Committee of the Whole (2) Report

DATE: Tuesday, November 12, 2024 **WARD(S):** ALL

TITLE: **DEVELOPMENT AGREEMENT SURETY BOND POLICY PILOT AND LETTER OF CREDIT POLICY UPDATE**

FROM:
Michael Coroneos, Deputy City Manager, Corporate Services, City Treasurer and Chief Financial Officer

ACTION: DECISION

Purpose

To seek Council approval for a new Surety Bond policy for a two (2) year pilot program, as an alternative to requiring letters of credit from developers when securing for works under various forms of development agreements.

Report Highlights

- Request from the development industry to consider pay on demand surety bonds as an alternative to letters of credit, to help free up cash to expedite developments.
- Two (2) year pilot program to accept surety bonds for development agreements (subdivision, site plan) only.
- Proposed policy wording such that risk to the City is minimized and the administrative processes are similar to current letter of credit processes.
- Current Letter of Credit policy to be updated to include surety bonds as an alternative form of security.

Recommendations

1. That Council adopt 12.C.21 *Development Agreement Pay on Demand Surety* policy ("Surety Bond Policy") regarding the use of on-demand surety bonds, which will be effective for a two-year pilot period, substantially in the form of Attachment "1" to this report;

2. That Council adopt 12.C.04 *Letter of Credit* policy, as updated to include surety bonds as an alternative form of security, substantially in the form of Attachment “2” to this report.
3. That Council direct staff to update the language used in development agreement templates to permit surety bonds that conform to the Surety Bond Policy as an acceptable form of security;
4. That Council direct staff to report back on the uptake and any challenges encountered with surety bonds within two years of accepting the first on-demand surety bond under the Surety Bond Policy; and
5. That Council direct staff to take all necessary actions, including the execution of all necessary documentation, to give effect to the two-year pilot of the Surety Bond Policy.

Background

In March 2022, the Province proposed through Bill 109, More Homes for Everyone Act, 2022, that surety bonds could be accepted as an alternative form of security, if a municipality required an obligation to be secured as a condition to an approval in connection with land use planning.

Staff have not received a site specific request from the development industry to implement pay-on-demand surety bonds, however the City has been approached over the last few years to discuss the benefits of surety bonds. Municipalities have been slow to accept such bonds as a form of security and as an alternative to letters of credit. This is largely because the security for such bonds derives from private companies, as opposed to banks as in the case of letters of credit. In addition, the process of calling on bonds may not be as straightforward.

Developers favour the implementation of this alternative form of security to achieve greater liquidity and accelerate their development project. A few municipalities in Ontario have started to accept this form of security. For example, on June 3, 2021, the City of Hamilton implemented a policy for the use of on-demand surety bonds as a form of security in development agreements. This policy was implemented after consulting with surety providers, the developer community, and other municipalities. The City of Niagara Falls and the Region of Durham have also followed with a similar approach.

The intention behind such initiatives is that the risk involved in this alternative form of security may be worth bearing and managing in order to accelerate development and ultimately provide greater benefits to the municipality. Accordingly, it is recommended that Council consider the acceptance of on-demand surety bonds as an alternative form of security as part of a two-year pilot. During such a pilot, the use of and experience with such bonds would be monitored, and staff would report back to Council with the results. The language recommended for the actual terms of the bond within the proposed policy, as well as the condition that only top-tier sureties be used, may assist with mitigating the risk associated with this type of alternative security.

Previous Reports/Authority

Not Applicable

Analysis and Options

Benefits of Pay-on-Demand Surety Bonds

The benefits of implementing pay-on-demand surety bonds using the conditions specified within the proposed Surety Bond Policy include the following:

- As a method of security, on-demand surety bonds do not restrict a developer's capital in the same way that a letter of credit or cash security does. In turn, this may help developers use their capital more efficiently to develop more and faster than is currently possible with other accepted forms of security. This ensures more growth and development within the City.

- For the City, this form of security represents greater liquidity. An on-demand surety bond is payable on demand. Accordingly, in the event of default, the City can make a demand on the bond and be in possession of funds to correct the default. Through specifying the language of the bond and the conditions which must exist for payment to be triggered (which, for this type of bond, would be simply a demand), the City has the ability to ensure that the on-demand security truly serves its purpose in the event that it is needed. Through the Surety Bond Policy, the City has the ability to customize the terms of the bond to ensure that risk is managed, mitigated, and transferred appropriately.

- The Surety Bond Policy would also specify that the developer has to pre-qualify financially to obtain an on-demand surety bond from a top-tier surety. In addition, if the surety has to pay the City in the event of a default, the developer would be obligated to repay all amounts to the surety. Similar terms and conditions exist in the current policies on on-demand surety bonds of other municipalities.

These conditions ensure that the developers have the financial commitment for the project and that the City is protected in the risk of default.

Below is a summary of the benefits of surety bonds as a security to the municipality and the development community:

City of Vaughan	Development Community
Liquid	Off-Balance Sheet security
Responsive	Access to unproductive cash
Prequalification Requirement	Great credit availability
Promotes Growth	

Concerns of Pay-on-Demand Surety Bonds

A number of concerns associated with the use of on-demand surety bonds may ultimately be mitigated by the language set for the terms of the bonds as well as other conditions within the proposed Surety Bond Policy, such as specifying the tier of the surety and other responsibilities that the developer must assume in exchange for the benefit of this type of security.

The most common concern that staff heard throughout researching surety bonds was a concern that payment would not be disbursed or that the municipality would need to spend extended amounts of time proving default prior to accessing funds through a surety bond. The surety industry has also heard those concerns and have adapted bonds accordingly. The proposed surety bond template language ensures that the City, in its absolute and sole discretion, can determine that the developer is in default and the payment will be made within 10 business days.

The concerns identified above can be addressed through the wording of the on-demand bonds. The wording provides the conditions that must exist for the security to be accessed. This wording can specify that the surety bonds function on-demand and, for all intents and purposes, like a letter of credit. For example, the language of the bonds can specify that:

- the City, in its sole and absolute discretion, can determine that the developer is in default;
- the surety shall pay the City within 10 days of receiving the City’s demand; and
- the City is not required to provide proof of default in order to make a demand under the bond.

These conditions are similar to what is used by other municipalities for these types of bonds.

If the amount of the security is to be reduced because of the accomplishment of project milestones, the City would have the ability and sole discretion to determine that the milestone has been reached and would call on the release or reduction of the security by providing the surety with a notice in writing, similar to our current letter of credit processes.

Top-tier sureties

Surety providers are subject to oversight by the Office of Superintendent Financial Institutions (OSFI) and staff recommends, through the Surety Bond Policy, that in order for the City to accept a bond, the company must have a minimum credit rating of "A-" or higher as assessed by S&P or an equivalent rating from Dominion Bond Rating Service Limited ("A"), Fitch Ratings ("A-") or Moody's Investors Services Inc.(A3).

Proposed Surety Bond Policy

The terms of the proposed policy were also prepared after reviewing and considering the terms of the letter of credit process as well as the language of the Construction Act. The Policy wording was also compared to current policies with other municipalities to ensure consistency and their experience was factored into the policy.

Below is a comparison of surety bonds and letters of credit.

Features	**Surety Bond**	**Letter of Credit**
Issued by	Licensed insurance company	Banking institution
Collateral	Unsecured	Secured
Provider has assessed ability of developer to complete the development project	Yes	No
Provider has an interest in having the security released (project completed)	Yes	No
Borrowing ability of developer	Unchanged	Decreased
Restriction of capital	Non-restrictive	Restrictive
Payable "on-demand"	Yes	Yes
Administrative burden	Same	Same
Length of time to access funds	10 business days (can be set by municipality)	Upon written demand
Automatic renewal provisions	Yes	Yes
Ability to make multiple demands	Yes	Yes
Notice required to cancel instrument	90 days	1 month

Should Council accept the first recommendation, the language of the development agreements should also be amended to include on-demand surety bonds that conform to the proposed Surety Bond Policy as a form of acceptable security. The City's current Letter of credit policy would also need to be updated to allow for surety bonds to be used as an alternative form of security. The revised letter of credit policy is included as an attachment to the report.

Financial Impact

There are no additional costs that the City would incur related to accepting surety bonds. No staffing implications are anticipated, as the administrative process for the on-demand surety bonds is understood to mirror the process for letters of credit. As surety bonds are considered an insurance instrument and therefore are significantly different from letters of credit. From a legal perspective, in order to address the risk associated with a private insurer providing the security, the language of the bonds, and the triggering conditions for demand, as well as other conditions and processes within the Surety Bond Policy are proposed to reduce and transfer potential risk to the City. For example, the proposed language makes it so that the bond issuer cannot oppose payment of the claim where the City makes a demand. In addition, the fact that this proposal is a pilot, with the direction to staff to report back on the experience of using this form of security as an alternative to traditional letters of credit, allows the City to assess and inform itself on whether risk is sufficiently mitigated through this process, and whether the anticipated benefits of using this form of security are being realized for the community.

Operational Impact

Development Engineering and Development Planning will need to adjust some of the language in their respective agreements to incorporate the use of surety bonds instead of only referring to letters of credit and other alternative forms.

Broader Regional Impacts/Considerations

There is no regional impact, as this policy is only applicable to City development agreements. The Region is not obligated to use surety bonds for their own development agreements.

Conclusion

To assist the development industry to expedite their development projects, staff are proposing to allow pay on demand surety bonds as an alternative form of security relating to various forms of development agreements. The proposed policy language has been drafted using the experience of other municipalities, to mitigate any inherit risk typically associated with the use of construction bonds. The Province has also incorporated language into the Planning Act, allowing municipalities to use surety bonds in lieu of letters of credit. This policy would take the form of a two-year pilot program to allow the City to gain further insights and experience on this form of security.

For more information, please contact: Nelson Pereira, Manager Development Finance, extension 8393

Attachments

1. 12.C.21 Development Agreement Surety Bond Policy
2. 12.C.04 Letter of Credit Policy

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