



PERFORMANCE BONDS IN CONSTRUCTION

INFORMATION FOR CONTRACTORS AND SUB-CONTRACTORS

INTRODUCTION

To varying degrees, every construction project is marked by some uncertainty.

Clients in the construction industry are becoming more and more risk averse. Many of them are looking to eliminate as much uncertainty as possible from every construction project.

One way to achieve this is by requiring all contractors and sub-contractors to provide bonds.

In the current climate, you may find that you are required to produce a bond on a more regular basis. This is especially so with the ever increasing influence of lending institutions in dictating these terms.

This is not a situation to be feared by most contractors. Being able to produce a bond should be seen as reflecting well on your organisation. It separates you from less reputable operators and confers a competitive advantage over the opposition.

BONDS SHOULD BE EMBRACED NOT AVOIDED.

This booklet will explain the role contract bonds play in the construction industry and answer some commonly asked questions.

BONDS IN CONTEXT

As utilised in the construction industry, a Performance Bond is a "contract of guarantee" whereby one party (the Guarantor) undertakes to pay damages to a second party (the Employer) arising from breach of contract by a third party (the Contractor).

The damages payable would comprise the additional expense incurred by the Employer as a result of the Contractor defaulting on its original contractual obligations.

The most obvious, and usually the largest *additional expense* is the extra payment required to secure a new Contractor to complete the unfinished project.

Other additional expenses can include additional design team fees, security, insurance and so on.



PROCURING BONDS IN PRACTICE

A bond is a discretionary item in any contract. It is a matter for each individual Client to decide whether a bond is required from a contractor. This decision is usually made pre-tender and all tenderers would be made aware of the requirement.

Once the contract is awarded, the Contractor must arrange for a bond to be put in place. At this point the contractor should approach a reputable bond provider.

The Contractor will need to satisfy the guarantor that it has the financial and technical resources and management capability to carry out and complete the contract in question.

There is no magic formula - the guarantor relies on experience and intuition combined with an understanding of the contractors business.



The ease or difficulty with which a contractor can procure a bond will depend on many factors but the key is the contractor's relationship with the guarantor. Thus a contractor who has never had to arrange a bond will find it takes a little longer than one who has a long standing relationship with a guarantor.

That being said, professional guarantors are in business to do business.

We at **CONSTRUCTION**

GUARANTEE pride ourselves on the speed

of our decision-making

We can usually confirm the availability of a bond within a matter of days of all the relevant information being submitted to us.

WHAT HAPPENS IF SOMETHING GOES WRONG? - A WORKED EXAMPLE

In this example, the original contractor has defaulted and been removed from the contract having completed €500,000 of a €1 million project.

	€	€
Original Contract Sum		1000000
Certified at date of default	400000	
Estimate of uncertified work	60000	
Retention	40000	500000
Work remaining per original contract		500000
New Contractor's Price to complete		600000
Cost Overrun		100000
Additional Fees etc		10000
Loss payable under Bond		110000

PAPERWORK

Unlike most financial institutions, at CONSTRUCTION GUARANTEE we try to keep paperwork to a minimum. However we do need current information to make effective decisions.

Typically, what we require is as follows

- Application Form (For new clients only)
- * Copy Most Recent Audited Accounts and Management Accounts where available
- * Basic Details of work on hand
- * Bank Facilities Form completed by your bank

We also obtain some contract details from the Architect, Engineer or Quantity Surveyor acting for the Client.

FACE TO FACE MEETINGS

Of much more importance to us than paperwork is meeting our clients face to face. Insofar as we can, we prefer to meet Contractors in their place of business and learn directly from them about their operation and plans for the future.

Our motto is simple KNOW YOUR CLIENT - the more knowledgeable we are about our clients the better our service and our underwriting.

Whilst general insurance such as Employers and Public Liability is best arranged through an insurance broker, arranging a bond is ideally done by direct contact between contractor and bond provider.

TIME

The time it takes to acquire a bond depends on how fast the information we require is made available to us.

Once the information is to hand, we can usually move on to the next stage immediately -be that processing the bond or arranging a meeting as appropriate.

Many contractors believe that the process is lengthy - CONSTRUCTION GUARANTEE sees no reason why it should be.

It is simply a matter of supplying information which is readily available



COMMON ISSUES

Cost - Unlike all other classes of insurance the cost of bonds has not risen. Construction Guarantee's rates have remained stable. As a specialist provider, we are not affected by national or global insurance trends.

Bond Wording - Not all bond wordings are the same. Construction Guarantee's wording is fair, easily understood and provides adequate protection to both Employer and Contractor. It also complies with the recommendations of the Strategic Review Committee.

Collateral Security - Many institutions, particularly banks, will require Collateral in support of bond facilities. Construction Guarantee's attitude is that Collateral is best left in the hands of the Contractor and as such we do not generally require Collateral Security.

CONTRACTORS HAVE NOTHING TO FEAR

Professionally run, well-organised construction firms who have quality human resources and sound fundamentals have nothing to fear from a policy of requiring bonds.

A construction industry with a "Bond Culture" is a stable one with no place for Fly-By-Nightly Construction Limited.

Being able to produce a bond in a timely manner makes a strong statement about a contractor's organisation and its position in the construction industry.

It demonstrates sound management, financial stability and a professional attitude.

BANK BONDS: NOT RECOMMENDED, BUT WHY?

Banks are in the business of lending money. When a bank issues a bond it treats it as a form of loan.

No money changes hands but collateral security will be required by the bank and consequently, the contractor's ability to raise further finance is affected.

Imagine a situation where credit facilities were limited or a contractor couldn't invest in plant or a site simply because their bank had arranged their bonds.

Specialist bond providers don't look at bonds in this way.

THE MESSAGE IS CLEAR

*Your Bank for
finance - Your Bonds
from a Specialist
Provider*





EMPLOYER



CONTRACTOR



Construction Guarantee



- *Specialist provider*
- *Close Relationship*
- *Efficient Service*
- *Letters of Intent*
- *Forms of Undertaking*
- *Un-bureaucratic*

KEEP IT SIMPLE - USE A SPECIALIST

ABOUT CONSTRUCTION GUARANTEE

Construction Guarantee was formed in 1984 to provide an alternative source of bonding for small to medium sized building contractors and sub-contractors.

Construction Guarantee has grown to become the largest specialist providers of bonds to the Irish market by maintaining this focus and providing a highly efficient service to our clients

Creative and flexible, our approach is personal and un-bureaucratic.

Contractors finding it difficult to procure a bond have found us to be open-minded, willing to listen and

often able to assist where larger institutions have proven uninterested.

Our modern, plain-English bonds have been praised for their clarity and ease of understanding.

Clients and Design Teams regularly recommend us to their contractors

In association with Hiscox Insurance Company Limited, a leading UK specialist Insurer, we offer market leading expertise to over 700 Contractors and Sub-Contractors in all areas of the Irish Construction Industry.



Construction Guarantee

Performance Bonds for the Construction Industry

No. 2 Cranford Centre, Montrose, Dublin 4

[t] 01 - 218 0120 [f] 01 - 218 0122 [e] info@constructionguarantee.ie [w] www.constructionguarantee.ie