



August 24, 2024

Bonds on Construction Projects

Dear Reader:

The following document was created from the CTAS website (ctas.tennessee.edu). This website is maintained by CTAS staff and seeks to represent the most current information regarding issues relative to Tennessee county government.

We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

Sincerely,

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Reference Number: CTAS-939

Bid Bond—The National Institute of Governmental Purchasing (NIGP) defines a bid bond as “a written agreement or check by which a third party guarantees that a bidder will accept a contract as a bid, if it is awarded.”¹If the bidder does not accept the award, the bond is forfeited in whole or in part. A bid bond is issued most often in an amount equal to 5 percent of the total price of the bid.² Some Tennessee statutes or local government policies may require a different amount for certain projects or services; e.g., T.C.A. § 62-6-129 states that “no contract for the services of a construction manager shall be awarded for any public work in this state by any city, county, or state authority, or board of education unless there is posted at the time of submittal of a proposal for services by a construction manager a bid bond equal to ten percent (10%) of the value of the services proposed and the value of the work to be managed, or may at the time of contracting provide payment and performance bonds in amounts equal to the combined monetary value of the services of the construction manager and the value of the work to be so managed.”

Performance Bond—The National Institute of Governmental Purchasing (NIGP) defines a performance bond as “a contract of guarantee, executed subsequent to award by a successful bidder to protect the buyer from loss due to the bidder’s inability to complete the contract as agreed.”³

A performance bond is issued to the local government by a surety company at the contractor’s request after the contractor has received notice of award; the contract is usually not signed until the local government receives the performance bond.⁴The amount of the performance bond is usually for 100 percent of the contract price; however, some local government’s policies may specify the minimum amount of the bond or use considerable leeway to determine the amount and whether it will be issued as a percentage of the contract price or for a specific sum.⁵

Payment Bond—A payment bond guarantees that the contractor will pay all suppliers and subcontractors who assist in the performance of the work.⁶A payment bond, issued in the same manner as a performance bond, is a surety company’s guarantee that the contractor will pay its subcontractors and the suppliers. Payment bonds are used primarily in construction contracts but are applicable to service contracts under which the contractor contracts all or part of the work to one or more subcontractors.⁷The usual amount of a payment bond is 100 percent of the contract price;⁸however, some Tennessee statutes stipulate the amount of the bond as a percentage of the contract price (T.C.A. § 12-4-201 states that for public works projects over \$100,000 the bond shall be for at least 25 percent of the contract price).

¹National Institute of Governmental Purchasing, *The Dictionary of Purchasing Terms*, 3.

²Donald F. Harney, *Service Contracting: A Local Government Guide*, ICMA (Washington D.C.: 1992), 61.

³*The Dictionary of Purchasing Terms*, 22.

⁴Harney, 61.

⁵ibid, 61.

⁶ibid, 60-61.

⁷ibid, 61.

⁸ibid, 61.

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