

Subject: Potential Use of Surety Bonds in Lieu of Letters of Credit as Security for Development Projects

Recommendation:

BE IT RESOLVED THAT Council receive Report # 2024-0106 – Potential Use of Surety Bonds in Lieu of Letters of Credit as Security for Development Projects, for information;

AND THAT Council determine if it is desirable to permit the use of surety bonds as security for development projects in the Town of Pelham;

AND THAT if it is desirable to permit the use of surety bonds as security for development projects in the Town of Pelham, that Council direct staff to prepare a Surety Bond Policy to establish criteria and requirements for acceptable surety bonds.

Background:

The Town has recently been approached on behalf of several property developers about the possibility of using surety bonds as security for development projects in lieu of letters of credit or cash. The purpose of this report is to provide Council with an overview of the anticipated benefits and drawbacks of accepting surety bonds as security for development projects.

Analysis:

Municipalities have historically been reticent to accept surety bonds as security for development projects as they are traditionally seen as riskier than cash or letters of credit. In recent years, however, several municipalities have implemented policies to accept surety bonds, subject to a number of conditions to mitigate those risks. Staff have confirmed that Hamilton, Welland and Niagara Falls have surety bond policies and have been advised that Haldimand County, Brantford and Thorold accept them as well.

In the context of development projects, surety bonds are three-party agreements between a municipality, a developer and a surety that issues the bond. The surety is obligated to answer to the municipality for a default of the developer. The surety is typically required to determine that there has been a default under the contract between the municipality and the developer before honouring the bond. If a surety is satisfied that there has been a default, it steps in to complete the work or pays

the municipality the amount required by the terms of the bond. Legal action may be required to collect under a bond where the default is disputed.

Letters of credit are also three-party agreements that involve a municipality, a developer and an issuer, which is usually a financial institution. The developer is the issuer's customer but the municipality is the beneficiary of the letter of credit. A letter of credit guarantees that the beneficiary will be paid on demand without the issuer determining if a default has occurred. Given the unconditional nature of the payment obligation, issuers often require developers to collateralize letters of credit against the value of the underlying project. This reduces the credit available to the developer and thus may delay or limit other projects that require the same type of security. Surety bonds do not have the same impact on financing capacity, which the development community indicates will promote development and reduce the risk of default as more cash and credit are unencumbered and available.

Commonly cited concerns related to surety bonds are that they are not as secure as letters of credit as they are issued by private institutions and may not be subject to collateralization, and that the default requirement may lead to difficulty accessing the bond and/or the need for litigation to enforce it. While these risks are real, they can be mitigated by imposing terms such as a minimum credit rating or pre-qualification requirement for surety providers and by providing for payment to the municipality on demand without proof of default.

The Town currently accepts surety bonds as security for some construction projects and has rarely been required to seek payment due to default. The Town presently requires a different form of security for development projects, such as a letter of credit. However, the Town has rarely been required to draw on those securities.

Financial Considerations:

There are no direct financial implications associated with this report.

Alternatives Reviewed:

Council may determine that it is desirable to permit surety bonds as security for development projects or it may opt to maintain the *status quo*. Council may also consider implementing a pilot project to accept surety bonds as security for a limited time or in a limited number of development projects.

Strategic Plan Relationship: Community Development and Growth

Requiring adequate and appropriate forms of security for development projects supports community development and growth.

Consultation:

The Senior Leadership Team was consulted in the preparation of this report.

Other Pertinent Reports/Attachments:

None.

Prepared and Recommended by:

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