

BERKSHIRE PLANNING TOOLS



One in a series of “toolbox” items to accompany the Regional Plan for the Berkshires

June 2003

Financial Performance Guarantees

What are Financial Performance Guarantees?

A financial performance guarantee is a financial commitment to ensure that a development is completed in a satisfactory manner or to ensure that upon cessation of a specific activity, a possibly hazardous or undesirable situation is removed. Financial guarantees are also often required to be in place after improvements have been completed for a fixed period of time to ensure that the improvements were constructed in a satisfactory manner. Such guarantees are often called “bonds” but that is actually one specific, and not necessarily desirable, form of financial guarantee. A more appropriate, generic term that will be used in this discussion is “Surety.”

Why Require Surety?

Unfortunately, sometimes projects are abandoned during the development phase. This can occur due to financial, legal or market problems that may be outside of a developer’s control. There can also be problems with improvements not being installed correctly or with landscaping or site stabilization measures not surviving. However, it is important that a municipality not be left with a financial liability to either correct a problem or to complete the installation of public infrastructure that is needed to complete a development.

The actual use of surety by the municipality is almost always a tool of last resort, after repeated attempts have failed to get the responsible



developer or owner to actually complete activities or to correct problems. Often, if threatened with the use of the posted surety, a developer will complete the required improvements or correct the problem as the developer’s cost for obtaining future surety will be higher.

Typically, financial performance guarantees have been used in the following circumstances across the U.S.:

- *For land disturbance activities, including site clearing and grading related to a development project or for a surface mining project:* Surety is often required to ensure that a site can be stabilized (graded and seeded). If a site has been cleared and the land disturbed, and then abandoned or erosion and sediment control devices not installed or maintained, the impacts on down-slope properties can be severe, as can the impacts on drainage systems, sensitive environmental areas and public roads. For a

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surface mining activity, where the site may actually pose a public safety risk, even items such as fencing will often be included in the surety requirement.

- *Public improvements within subdivisions:* Often subdivision development occurs in phases such that all the public improvements are not completely installed before construction (and even occupancy) of houses in the development begins to occur. In allowing building construction, much less occupancy, to occur before all public improvements have been completed, the municipality can incur a risk that the developer will not complete the public improvements and the municipality will have to step in to do so. Adequate surety protects the municipality and new building owner from those risks.

- *Maintenance (Work Quality) Guarantees:* Surety is often required to ensure that work was done in an adequate fashion. Often it takes a full year to determine that a public facility (roads in particular) was installed properly. Having adequate surety to ensure that work can be redone, if necessary, is important in these cases.

- *Improvements within an existing public right-of-way or easement (installation of a driveway, utility connections, or drainage improvements):*

Typically an individual site development project, including building a home, but particularly a commercial development, requires installation of a driveway from a public road and may include hook-ups to municipal utilities in the right-of-way or in an easement and may include drainage improvements. On large construction projects, construction access over public roads can cause damage to town roads or bridges. When these impact a public facility, the municipality may want financial surety to ensure that the public facility is not damaged and is completely restored after the work is completed. This use of financial guarantees is not used as much as the first three.

- *Removal Guarantees:* With the proliferation of telecommunications towers and the possibility of commercial wind turbine developments, the requirement for surety to ensure the removal of such towers if they subsequently are not used as intended, for whatever reason, has become a normal permit condition in many municipalities. It is felt that these types of facilities, while serving a legitimate public purpose, do have an ongoing impact on the community and therefore, if they are abandoned or decommissioned for a specified period of time, there should be resources to ensure that they can be removed at the owner's expense.

Legal Status of Surety Requirements under Massachusetts General Laws

The only specific citation and limitation in Massachusetts General Laws regarding surety is in the Subdivision Control Law (Chapter 41, Section 81U). A copy of the pertinent portions of Section 81U is attached. That section stipulates the forms of surety that can be required for subdivision improvements and gives the developer the choice of the form of surety to be provided. The three forms of surety allowed in the Subdivision Control Law are: 1) bond; 2) cash or negotiable securities; or 3) a construction agreement (loan) to the developer from a lender based on the value of the property with retention of sufficient funds to ensure completion of improvements. Alternatively, the developer can record a covenant that restricts the sale of some or all lots before the public improvements are completed.

The Zoning Act (Chapter 40A) and the Berkshire Scenic Mountain Act (Chapter 131 §39A) are silent on financial surety and therefore municipalities are able to determine appropriate requirements, standards and procedures for surety for projects that fall under those laws using their home rule authority. Similarly, a municipality's general bylaws can also allow requirements for surety (for instance, for an earth removal activity covered by an Earth Removal

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Bylaw). However, to be safe, these should be explicitly adopted in the local bylaws as being permissible and appropriate rules and regulations developed governing their use and administration. The Wetlands Protection Act (Chapter 131, S. 30A) does not stipulate that surety can be required. Therefore it is probably not permissible for a Conservation Commission to require surety under that authority; although it can if there is a local Wetlands Bylaw that requires surety (Stockbridge, Great Barrington and Richmond currently have local wetlands bylaws).

Forms of Surety

Financial surety comes in various forms and varieties. The primary interest of the municipality is to have surety in a form that is easily collected. Common forms are:

- *Cash:* A developer can provide cash surety to the municipality. When the improvements called for are completed in an acceptable manner, the cash, with interest, is refunded to the developer. Cash is the easiest form of surety for a local government but usually is neither desirable nor practical from the developer's standpoint for an expensive set of improvements. It is more useful if the surety amount is fairly small and the amount of time that the surety will be encumbered is relatively short.
- *Letter of Credit:* A letter of credit is a line of credit at a financial institution that the municipality is able to draw down upon demand. Letters of credit are relatively easy and inexpensive for a developer to obtain. From a municipal standpoint, as long as the letter of credit is from a sound financial institution that is relatively local, it is a very useful form of surety.
- *Lender's Agreement:* The Subdivision Control Law allows the use of a "Lender's Agreement." This is the equivalent to a construction mortgage with respect to the portion of the developer's first mortgage that the bank, the developer and the Planning Board agree will be retained by the lender to assure completion of the required improvements.
- *Negotiable Securities:* Negotiable securities can be provided by the developer. The municipality would have to have the right to cash those. In the case of negotiable securities the market value can fluctuate and the municipality would have to protect itself from potentially significant decreases in value over relatively long periods of time (months or even years). From a municipality's standpoint, this is a less desirable form of surety.
- *Bond:* A bond is actually an insurance instrument and collectable from an insurance company. Typically, these are not favored by municipalities because collecting a bond can require suing the bond company.
- *Covenant:* A covenant is a non-financial form of performance guarantee. The developer records the Covenant in the Registry of Deeds, which acts as a lien and prevents sale of the lots within the section of the subdivision until all improvements have been completed to the satisfaction of the Planning Board, or another form of surety is provided for final completion.

Administration of Surety

There are several important steps in requiring and administering financial sureties. These are:

1. *Requiring surety:* The governing local bylaws (erosion and sediment control, local wetlands, earth removal, zoning, scenic mountains, driveway, utility connections, etc.) should explicitly allow for surety requirements. As an example, the Amherst Zoning Bylaws state: "In granting a Variance, the Board of Appeals; or, in granting a Special Permit, the Special Permit Granting Authority, may require a bond or other security to insure compliance with the

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conditions and approved Site Plan.” The permitting or approval authority should clearly establish in its rules and regulations:

- 1) when surety may be required;
 - 2) the forms that are acceptable;
 - 3) the manner in which the covered improvements and the amount of surety will be monitored;
 - 4) the procedures for releasing the surety in whole or in part upon successful completion of required work; and
 - 5) the procedures for determining what events would allow the municipality to take and use the surety
2. *Determining appropriate amounts:* Detailed construction plans with cost estimates, bearing a professional engineer’s or certified land surveyor’s seal, should be submitted. For landscaping components, an estimate or actual bid from a landscaping firm is often used. The estimates or bids should be reviewed for reasonableness by the municipality’s staff or paid engineering consultant. The municipality wants the total surety amount to be able to cover “worst case” scenarios, and should also keep in mind that the amount of the surety will usually be higher than the developer’s cost to allow for inflation, municipal overhead for administering bidding and construction, state wage rates, and allowance for contingencies.
3. *Accepting the form of surety:* Surety being offered should be reviewed by the local government’s attorney for form. It should be reviewed by the approving authority or designated local official for compliance with local rules and regulations concerning surety.
4. *Administering and Monitoring Sureties:* Internal processes should be established to

file, protect and track sureties that have been provided. The appropriate municipal officials may vary between communities but typically the local treasurer, finance office, inspecting officials and the approving authorities may be all involved. At a minimum, the following are needed:

- a. Cash surety needs to be deposited in an interest-bearing account and tracked
- b. The originals of letters of credit, pass books, negotiable securities and bonds need to be stored in a place that is safe from theft, fire, flood or other loss.
- c. A procedure for inspecting and documenting that work has been completed satisfactorily must be established.
- d. A procedure should be established for substituting a “maintenance” surety for the construction surety for an appropriate length of time after work has been completed but allowing enough time, through appropriate seasons of the year, to ensure that obvious defects in the work would appear.
- e. All surety should be constantly monitored for when it expires.
- f. For semi-permanent surety requirements, such as for removal of cell towers or wind turbines, an ongoing review and renewal of the surety is needed.
- g. Under the Subdivision Control Law, the proceeds of any surety are to be made available to the municipality to meet the cost and expenses of the municipality in completing the work as specified in the approved plan.

This publication is one in a series of “toolbox” items to support the Regional Plan for the Berkshires. If you would like to receive additional copies of this or other toolbox items, please contact the Berkshire Regional Planning Commission, 1 Fenn St., Pittsfield, MA 01201 or call (413) 442-1521. Copies of the toolbox items are also available on the web. Visit www.berkshireplanning.org

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