

## BONDS

### SURETY BONDS

A surety bond is a form of a financial guarantee. It is a three party contract between a surety company, the contractor (a.k.a. principal) and the owner (a.k.a. obligee). Should the contractor become financially unable to complete the project the surety company will step in on behalf of the contractor and complete the project as per the requirements of the underlying contract.

A surety bond requirement in the tender documents ensures that the Community Group is retaining financially solvent and reputable contractors for the project. It also ensures that if the contractor does become financially unable to complete the project, the surety company will be there to guarantee completion.

There are several different types of surety bonds used in a construction project:

#### **Bid Bond**

A bid bond is provided by the contractor with the tender documents when bidding on a project. A bid bond provides financial assurance to the owner of the project that the bid for the work has been submitted in good faith and that the bidder intends to enter into the contract at the price bid. The bid bond also provides assurance to the project owner that should the bidder be successful, he/she will provide any other required bonds as stipulated (such as a performance bond or labour and materials bond). Additionally, should the bidder pull out of a tendered project, the surety company guarantees under the bond that any additional costs incurred in selecting another contractor will be paid by the surety company.

#### **Performance Bond**

A performance bond protects the project owner from financial losses if the Construction Contractor becomes financially unable to complete the project. Should a contractor failure occur the surety company would step in and complete the project up to the stipulated limit on the bond. Since most contractor defaults happen after the construction has started, a bond in the amount of 50% of the contract sum is adequate to protect the interests of the owner. In some situations, bonds in the amount of 100% of the contract sum are obtained should the project be heavily financed or if the owner is risk-adverse. Understandably a bond for 100% of the contract sum is more expensive than a bond which covers 50% of the contract sum. A performance bond can be purchased on its own without the necessity of a labour and materials bond.

The requirement of a performance bond is set out in the tender documents. Work cannot commence until the bond is provided to the owner.

#### **Labour and Material Payment Bond**

A labour and material payment bond protects the interest of subcontractors, material suppliers and labourers against forfeiture of payment from the Construction Contractor. As in the case of the performance bond, a labour and material bond can be sold in increments of 50% and 100% of contract value. A labour and material payment bond cannot be purchased on its own but must be purchased in tandem with a performance bond.

The requirement for a labour and materials bond is set out in the tender documents. Work cannot commence until the bond is provided to the owner.