

## **What You Need to Know About Contract Bonds**

If you are a small contractor who performed work for municipalities or considered such work, you have probably seen or heard about a requirement for a contract bond. If you have no or limited experience with contract bonds, you probably have a lot of questions. I want to help you better understand what a contract bond is and what is needed to qualify for a contract bond.

### **What is a Bid Bond?**

The first stage of bonding is the bid bond. As the name suggests, the bid bond is required as part of a contractor's bid packet. The bid bond ensures a contractor can comply with the terms of the project contract and the ability to complete the project. The amount of the bid bond will be 5% or 10% of the contractor's bid. A contractor will normally also be given an option of providing a cashier's check for the 5% or 10% of the bid amount rather than providing a bid bond. I do not recommend the approach of providing a cashier's check. Providing a bid bond provides the project owner peace of mind knowing the contractor will be able to qualify for a contract bond if they are low bidder. While the cashier's check meets the bidding requirements, it does not demonstrate the contractor's ability to obtain a contract bond. Most standard bond companies do not charge a fee to provide a bid bond.

### **What is a Contract Bond?**

A contract bond ensures the fulfillment of a contract. There are two bonds that fall under the contract bond umbrella, performance bonds and payment bonds. A performance bond guarantees the performance of the contractor to the project owner per the specifications of the contract. For example let's say a contractor begins a project for a local city then walks away from the project leaving it uncompleted. The bond company would work with the city to find a way to have the rest of the job completed.

A payment bond protects a project owner in the event a contractor fails to pay its employees, suppliers or subcontractors in carrying out the project. The bond company handles claims of payment issues, relieving the project owner of that responsibility.

### **When are Contract Bonds Required?**

You can see how a contract bond is beneficial to a project owner. Private project owners may require contract bonds depending on the size and scope of a project. In the State of Illinois, contract bonds are required for public work of any kind costing over \$50,000. This means almost all projects for the State of Illinois, a county or a city will require a contract bond.

### **How do I Get a Contract Bond?**

The requirements of a bond company to issue a contract bond depend on the size and scope of the project. No matter the size of the contract bond, the credit history of the owner(s) of the company will be a large part of consideration. Many bond companies have made the process of contract bonding for small projects easier through fast bond or easy bond programs. Bond approval is as simple as the approval of a one or two page application and acceptable credit history of the owner(s) of the company. Bond companies have attempted to increase these fast bond capabilities. Some bond companies have expanded their fast bond program to projects up to \$750,000.

For larger bonds, bond companies will need more detailed financial information. This can consist of tax returns, internal financial reports or CPA prepared financials for the business. The level of financial information will depend on the size of the project and other underwriting factors.

### **How are Contract Bonds Different from Insurance?**

The difference between a contract bond and a commercial property and casualty insurance policy is indemnification. If a windstorm damages your commercial building or you are responsible for an auto accident in a company vehicle, your insurance company pays the claim less any applicable deductibles without seeking any recovery from the business owner.

A requirement of contract bonds is an indemnity agreement between the business owner(s), their spouse(s) and the bond company. This indemnity agreement allows the bond company to pursue recovery of any paid claims on a contract bond from the business owner(s). For example, if a contractor does not complete a job per the specifications of the project contract, the bond company might have to pay a claim brought forward by the project owner. The bond company would then pursue the contractor personally for any claim amounts paid.

The contract bond process can seem complicated and intimidating to contractors who are new to the process. The best thing to do is work with an experienced agent who can walk you through the contract bonding process and your unique situation. If you ever have any contract bonding questions, always feel free to contact me.

**Dan Gabel, CRIS**  
**Partner, Shore Murphy & Associates of Casey**  
**Office: (217) 932-2267**  
**Cell: (217) 962-0461**  
**E-mail: [dan@shoremurphycasey.com](mailto:dan@shoremurphycasey.com)**