Contractors on Private Projects Also Need Bonding

By Martin C. McCarthy | Thursday, January 14, 2021

Contractors working on public and government projects typically must be bonded. Although private projects generally do not require surety bonds, many owners are bonding their contractors and general contractors are bonding subcontractors.

REASONS FOR SURETY BONDS ON PRIVATE PROJECTS

Contractors typically work on several projects simultaneously. There are inevitable delays when a subcontractor is unavailable. Almost every step in a construction project builds on the step before it. One delay can push back the delivery date of the project, causing costs to escalate and possible breach of contract. There could be increased costs for carrying materials and supplies while certain phases remain behind schedule. The owner or general contractor can minimize or redistribute those risks through the use of construction bonding.

Bonding is an agreement made with a surety, contractor and the entity that will benefit from having the bond, usually the project owner. Bonding protects the owner from contractor default on the terms of the contract. Bonds guarantee that the contractor is protected from disruptions, the inability to finish the project, failure to satisfy the project specifications and the inability to pay debts. In addition, a contractor who is bonded typically has exhibited fiscal responsibility and met performance obligations that allowed them to obtain a bond line.

Bonds provide an extra level of assurance to the owner of the project. and can set a contractor apart from its competitors and help win a job bid. The bond guarantees that the contractor will deliver as specified in the terms of the contract and that the contractor seemingly has the financial ability to finance its operations during the job. In the unfortunate circumstance that the contractor does not perform in accordance with the terms of the contract, the surety may be responsible.

TYPES OF BONDS

There are several types of bonds:

- **Bid bonds**. The surety guarantees the accuracy of the financial credentials in the bidding information and the readiness of the contractor to work on the project.
- **Performance bonds**. The bond commits the contractor to complete the job per terms of the contract.
- **Payment bonds.** Assures that subcontractors, laborers and suppliers will get paid.
- **Supply bonds**. Guarantees to supply the quality materials specified in the contract.
- **Maintenance bonds.** Commits the contractor to use high-quality materials and workmanship for a specific timeline.
- **Subdivision bonds.** Ensures that improvements will be made on the project such as sidewalks, wastewater systems or trees.
- **Site improvement bonds.** Commits the contractor to update older structures in pre-existing projects.

  Contractor license. Ensures the contractor is licensed at the state, local or city level.
- **Utility bonds.** Ensures that the contractor runs the utilities as specified in the contract.
- **Lien bonds.** Names a person's property as collateral against a loan in order to ensure that all debts are paid.

CONSIDERATIONS

There is a lot to consider when obtaining certain types of bonds. For example, with performance bonds, the rights of the surety, owner, contractor and subcontractors needs to be taken into consideration. To ensure that everyone's rights are protected, at a minimum all involved parties should understand:

- what would trigger a default;
- notice requirements;
- what would cause a construction contract to be terminated;
- the surety's obligations on default and proper notice; and
- what the performance bond will cover.

Payment bonds provide a level of security to subcontractors, laborers and suppliers that they will be paid in a timely manner. This type of bond allows the project to be free of liens if the contractor fails make payments.

CONTRACTOR DEFAULT INSURANCE

While there is a lot of controversy around contractor default insurance, there may be advantages over traditional construction bonds. For example, after paying the deductible, an insured contractor may be entitled to compensation for costs that would not be covered in a surety bond. This could include compensation for legal and other professional services fees if a subcontractor defaults on their performance obligations. Typical bonding contracts do not cover these expenses.

In addition to the considerations addressed, it is advisable that the contractor is mindful of potential issues that can come up, especially during the COVID-19 pandemic. At any moment, the government could shut down job sites or enforce additional safety requirements which would increase job costs. It is more important than ever for contractors (and owners) on private projects to protect themselves by having the proper surety bonding in place. No one knows what the future will bring, so err on the side of caution.

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