APPENDIX C
CONCERNS RELATED TO SURETY BONDS

1. There is a large burden borne by the City in order to make a claim against the bond in the event of default by the developer.

This concern stems from the challenges encountered with performance bonds in the past. With performance bonds, the City was required to demonstrate that a developer had not met its performance obligations before being able to access funds from the bond which could turn into a lengthy and combative process. Today’s surety bonds do not require the municipality to prove default in order to gain access to the funds.

The terms of the surety bond will be such that it is paid “on-demand.” In order for a claim to be made, the City provides a demand letter to the surety provider but is not required to provide proof or justification of default. The surety provider immediately provides the requested funds to the City and seeks recovery from the developer. Collection or non-collection of funds by the surety provider from the developer does not impact the City.

2. Surety bonds are riskier than letters of credit.

This concern stems from the challenges encountered with performance bonds in the past where municipalities would be required to prove default and the performance bond issuers were motivated to pay out as little claims as possible.

Today’s surety bonds are on-demand in nature and do not require the municipality to prove default in order to gain access to the funds, thus making the bonds comparable to an on-demand letter of credit.

Both surety bonds and letters of credit bear a certain degree of risk. The Development Agreement Surety Bond template included in Appendix “A” to Report FCS21056 / LS21021 achieves a comparable level of risk when compared to a letter of credit.

3. Letters of credit are safer than surety bonds because they are secured and issued by regulated banking institutions.

Surety bonds are only issued by licensed insurance companies which are also subject to government regulation by the Office of the Superintendent of Financial Institutions.

Letters of credit are secured by collateral while surety bonds are unsecured. This has raised the question of how the City can be sure funds are available when demand for payment is made. Financial ratings for insurance companies in Canada are provided by AM Best and the City can set a minimum rating for the insurance company to provide additional assurance that the surety bonds are being extended by reputable companies. Further, the insurance companies are required to be sufficiently capitalized and have funds in place to satisfy any potential claims.

4. It takes a long time to access funds from a surety bond.

The City is able to specify how long the surety provider has to turn around funds. Appendix “A” to Report FCS21056 / LS21021 requires that funds be released within 10 business days of a request being made.

5. The bond is being issued by an insurance company, they are not going to want to pay out requests.

Typically, surety companies engage in a thorough prequalification process to gather and verify an extensive amount of information about a developer under consideration for a surety bond, including: organizational structures and processes, business plans, historical project outcomes, risk mitigation strategies, financial statements and schedules, etc. For the City, a developer who has obtained a surety bond, demonstrates a level of prequalification that indicates decreased risk.

Surety companies receive payment from the developer regardless of whether a default occurs. The cost of a surety bond is variable based on several factors (e.g. credit worthiness, history, etc.) but is typically between 0.75% to 1% of the total bond amount.