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Real Estate Alert

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Our Amended Performance Bond Law: Sensible Changes, But More Needed

Public Act 11-79, effective October 1, 2011, makes several significant changes in how developers and builders post performance bonds with municipalities to ensure the proper and timely construction of infrastructure and key amenities in site plan approvals, and public improvements (roads, infrastructure, and erosion controls, etc.) in subdivisions. This new law contains several straightforward improvements to the process of calculating, posting, and releasing performance bonds. However, it also contains language about the obligation of towns to accept performance bonds that, we agree, is somewhat confusing and needs clarification.

Unfortunately, in response to this confusion, we are starting to witness some towns amending regulations to prohibit the use of all performance bonds going forward. As explained below, we think that prohibiting performance bonds is unnecessary, and will slow economic development at a very bad time.

1. **"Performance bond."** A performance bond is a builder's financial guarantee to a town that it will complete certain aspects of an approved site plan or subdivision plan. In general, with site plans, bonds cover the cost of building infrastructure and major amenities, and in subdivisions, they cover public improvements such as roads and utilities. A performance bond gives the town an assurance that these components will be built, and protects ultimate users such as residential lot purchasers, and building tenants. "Performance bond" is a generic term; types of bonds include cash in a savings account, an irrevocable letter of credit from a bank, or a surety bond issued by an insurance company. The word "surety" means that a third party is standing behind the builder and is obligated to complete unfinished work if the builder does not or cannot.

2. **Stakeholders Meeting, August 23, 2011.** During the summer of 2011, the new Public Act generated a great deal of discussion and confusion. In August 2011, we convened an informal meeting of town planners, town attorneys, and builders to discuss the situation. From this meeting, we provided a set of minutes, available at **http://www.shipmangoodwin.com/files/upload/Minutes082311.pdf.** Those minutes form the basis for much of the analysis below. (One conclusion that emerged from this meeting is that performance bond practices currently vary a great deal, statewide.)

Questions?

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3. **Straightforward, sensible changes.** Public Act 11-79 makes the following improvements to the existing law:

   a. **Release procedures.** Under the new Act, if a builder submits a request for a partial or total release, the zoning or planning commission, within 65 days of the request (which we interpret to mean 65 days from when received at a meeting), must either release the funds or provide a written explanation as to what needs to be completed before release. This provision adds a timeframe to what was an open-ended process. We believe an applicant may consent to an extension of this 65 days.

   b. **Phases.** The amended law clarifies that if an approval provides for phases, bonds may be posted in phases.

   c. **No long-term maintenance bonds.** The law now prohibits towns from requiring long-term bonds for the maintenance of public improvements after acceptance by the town. To our knowledge, this was a practice adopted in two towns, but was not authorized by the prior law. The amendment clarifies this.

   d. **Contingency limits.** Public Act 11-79 provides that for improvements bonded through site plans – not subdivision plans – contingency amounts (additional money set aside to cover potential cost overruns) may not exceed ten percent of the total. At the August 2011 stakeholders meeting, it was observed that this limit will require greater care from all concerned in the initial cost calculation, and we agree.

   e. **Timing.** The new Act provides that a bond or surety, at the discretion of the party providing it, may be posted at any time prior to the improvements being completed. The only exception is that a commission may require a bond or surety for erosion controls to be posted prior to the commencement of any work, for either a site plan or subdivision approval.

4. **Controversial / confusing provisions.** Public Act 11-79 gives, and takes away. On the one hand, it states that commissions "shall accept surety bonds, cash bonds, passbook or statement savings accounts or other surety, including but not limited to letters of credit . . . ." On the other hand, the bond or surety must be "in a form acceptable to the commission." If a letter of credit is proposed, the financial institution issuing it also must be "acceptable to the commission."

   This new language, in our view, does not require a zoning or planning commission to accept whatever performance guarantee a builder / developer proposes. What it does is prohibit commissions from categorically refusing certain types of bonds such as surety bonds; the new Act requires them to consider the form of the bond (and for letters of credit, the bank issuer) on a *case-by-case* basis. (For what it's worth, this was the apparent consensus of the stakeholders meeting on August 23.)

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Thus, while much of the on-line discussion this past summer focused on whether Public Act 11-79 requires commissions to accept all offered surety bonds. It does not, because the amended statute allows commissions to object to the form of the bond. There are situations in which surety bonds are problematic – for example, bonding a small amount ($10,000 for example), or for a short time for a minor improvement such as a repair. Surety bonds, being third-party obligations, are harder to collect than other forms. Also, residential subdivision builders rarely use surety bonds because they are expensive and cumbersome; surety bonds are seen more frequently on longer commercial and industrial projects – where the financial strength of an insurance or bonding company behind the deal may be important to the town.

Thus, as to this core provision of Public Act 11-79 requiring towns to accept more types of performance bonds, the Act:

- does not require acceptance of surety bonds in all cases, because the town may reject the form of a particular bond; but

- requires case-by-case evaluation of the proposed bond, and allows towns to reject the proposed bond based on whether the bond is appropriate to the situation.

We believe that proposals to amend a town's zoning or subdivision regulations to prohibit all use of performance bonds, based on a perceived new requirement to accept all surety bonds, are a misreading of the amended statute, and eliminate a potentially valuable planning tool to ensure the completion of improvements in an approved development.

Overall, Public Act 11-79 offers some needed improvements to performance bonds, but warrants future legislative clarification.

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