

BY DAVID BOWCOTT

Housing: Are Surety Bonds Part of the Solution?

ONTARIO CONSULTATIONS MAY ALLOW SURETY BONDS AS AN ALTERNATIVE TO LETTERS OF CREDIT

It is no secret that one of the top issues facing all levels of government in Canada is solving for the housing crisis. Increased population combined with a substantial growth in the cost of housing, driven by a shortage of housing supply and higher financing costs, have pushed the crisis to the top of the agenda when it comes to issues facing Canadians, and the overall Canadian economy.

To address the issue, governments at all levels are introducing solutions to catalyze development in the hopes of driving up supply and alleviate affordability challenges.

In Ontario, the province is exploring the use of pay-on-demand surety bonds to secure homebuilders' land-use planning obligations under Section 70.3.1 of the Planning Act during the development process. The impact of such a change would allow developers to use less restrictive and potentially more affordable surety bonds as a substitute for the more constraining and often more expensive letters of credit, which often tie up developer capital that could be better used as investment in the development.

By allowing this surety option, the hope is it will encourage greater development activity and accelerate the pace at which new housing comes onto the market. The Ontario Home Builders Association (OHBA) is very much in favour of this optionality when it comes to homebuilder/developer security.

“ This is a great step forward for Ontario’s housing industry and the issue of housing affordability. Allowing builders to access capital held up in letters of credit and reinvest it into new projects is precisely the type of innovative regulatory updates we need to effectively increase our housing supply. ”

— Scott Andison, CEO of OHBA

The use of on-demand surety bonds to secure such obligations isn't new. Several municipalities across Canada have already allowed developers to put up on-demand surety bonds in lieu of letters of credit. Over 40 major municipalities have allowed this option, with the City of Calgary being the first. What would be unique about Ontario is that it would mark the first provincial acceptance of surety bonds, representing a top-down versus bottom-up approach.

Typically, to be accepted as part of these housing programs, an on-demand surety bond has to have the following features: demand in nature (seven to 10 days' payment period); irrevocable; evergreen/continuous; partial drawdowns permitted; partial reductions in amount permitted; reference specific agreement; and notice of cancellation required.

In almost all cases, the issuing surety company must have an acceptable credit rating from one of the following rating entities: DBRS, Fitch, Moody's, S&P or AM Best. For instance, a rating of A or higher from AM Best would be sufficient to qualify under the

Ontario Planning Act, if this change is allowed after the consultation process. Most municipalities require a rating of A-, which broadens the market options.

Developers would be advised to ensure that they have, or will have, an on-demand developer surety facility in place to take advantage of these optional security provisions. A trusted advisor (broker) can help navigate all the requirements that potential surety partners will require, and to secure best terms.

The acceptance of on-demand development bonds as an alternative to letters of credit will, without doubt, stimulate more development and help address the housing crisis. It is crucial that development organizations not only establish an on-demand surety facility, but also ensure that it is secured with the best possible terms.

Surety Tips

Best Foot Forward

Sureties require information on credit quality, development history, and information specific to individual developments (project economics, schedule, and sources of financing). Ensure you understand the surety underwriting process and have this information presented in the most appealing submission.

Ratings and Records

Ensure your advisor identifies sureties that will satisfy any rating entity criteria and ensure the surety options brought forward are willing to write, and have a strong record of writing, on-demand developer instruments.

Indemnity and Security Negotiations

Work with your advisor to secure most efficient indemnity and security terms for your on-demand surety facility. Ensure intercreditor issues between your new surety partner and your bank are identified and optimally negotiated to your benefit.



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