Construction Bonds Effect for Novice Construction Firms in Kampala Uganda

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Abstract: **Surety bonds are of ancient times dating back to 2750 BC when a farmer who was offering services to a king, when not able to fulfill his duties hired another farmer to do the duties on his behalf and share the proceedings equally, a local merchant acted as surety and effected the compliance of the second farmer to the agreement. Suretyship grew up steadily over years and has today taken root in many business transactions requiring guarantors. In Construction projects, surety bonds are fundamental as construction projects are a risky business and at times referred to as a war fare. Apart from mobilization of materials and labor there is usually a divergence between project teams. The cause of divergent views between the project owner, principal contractor, sub contractors and the architect arrive from the payments allocations for all the concerned in the construction project. There is high entry new firms into construction ventures in Uganda, an investment that is fragile by nature of operations which is motivated the need for creating awareness on construction bonds that are vital for all parties involved in the construction project. This paper aims to craft knowledge on surety bonds /construction bonds to the novice construction companies getting aboard of the construction industry in Uganda. The study applied literature review, generalizations and systemization methods to diffuse the concept of construction bonds to the novice construction contractors as they enter the volatile construction business particularly in Kampala, Uganda.**

Key words: **Surety bonds, construction bonds, construction contracts.**

I. INTRODUCTION

A surety bond can be defined as the legal agreement between three parties involved in a construction project i.e. the principal, obligee and a surety. Where the company to perform the works is the principal, the oblige is the party that requires the service provider to secure a surety bond usually a government representative and the surety is the guarantee to the obligee that your company will do all the contracted duties in respect of the agreement made[5]. The surety bond protects the third party hiring your company to perform the project from the unforeseeable losses that would result from your company failing to complete the works as agreed [7]. In essence surety bonds provide financial security and construction assurance to the project owners that the contractors will perform all the work contracted and pay all sub contractors and laborers and material suppliers [8]. The cause of discomfort usually originates from payments as on who gets what payments on the construction project. The construction project financing is a highly specialized area of finance where rules and procedures are followed due the risks involved in this nature of venture [2]. The construction projects agreement are so technical whether for a small project or a bigger project because the result of it affects the three parties involved. The project owner who hires an architect that designs plans formulates the bills of quantities for the project. This leads to open bidding with the aim of get a best construction company with the least project cost. While the construction company also bids for sub contactors and material suppliers and laborers [4]. The whole of this process makes the construction project business complicated and very pertinent to the parties involved.

II. COMMON CONSTRUCTION BONDS IN PLAY

There are a number of construction bonds in effect but the commonly effected bonds in the construction projects are as follows according to [1, 3, & 6]

(a) *Bid bond.* This bond guarantees that if a contractor wins a contract in respect of a tender and declines the terms of the tender, the surety pays the owner the price difference between the dishonored bid and the next lowest bid as a penalty.

(b) *Performance bonds.* This guarantees that the contractor will perform all his contractual obligations as they all his contractual obligations as they are stated in the contract. This type of bond is involved when there is failure of the principal on one of the following conditions ; when he fails to meet financial obligations like paying sub contractors when he bankrupt , when he failed to rectify technical construction faults and when he fails to meet the project scheduled without clear grounds to the obligee.

(c) *Labor and material payments bond.* This type of bond ensures that the principals sub contractors are paid and material suppliers. It is involved when the principal fails to meet his obligation of paying them.

(d) *Construction lien bonds*. This bond ensures that lien claimants for whom the bond is posted are paid. This is according to the builders’ lien Act owners usually post lien bonds paving way for removal of construct lien claims from projects without waiting for the resolutions over the claims.

III. SIGNIFICANCE OF CONSTRUCTION BONDS

The drive for construction bonds is to protect all parties involved in the risky construction venture against the unforeseeable risks. These include the lenders, owners, taxpayers, contractors and sub contractors [2, 7, 8, and 9].

1. From the prequalification process, a contractor is judged to be capable after fulfilling the obligations of the contract.
2. Contractors have chance of completing bonded projects than non bonded ones since surety companies may require personal or corporate indemnity from contractor.
3. Subcontractors are protected by the payment bond thus they may not need to file a mechanics lien on a private project
4. Bonding capacity can catalyses chances for the contractors or sub-contractors have the higher chances of getting technical support from surety bond producers and underwriters.
5. The surety company will fulfill the contract in the event of contractor default.

IV. EFFICACY OF A CONSTRUCTION BOND

The construction bonds effectiveness begins from the time the involved parties execute it by pending authorized signatures to it and deliver it to the obligee. Should the construction bond be not delivered to the obligee for any reason, he has no right to claim on it [3,9].

A construction bond is triggered when the principal fails /defaults on the contracted obligations by the bond and the obligee can in procedure claim damages. The obligee provides notice to the principal about the default. The notice issued to the principal should be clear and additional notice requirements should be adhered to. The notice should be in writing and delivered within stipulated time following the default.

Suing on bond is enforced by the obligee within the time limit stipulated in the bond from the time payment was refunded, often one to two years.

The surety liability is limited to the actual damages sustained by the obligee up to the face amount of the bonds penal sum. However, recovery of damages beyond above the face amount can be claimed from the defaulting principal

Acquiring construction bonds in Kampala Uganda

The major suppliers of construction bonds in Uganda are the commercial banks while the National housing bank takes the lead in this perspective because its major goal is to support construction projects in the country. Also some insurance firms have been identified to offer surety bonds for example NIC, SWICO, UAP, Britam and others

V. RECOMMENDATIONS

Construction ventures are risky and volatile, therefore important that all parties involved in a construction contract should consider surety bonds/construction bonds as very paramount as a security cover for any unforeseeable eventualities, also novice contractors should seek knowledge from construction bonds suppliers who in Uganda are particularly banks like, National housing bank, UBA, Centenary bank and all major commercial banks for better understanding of how they can acquire and effect the bonds.

VI. CONCLUSION

There was limited academic literature on construction bonds focused to generate that awareness that novice construction contractor require for proper management of their construction contracts. The study has identified that no matter the size of the construction firm, the amount of years spent in operation, experienced or novice construction bonds are paramount for managing the involved risks for all parties involved in the construction project. Construction bonds service providers are available in the country and should be utilized to assist construction firms in minimizing risks associated with construction projects like the recent trend of construction structures collapse at some cites in Kampala Uganda.

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