Corporation of the Township of Brock

Staff Report to the Mayor and Members of Council

From: **Trena DeBruijn and Robin Prentice**
Position: **Director of Finance and the Director of Development Services**
Title / Subject: Surety Bond Regulations
Date of Report: February 14, 2025
Date of Meeting: February 24, 2025
Report No: 2025-FI-004

1.0 Issue / Origin

This report addresses a new regulation, O. Reg. 461/24, as approved on November 20, 2024, regarding the acceptance of Surety Bonds as security.

2.0 Background

When municipalities accept the dedication of public highways and other municipal services through the development process, these services are typically built by the developer. They are assumed by the municipality following a period of maintenance by the developer to ensure that the services function as designed. The obligation to build is most typically found in either a subdivision agreement, a site plan agreement, or some other form of development agreement. The agreement will describe the services to be constructed by reference to plans and specifications prepared by the developer's consulting engineer and reviewed and approved by the municipality's engineers. The services will be constructed to an acceptable and common standard.

The agreements also contain certain financial provisions which are intended to guarantee to the municipality that the services will be completed to the approved specifications and that they will function appropriately. The most common form of guarantee has historically been limited to a very narrow range of instruments. Most typically, municipalities will require the posting of cash, a certified cheque, or an irrevocable standby letter of credit.

With the introduction of Bill 109, Homes for Everyone Act, 2022, the Province of Ontario included the authority to enact a regulation to prescribe and define Surety Bonds and potentially require, or even allow the developer to require a municipality to accept surety bonds.

On November 20, 2024, the Minister of Municipal Affairs and Housing filed O.Reg. 461/24, which came into force the same day. A copy of the regulation is attached to this report. This regulation updates section 70.31.1 of the Planning Act and allows owners of land and applications for approvals in respect of land use planning matters to stipulate that a surety bond will be used as security.

3.0 Analysis

With the passing of O. Reg. 461/24, the Township is now required to accept surety bonds as security for performance and maintenance obligations under development agreements that meet the terms of the legislation.

With the approval of this policy, owners of land and applicants for approvals in respect of land use planning matters can submit a request to the Director of Development Services and the Director of Finance/Treasurer to use a surety bond for new applications, or to have existing securities replaced with a surety bond.

Staff have worked with neighbouring municipalities to develop a policy for the acceptance of surety bonds and have attached the draft policy.

To be accepted, the surety bond must meet all of the requirements in the attached policy and be approved by the Director of Finance. Existing securities will not be released until the replacement is approved and in the physical custody of the Township's Finance Department.

In the past, the Township of Brock did not accept surety bonds as security. This is not unique, with many other Durham Region municipalities finding that letters of credit traditionally offer a better level of security that provides a guaranteed payout if work is not done to the agreed standards.

<u>Letter of Credit</u> – is a document issued by an issuer (usually a bank), whereby the issuer undertakes to a beneficiary, at the request of the issuer's customer, to honor a documentary presentation by payment or delivery of an item of value.

Some important features included in letters of credit for municipalities include:

- The credit is a separate document from the contract on which the credit is based. This allows for payment to be immediate and without regard to the equities between parties to the contract.

- The credit must have an expiration date, with most being issued for one year and having automatic renewal clauses.

- A credit cannot be amended or cancelled without the consent of the issuer and the beneficiary.

Surety Bonds have been around for a number of years however they were not popular with municipalities due to the limitations the surety companies place on this form of security.

Surety Bonds – a surety bond obligates the Surety (the insurer) to answer for the debt or default of the Principal (the developer). The Surety is primarily liable to the Oblige (the municipality) for the debt. The liability to pay or perform only exists on the part of the Surety to the extent of the default and actual damages sustained.

Consequently, the developer is no longer required to allocate additional funding as in a letter of credit to cover any potential default. Surety will first determine whether there has been a default under the underlying contract before they pay out. As originally written, surety bonds did not provide the easiest recovery of funds and the Township, along with most other Ontario Municipalities hesitated to allow them as a form of security. Recently surety bond issuers and the development industry created a newer version of a surety bond, commonly referred to as a **Pay on Demand Bond, Subdivision Bond or Development Bond**. The new version of the surety bonds now provide the level of protection required in financial securities by a municipality.

The Township includes a section within its Subdivision Agreements, Pre-Servicing Agreements, Site Plan Agreements, and Earthworks Agreement related to the requirement for financial securities. These sections make reference to the use of letters of credit or cash securities only as this has been the standard used historically. The templates for these agreements will be updated to reflect the additional form of security through surety bonds as permitted by the regulation.

The Township does not have a documented policy for the acceptance of letters of credit, only the reference made in the above-mentioned agreements.

Attached to this report is a policy for the acceptance of letters of credit that documents the existing process used by departments within the Township. Approval of this policy will provide guidance to staff handling letters of credit in future.

The process for accepting Letters of Credit is well known and part of the Townships normal processes. While it requires the involvement of three departments, each has their responsibilities in the process and minimal additional work is required to monitor the securities once they are in the hands of the Township. To permit the use of alternate securities would require staff to implement new procedures and processes.

For Surety Bonds specifically, staff would need to develop a process to continually monitor the surety company. Unlike Canadian Chartered Banks, insurance companies have different requirements and regulations. Staff would need to review the surety company to ensure they meet the Township's requirements and monitor their continued financial stability until the contract ends.

Acceptance of Surety Bonds would require a "Pre-Approval" process for the bonding company. This would be done by staff in advance of finalizing agreements and negotiations with the developer. The developer would submit details of the bonding company that they plan to use to the Township for consideration. Township staff would be required to review the corporate information; determine that the company meets the regulations of their industry monitored by the Office of the Superintendent of financial institutions; and has a credit rating that meets our requirements as set out in the policy provided. Once a bonding company has been approved, staff will be required to continue to monitor their credit rating to ensure the bond can be drawn on if the rating falls below the acceptable level. This monitoring can continue for years since some agreements take many years to finalize.

While the wording used for standard Letters of Credit has been in effect for years, staff have worked to develop standard Surety Bond wording that will be required. The policy includes wording that allows for the bond to remain in effect until the terms of the agreement are fully satisfied. This can be defined as an "evergreen" clause that protects the Township should the developer not complete the work. It has been noted by other municipalities that some bonding companies are not in favour of these clauses and wish to stipulate the number of years they are willing to hold the bond for. If any change in the wording is included in the surety bond agreement, the Township will not accept the bond as security and the agreement will not move forward.

The attached draft policy for the acceptance of surety bonds offers the level of protection required by the Township and reflects the newer version of the bonds and offers protection similar to letters of credit. It is recommended that this policy be approved and put into place for the acceptance of Surety Bonds.

4.0 Financial / Budget Assessment

The acceptance of letters of credit has traditionally been done without added charges to the developer as the staff time to review, document and maintain files for these securities can be substantial.

It is anticipated that the added time and effort to process and monitor surety bonds will be significant. Accordingly, to offset some of the administrative costs, staff are recommending a charge of $475 be applied to the initial acceptance of, and any subsequent exchanges of surety bonds. There would not be an additional charge for reductions or drawdowns on the financial instruments held. Should additional legal costs be incurred to update existing development agreements to allow for the acceptance of this alternate financial instrument (surety bonds), this cost will be charged back to the developer and must be paid before the update is finalized. These changes would come into effect with the approval of this report and would subsequently be included in the fees and charges by-law updates annually.

The net financial impact to the Township of this process should be minimal since we are simply recovering costs. The Township will benefit from the implementation of a new fee for the handling of surety bonds.

5.1 Asset Management

New assets come under the Township's ownership through subdivision development (such as parks, trails, stormwater management infrastructure, roads and associated amenities). Financial securities, such as letters of credit and surety bonds help to ensure such assets are constructed to the Township's satisfaction.

5.0 Climate Change Impacts

N/A

6.0 Communications

Developers have been requesting the use of surety bonds as a way to offer security to the Township. Finance staff will work with Development Services staff to update the Township's application materials to outline the revise financial security options.

7.0 Conclusion

With the passing of O. Reg. 461/24, the Township is required to accept surety bonds as a form of security for land use planning agreements. This policy document reflects the requirements of the regulation.

8.0 Recommendation

That Council accept report 2025-FI-004 and approve the attached policies for Letter of Credit and Surety Bond acceptance.