Performance Guarantees

Once you know what you are going to build and who will be doing the work, it is important to ensure that the work is completed on schedule and within the allocated budget. Performance Guarantees are techniques and methods used to ensure that the contractor completes the job. These include holding retainage from the contractor, requesting partial release of liens, letter of credit, bid bonds, or payment and performance bonds.

Risk:
Contractors may have difficulty completing the project on time, within the desired schedule and budget.

There is also the risk that the contractor may default and not complete the project at all.

If the contractor’s performance is unacceptable due to poor workmanship or quality of materials, the work may have to be redone.

Mitigation:
There are many effective methods non-profits can use to protect themselves against contractors defaulting, project delays or cash flow problems. Non-profits should become familiar with performance guarantees and should determine which method best suits their needs. Performance guarantees should be made part of their contract. Bid bonds, payment and performance bonds are generally not required for acquisition/rehab/resale programs.

It is also recommended that non-profits hold retainage from contractors to help guarantee project completion. Retainage is a specified sum of money withheld from the contractors monthly payment, usually 10% of the earned payment. Retainage is held on each draw and paid to the contractor once the project is complete. A "certificate of substantial completion" indicates that all the work has been completed except for punch list items. In some situations, depending on the scope of the punch list and satisfaction with the contractor, retainage can be reduced to 5%. Final retainage should never be paid before completion of all punch list items.

Release of Liens is a legal statement made to the owner by a contractor or subcontractor stating that the property is free of liens. (Claims against the property for nonpayment of a debt relating to the construction contract). Partial release of liens should be requested during the draw payments and final release of liens should be provided when the work is completed.