance and direction,” boomers and Xers responded

at 44% while millennials responded at an astounding 72%. Millennials, unlike any other generation, thrive on feedback. Research and experience show that constant feedback is a key motivator for the millennial employee. Now, pair that with a manager or supervisor who prefers someone who will “take the ball and run with it” or “figure it out themselves” and you have the makings of a clear “generation gap.”

To remain successful in today’s multigenerational workplace, organizations need to attract, retain, and engage their employees.

Let’s take a look at some seven traits of the millennial worker and then think about how these characteristics might affect motivation and performance.

From an early age, millennials have been told they are **special**. They are unique in the world and have been treated as such. Millennials have been **sheltered**, as can be seen by the rise in car seats, bicycle helmets, and the ubiquitous “Baby on Board” stickers.

They are **confident** since their parents, teachers, and coaches have told them that they can do anything and have encouraged them. Their education has been **team-oriented**, and they find comfort and success in the group. They tend to be **conventional**, follow the rules, and need structure.

Most millennials were and are under a great deal of **pressure** since their entire lives are multi-tasking and the push to succeed. The last general trait of millennials is that they are an **achieving** generation. From an early age they have been asked to think about and develop short- and long-term goals to follow. Many working millennials today have 5- and 10-year career goals as well.

If you are a boomer or Xer, ask yourself how these characteristics fit with your view of the millennial and your workplace. Rather than change the perspective of the millennial to match your view, how can the workplace be adjusted to address these characteristics?

If you are a millennial, what do you know about the characteristics and expectations of your workplace?

How can you adjust your perspective and needs to move closer to these expectations?

By asking and answering these questions, you and your organization can truly attract, retain, and engage all employees. This fall, the NASBP membership will have an opportunity to answer some of these questions and explore how perspectives can assist in achieving an organization’s long-term people strategy.



NASBP has organized a Leadership Workshop on “Leading a Multigenerational Workforce” that will be conducted by New Haven Consulting Group and held Sept. 19, 2018, in Charleston, SC, immediately following the Regions 8, 9, 10 & 11 Meeting.

Also consider purchasing recordings of past NASBP Virtual Seminars on leadership and hiring and training employees by going here: <http://nasbp.formstack.com/forms/VSccontentlicenseagreement>

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### End Note

\*According to a McKinsey & Co. report, the average age of an insurance agent in the U.S. in 2014 was 59. Given this, it is expected that one-fourth (about 400,000) of the industry’s work force will retire by 2018. Even if not all those eligible for retirement end up doing so in 2018, many or most will over the next couple of years.





## HOW BOND PRODUCERS AND UNDERWRITERS WILL SEE IMPROVED ACCURACY AND EFFICIENCY WITH THE IMPLEMENTATION OF UNIFORM DATA STANDARDS

*This is part 2 of a series of articles on the benefits of establishing data standards for the surety industry. The role of XBRL US was discussed in the Spring 2018 issue of Surety Bond Quarterly.*



BY MALOU AUGUST

**IN A NASBP *Surety Bond Quarterly* exclusive interview, Malou August, ACORD's Vice President of Standards & Membership, describes ACORD's role in facilitating data exchange for the surety industry.**

The Association for Cooperative Operations Research and Development (ACORD), a global nonprofit organization serving the insurance and related industries, facilitates fast, accurate data exchange and more efficient workflows by developing electronic standards, standardized forms, and tools to support the use of those standards and forms.

# ACORD

**SBO: What will having uniform data standards accomplish for the surety bond industry?**

**MA:** ACORD's objective is enabling the efficient and effective flow of data

among all stakeholders across the insurance value chain. All insurance transactions rely upon timely and accurate exchange of data, and, with ACORD Standards, the insurance industry is able to operate optimally and provide the best experience for its consumers. Sureties, bond producers, and software providers are beginning to eliminate inefficient processes by using industry data standards. ACORD bond request forms (eForms) that use standardized data fields streamline the bond creation process and allow for automatic upload of bond request details.

ACORD Standards are already being used throughout the insurance industry. ACORD eForms for surety are just an extension of this. Similarly, XBRL is a financial data standard required by the Securities and Exchange Commission. Using XBRL in the surety industry

simply requires adding contractor-specific data fields like those in a WIP report. The WIP Taxonomy, a digital dictionary of data fields representing the WIP report, has already been created and is ready for use.

Because of XBRL's prevalence, there are numerous XBRL-enabled software tools that can be adapted to work with contractor financials as well. Modifying current producer and surety systems to accept standardized data requires a minimal, one-time investment that is immediately scalable to all account activity. Underwriting is faster and data quality is higher with standardized data, allowing producers and sureties to better serve their clients.

Benefits of ACORD's eForms for forms' users include the ability to gather and transmit data faster and facilitate straight-through processing. The eForms are programmed to extract data right into an agency's management system. These same eForms can also be used through an insurer's website.

Using eForms, insurers can receive more accurate data, shorten update cycles, and eliminate the possibility of errors caused by incorrect manual data reentry. eForms are simple to use. An agency can train its staff quickly and easily by using eForms.

Forms' developers will benefit from eForms because they contain a consistent XML format and unique XML tags for each form field, called eLabels. These eLabels are applied consistently across all ACORD eForms. ACORD has done the mapping from the physical form fields to the eLabels. As a result, updates can easily be downloaded and plugged into any user's systems. Incorporating ACORD eForms into producers' products will help them stay current and compliant while eliminating the time and expense of creating and maintaining proprietary forms.

**SBO: How much more efficient will it be for surety bond producers to use these data standards?**

**MA:** ACORD eForms and data standards automate data transmission, making it easier, faster, and more reliable. To request a bond, a principal fills out an ACORD eLabel form with tagged fields for pertinent bond information, such as the principal's name, the bond amount, and the obligee. Then the form is sent to the principal's producer or directly to the surety. The systems used by these entities can automatically extract the data in the tagged field and use it to create a bond request. The surety's system can also automatically upload supporting documents, allowing for expeditious and informed underwriting decisions. When the bond is created, the same information can be auto-populated into a standard bond form. Time-consuming, costly, and potentially erroneous data entry is eliminated.

**SBO: How much will accuracy in the data itself be improved?**

**MA:** Having uniform data standards will greatly improve the data's accuracy by eliminating manual reentry and dependencies, increasing efficiencies, and reducing the time to market. Currently, one party cannot begin its work until the previous party finishes. If a principal needs a bond quickly, he or she must fill in a bond details page for the producer and then wait for both the producer and the surety to fill in the same information in their respective systems.

**SBO: What kind of testing is being done using ACORD's standardized surety forms? How is the test going so far?**

**MA:** Use of ACORD's standardized surety forms is currently running as a pilot program with NASBP and the Surety & Fidelity Association of America (SFAA). So far the program is progressing well and both NASBP and SFAA are realizing benefits. We look forward to continuing those relationships and fostering new ones.

**SBO: What will sureties, producers, and principals need to adopt data standards beyond**

**the computer equipment and software they are already using? How likely is it that these things are already in their possession?**

**MA:** The adoption of standards already in existence, such as ACORD eForms, may require a fee to the licensing entities for use of these forms. Prohibitively high fees would negatively affect the rate of adoption and the value of data standards. This risk is mitigated, however, because there is no additional licensing cost to members of ACORD. In addition, ACORD has offered a special, very modest licensing fee for non-member purchasers needing only those documents required for surety automation.

Using the Internet, users can logon from anywhere in the world using any browser without installing extra software and then fill in any ACORD eForm. They can also save the data to ACORD's secure server. Once the data is entered, users can recall any previously saved eForm, make changes, and then print or email from anywhere with an Internet connection. There are modest fees for using this service.

Given the enormous efficiencies that standardized forms can bring and the relatively low implementation costs faced by potential adopters, the risk of fees interfering with adoption of eForms is minimal. The risks are further reduced by the close working relationship that has developed between the working group and ACORD.

**SBO: Is there anything else surety bond producers should know about the proposed data standards?**

**MA:** The proposed data standards will greatly improve and advance straight-through processing. Forms can be mapped to any of ACORD's Property & Casualty or AL3 Standards. Any organization on the surety supply chain is welcome to participate in the Surety Forms Working Group. To participate, contact Steve Karlin, Director of Technology and Database Services, at [skarlin@nasbp.org](mailto:skarlin@nasbp.org).

# Bond Producers' Perspectives



## **SBO: How will surety automation affect your agency's operations?**

**Maureen O'Connell**, Sr. Vice President, Surety Bond Manager, Arthur J. Gallagher & Co., San Francisco, CA: Our office has been using a specific product, SurePath, now SuretyWave, for over 15 years, which has helped with communicating with clients and underwriters and tracking open bonds, bid bonds, and bond liability. With the implementation of ACORD standards, we hope our system will be able to communicate and transmit invoices from our office to our carriers' systems in one step, a true business-to-business solution.

## **SBO: How will surety automation affect the surety industry?**

**MO:** Surety automation will drive efficiencies and allow for smoother flow of business information. We want to drive the repetitive "re-keying" of information out of the business and allow our teams to focus on clients, risk analysis, and areas where we can add value to our customers.



## **SBO: How will surety automation affect your agency's operations?**

**Josefina Rojo**, Assistant Vice President, Alliant/Mesirow Insurance Services, Chicago, IL: Automation will impact us differently depending on how surety savvy our clients are. Once this information is available, automation will save us time and avoid double entry when clients complete most of their information on the ACORD eForms. However, for clients who are not familiar with surety, we, as agents, will still need to make sure the information provided complies with the obligee's requirements for its specific bond needs while satisfying the carrier's underwriting guidelines. We will still be responsible for completing the initial request form and/or correcting information on the forms before moving on to the next step.

## **SBO: How will surety automation affect the surety industry?**

**JR:** The surety industry is already being affected by some automated processes. Agents, carriers, and obligees will need to work together to maintain the momentum. The Nationwide Multistate Licensing System demonstrates how technology is streamlining the surety bond process for all parties involved. More obligees will want systems like it put in place for verifying and confirming bonds. We must be ready for these changes, because it is not a question of when it will happen, but how soon.



## **SBO: How will surety automation affect your agency's operations?**

**Chris Von Allmen**, Producer, Garrett-Stotz Company, Louisville, KY: We know surety automation will directly benefit our agency's efficiency and accuracy. For our carrier partners, surety automation will be an effective, efficient, and accurate means of communication and reporting. For our clients, surety automation has the potential for us to provide services beyond the bond.

## **SBO: How will surety automation affect the surety industry?**

**CVA:** To establish a means of communication, cavemen all had to agree a rock was called a "rock," not a "fish." Until they agreed, conversation and growth were impossible. In the world of surety automation, we are truly at this basic stage. Standards become the foundation and platform for technology to be built. Until the industry embraces data standards, their usage and impact will be limited. Once fully embraced, it is unknown how far reaching the benefits of surety automation will be to our industry.



## **SBO: How will surety automation affect your agency's operations?**

**Jenni Waggoner**, Vice President and Bond Manager, M.J. Schuetz Insurance Services, Inc., Indianapolis, IN: Automation will immediately increase the productivity of our agency's staff by eliminating duplicate entries within multiple systems, reducing time spent going through postal mail or emails to scan and/or electronically file documents and allowing for download of accounting entries for direct bill commission. These improvements will obviously result in an increased net profit but, more importantly, they will allow our agency to plan for the future by adding staff or purchasing additional management and/or software applications.

## **SBO: How will surety automation affect the surety industry?**

**JW:** Automation would encourage development of more user-friendly software and applications for sales staff and agency customers. It could also allow for the creation of nationwide databases for obligees and/or principals and establish a central repository for authorized powers of attorney (providing a tool for obligees and interested parties to "validate" bonds). ●

## **Interested in the promotion of surety data standards, their adoption and implementation by the surety industry?**

Contact Steve Karlin at [skarlin@nasbp.org](mailto:skarlin@nasbp.org) and ask about the Standards Adoption Toolkit, which was developed by the Surety Forms Working Group and includes a workflow summary, a white paper outlining the business case for using the standards, a cost-benefit analyzer, a customizable slide presentation on the benefits of surety data standards, and links to demonstration videos. For more information, go to [www.suretyautomation.org](http://www.suretyautomation.org).





# Bond Producers and Their Clients Should Understand Tax Depreciation Treatment of Fixed Assets



BY KEVIN DOYLE

**SURETY PROFESSIONALS AND** their construction clients should take note that the recent Tax Cuts and Jobs Act has many changes to tax depreciation treatment of fixed assets that will impact many contractors. A number of the changes are beneficial to contractors and allow for immediate tax deductions. Although many of the provisions of the Act start in 2018, there are some changes that will affect 2017 tax filings. Below is a brief summary of some of these changes, along with tables showing the comparison of

2017 to 2018. Dates that refer to tax years are indicated as such. All other dates are calendar year dates.

## Bonus Depreciation

Bonus depreciation, which has been available for a number of years, allows a taxpayer to take a first-year depreciation deduction on qualified depreciable property. Prior to the Act, bonus depreciation was 50 percent for assets placed in service in 2017 and was scheduled to phase-out and decrease to 40 percent in 2018. The main qualifications for bonus depreciation were that the property had

to be new (original user) and have a recovery year of 20 years or less. The Act made two significant changes to bonus depreciation. First, it increased bonus depreciation to 100 percent for assets acquired and placed in service after Sept. 27, 2017. The second change is that the original use requirement has been eliminated after Sept. 27, 2017, which means bonus now can be claimed on new and used assets. While used assets qualify, a contractor cannot have used the asset (such as leasing) before purchasing the asset. A contractor does have the option of electing not to take bonus in any year.

Bonus Depreciation	Assets Acquired and Placed in Service Jan. 1, 2017-Sept. 9, 2017	Assets Acquired and Placed in Service Sept. 28, 2017-Dec. 31, 2017	Assets Acquired and Placed in Service in 2018
First-year Deduction	50%	100%	100%
Original Use Requirement	Only New Assets	New and Used Assets	New and Used Assets

## Section 179

Section 179 allows a taxpayer to elect to deduct the cost of certain qualifying property that otherwise would be depreciated. Unlike bonus depreciation, section 179 has more limitations that must be applied. The amount of section 179 that can be elected each tax year is subject to an annual limit, which will be phased down if total property acquired during the year exceeds the annual threshold. The amount of section 179 taken on the contractor's return is also limited by taxable income. For the 2018 tax year, the new tax law significantly increased the annual deduction as reflected below.

Section 179	2017 Tax Year	2018 Tax Year
Annual Deduction	\$510,000	\$1 million
Property Threshold	\$2,030,000	\$2.5 million

The Act expanded the definition of qualifying property eligible for section 179. The additions to qualifying property include:

- Qualified Real Property
  - Qualified Improvement Property (discussed below)
  - Following improvements to non-residential real property:
    - Roofs
    - HVAC property
    - Fire protection and alarm systems
    - Security systems
- Personal property used with the furnishings of rental properties

### Qualified Improvement Property

The Act simplifies previous categories of building improvement property. Starting with assets placed in service Jan. 1, 2018, there will be one category known as Qualified Improvement Property (QIP). QIP is defined as any improvement made to an interior portion of a nonresidential building after the date the building was first placed in service. QIP excludes an enlargement to a building, elevators and escalators, and costs attributable to the internal structural framework of a building. QIP is depreciated over a 15-year life\* and is eligible for both

bonus depreciation and section 179. This is a significant change, as this property was formerly depreciated over 39 years. With the option of bonus depreciation and section 179, a building improvement, once taken over 39 years, can now be fully written off in the year of the improvement.\*

### Vehicle Depreciation

Passenger automobiles and certain smaller SUVs and trucks have always been subject to annual depreciation limits, which made it practically impossible to ever fully depreciate the cost of a vehicle. The Act has increased the annual depreciation caps for these types of vehicles, as shown below. These new higher limits will now allow contractors to write off substantially more for these types of vehicles than in the past.

### Like-Kind Exchanges

Previous law allowed taxpayers to defer gains when they exchanged like-kind business property. Property eligible for this tax-free exchange included both real and personal property. So, in other words, a building could be exchanged for another building or a vehicle could be exchanged for another vehicle (assuming all business-use property). The Act has modified the rule on like-kind exchanges and now eliminates the ability to exchange personal property starting with transactions Jan. 1, 2018 and after. The main reason for this change is that Congress felt the Act already provided increased benefits for personal property with respects to bonus depreciation and section 179.

### 263(a) Repair Regulations and Depreciation

The above discussion on bonus depreciation, section 179, and

qualified improvement property is for assets that are capitalized and depreciated, after applying the 263(a) repair regulations. The repair regulations can help minimize the dollar amount of assets that need to be capitalized and depreciated, minimize depreciation recapture, and maximize repair expenses.

The above summary touches on a small portion of the 2017 Tax Cuts and Jobs Act. With the significant changes to the tax law, it is important to consider how they will impact a contractor's business. Many of the depreciation changes will provide relief for contractors, and contractors should consult their tax advisors to ensure they are maximizing the benefits. ●

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### End Note

*\*Note that the language in the Act does not indicate that QIP is 15-year property. But it is clear in the Conference Report issued that the absence of this language was in error and that it will be addressed in future technical corrections.*

Annual Depreciation Limits for Luxury Automobiles	For Business Vehicles Placed in Service in:			
	2017 (New Auto)	2017 (Used Auto)	2018 (Bonus)	2018 (Elect Out of Bonus)
1st Year	\$11,160	\$3,160	\$18,000	\$10,000
2nd Year	\$5,100	\$5,100	\$16,000	\$16,000
3rd Year	\$3,050	\$3,050	\$9,600	\$9,600
All Years Thereafter	\$1,875	\$1,875	\$5,760	\$5,760



feature

# The Tax Cuts and Jobs Act: **TOP 10** Focus Areas for Contractors



BY JACK CALLAHAN

**ON DECEMBER 22, 2017**, the Tax Cuts and Jobs Act was signed into law. The most sweeping tax change since 1986, the Act is intended to encourage economic growth and bring back jobs and profits from overseas by reducing corporate tax rates and providing other incentives. It is too soon to analyze the entire Act and to determine if it will achieve the desired results. Early signs have been very positive, with a surge in the stock market and growth in stocks of home builders and infrastructure companies.

The timeline on the Act—from a start date of October 2017, to signing on December 22, 2017—was certainly impressive. The legislation moved at a record pace for such comprehensive reform. As a result of the speed at which the Act was passed, there are portions of the Act that need to be corrected through the technical corrections process. Without these changes, there could be unintended consequences.

One interesting note: the words “tax simplification” were dropped from the title of the legislation; for many contractors, there will be nothing simple about the new tax law.

Below are 10 key items related to the new legislation that have the greatest impact on engineering and construction companies and their employees. These are high visibility items that may have significant impact and should be carefully considered when assessing positive actions to take in order to maximize

the benefits of the Act. The changes to international tax and the details on executive compensation are too detailed to cover in this article. As with any new tax law, the Internal Revenue Service (IRS) and U.S. Treasury Department will need to chime in to clarify important “gray areas.” It could take months for the IRS and Treasury to provide such guidance.

## **1 Whether or Not to be a C Corporation**

C corporations are clearly the big winners in the Act. Corporate tax rates have been cut from 35 percent to 21 percent, effective for tax years beginning after Dec. 31, 2017. This 14% reduction is the largest single cut, and it is compounded by numerous other significant wins for C corporations, including:

- The repeal of the corporate alternative minimum tax (AMT)



- Increased ability to expense acquisitions and capital improvements (see discussion below)

There are some other provisions that temper the big benefits above. While many engineering and construction entities have organized as S corporations or LLCs, there are still a number that operate as C corporations. Each entity and tax advisor must look at the specific facts to decide whether the company would benefit from converting to a C corporation. There may be some good reasons to consider a change; however, the double taxation concerns that drove the original entity selection decision still exist. Any changes in entity need to be made with careful thought and discussion.

## 2 Reduced Tax Rates are Not All Created Equal

While corporate tax rates were dropped to a 21% flat rate, the trust and personal rates cut were not that generous or as simple. For trusts, we now have four tax rates: 10%, 24%, 35% and 37%. Individual rates are 10%, 12%, 22%, 24%, 32%, 35% and 37%. The highest individual rate had previously been 39.6%.

Capital gain tax rates have remained at 0%, 15% and 20%, with new inflation indexes added for the determination of the phase-in rates. These rate reductions did not come without offsets, such as the elimination of the personal exemptions and the elimination of other itemized deductions, discussed below.

## 3 Pass-through Deductions May—or May Not—Provide Significant Relief

For tax years beginning in 2018, the Act adds a new deduction for taxpayers that earn qualified business income (QBI). We call the deduction the “pass-through deduction.” The pass-through

deduction is generally 20 percent of a taxpayer’s QBI from partnerships, S corporations, or sole proprietorships (there are quite a few defined terms contained in the Act). The calculations and the eligibility will be very fact specific. For surety bond production attorneys and accountants, it depends. The rules are somewhat complex. It will take a detailed analysis of your specific facts and circumstances to determine the benefits, and you should get used to hearing the term “it depends.”

## 4 Small Contractors Get Some Significant Relief

In keeping with the goal of the Act to benefit businesses and create jobs, the small contractor may well benefit here. Additionally, the small business provisions might simplify tax filings for qualified businesses. A small business is one with average annual gross receipts of \$25 million or less. While specific rules are not available, it is likely that the IRS will require a company to aggregate revenues from related companies to determine if the businesses meet the \$25 million test. Those contractors that meet the \$25 million gross receipts test will have the following advantages:

- They can use the cash method.
- They are not required to account for inventories (though inventories would be treated as supplies).
- They are exempt from applying uniform capitalization rules.
- They do not have to use percentage of completion.
- They face no limits on the deductibility of interest expense.
- They do not need to worry about conformity to financial statements.

These are all very beneficial and will provide tax benefits; however, it is important to caution the need to plan carefully around the timing differences and be certain

that cash for taxes will be available when the timing differences turn around.

## 5 SALT (State and Local Taxes) in the Wounds

This was one of the more controversial matters in the Act. Beginning in 2018, individual deductions for state, local, and foreign property taxes and state and local income and sales taxes are limited to \$5,000 for individual filers, or \$10,000 for joint filers. The deduction for such taxes is not limited if the taxes were paid or incurred in carrying on a trade or business. We are not certain at this time what any states might do in response to the new limitations.

## 6 Interest Expense Deduction Gets Interesting

Residential home mortgage interest will now be limited to interest on a first and secondary residence with a principal amount capped at \$750,000. This amount is a reduction from the prior \$1 million, but better than what had been proposed initially. Interest on home equity lines of credit will no longer be deductible.

On the business side, starting in 2018, the deduction for business interest will be limited to 30% of the business’s adjusted taxable income. In simplest terms, if a company has EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of \$1 million, its interest expense deduction will be limited to \$300,000. Real property trades or business can get around the limitation by electing to be a “qualified real property trade or business.” However, doing so will subject them to less favorable depreciation methods. Once made, the election is irrevocable. The definition of a “qualified real property trade or business” is broad and includes construction companies. Companies potentially subject

to the interest deduction limits should weigh the long-term cost of interest deductibility versus the effect on depreciation.

Floor plan interest for auto dealers and “certain” equipment dealers will continue to be deductible; the qualification of types of dealers will likely be challenged. And again, the small business exclusion will exempt small contractors from this limitation.

## **7 Equipment Purchases and Capital Improvements Provide New Opportunities**

The Act provides for 100 percent expensing (bonus depreciation) in connection with qualified property acquired and placed in service after Sept. 27, 2017. Bonus depreciation now applies to used equipment as well as new. The new bonus depreciation rules, combined with an increase in the Code section 179 expensing (from \$500,000 to \$1 million), will provide a real opportunity to maximize the amount of deductions related to fixed asset acquisitions and construction. These new rules could make cost segregation studies even more beneficial. Lives for certain assets have been shortened; however, Congress needs to provide a technical correction as it relates to Qualified Improvement Property. It is critical to remember that depreciation is only a timing item that will turn around quickly. The Act changes section 1031 to allow like-kind exchanges of real property only for exchanges occurring on or after Jan. 1, 2018.

## **8 Where did the Net operating Loss Carryback Go?**

The new Act eliminates the ability to carry back net operating losses. However, there is the opportunity to carry those losses forward indefinitely. There are also limitations in place that cap

the amount of net operating loss utilized to 80 percent of taxable income. Given the recent hurricanes and wildfires, a provision was built in to allow property and casualty companies to carry back two years and carry forward 20 years and offset 100% of taxable income. This had been available to contractors, and in the past a troubled contractor often relied on the quick cash infusion from a loss carryback refund to get them through a tough time. That remedy will no longer be available. Be certain to have adequate cash reserves.

## **9 Deductions: Then You had Them; Now You Don't**

While there are several attractive elements in the Act, most notably, the near doubling of the standard deduction for individuals to \$12,000 (individual filer) and \$24,000 (joint filer), there are some long-valued deductions that will no longer be allowed. These include:

- Domestic production activity Code section 199
- Unreimbursed employee expenses form 2106
- Personal casualty and theft losses, except for federally declared disasters
- College athletic seat licenses
- Entertainment expenses
- Alimony paid for separation agreements dated after Dec. 31, 2018
- Moving and relocation expense
- Living expenses of members of Congress
- Fines and penalties
- Settlement of sexual harassment claims
- Limitations on deductibility of employee meals

These are some of the more relevant and interesting deductions. As they impact your business, it is recommended you begin discussions with your tax advisor to account and plan accordingly.

## **10 Time is Now to Revisit Estate, Gift and Trust Planning**

Estate and gift taxes have been substantially impacted by the Act. While not delivering on the elimination of estate and gift taxes, the Act did double the basic exclusion to approximately \$11 million. We recommend revisiting with your estate and trust professionals and looking at your gifting and inheritance strategies to be certain you maximize your family's estate tax deductions. Not all of us can be as prudent a planner as George Steinbrenner was to die in the short window of time when the United States had repealed estate taxes. The rest of us must be certain to react to the laws in place each time they adjust and be certain that our estate plan is appropriately adjusted.

The taxability of trusts also may present some interesting tax planning opportunities. Revisit your plans.

### **This Saga Promises a Sequel**

The Act provides a roadmap to the future. However, there are many details that still need to be worked out and many areas that need to be clarified or fixed. There is no set timetable for IRS guidance or for the necessary technical corrections. It is important to take time to absorb all the changes and determine how they impact your business. There is still time to analyze these changes in personal and business cases and take appropriate, informed action. Every individual case will have a different outcome. ●

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