

## Bond Premium and the Project Time Extension

**Executive summary.** Most traditional bond rates have two variables in their cost: the contract value and the time threshold. Do not forget to include both in time extension negotiations.

**What's in a bond rate?** The bond rate from your surety agent comes in two parts: (1) the cost as a function of the contract value and (2) the cost as a function of time.

**The contract value calculation.** The component of the bond rate that most people are aware of is the calculation based on the contract value. Bond rates vary greatly, but here's a sample of a small to medium construction company's rates:

First \$500,000	\$14.40 / \$1,000 of contract value
Next \$2,000,000	\$11.40 / \$1,000 of contract value
Next \$2,500,000	\$9.90 / \$1,000 of contract value
Remainder	\$8.70 / \$1,000 of contract value

This equates to 1.44% down to 0.87% of the contract value. It follows that a bond fee on a \$10,000,000 project will be approximately \$98,000.

**What's the time component?** It's called a time threshold and a typical rate for most construction companies is 1% of the project premium per month after 24 months. So, it follows from our above example that on a 36-month project (which is 12 months beyond a typical bond time threshold of 24 months), the additional premium beyond the contract value component above is



$$12 \text{ months} * \$980/\text{month} = \$11,760.$$

**Why is this important on bid day?** It's important on bid day because it's almost \$12,000 and that's real money! Don't forget it.

**Why do I care if I'm a project manager in the field?** You care if you're a project manager in the field because if you have an contract for 24 months, and the owner just

gave you a change order for another 12 months, you need to add in the cost of the bond fee for exceeding your time threshold. Even if the contract was extended into the 25<sup>th</sup> month it's still \$980.

**My story.** A bulk of my career was spent on projects that were extended for reasons outside the control of the contractor (me). Knowing this fact can save thousands of dollars. Be careful though, many of the “canned” extra work forms limit the bond fee. Often times I see it as capped at 1% of the value of the extra work. A Contracting Officer needs to be educated on this calculation and perhaps a little education will prevent owners from haphazardly protracting project schedules.

