Dealey, Renton & Associates

Insurance Brokers

# 10 Things You Should Know About Surety Bonds

1. **Surety vs Insurance:** Insurance is a mechanism to transfer risk to another party. Surety is a guarantee by one party to pay the debts of another. Surety is designed to prevent loss while insurance is designed to compensate the insured against unforeseen adverse events.

2. **Surety Bond is a Three-Party Agreement:** Surety company, Obligee (E.G. Owner) and Principal (E.G. Contractor, Entity performing the work)

3. **Contract Bonds vs Commercial Bonds:** Contract bonds are project specific. The bond falls back on the contract. Commercial bonds (license and permit bonds) are under a broader umbrella. They are compliant in nature—the principal will "comply" with the law. License and permit bonds are required to make sure the licensee will conform to the ordinances/laws relating to the business in which the licensee is engaged.

4. **3 Types of Contract Bonds:** Bid, Performance and Payment.
   - Bid Bond prequalifies the contractor to the owner and guarantees in good faith that the surety will provide a payment and performance bond if the contractor is awarded the project and enters the contract.
   - Payment Bond assures the owner that the job will be turned back over free of liens. It guarantees that the contractor will pay their subcontractors and suppliers.
   - Performance Bond assures the owner that the contractor will complete the work as specified in the contract documents.

5. **Miller Act:** In 1935 the US Government required all contractors on federal public works contracts to obtain payment & performance bonds for contracts that exceeded $100,000. Little Miller Acts are individual state legislation requiring bonds on public works projects.

6. **Construction is Risky:** Surety bonds offer assurance that the contractor is capable of completing the contract on time, within budget and according to specification. Burden of construction risk is shifted from owner to surety.

7. **Premiums:** Premiums range from 0.5% to 3% of the bond amount.

8. **Prequalification Process:** Underwriting for contract bonding revolves around "The Three C's."
   - Character: Does the contractor have integrity? Do they pay bills on time?
   - Capacity: What size of job are they equipped to handle and capable of completing?
   - Capital: What is the financial strength of the contractor? Is there equity in the company and have they been profitable? Do they have the cash, working capital, credit lines, etc. needed to support the work on hand?

9. **Contractors Default:** In the event of contractor default, the surety has a few options. Options might include the right to re-bid the job for completion, provide financial assistance to the current contractor, or pay the penal sum of the bond to the owner.

10. **Marketplace:** From small companies to large, brand new startups to third generation organizations, some flush with cash, some with cash issues; different Contractors have different needs. The surety marketplace offers a wide range of support to handle those various needs. Contact DRA today for more information.