Why surety bonds are so important for contractors.

Contract surety bonds are critical for contractors that wish to work on government projects and are often requested for other jobs as well. Finding a reliable surety company to back your projects can give your business a competitive edge when bidding for jobs and lend credibility to your company.

Before we discuss the importance of surety bonds for your business, however, let's review some bond basics.

Surety bond basics.

Here are the basic terms and definitions you need to know to understand surety bonds for contractors.

Principal: You, the contractor hired to perform the work.

Obligee: The entity — public or private — that owns the project and is hiring you. Often referred to as the owner.

Surety: The bonding company (such as Frankenmuth Surety) that guarantees your performance under the contract. Surety companies work exclusively through agents that represent you, the contractor, and act as a conduit for their operations.

How it works: If you, as the contractor, fail to meet your obligations under the contract, the surety company steps in to make things right for the obligee. These bonds also protect the obligee in the event that payments are not able to be made to subcontractors and suppliers. The surety company might take over the job and hire a new contractor or just cover the costs for the obligee to do so.

How different contract surety bonds keep projects moving.

Now that the basics are covered, let's look at the different kinds of contract surety bonds. The purposes of these bonds are different at each stage of a project, but they all help the parties involved move forward with confidence.

Stage: Bidding for the job
Bond: Bid bond

A bid bond guarantees that you (the contractor), if approved as the lowest bidder, will enter into the contract for the specified work and provide the necessary performance and payment bonds (explained below). This gives the project owner (obligee) confidence that you are a qualified and responsible bidder. The contractor must be pre-approved by the surety company in order to obtain a bond before bid day.

Stage: Performing the contracted work
Bond: Performance bond

A performance bond guarantees that you will complete the work as specified in the contract. If a contractor walks out mid-project or finishes the job but fails to meet the specifications in the contract, the surety company will step up to complete the job properly and/or reimburse the project owner for their losses.

Stage: Paying subcontractors/workers/suppliers
Bond: Payment bond

A payment bond guarantees that everyone involved with the project gets paid and protects the obligee/owner from being sued for non-payment or having liens placed on the project.

Stage: Post-completion of project
Bond: Maintenance bond

A maintenance bond protects the project owner against defects in a contractor's work that surface post-completion, usually over a limited period (for example, 12 months after the job is finished).

Why are surety bonds so important?

Here's why surety bonds are essential to your success as a contractor.

- **Federal and state public projects require bonding by law.** The Miller Act requires performance and payment bonds on any federal construction project over $150,000, and most states have a version of this law as well. You will not be allowed to bid on these jobs without surety bonds. Many private projects also require bonding.
- **Bonding establishes you as a stable and credible contractor.** Because the application process for bonding requires contractors to submit financial statements, work experience, and references before being approved, project owners can feel more confident when hiring bonded companies.
- **Bonding makes other contractors more eager to work with you.** It's easier to get the best subcontractors, workers, and suppliers to sign onto your project when they're confident that you're a reputable company and that they will be paid.

Is a surety bond the same as insurance?

In a word: no. There are some important differences between insurance and surety bonds.

- **Difference #1: You (the contractor/principal) must pay back the surety company for all claims.** With an insurance policy, the insurance company pays for most costs as long as the policyholder has paid their premiums. With a surety bond, the principal must pay the bond company back in full for any claims they pay out.
- **Difference #2: There are more parties involved.** Insurance involves two parties: the insurer (like Frankenmuth Insurance) and the insured (policyholder). Surety bonds involve three, as specified earlier: principal, obligee, and surety company.
- **Difference #3: You (the contractor) are not the protected party.** In a surety bond arrangement, the main protected parties are the project owners (obligees) and the subcontractors, workers, and suppliers you employ. With insurance, when you purchase a policy, it protects you. However, as we've seen, getting bonded does give your company competitive advantages and helps you grow your business.

Still have questions about surety bonds and how they work? Learn more about surety bonds for contractors on our website, or find a Frankenmuth Surety agent here.

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