

# RETAINAGE BONDS

## A Practical Guide for Contractors and Owners



### Introduction

Retainage is commonly used in construction to withhold funds until project completion. Unfortunately for some contractors, this means their payment for completing the project may get delayed for years until the project is completed. While retainage protects owners, it restricts contractor cash flow which is vital for success. Lack of prompt payment is often cited as the number one problem for many small- and medium-sized contractors. Construction is a complex business environment where both contractors and project owners seek ways to reduce risks and enhance financial stability. One way to enhance financial stability for subcontractors is using statutorily authorized retainage bonds, which increase cash flow to the general contractors, as well as subcontractors.

In Washington and other jurisdictions that permit retainage bonds, posting the bond as set by statute allows contractors to access contractual retainage cash flow while still maintaining project financial security<sup>1</sup>. Because this is relatively new, many questions have arisen about how retention bonds are obtained and what rules need to be followed. This white paper helps address some of those issues.

### What is a Release of Retainage Bond?

Retainage is a percentage of each payment made to the contractor that is held back until the project is completed to the owner's satisfaction. Traditionally, this money is withheld to ensure the contractor finishes the project and addresses any issues that may arise. A Release of Retainage Bond replaces retained funds with a surety guarantee. Instead of holding cash, the owner relies on the bond for protection related to completion, defects, and certain payment obligations.

Consider the case of a subcontractor working on a significant highway interchange project. This subcontractor completed their work early, but the project wouldn't be finished for another two years. With 5% of the payment withheld as retainage, the subcontractor faced a long wait to receive \$50,000. By securing a Release of Retainage Bond for a \$500 premium, the subcontractor was able to access these funds immediately, greatly improving their cash flow and financial stability.

Please note that in some states, the amount of retainage withheld can typically run between 5% 10% and serves as an incentive for contractors to finish their work according to the contract. It also provides a financial safeguard for the project owner. Because release of retainage can be negotiated as part of the contract, it is important to define what constitutes "substantial completion" as well as when retainage should be released on the job rather than being held back until the project is fully completed and accepted by the owner. It is also advisable to negotiate who pays for the bond premium and the definition of when the project is accepted for purposes of final payment.

It is always important to ask for and receive copies of any bonds relevant to the subcontractor posted for a particular project at the time of initial contracting, along with copies of all documents that are incorporated into the contract.

### How Does the Bond Work?

The bond, issued by a surety company (i.e., a financial institution, usually an insurance company), guarantees coverage of the withheld amount if the contractor fails to meet its obligations. This allows contractors to utilize their earned money, and owners to feel secure about project completion. To obtain the bond, the applicant must provide financial information to the surety to meet the underwriting requirements. The surety evaluates financial strength, credit history, experience, and bonding capacity, meaning the maximum amount of surety bonds a

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<sup>1</sup> The core bond substitution mechanism for public works is found in RCW 60.28.011. The statutory framework for retainage release bonds on private construction projects exists under RCW 60.60.30.010, RCW 60.30.020.

contractor can obtain at one time, based on what the surety believes the contractor can safely perform and repay. These bonds typically have a lighter underwriting process than full performance bonds for already established firms with the surety. The surety requires personal guarantees back to the surety in the event payment on the bond is required. This contingent personal liability is something the owner of the business must carefully consider for purposes of succession planning for the business when transitioning to a new generation of owners or possibly selling to a new entity.

In the suretyship relationship, the contractor (called “the principal”) is the party requesting early release of retainage. The project owner (“obligee”) is the party protected by the bond. The surety company issues the bond, guaranteeing that the contractor will fulfill all remaining obligations during the retention period. The bond amount is typically equal to the amount of retainage being released. The premium is a percentage of the bond amount, usually in line with the contractor's standard bond rates.

To obtain the bond, the contractor should follow these steps:

### **Step 1: Engage a Qualified Surety**

Before submitting a bond, the contractor must secure a surety bond facility from a surety that meets Washington's statutory qualifications. Under RCW 60.28.011, the bond must come from an "authorized surety insurer." General surety insurance provisions in RCW 48.28.010 establish that any bond guaranteed by an authorized surety insurer satisfies all legal requirements as to the number of sureties, residence, and status of sureties, and no further justification by the surety is necessary.

The bond amount can cover all or any portion of the contract retainage—meaning the contractor has flexibility in whether to substitute a bond for the full retained amount or only a part of it. RCW 60.28.011.

It is important to note that, unlike public works projects which use RCW 60.28.011, private construction follows a streamlined process with mandatory acceptance requirements. Any subcontractor, supplier, or contractor may tender a retainage bond in lieu of cash retainage, and the contractor or owner must accept it if it meets statutory requirements RCW 60.30.010. This creates a right to bond substitution rather than leaving acceptance to the discretion of the owner or contractor.

### **Step 2: Prepare the Bond in an Acceptable Form**

The bond must be in a "form acceptable to the public body" RCW 60.28.011. Washington statute does not prescribe a single universal form for retainage release bonds, leaving this determination largely to the owner or public agency.

On private construction, the bond must come from an authorized surety company and be conditioned on the bonded party's faithful performance of the contract, payment of all laborers, mechanics, subcontractors and material suppliers, and payment of taxes, increases, and penalties incurred on the project RCW 60.30.020. The contractor or owner may require a minimum A.M. Best financial strength rating for the surety but cannot exceed A-. RCW 60.30.020.

The bond should also address whether change orders are automatically added to the bond amount, so the contractor does not risk the surety claiming the bond has been released due a material change in the risk.

### **Step 3: Submit the Bond to the Public Body or Owner**

The contractor may submit the bond at any time prior to final formal acceptance of the project RCW 60.28.011. This means the request can be made during the project, not only at or after completion. The same rule applies to private construction.

### **Step 4: Review and Acceptance (30-Day Deadline)**

Upon receipt of the bond, the public body must accept it within 30 days RCW 60.28.011, unless it can demonstrate

one of three grounds for refusal:

1. Good cause for refusing to accept the bond,
2. The bond is not commercially available, or
3. Where the bond is submitted at a subcontractor's request: the subcontractor refuses to pay its portion of the bond premium and to provide the contractor with a like bond.

If none of these exceptions applies, acceptance is mandatory. The statute places the burden on the public body to demonstrate good cause if it refuses acceptance.

This review and acceptance process does not exist under the private construction statute.

### **Step 5: Release of Bonded Retainage Funds**

Once the public body accepts the bond, it must release the bonded portion of the retained funds to the contractor within thirty days of that acceptance RCW 60.28.011. This is a mandatory, time-bound obligation. There is no additional waiting period required before the bonded portion is released—those conditions apply only to the standard final retainage release process at project completion, not to a mid-project bond substitution.

On private works, the retained funds must be released within 30 days of accepting the subcontractor's or supplier's bond RCW 60.30.020.

## **Washington State Legal Framework For Bonds**

Washington law requires public and private owners to accept retainage bonds in place of withheld funds. However, traditional surety principles still apply, including the importance of consent by the surety for material contract changes. *Federal Ins. Co. v. Turner Const. Co.*, 779 F.Supp.2d 345 (S.D.N.Y 2011). This becomes relevant when change orders are issued and this materially increases the amount of the original contract. This has the effect of increasing the risk to the surety. Washington follows traditional surety principles when it comes to questions about bonds but consult your local jurisdiction or federal law for projects outside of Washington.

The bond and any proceeds remain subject to all claims and liens in the same manner and priority as the original retained percentages RCW 60.30.020. For private works, this framework excludes single-family residential construction projects with fewer than 12 units RCW 60.30.010, RCW 60.30.020.

## **Key Differences from Performance Bonds**

Retainage bonds are limited financial guarantees, whereas performance bonds ensure full contract completion. Understanding this distinction is critical for risk management. There is some overlap between coverage on a retention bond and a pre-existing performance bond issued by the general contractor. This may cause some general contractors or owners to resist a request for retainage bond even though the statute is mandatory. Be prepared to enforce your rights to get the bond.

## **When to Use Retainage Bonds**

These bonds are most beneficial on long-term projects, when retainage amounts grow large, and when contractors need improved cash flow and working capital.

The bond statute establishes a cascading obligation for lower-tier contractors and subcontractors. When an owner accepts a bond from a contractor, that contractor must accept bonds from any subcontractors or suppliers from which it has retained funds, and must release those retained funds within 30 days of accepting the subcontractor's or supplier's bond RCW 60.30.020. The contractor may withhold the subcontractor's portion of the bond premium when the contractor provides its own retainage bond to obtain release of the subcontractor's retainage RCW 60.30.020.

## **Cost vs. Benefit**

When considering requesting a retainage release bond, the applicant should expect the typical bond premium costs to range from 1%–2% of the bond amount. For example, a retention bond releasing \$500,000 in retainage might cost \$5,000 in premium. In exchange, contractors gain immediate access to retained funds, improving liquidity and financial ratios. Additional cash flow allows the contractor to pursue new work rather than waiting for the close out of the project and final payment being issued to the general contractor and subcontractors.

One important consideration: a retention bond might be included in the contractor's bonding capacity, just like any other bond. The bond amount may count against your aggregate limit the surety is willing to underwrite. For example, if you have \$10 million in aggregate capacity and \$8 million in active bonded work, a \$500,000 retention bond reduces your available capacity to \$1.5 million.

The outcome for obtaining the bond is straightforward: the project owner keeps the same financial protection they had with the retainage holdback, and the contractor gets access to money they have already earned. That cash goes back into the business where it can fund operations, support other projects, and strengthen the contractor's balance sheet.

## **Claims and Risk Considerations**

Claim triggers can include incomplete work, defective work, or failure to complete punch list items. Bond language is critical in determining coverage. You should also review the bond to determine if there is a contractual time limit to maintain a bond claim. If so, the bond claim must be initiated within the contractual time period.

## **Common Pitfalls**

The common pitfalls involved with obtaining a bond include failing to notify the surety of changes, misunderstanding bond scope, and extending bond obligations into warranty periods can create significant risk. You should consult with your surety broker and legal counsel regarding the terms included in the bond.

## **Conclusion**

Retainage bonds provide a valuable tool for both contractors and project owners, offering financial flexibility and risk mitigation in the construction industry. Understanding how these bonds work and the benefits they offer can help both parties navigate the complexities of construction projects more effectively. For more information or assistance with obtaining these bonds, reach out to your surety professional and attorney to help navigate the bond application process.

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