

Your basic guide to bonding

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Whether you're a large contractor or a small construction company just starting out, sooner or later you'll likely need Contract Bonds. SGI CANADA wants to help you understand the basics of bonding.

What's bonding?

A Surety Bond is a guarantee by the bonding company (surety), to the owner (obligee), that the contract will be fulfilled by the contractor (principal).

Bonding is an extension of credit to an individual or contractor. A bond will be issued only if the bonding company is sure the contractor can and will complete the project.

What are the different types of bonds?

Bid Bond

When a contractor bids on a project, the Bid Bond accompanies the tender. It guarantees the owner that if the contractor is "the low bidder," the contractor will honour that bid, sign a contract to do the work and provide any further bonding that's required to fulfill the contract. If the contractor backs out, he or she must compensate the owner for the difference between his or her bid and the next lowest bid. If the contractor doesn't compensate the owner, the bonding company must pay out under the Bid Bond.

A tender often calls for a consent of surety (surety letter) from the bonding company to accompany the Bid Bond. The consent of surety guarantees that the bonding company will provide the specified bonds to complete the contract.

Instead of a Bid Bond, a certified cheque may be used with many tenders. But this isn't recommended for several reasons:

- A certified cheque ties up the contractor's working capital and bank credit.
- If a contractor can't get a Bid Bond, it's unlikely that he or she will be able to get the necessary followup bonding for the project.
- Time limits for accepting tenders or claiming under the Bid Bond don't apply to certified cheques.

Contractors must request the Bid Bond and/or consent of surety before the closing date for tenders.

Performance Bonds

A Performance Bond guarantees the owner that the contractor will perform the contracted work. If the contractor doesn't, the bonding company must make arrangements to complete the project or pay out the bond penalty.

The Performance Bond should be requested as soon as possible before work begins on the project.

Labour and Material Payment Bond

A Labour and Material Payment Bond ensures that suppliers of labour and material used on the project and covered by the bond will be paid.

What's required to open a bonding account?

Bonding companies deal through a network of brokers. Your SGI CANADA broker will be glad to help you apply for bonding. Bonding companies need a broad range of information to evaluate the contractor's qualifications. The following information should be submitted to SGI CANADA when applying for a bonding account.

Report on Contractor

This form must be completed in full and provides information on the company, owner, key personnel, bank contacts, previously completed projects and credit references.

Bank and Reference Authorization

This form authorizes SGI CANADA to contact any bank and/or reference to help in assessing the applicant.

Schedule of Uncompleted Work

This form provides information on all bonded and unbonded work in progress, as well as projects the contractor has committed to in the future.

General Indemnity Agreement

Its main purpose is to assure SGI CANADA of the availability of finances and to ensure that SGI CANADA has access to the finances to seek reimbursement if a claim is made under a bond.

Personal Financial Statements

Personal financial statements from each owner must be submitted to show all of the owners' obligations as well as the additional backing available to the bonding company.

Contract Bond Premium and Service Fee Agreement

This form explains SGI CANADA's contract bond premium and service fee structure. Contractors are asked to sign the form to indicate they are aware of and understand these procedures and fees.

Company financial statements for the most current and previous two year-ends

The financial statements show the growth and profitability of the company and how sound its financial position is. This is key information in determining the level of bonding a company will be offered.

Because financial statements are so important in this process, SGI CANADA has to be certain the information is accurate. Therefore, financial statements must be prepared by an accountant, with a professional accounting designation, independent of the contractor, who has done a review engagement. Review engagement refers to the extent of analysis and review done by the accountant.

The most current year-end financial statement of any associated companies

An associated company is a company which:

- has ownership in the corporation being bonded
- is owned by the corporation being bonded
- has common ownership with the corporation being bonded

This information is needed to calculate the complete and accurate financial position of the applicant.

How much notice is required?

It takes time for SGI CANADA to review the information and determine the amount of bonding support that can be provided. Therefore, the information should be submitted at least two weeks prior to any bond requests.

What do bonds cost?

When a bonding file is established, a minimum Contract Bond service fee will be charged. An annual service fee will be charged thereafter. The annual charge is based on the number of Bid Bonds requested in the previous term, subject to the minimum service fee. The main purpose of the fee is to cover the cost of investigating, analyzing and servicing the file. The fee isn't a premium that will cover potential claim costs. Contact your SGI CANADA broker for the current minimum service fee rate.

The rate charged on Performance and Labour and Material Payment Bonds will vary, depending on the specifics of the job and bond requested. Once you have the details on the project, contact your SGI CANADA broker for the rates.

This brochure is a general introduction to contract bonding. Your SGI CANADA broker will gladly provide additional information and help you apply for a bonding facility.