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Mountain Region

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Agenda

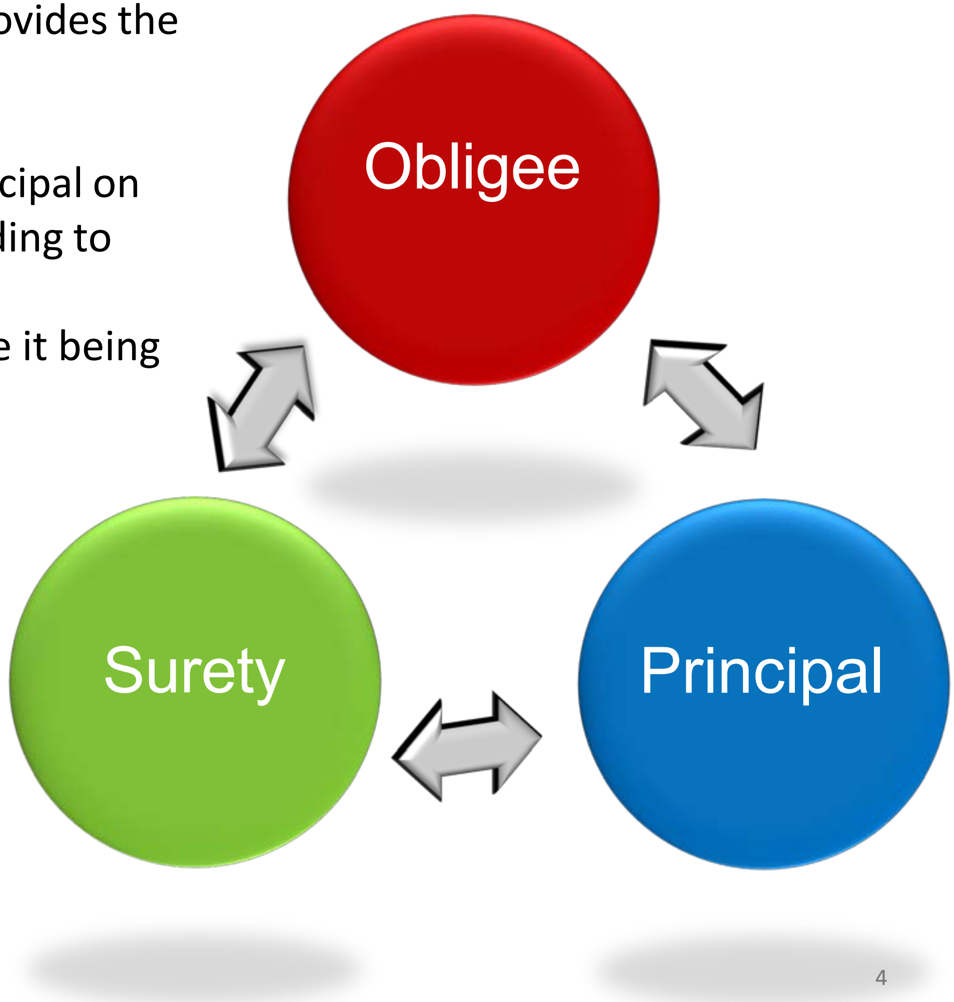
- What is a surety bond?
- What is a subdivision/improvement bond?
- Improvement bonds vs cash
- Underwriting a developer
- Development agreements
- Risks associated with not using an improvement bond
- The claims process

What is a surety bond?

- Three-way agreement between:
    - **Obligee** – Party requiring the bond
    - **Principal** – Party being required to obtain the bond and whose work is guaranteed
    - **Surety** – Insurance company that provides the bond guarantee

- Credit product guaranteeing that the principal on the bond will complete the project according to contract terms.
    - Surety is the financial backing; hence it being considered a credit product

- Protects the Obligee



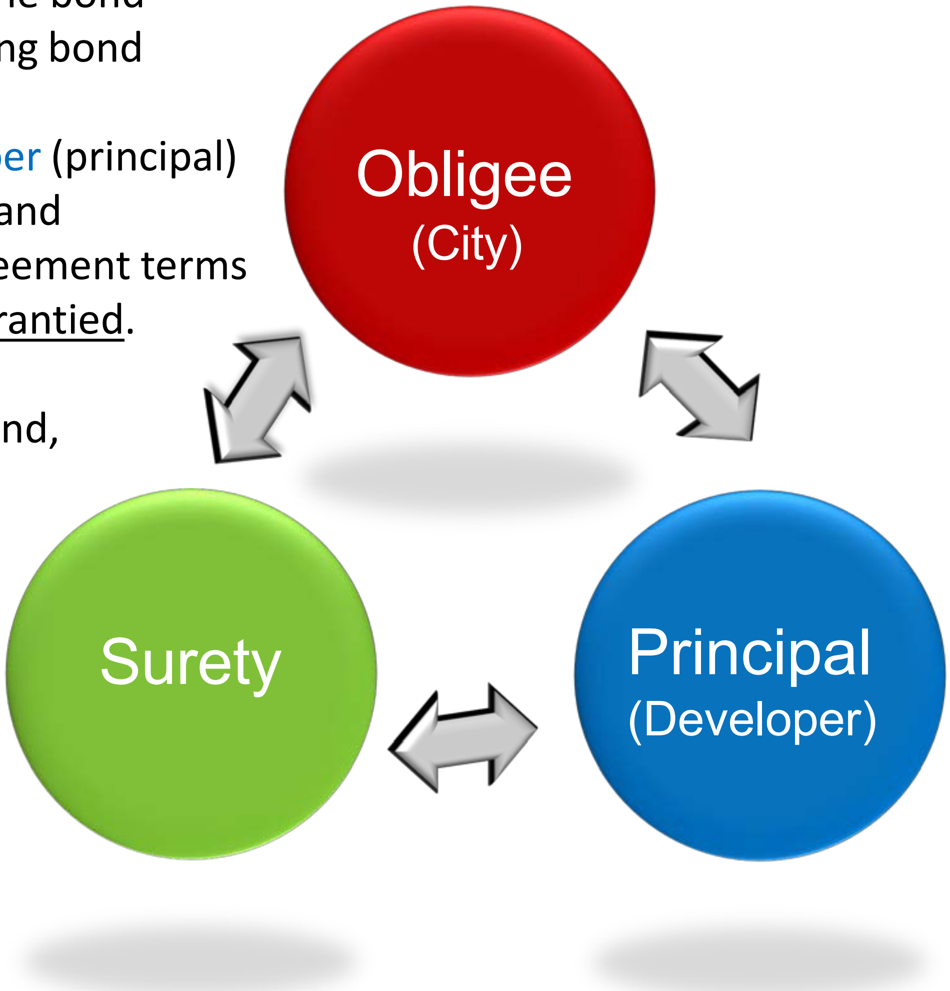
What is a subdivision/improvement bond?

- Surety bond specifically for developers

- Three-way agreement between:
  - **Obligee** – City requiring the bond
  - **Principal** – Developer required to post the bond
  - **Surety** – Insurance company guaranteeing bond

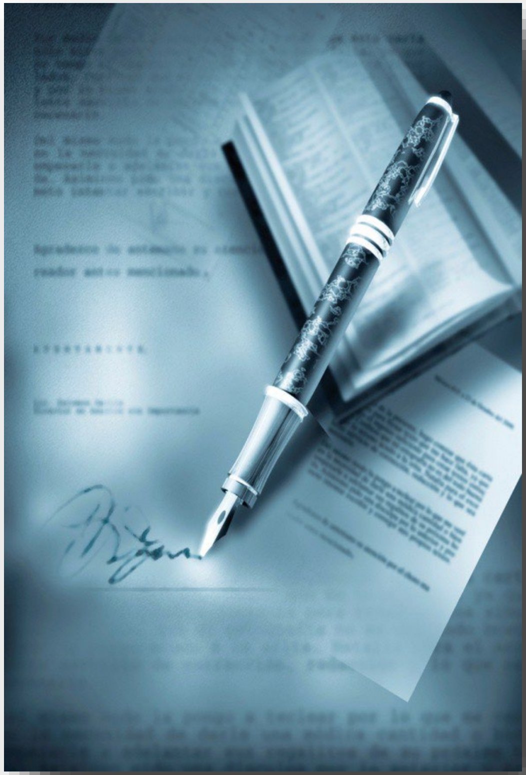
- Credit product guaranteeing that the developer (principal) will complete the development/subdivision/land improvement according to Development Agreement terms and conditions, and once done, it will be warrantied.

- Synonyms: Developer bond, improvement bond, subdivision bond



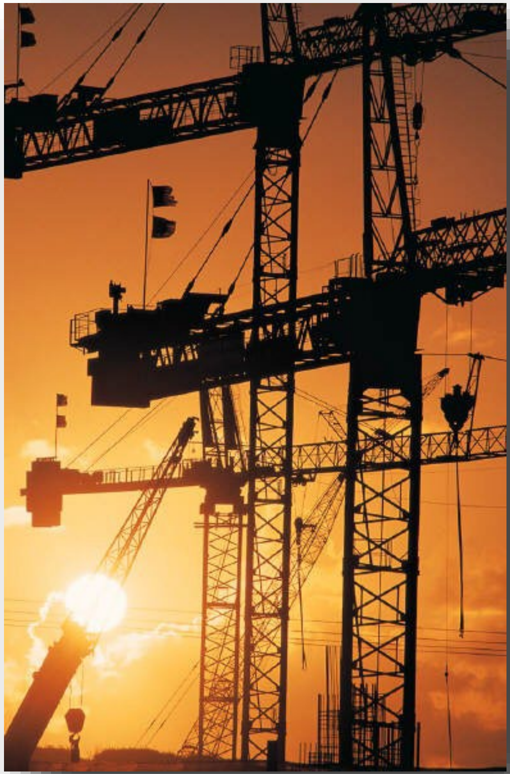
Improvement Bonds

The ***Surety*** guarantees the Developer's completion of the development.



The ***Developer*** has the primary responsibility to fulfill the bond obligation.

The ***Bond*** protects the City from default by the Developer.



Improvement Bonds vs Cash

Cash/Line of Credit:

- Gives the municipality direct control of the funds

Improvement Bond:

- Requires the developer to go through financial and experience underwriting
- In the event of default, a claim must be filed with the surety
- Improvement bonds typically come with a warranty/maintenance bond that protect the municipality against defective materials and workmanship. Most warranties are for 1 year from completion.

Underwriting Considerations

- The 3 C's of Suretyship

- **Capital** – does the applicant's financial condition support the size and nature of the obligation?

- **Capacity** – does applicant posses the skill, experience and knowledge to perform the obligation?

- **Character** – is the applicant trustworthy, of good character

Underwriting a Developer

- **Developer Questionnaire**
  - Narrative report on company history
  - Completed projects
  - Resumes of owners, partners, and/or key people
- **Copy of Development Agreement**
- **Verification of funding for development**
  - Self-funding (Copy of bank statements)
  - Loan (Copy of loan documents)
- **Fiscal year-end financial statements for past 3-5 years**
- **Personal financial statements for the owners and/or partners**

Development Agreement

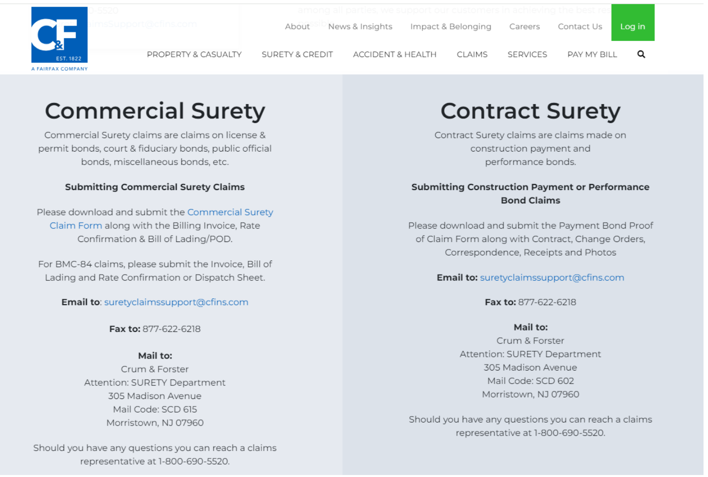
- Land development laws have a commonplace statutory scheme, which are laws and regulations that ensure the developer properly installs improvements to prevent the subdivision from becoming an undue burden on the community and local taxpayers.
- The Development Agreement will require the developer to construct improvements consistent with laws and regulations and sets forth the time within which the improvements must be completed.
- The bond will guarantee compliance with this agreement which the developer signs with the Obligee.
- Development Agreements will typically reference engineers estimates which outline expected work to be completed before final sign off

Risks Associated with Not Using an Improvement Bond

- Municipality cannot "discriminate" against developers
- Municipality becomes a fiduciary custodian of collateral
- Municipality may become a "completion contractor" for which it is not licensed or insured
- Municipality accepts financial risks of completion after collateral is exhausted
- Municipality accepts warranty obligation of completed work

Claims Process

- Surety bonding companies have the opportunity for three different remedies. They will choose the least expensive legal option to fulfill their obligation to the city:
  1. They can write a check for the bond amount
     - This would only happen in extreme cases where a claim happens very early on in the project, or potentially during hyperinflation
  2. They have the opportunity to provide cashflow for the principal to help them complete the project
  3. They can hire a replacement to complete the obligation



Understanding the Obligation

- What is the nature of the obligation?
- What are the terms and conditions?
- Duration: cancellable or non-cancelable?
- What is the likelihood of default?
- What are the remedies to default?