

# Renovations and Capital Improvements: Performance and Payment Bonds Protect Association Assets

By Martha L. Perkins, Attorney at Law

It is a fact of community association life that renovation and capital improvement projects are inevitable. Sometimes those projects are small, such as a new wall color in the lobby; and other times those projects are large, such as a new roof or a new heating and air conditioning system. When an association undertakes a large improvement project, it especially needs to ensure that it does not jeopardize the association's assets. To protect its assets and the integrity of the large improvement project, an association

contractor, and a surety. The surety issues to a contractor a bond, which is for the benefit of the owner.


A performance bond guarantees to an owner that the project will be completed in accordance with the plans and specifications in the construction contract, even if the contractor defaults. A payment bond ensures that certain laborers and suppliers of materials on the project will be paid for work performed and materials supplied, if the contractor does not pay them. These bonds provide an owner, such as a community association, assurance that the construction project will be completed in accordance with the plans and specifications. Indeed, in the public sector, performance and payment bonds are required by federal, state, county, and municipal governments to ensure successful completion of public construction projects and protection of the public treasury.

Practically speaking, what should a community association faced with a large improvements project do to protect its assets? The association should seriously consider requiring that any general contractor bidding on the project obtain performance and payment bonds. Because a surety issuing a bond is guaranteeing a contractor's performance of the project and payment of the bills, the company will "prequalify" the contractor by gathering information about the contractor. The surety will review the résumés of the contractor and the key people in the contracting organization, all the projects the contractor is performing, and the financial strength of the contractor. This prequalification should provide the association peace of mind that, in the surety's opinion, the contractor is capable of performing the project.

The association should keep in mind that, while it is the contractor that must obtain the bonds, it is the owner that generally pays for them. The cost of the bonds becomes a line-item of the contract amount. The bonds are almost always for 100 percent of the construction cost of the project. The cost of the bonds will vary, but is typically one

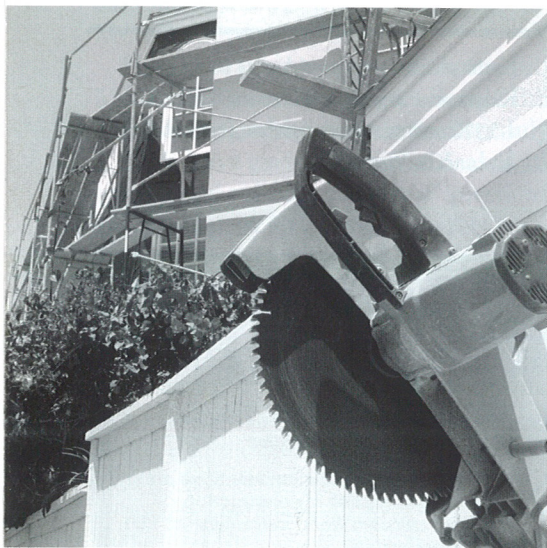
payment of between 3-4 percent of the contract amount. Thus, if the construction cost of a project is \$600,000, then the performance bond and the payment bond will each be in the amount of \$600,000. Usually, the cost of both the performance bond and the payment bond together will be 3-4 percent of \$600,000, or \$18,000-\$24,000. This amount is a relatively small price to pay for assurance that the project will be built according to the plans and specifications and that the subcontractors will be paid (and not walk off the project or lien the project).

If a contractor claims that it cannot obtain a bond, it may mean that a surety is unwilling to bond that contractor, or it may mean that the contractor is unwilling to go through the prequalification process required by the surety. In any event, the association should forego consideration of that contractor.

A community association should remember that the process of making a bond claim is governed by the entire body of construction law and precedence associated with the construction industry. If the contractor defaults on its obligations under the construction contract, in order for the community association to make a claim under the performance bond and/or the payment bond, the association must comply with all its obligations and responsibilities under both the underlying construction contract and the surety bond. If a community association becomes embroiled in a dispute with a contractor, that association would be wise to seek legal counsel that is familiar with the specialized field of construction and surety law. 

should consider requiring two specific types of surety bonds from its general contractor, a performance bond and a payment bond.

For many people, performance bonds and payment bonds are shrouded in mystery. The purpose of this article is to shed some light on that mystery. A surety bond, in general, is a promise to be liable for the debt or default of another. Surety bonds are contracts issued by an insurance company, often referred to as a surety, which "prequalifies" the contractor seeking a bond. Surety bonds are unlike traditional insurance, in which there are two parties, whereby one party pays for another party to protect it from a well-defined risk (for example, car insurance). Suretyship is a three-party relationship, with an owner, a



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