Securing Subdivision Agreements With Surety Bonds

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SUBDIVISION BOND HAS KEY FEATURES OF LOC

- Subdivision Bond guarantees developer's obligations to municipality under a subdivision agreement (aka Development Agreement, Servicing Agreement, Site Improvement Agreement, etc.)
- Subdivision Bond is designed to incorporate core elements of a letter of credit

Three Party Agreement Clause

- Subdivision Bond is a three party agreement between:
  - Municipality (beneficiary)
  - Developer
  - Surety

Bond Amount Clause

- Subdivision Bond contains a maximum amount payable
- The bond amount is determined by the Obligee in the Subdivision Agreement

Description of Contract Clause

- Subdivision agreement is described in the bond

Obligation Clause

- Surety's obligation under the Subdivision Bond arises if the Developer fails to perform the obligations to the Municipality under the Subdivision Agreement, subject to the conditions described in the rest of the bond

Notice of Default Clause

- Municipality is to declare the Developer in default under the Subdivision Agreement in accordance with the terms of the Subdivision Agreement
- Municipality is to advise Surety of the declaration of default and provide a copy to the Surety

DEMAND / CERTIFICATE CLAUSE

- When Municipality requires payment under the bond, it provides a written demand for payment to the Surety.
- Demand is to incorporate a certificate:
  - specifying the amount demanded
  - certifying that the monies demanded have been paid, are payable, or will be payable by the Municipality to remedy the Principal's default under the Subdivision Agreement
- Form of Demand is appended to the bond as an exhibit

PAYMENT CLAUSE

- Surety is required to promptly pay the Municipality the amount demanded

Multiple Demand Clause

- Municipality may make multiple demands under the Subdivision Bond

Accounting Clause

- At the end of the claim, Municipality is to provide Surety an accounting of the amount expended to remedy the Developer's default.
- If the Municipality has overdrawn on the bond, the Municipality is to return the excess amount to the Surety.

Bond Reduction Clause

- Municipality provides written notice to the Developer that the security may be reduced
- Subdivision Bond is reduced by written endorsement signed by Surety and Principal, delivered to the Municipality
- All endorsements are subject to consent of Municipality
- Specimen Bond Reduction Endorsement is appended to the bond
- This is the same process used when reducing a letter of credit

Bond Cancellation Clause

- Bond may be cancelled by Surety on 60 days prior notice.
- Cancellation is effective only if the Developer provides the required replacement security – in a form and amount acceptable to the Municipality - 30 days before the cancellation of the bond.
- If acceptable replacement security is not provided to the Municipality by the Developer, the bond remains in effect.

Bond Return Clause

- When all obligations of the Developer under the Subdivision Agreement are performed to the satisfaction of the Municipality, the Municipality is to return the Subdivision Bond to the Surety for cancellation.
- This is the same process used when reducing a letter of credit

Boilerplate Clauses

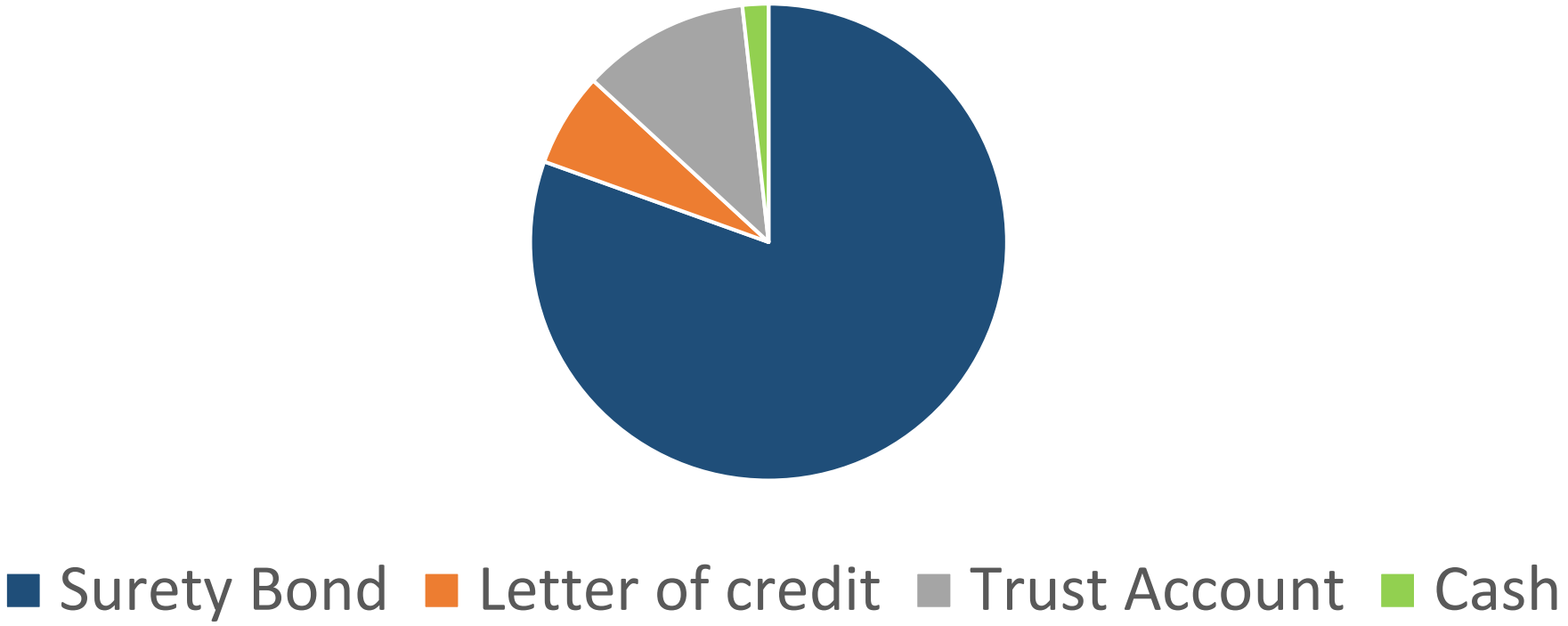
- Surety is not liable for more than the bond amount.
- Each payment made by Surety reduces the bond amount
- Only Municipality may sue Surety under the bond
- Bond does not limit Developer's obligations to Municipality under Development Agreement
- Notices
- Governing law

Frequently Asked Questions

- Why have a cancellation clause?
- Can we have the same cancellation clause as the letter of credit?
- How quickly will the Surety pay our demand?
- We know that banks are regulated and are able to pay our demands under letters of credit. How do we know sureties are able to pay our demands under subdivision bonds?
- What experience do sureties have paying under bonds like this Subdivision Bond?

$2,441,280,000

Amount of Surety Bonds Held By Tarion Warranty Corporation



THE GUARANTEE®

Accepting Alternative Forms of Security:

Options for Municipalities

Surety Bonds

- In-house municipal lawyers inevitably function as both lawyer and client. They advise the City or Town of which they are themselves a part.

- Consider surety bonds as both solicitor and municipality.

- Common practice in Ontario to take letter of credit (LC) as security for a developer's obligation to install services.
- LC security is most frequently used in the context of a Subdivision Agreement or Site Plan Control Agreement entered into per the *Planning Act (Ontario)*.
- Long history of LC security in the development context. Numerous court cases have recognized the reliability and predictability of letter of credit security.

- Direct benefit of surety bond over LC security accrues to the developer.

- To obtain an LC for the benefit of a municipality, developer must either post cash with issuing bank or tie up part of its credit (loan) facility in the full amount of the LC.

- This is not required to obtain a surety bond.

- What’s in it for the municipality?

- Surety bond is a tool for encouraging/ facilitating development.

- To be used like an LC, the surety bond must function like an LC.

Features of LC security:

- In 1933, the International Chamber of Commerce (ICC) set standards for LCs.

Features of LC security: (continued)

- Now called “Uniform Customs and Practice for Documentary Credits”, UCP600 came into effect in 2007.

- UCP600 sets out 39 principles which establish predictability, reliability and trust necessary for international trade.

UCP Principles that apply to development in the municipal context are:

- payable on demand
- automatic renewal
- notice to Obligee of pending cancellation with opportunity to call
- partial drawings/reductions permitted

UCP Principles that apply to development in the municipal context are: (continued)

- irrevocable
- expressly references underlying development agreement

- If a surety bond can incorporate these principles, then, in theory, it can secure subdivision works just as well as an LC.

- “In theory, there’s no difference between theory and practice. In practice, there is.”

Yogi Berra

- Negotiate the terms of the surety bond to incorporate the most important UCP600 Principles.
- Perform due diligence to verify the reliability of the Issuer of the surety bond.
- Like banks, insurance companies are Federally regulated.

- The Office of the Superintendent of Financial Institutions (OFSI) conducts prudential reviews of the federally regulated insurers to determine their financial soundness.
- Public information is available re Issuer's financial and reporting obligations (minimum capital tests, financial/operational monitoring)
- A. M. Best Company credit rating

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