

Construction: What Contract Bonds Exactly Are And How To Acquire Them

What do you do when a contractor does not meet your standards after payment? Sack them?

Unfortunately, that may not be effective because they are on a contract. However, what you can do is avoid such a situation or get adequately compensated by having a contract bond in place. This may sound familiar, especially if you have worked closely with financial institutions, and they are no different. Credible construction companies and workers issue contract bonds to:

1. Protect their interests and that of their clients.
2. Show credibility and gain trust.
3. Reduce financial risks on both ends (the contractor and the client).

In simple terms, a contract bond is a document provided by a surety company to mortgage the performance of the contractor. This means that the surety company understands that things could go south even after paying a construction worker, so to avoid contractors doing substandard jobs and getting away with it, a contract bond is issued between three parties:

1. The surety company
2. The contractor in question and;
3. The prospect.

You may see this also being referred to as a construction bond or surety bond in the construction industry. Whatever name it goes by, the aim remains the same.

Picture 1 of Construction: What Contract Bonds Exactly Are And How To Acquire Them

Why Do You Need a Contract Bond?

Contract bonds are like wagers for clients (or bond obliges), and no public client would knowingly want to embark on a project without having one in place. However, contract bonds are just as valuable to the construction firm as they are to the clients. These are some of the reasons every construction firm should invest in construction bonds:

1. Having a contract or surety bond in place enhances public perception, builds credibility, and develops trust in the firm. No client would want to work with a company that cannot give them a full guarantee.
2. Sureties or insurance firms do not only serve as guarantors, they also provide technical assistance if needed to alleviate or reduce risks on the side of the contractors.

3. Construction bonds broaden your client base. Government agencies and public institutions always demand contract bonds before they embark on a construction project, and without one, you would be limited to just working with private entities who are not too bothered about bonds.

How Does It Work?

For clarity, in bond issuance, the client is referred to as the bond obligee and the construction firm, the bond principal. For a bond to exist, it has to have a clearly stated amount that would be paid in compensation if the contractor's performance is not up to standard. This means there is also a clear definition of 'up to standard' which is contained in the 'terms of contract' of an indemnity agreement. If for any reason, the principal doesn't meet the desired standard, the obligee can lay a claim against the bond for adequate compensation.

There are several types of contract bonds, and although they all have different specifications, one thing remains unchanged – they serve as a mortgage in any contract. Construction companies looking to lay their hands on bonds may want to look into any of these five types:

1. Performance bonds.
2. Bid bonds.
3. Public works bond.
4. Payment bonds.
5. Maintenance bonds.

The most vital type issued in the construction industry is the "bid bond", which is provided even before the contract commences. It can be seen as an incentive to a proposal or bid.

How Do You Get a Contract Bond?

Knowing the risk a surety would be taking on by standing in for a construction firm, you should know that crucial steps would be taken to ensure that they are also protected. Construction firms are required to approach relevant companies with a request to serve as surety. The surety then goes ahead to analyze the state of the construction firm including its assets, net worth, technical competence, and track record. If the firm appears to be worth the risk, the surety proceeds to approve the request and issue necessary documents.

By accepting to serve as a surety for a construction firm, the company is saying to the client, 'yes, I trust them to do a great job on your project. Here's my word with a wager'. That's a lofty statement to make for any firm at all.

Picture 2 of Construction: What Contract Bonds Exactly Are And How To Acquire Them

It is always advisable to speak with a bonds expert before applying to a surety. This would assist the management in identifying which bond would be the most suitable for their projects and which surety would provide the best options for the firm. At the end of the day, both surety and construction firms are held responsible if the terms of the contract are not fulfilled.

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