CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Planning, Administration and Policy Division
and
Legal and Risk Management Services Division

TO:	Mayor and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	June 3, 2021
SUBJECT/REPORT NO:	Development Agreement Surety Bonds (FCS21056 / LS21021) (City Wide) **(Outstanding Business List Item)**
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Ailish Brooke (905) 546-2424 Ext. 2132 Lindsay Gillies (905) 546-2424 Ext. 5491 Larry Tansley (905) 546-2424 Ext. 3588
SUBMITTED BY: **SIGNATURE:**	Brian McMullen Director, Financial Planning, Administration and Policy Corporate Services Department
SUBMITTED BY: **SIGNATURE:**	Michael Kyne Acting City Solicitor Legal and Risk Management Services

RECOMMENDATIONS

(a) That Development Agreement Surety Bond Policy FPAP-DA-001 and accompanied Development Agreement Surety Bond Language Template, substantially in the form attached as Appendix “A” to Report FCS21056 / LS21021, be adopted;

(b) That staff be directed to update the language used in the Development Agreement templates to permit surety bonds as an acceptable form of security;

(c) That staff be directed to bring forward a report to the Audit, Finance and Administration Committee which summarizes the uptake and any challenges encountered with Surety Bonds within 24 months of accepting the first Surety bond under the Development Agreement Surety Bond Policy;

(d) That "report back to the Audit, Finance and Administration Committee on the potential for the use of surety bonds as financial security for development projects" be identified as complete and removed from the Audit, Finance and Administration Committee Outstanding Business List.

EXECUTIVE SUMMARY

The General Issues Committee, through its meeting on December 9, 2020, received as Item 8.1, a presentation and report from the Mayor's Task Force on Economic Recovery. Several motions were put forward related to the presentation, one of which directed:

> "That Finance and Legal staff be directed to report back to the Audit, Finance and Administration Committee on the potential use of surety bonds as financial security for development projects to secure municipal agreements."

The purpose of Report FCS21056 / LS21021 is to provide the report back from that direction.

Through the Mayor's Task Force on Economic Recovery and discussion through the City's Development Industry Liaison Group, staff understands that the request to consider the use of surety bonds was brought forward by the development community to provide more options and flexibility to developers. Permitting the use of surety bonds would provide a method of security that would not restrict a developer's capital the same way that a letter of credit or cash security does. In turn, this proposed tool could potentially enable developers to use their capital more efficiently than is possible with the currently accepted forms of security.

The use of surety bonds in Ontario municipalities is limited. The limited use appears to be connected to the challenges that were experienced with previous forms of performance development bonds. Previous performance development bonds required municipalities to meet a burden of proof when accessing funds. Although the frequency of drawing on development securities is low, the administrative burden and risk of not meeting the arbitrary burden of proof was too much for municipalities to tolerate and the use of performance development bonds ceased in favour of letters of credit.

The City of Hamilton currently accepts letters of credit and / or certified funds as security for development agreements.

A surety bond is a bond from a surety provider which guarantees the assumption of responsibility for payment of security in the event of default of a Development Agreement by the developer. Surety bonds and their terms have evolved over time and are now highly flexible. The City has the ability to dictate acceptable language for surety bonds. Therefore, the comments and comparisons of surety bonds and letters of credit in Report FCS21056 / LS21021 are based on the proposed surety bond language in Appendix "A" to Report FCS21056 / LS21021 which is supported by the City Solicitor. The language in Appendix "A" to Report FCS21056 / LS21021, specifically section 3, ensures that surety bonds function on-demand and for all intents and purposes, function like a letter of credit despite being procured and structured in a different manner.

Staff has outlined the benefits of surety bonds for both the City and the development community in Figure 1 and Appendix "B" to Report FCS21056 / LS21021. A comparison of surety bonds and letters of credits has been provided in Figure 3 of Report FCS21056 / LS21021.

Staff is recommending that Council approve the use of surety bonds as an acceptable form of security for development agreements.

Alternatives for Consideration – Not Applicable

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial: There are no additional costs that the City will incur related to accepting surety bonds.

Staffing: The administrative process for surety bonds will mirror what is currently used for letters of credit and, therefore, no additional staffing is required.

Legal: Demand worded bonds are an insurance instrument and, therefore, are significantly different than letters of credit. Insurers, for instance, have traditionally availed themselves of the right to defend claims and to refuse to pay in circumstances where a dispute might exist, opposing claims in court, if necessary. Banks, on the other hand, traditionally pay claims in relation to letters of credit without any inquiry into the underlying merits between the parties and this reflects the fact that the letters of credit originated as a payment arrangement where absolute certainty of payment was a commercial necessity.

While these traditional differences between banks and insurers persist, staff has prepared a standard form of demand worded bond which includes words that eliminate the ability of the bond issuer to oppose payment where a claim has been filed by the City. If this standard form bond is the form issued by the bond issuer, the risk of refusal by the bond issuer will be minimized and possibly eliminated entirely so that the two varieties of instrument will be as close to one another as possible. In our case, this has been done by creating a document that provides a general rule that a claim for payment will not be resisted, followed by examples of that general principle in operation.

HISTORICAL BACKGROUND

Previous performance development bonds required municipalities to meet a burden of proof when accessing funds. Although the frequency of drawing on development securities is low, the administrative burden and risk of not meeting the arbitrary burden of proof was too much for municipalities to tolerate and the use of performance development bonds ceased in favour of letters of credit. The new iteration of bonds being proposed are substantially different from the previous performance development bonds and a new analysis is warranted.

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> "That Finance and Legal staff be directed to report back to the Audit, Finance and Administration Committee on the potential use of surety bonds as financial security for development projects to secure municipal agreements."

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

The City will need to adopt a Policy which establishes minimum requirements related to accepting Surety bonds. The recommended Policy is attached as Appendix "A" to Report FCS21056 / LS21021.

The City of Hamilton's Letter of Credit policy (FCS02016) outlines the requirements for letters of credit and was used in the creation of the proposed Policy.

RELEVANT CONSULTATION

Staff has consulted internally with divisional staff representatives from the Planning and Economic Development Department and externally with other municipalities and surety providers as outlined below.

Surety Providers

- Cowan Insurance Group
- Marsh
- Masters Insurance

Development Community

- Development Industry Liaison Group
- T Johns Consulting
- Urban Solutions
- Branthaven Development

Municipalities

- Association of Municipalities of Ontario (AMO)
- City of Calgary
- City of Guelph
- Town of Innisfil
- Municipality of Leamington
- City of London
- Township of Norwich
- City of Pickering
- Corporation of the City of Sault Ste. Marie
- City of St. Thomas
- City of Woodstock

ANALYSIS AND RATIONALE FOR RECOMMENDATION(S)

Staff's recommendation to accept surety bonds as an acceptable form of security for development agreements was formed after:

- Identification of request
- Clarification of needs through one-on-one discussions with the developers advocating for these bonds
- Participation in learning opportunities, such as webinars
- Identification of concerns from staff and other municipalities
- Research into if / how each concern has been or can be addressed

- One-on-one discussions with members of the surety bond industry
- Leveraging lessons learned from other municipalities that have approved the use of surety bonds
- Confirming with the developers advocating for the bonds to confirm what is being recommended through Report FCS21056 / LS21021 meets the needs of the developers while protecting the City

Appendix “A” to Report FCS21056 / LS21021 is the recommended Development Agreement Surety Bond Policy. The Policy outlines the terms and language that staff recommends for surety bonds. A surety bond is a bond from a surety provider which guarantees the assumption of responsibility for payment of security in the event of default of a Development Agreement by the developer. Any developer who would like to post a bond with the City would need to be able to provide the bond within the scope of this Policy.

Staff has prepared Figure 1 to highlight some key benefits of surety bonds to both the City and the development community. Each of the benefits is further explored in Appendix “B” to Report FCS21056 / LS21021.

Figure 1
Benefits of Surety Bonds as Security

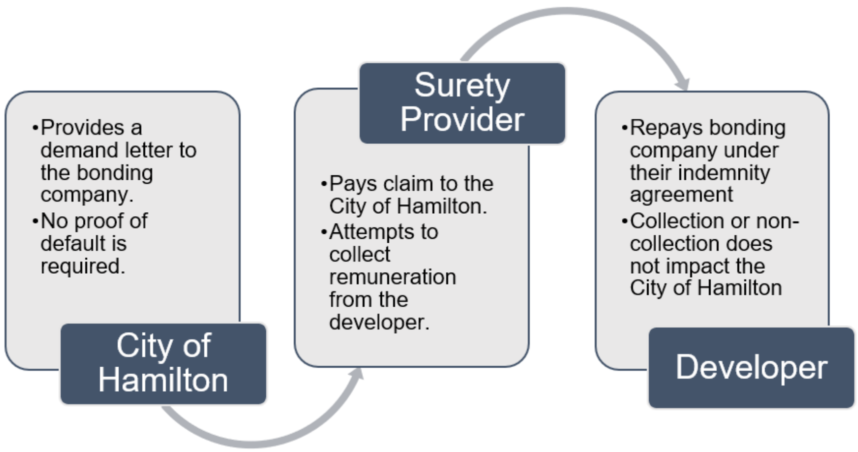
City of Hamilton	Development Community
• Liquid • Responsive • Customized • Prequalification requirement • Improves performance • Promotes growth	• Off-balance sheet security • Access to unproductive cash • Greater credit availability

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 bond language presented in Appendix “A” to Report FCS21056 / LS21021 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.

Municipalities, such as The City of Calgary, who were early adopters of surety bonds, have worked with the surety providers to develop language that is truly on-demand and does not leave room for negotiation of payment. If a demand is made for payment, the surety provider is obligated to make the payment without question. Figure 2 provides a brief illustration of this process.

Appendix "C" to Report FCS21056 / LS21021 lists some of the concerns that were raised through the research and consultation process, as well as, responses to those concerns.

Figure 2
Process to access funds from a Surety Bond



Surety providers are subject to oversight by the Office of Superintendent Financial Institutions (OSFI) and staff recommends, through the Surety Bond Policy attached as Appendix "A" to Report FCS21056 / LS21021, 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).

Risk mitigation was at the forefront of staff's mind throughout the review, consultation and policy development process. The terms recommended through Appendix "A" of Report FCS21056 / LS21021 for Development Agreement Surety Bonds reflect those found in the City's Letter of Credit Policy. The language in the bond template utilizes on-demand language from Form 5 of the *Construction Act*.

Figure 3 provides a comparison of letters of credit with the type of surety bond recommended by staff in Report FCS21056 / LS21021.

Figure 3
Surety Bond vs Letter 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

Staff is recommending the full implementation of the Development Agreement Surety Bond Policy FPAP-DA-001, attached as Appendix "A" to Report FCS21056 / LS21021 with a report due back within 24 months, rather than a pilot. In order to obtain a Development Agreement surety bond, a developer must be vetted by the surety provider which includes a review of pro-forma financials and past successes / failures. This means that not all developers will be able to acquire surety bonds and those that can will have been heavily scrutinized from a risk perspective. The volume of surety bonds is expected to be low due to the involved and lengthy process required to obtain a surety bond.

Should Recommendation (a) be accepted, the City's Development Agreement templates will need to be updated to include language permitting the use of surety bonds pursuant to Recommendation (c). In order for a bond to be accepted, the related Development Agreement will need to authorize use of a surety bond as security. Existing Development Agreements will not be permitted to substitute a surety bond for an existing security without amendment of the original agreement.

ALTERNATIVES FOR CONSIDERATION

None

ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN

Community Engagement and Participation

Hamilton has an open, transparent and accessible approach to City government that engages with and empowers all citizens to be involved in their community.

Economic Prosperity and Growth

Hamilton has a prosperous and diverse local economy where people have opportunities to grow and develop.

Built Environment and Infrastructure

Hamilton is supported by state-of-the-art infrastructure, transportation options, buildings and public spaces that create a dynamic City.

Our People and Performance

Hamiltonians have a high level of trust and confidence in their City government.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to FCS21056 / LS21021 – Development Agreement Surety Bond Policy and Development Agreement Surety Bond Template

Appendix "B" to Report FCS21056 / LS21021 – Benefits of Surety Bonds as Security

Appendix "C" to Report FCS21056 / LS21021 – Concerns Related to Surety Bonds

AB/LG/LT/dt