



TOWN OF
HALTON HILLS
Working Together Working for You!

REPORT

TO: Mayor Bonnette and Members of Council

FROM: Moya Leighton

DATE: March 16, 2022

REPORT NO.: CORPSERV-2022-0010

SUBJECT: Pay-On-Demand Development Bonds

RECOMMENDATION:

THAT Report CORPSERV-2022-0010 dated March 16, 2022, regarding Pay-On-Demand Development Bonds be received;

AND FURTHER THAT Council approve the below outlined pilot program approach to accepting pay-on-demand development bonds;

AND FURTHER THAT Council direct staff to create a Town of Halton Hills specific pay-on-demand development bond template and obtain a legal review of its content, the cost of which will be funded from the current 2022 operating budget;

AND FURTHER THAT Council direct staff to amend the language in all contractual documentation used under the pilot program to include pay-on-demand development bonds as an acceptable form of security;

AND FURTHER THAT staff bring a Development Agreement Surety Bond Policy to Council for approval at a later date that includes the parameters of the pilot program outlined within this report;

AND FURTHER THAT staff report back to Council with a summary of any challenges experienced during the first twenty four months of the pilot program.

KEY POINTS:

The following are key points for consideration with respect to this report:

- Current policy to only accept letters of credit or cash as financial security for developments ties up critical funds and borrowing capacity for developers.
- Pay-on-demand development surety bonds are a new form of security instrument and carry the same level of risk to a municipality as a letter of credit
- Town extends the forms of acceptable financial security options to include pay-on-demand development bonds under a pilot program.

BACKGROUND AND DISCUSSION:

Current securities accepted by the Town

The Town currently accepts either a letter of credit (LC) or cash as security for agreements related to Planning Act approvals. This security represents a portion of the cost of municipal related construction work (sewers, grading, stormwater management etc.) and is held by the Town until the agreed upon work has been completed to the satisfaction of the Town.

A Letter of Credit is a form of security issued by a financial institution that guarantees payment or performance by allowing the Town the right to draw upon the security in the case of developer default. Any disagreement between the Town and the developer can be contested in court once the funds have been paid out by the financial institution.

To further mitigate the inherent risk that is attached to an LC, the Town follows the letter of credit policy that is approved by Regional Council (Policy Report ref # FN-15-17). This policy provides a framework that is to be followed when accepting LCs and also provides a pro-forma template for use in entering into the LC agreements. The LC eligibility framework contained within the policy, and followed by the Town, allows for the acceptance of LC's only from Schedule I and Schedule II banks. Further, the banks must have a credit rating of at least R-1 (Mid) as provided by the Dominion Bond Rating Service (DBRS) or equivalent acceptable agency. There is also a provision within the policy to accept LCs from financial institutions outside of the Schedule I and II categories, and they fall within the "Additional Class", however they are subject to further restrictions. A copy of the current policy is attached as Appendix A to this report and provides further details on the eligibility criteria for banks and other financial institutions.

The LC as a security instrument is popular with municipalities as it has a long-documented history and has been easy to use, with minimal risk to the municipality. The issuing financial institution is under legal obligation to pay the amount demanded and there is no avenue for them to undertake an investigation prior to payment.

However, they are not a preferred choice for developers as the cash amount equivalent to the LC value is effectively held by the financial institution for the duration of the LC which can be for extended periods of time, preventing effective use of working capital.

Pay-On-Demand Development Bond

Bonds are an alternative form of security and are available in many different formats. Bonds are favoured by the construction industry over LCs as they avoid the requirement for tying up working capital or borrowing capacity for long periods of time. A Performance Bond is a form of bond used as security as recourse for a failure to meet contractual obligations. Historically, municipalities have not accepted performance bonds as there was a requirement on the municipality to demonstrate proof of a contractual default prior to the release of any security. The additional ability for the developer to contest a default in court could result in a lengthy resolution process and high legal costs for municipalities, rendering this option very risky.

In order to advance the acceptance of bonds by municipalities, a negotiated change to the wording contained within the performance bond agreements was a preliminary step in removing some elements of risk from this instrument in the hope that they would be accepted by municipalities. However, this was still perceived to be risky, and there was minimal take up by municipalities.

In the search for a practical solution, the modern pay-on-demand development bond was created as an alternative bond instrument through industry and municipal collaboration. This bond provides financial assurance to the municipality that a developer will successfully complete all obligations under the developer agreement. The bond is payable upon demand within a set number of days (current agreements contain a 7- or 10-day clause), there is no onus on the municipality to prove default and the surety company has no right to defend and withhold payment. The bond is welcomed by the developers as it does not require the holding of an equivalent cash amount, thereby freeing up valuable working capital. Similar to the LC, in the case of a disagreement between the developer and the municipality, this can be contested in court after the funds have been paid out to the municipality.

A comparison of LCs versus pay-on-demand development bonds shows the salient points where the two instruments are consistent and contain the same features. These are outlined in the table below:

Features	Letter of Credit	Development Bond
Demand in nature	✓	✓
Irrevocable	✓	✓
Evergreen / continuous	✓	✓
Partial draw-downs permitted	✓	✓
Partial reductions in amount permitted	✓	✓
References specific agreement	✓	✓
Notice of Cancellation required	✓	✓

(Marsh Canada Ltd.)

One difference between LCs and the proposed demand bond is that the instrument is held with an insurance company rather than a financial institution. Like the banking industry, the insurance industry is regulated by the Office of the Superintendent of Financial Institutions (OSFI) and is subject to credit ratings.

AM Best Rating Services is a leading independent creditworthiness rating service for the insurance industry. AM Best ratings are based on a careful analysis of the insurance company's overall financial health along with economic and regulatory factors and denote a company's ability to meet their financial obligations. AM Best Long-term Credit Issuer ratings range from 'aaa' (Exceptional) to 'c' (Poor) and the Short-term Credit Issuer ratings range from AMB-1+ (strongest) to AMB-4 (questionable). A Town policy for accepting demand bonds will include a minimum acceptable AM Best rating of 'a-' (Excellent) or AMB-1 (Outstanding).

Developers who wish to obtain a pay-on-demand development bond must undergo a thorough underwriting process by the surety company. This includes a review of the developer's credit, their history and project specific details such as the economics, schedule and trades used. The developer must also provide a corporate guarantee to the surety company.

The benefits of a pay-on-demand developer bond can be summarized as follows:

- Improved liquidity for the developer
- Municipality has the same financial assurance as an LC
- The prequalification process provides the municipality with additional assurance of the developer's ability to successfully complete the development which is not included in the LC option

Due diligence undertaken

Marsh Canada provided a presentation to Town staff on the differences between an LC and a pay-on-demand development bond. Staff's understanding from this presentation was that the risks between the two forms of security are the same.

Finance staff have contacted the following municipalities who are currently accepting these instruments as security in order to gain an insight into the benefits and challenges:

- City of Pickering
- Municipality of Chatham-Kent
- City of St. Thomas
- City of Hamilton

In addition, staff have carefully reviewed the City of Hamilton's policy on the acceptance of development agreement surety bonds (Ref: FPAP-DA-001 Report No. FCS21056/LS21021) and consider its contents consistent with the Town's due diligence already undertaken.

The recent publication of the Ontario Housing Task Force Report includes a recommendation to the Province that would require municipalities to accept these types of bonds, as detailed below:

25. Require municipalities to provide the option of pay on demand surety bonds and letters of credit.

More widespread use of this instrument could unlock billions of dollars of private sector financial liquidity that could be used to build new infrastructure and housing projects, provide for more units in each development and accelerate the delivery of housing of all types.

As of the date of writing this report, it is unclear whether or how the Province will implement this particular recommendation.

Summary

Pay-on-demand development bonds are still a relatively new instrument and although staff are recommending the addition of demand bond to the list of acceptable securities, it will be on a trial basis with eligibility parameters at the discretion of the Treasurer and with the acceptance of a pay-on-demand bond request only upon approval of the Chief Administrative Officer.

The pilot program:

The pilot program will be effective immediately upon Council approval and will be limited to:

1.	A maximum security bond value of \$1Million
2.	One security bond per developer at any one time
3.	Surety must have an AM Best rating of at least a- (Excellent)
4.	Security bond eligibility applies only to works where there is no corresponding Region of Halton financial security in place
5.	Will not apply to Subdivision Agreements or other agreements for work on Town owned lands

The pilot program will also require the following steps to be undertaken:

1.	A change to the wording in the security agreement to include pay-on-demand development bonds
2.	Creation of a bond template that is approved by the Town's own legal counsel
3.	Creation of a policy and standard operating procedure to guide staff in the acceptance on these types of bonds as security
4.	Continual review and monitoring of the use of these bonds by other municipalities
5.	Creation of a cross functional staff working group to monitor performance of developments using bonds to track potential challenges

6.	A review and revision of the existing security policy
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Staff are recommending that a review period of 24 months following the acceptance of the first pay-on-demand development bond be undertaken whereby there is continual due diligence to assess the outcomes relating to the acceptance of this instrument and to document any risks.

STRATEGIC PLAN ALIGNMENT:

This report aligns to the Town's Strategic plan recognizing the value to foster a prosperous economy, maintain and enhance the economic vitality of the town through the provision of a wide range of opportunities for economic development.

This report also identifies shaping growth as one of the Town's Strategic priorities.

RELATIONSHIP TO CLIMATE CHANGE:

This report is administrative in nature and does not directly impact or address climate change and the Town's Net Zero target.

PUBLIC ENGAGEMENT:

Public Engagement was not needed as this report is administrative in nature.

INTERNAL CONSULTATION:

The Chief Administrative Officer, Commissioner of Corporate Services, Finance staff, Planning staff, Engineering staff and the Town's legal counsel were consulted on this report.

FINANCIAL IMPLICATIONS:

This report will be funded through an existing approved budget source.

Reviewed and approved by,

L. Lancaster, Acting Chief Administrative Officer