★ planning advisory service

AMERICAN SOCIETY OF PLANNING OFFICIALS
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PERFORMANCE BONDS FOR THE INSTALLATION OF SUBDIVISION IMPROVEMENTS*

When an individual undertakes a land subdivision project he engages in a business enterprise. As an enterpriser, he is subject to the usual risks involved in the investment of large capital sums and in the marketing of a costly and immovable product. Consequently, it will be his natural tendency to minimize the risk as much as he can and to sell his product and realize a profit as quickly as possible.

A bonding house -- likewise engaged in a business -- will similarly seek to minimize its risk and will issue bonds only to persons whom it considers good risks. A number of factors will be considered in the determination of a good risk: the builder's past record for fulfilling his contracts; the extent of his liquid and fixed assets; whether or not he owns the land that is being developed; and sometimes the nature of the local housing market.

The city or county government -- though not engaged in a business -- is also concerned with risks. The local governing body generally wishes to avoid risking funds in a new development. It may put up funds for improvements which are later to be amortized by taxes, service charges, or special assessments. Historically, the risk to the community has occurred when and after plats are recorded. Historically, cities have inherited premature subdivisions and residential areas devoid of paved streets, storm and sanitary sewers, and water supply structures, or premature subdivisions with paved streets and other structures subject to uncollectable special assessments.

The peculiar characteristic of the product of the subdivision business is that it eventually becomes a part of the physical city, i.e., it consists of residential and

commercial buildings, streets and sidewalks, and utility structures. Therefore, the municipal corporation possesses certain obligations toward the new subdivision. It does not, however, wish to execute these obligations under conditions that will result in a financial loss to itself. Consequently, the local governing body, in granting to the developer the privilege of recording his plat, extracts from him certain performances or promises to perform which will minimize the risk of the new development to the community as a whole and which, if possible, will result in the new subdivision becoming an asset to the community.

The private developer, then, in embarking upon a new land subdivision venture, encounters various conditions which must be met before he can complete his product and place it on the market. On the one hand, he must comply with the regulations established by the local legislative body. If he needs financial assistance, he must, on the other hand, be able to meet the requirements of the financial institution dispensing the funds or the credit.

Previous PLANNING ADVISORY SERVICE bulletins have dealt with certain aspects of the municipal regulation of land subdivision. (See especially Information Report No. 38, Installation of Physical Improvements as Required in Subdivision Regulations.) Subdivision regulations requiring improvements may, at a minimum, ask the developer to grade the streets and surface or pave the roadways. At a maximum, he may be expected to install curbs and gutters, sidewalks, street trees, storm and sanitary sewers, water supply, and a range of fixtures including street signs, gas mains, electrical conduits, fire hydrants, and street lights. Usually the ordinance or regulations governing the subdivision process require that the designated improvements be installed by the time of final plat approval and before the plat is officially recorded. However, most regulations having this requirement also offer to the developer one or several courses of action which he may follow in lieu of prior installation. These alternative courses in most cases take the form of a financial guarantee that the work will be completed within a fixed length of time. The most common type of financial guarantee is the performance or surety bond, with the cash deposit, certified check, negotiable bond, and special assessment experiencing less wide usage.

If the developer chooses to post a performance bond guaranteeing the completion of physical improvements, he must then secure the approval of the bonding house. In other words, in order to go ahead with his development on this basis he must be approved as a "good risk" by the financial concern involved. It is with the requirements made by the financial institutions upon private developers in the financing of improvements that this bulletin is generally concerned.

Improvement requirements (or performance bond in lieu thereof) are concerned with what is done to the land in newly platted areas. Consequently, they affect developers of land and attempt to curb uneconomic and speculative development of land. Since World War II, more and more subdivisions have been completed by developers who not only divide the land into lots and install streets and other im-

provements, but who also simultaneously build houses on lots. Their product is houses-on-improved land. Termed the "merchant-builder" by The Magazine of Building: Architectural Forum, they are subject to a wider variety of private and public controls than is the developer of land only. In addition to making the guarantee that street and lot improvements will be completed prior to sale, they must also guarantee that the dwellings will be ready for immediate occupancy upon completion of the sale. The financing institutions of the Federal Housing Administration and the Veterans Administration require that certain standards of house construction must be met as part of their terms for financial assistance. Private lending institutions are no less demanding. Consequently, the risks of the merchant-builder are greater than those of the land developer, he sells to a different market, and his financial arrangements are more complex. Street and lot improvements are only a part of the finished product, and a merchant-builder who embarks upon a development of houses-on-improved-land will probably not be unduly concerned about raising money or putting up security for a performance bond for physical improvements.

Although no differentiation was made in this survey between the experiences of land developers and merchant-builders, it is assumed for the reasons given above that it is with the land developer that the problems of performance bonding chiefly arise.

The question directly posed was: How widespread and how successful is the use of the financial guarantee in lieu of actual improvement installation? Or, stated more explicitly: Among those cities and counties that require the developer to install physical improvements and that permit the alternatives of bond, cash, deposit, or special assessment, how, in actual practice is the performance bond in particular working out?

To find answers to this question, PLANNING ADVISORY SERVICE sent a one-page questionnaire to a limited number of cities and counties. Certain qualifications determined the communities that were canvassed. The first and most obvious qualification was that the subdivision regulations in the community (1) must require the developer to install the improvements prior to final plat approval; and (2) must contain a provision for bond, cash deposit, or special assessment. The second qualification was that there must be a person who could be called upon for an analysis and appraisal of the bonding situation in his area. Since this kind of information would take time and perhaps considerable effort to secure, the questionnaire was sent chiefly to communities who are members of PLANNING ADVISORY SERVICE and to planning officials in certain non-member communities who are members of ASPO. The third qualification was geographical location. Although it was not possible within the limits set by the first two qualifications to get information from a city or county in every state, it was possible to obtain data from widely separated points.

The questionnaire consisted of two parts. The first was a short series of questions on the number of plats recorded in 1952, the number of subdivisions where improvements were installed prior to final plat approval, and the number of subdivisions in which different types of financial guarantees were given in lieu of installation. The answers to questions in the first part are amenable to tabulation and hence are summarized on the following page in Table I.

There is a temptation to total the columns in Table I to see what percentage of the total number of plats involving improvements actually had improvements installed prior to final approval, and what percentage was covered by performance or security bonds. This temptation should be resisted for two reasons: Firstly, because the number of cases examined is small, and yet does not constitute a sample. Secondly, because the significant percentages in this instance are the "horizontal" ones, i.e., the percentages of improved subdivisions that are accomplished by different methods in a particular community. Nonetheless, it can validly be concluded from this table that actual installation and posting of bond are the predominant methods of insuring physical improvements in this group of communities, with performance or surety bonds being the most frequently utilized.

The second part of the questionnaire was directed toward finding out the business relationships between developers and bonding houses and the characteristics of the bond market in various localities. To this end, a series of questions was asked. These are enumerated below with the number of affirmative and/or negative answers given by the communities.

1. To your knowledge, have developers experienced any difficulty in securing performance bonds? Yes - 9; No - 12. (In the remaining five cases, the answers could be placed neither in the "yes" nor in the "no" category because, although the regulations provided for bonding, in practice, other methods had been used.)

2. If developers have had difficulty, for what period of time has it existed?

   For the last six months - 2

   Since 1951 - 1

   Since 1946 - 5

   No time indicated - 1

TABLE I.

	Total No.of Plats 1952*	No.of Plats Requiring Improvements	Improvements Installed prior to final plat	Performance or surety Bond	Cash Deposit	Certified Check	Negotiable Bond	Spl. Assessment	Other
California									
Kern County	22	22	6	15		1			
Long Beach	11	11	1	8	1		1		
Pasadena	4	4	3	1					
San Mateo	5	5	4					1	
Santa Monica	1	1				1			
Connecticut									
Stamford	198	16		14		2			
Iowa									
Ames	9	7	1		1				
Davenport	26	13		11		1		1	
Kansas									
Wichita**									
Kentucky									
Ft.Thomas	8	8	6	1		1			
Lexington & Fayette Co.	33	33	8	19		6			
Louisiana									
New Orleans	209	7		6					1[a]
Maine									
Portland	3	3		3					
Michigan									
Flint	5	3		2	1				
Saginaw	9	9	7	2					
New Jersey									
Montclair	32	3	2			1			
New York									
White Plains	3	3		3					
No.Carolina									
Greensboro	25	25	25						
Ohio									
Dayton	44[b]	11		11					
Montgomery Co.	60	60	1	51					8[c]
Oklahoma									
Okla. City	25	25	1	24					
Tulsa Co.	56	56						X[d]	
Pennsylvania									
Mt.Lebanon Tp.	12	12	6					6	
So. Carolina									
Greenville	41	2[e]		1	1				
Virginia									
Alexandria	67	11		2	2				7[f]
Washington									
Tacoma	4	3		3					

* - Includes plats of previously developed sites and resubdivisions.
*\- Numerical data not given.
a - Contract with general contractor who was bonded.
b - Includes 3-mile jurisdictional area.
c - Personal bond posted.
d - Special assessment districts created. Number not given, but apparently most subdivisions are improved in this manner.
e - Improvement provision in ordinance enforced beginning October, 1952.

3. In your opinion, have developers been denied bonds because they lacked adequate security?

   Yes - 6

   Probably - 1

   No - 1

   Don't know - 1

4. Other comments and appraisal of the situation. (In this question interest was expressed in personal judgments on such things as whether or not bonds are easier to secure for certain types of improvements than for others, e.g., water as compared with sidewalks; and how much depends upon the reputation of the developer.)

The answers to the questions in the second part fall immediately into several different groups:

I. Communities where developers have experienced little or no difficulty in securing performance bonds (i.e., those that answered no to the first question).

II. Communities where performance bonding, though authorized, has not been used (those that answered neither yes nor no to the first question).

III. Communities where developers have experienced difficulty in securing performance bonds (those that answered yes to the first question).

IV. Communities which at one time or another have considered performance bonding but which at present are utilizing other arrangements for the establishment of tangible physical improvements in new subdivisions. (These are in addition to the cities and towns listed in Table I.)

Except for the first question, the significance of the answers in the second part also does not lie in their numerical distribution. Question one -- displaying a ratio of twelve localities having no difficulties with performance bonding to nine having some difficulties -- at least indicates that the performance bond is a successful device in nearly half the cases examined. But again, it is impossible to make any valid generalizations on the basis of this ratio because of the small number of cases involved.

The most interesting and informative answers were found to question number four, which dealt with local observations. Communities in all four groups responded enthusiastically and submitted plentiful illustrations. The information presented below under each of the four group classifications for the most part con-

sists of answers to question number four.

Group I. Communities where developers have experienced little or no difficulty in securing performance bonds. A minority of the twelve communities in this group made little or no personal observations on the bonding situation in their areas. It is probably fair to conclude that in these instances the arrangement had been working smoothly for some time. In a number of cases, however, amplifying statements were made, as indicated. Further light will be cast upon these examples if Table I is referred to for information on the extent of subdivision activity in each area.

Long Beach, California - No comment.

Pasadena, California - No indication of any difficulty at any time. However, the observation is made that 1952 was not a representative year.

San Mateo, California - No comment.

Santa Monica, California - This city has had very little experience in this field in recent years for the reason that little or no acreage remains in the city. For the same reason, subdivisions present very little risk to the subdivider or the bonding concern, so that it may well be that this community has enjoyed a preferred status. In any case, the planning director had not heard of a single instance in which a bond had been refused. In the one case of subdivision in 1952, a certified check was presented by the subdivider, a well-to-do builder, to expedite matters and to save the cost of the bond.

Davenport, Iowa - "Housing has been in such demand that developers are certain of selling their additions - hence no difficulty has been encountered in securing bonds for any phase of building except in very extreme cases." It is the opinion of the planning engineer that in those few cases the developers had been denied bonds because they lacked adequate security.

Portland, Maine - Portland requires the developer's bond for street (including gravel), sidewalks and sewer construction. "We have no knowledge of any developer experiencing difficulty in obtaining a bond for a bond-approved development."

Flint, Michigan - No comment.

Dayton, Ohio - This is another instance where most of the subdivision activity in the past year has taken place outside the city limits. Although the city plan board has the responsibility of approving or disapproving plats within a three-mile jurisdictional area, the county planning commission is responsible for securing bonds for all plats beyond the city limits. (See report of Montgomery County, Ohio, following.)

Inquiry was made of some of the engineers and developers who had worked on subdivisions within the city limits and none of them reported that they had had any difficulty in securing bonds.

Montgomery County, Ohio - This area displays the highest rate of subdivision activity of all the communities in our study. In this area also were posted the largest number of performance or surety bonds. The planning director reported that developers had experienced no difficulty in securing these bonds. In the course of answering the questionnaire, this director conferred with local bonding companies and reported the following observations:

"Local bonding companies find that improvement bonds are a very hazardous risk. However, subdivisions that merely require sidewalks and streets are more readily bonded than those subdivisions that require all improvements, i.e., sidewalks, streets, sewers and water.

"The financial background and experience of the developer is important to the bonding companies. Developers that have had good financial standing and have had experience in putting in improvements have a better opportunity to get bonded than a developer with meager circumstances and little or no experience in developing. Local bonding companies in the majority of instances require collateral as security for the bond. In addition, bonding companies have required that a performance bond be taken on the contractor putting in the improvements."

"Local comments on improvement bonds are: 'They are definitely not a preferred type of risk' and 'they are a hazardous type of bond.'

"Recently the bonding companies have raised another consideration and that is the area in which development is taking place. This consideration has arisen because of the saturation of housing in certain areas of the county. As a consequence, the companies will not bond improvements in those areas."

Oklahoma City, Oklahoma - No comment.

Alexandria, Virginia - No comment.

Tacoma, Washington - No comment.

Group II. Communities where performance bonding, though authorized, has not been used.

Ames, Iowa - The procedure now in practice in this city is to not accept the final plat until improvements are installed and paid for.

Wichita, Kansas - In this city, neither completed improvements nor bonded guarantee have been insisted upon prior to final plat approval, although one or the

other is required, according to the adopted regulations. Currently, all utilities and paving improvements are made on the basis of special assessments. The planning director reports, however, that these improvements are not ordered in unless there is sufficient building activity in the area to assure continuation of the project. In cases where storm drainage problems occur within a development, the city has required that the developer complete the necessary improvements prior to final approval of the plat. The planning commission has from time to time attempted to put the subdivision requirements into effect. However, it has, in the past, been successfully argued that the requiring of performance bonds will limit the field of development to large-scale operators. It has also been pointed out that whereas the city can secure bonds at a 1 1/2% interest rate, the individual must pay 4%. It is believed by a local observer that in the not too distant future some change will have to be made in the current practice because the major portion of the municipality's bonding power is now being absorbed by special assessments.

Greensboro, North Carolina - Improvements in all cases of subdivision in 1952 were installed prior to final approval. A suggested arrangement on two developments now pending is for the developer to secure a performance bond from the contractor which may then be assigned to the city.

Township of Mt. Lebanon, Pennsylvania - Although the subdivision ordinance permits the township to accept bond in lieu of improvement, the township has always required improvements, or petitions for them (to be paid by special assessment), prior to issuance of building permits.

Greenville, South Carolina - Another instance of extensive extraterritorial subdivision activity. Although the requirement of making improvements prior to the approval of the final plat is in the regulations, they do not apply outside of the city limits and have not been enforced until the last three months.

Group III. Communities where developers have experienced difficulty in securing performance bonds. It is in this group especially that the replies to question number four were complete and detailed. In some instances, respondents went to considerable trouble to report accurately upon the performance bond market in their communities and to document their replies with letters and specific illustrations. Some made the request that the information they had furnished be handled prudently. In order to pass on the lessons learned in these various places and, at the same time, to observe the request for discretion, letters of the alphabet have been used in reporting upon the cities and counties in this group.

A. "The bonding situation in A apparently began to 'tighten' about two years ago. This may have resulted from the fact that prior to this time, the county was extremely lax in the matter of requiring subdividers to live up to contractual agreements for subdivision improvements. Now the county takes a firm stand in this matter, and requires the subdivider (or the bonding company) to fulfill the agree-

ment. At the present time, a subdivider is generally required to produce liquid assets before a bond will be issued to him. The type of improvements involved does not appear to affect this situation."

B. "Surety bonds only have been required by this board since August 1950." No further comment.

C. "One developer seems to have had no difficulty. Another has."

D. "We have found the difficulty experienced by subdividers in obtaining performance bonds is due mainly to the red tape and delay the bonding companies have to go through in getting progress reports on the construction and in getting final release of the bond. The system we have worked out with the bonding company is as follows: The bonding company sends the subdivider a letter asking him to fill out a 'progress report.' If the work is all completed, he is instructed to send the filled-out progress report to us. We refer it to the road engineer, or to the city engineer for checking. After receipt of their statement that all improvements have been installed satisfactorily, we are authorized to sign a progress report, thereby releasing the bond and send it back to the company. Although this system seems to be working better than the previous one, it is still rather cumbersome, and results in considerable delays at times."

E. "It is the view of the largest bonder (who issues four bonds out of six) that 'speculators' are the only developers who need bonds. Subdividers bonded by this company in 1952 are all natives of E, and are thought to be exceptionally 'dependable.' Agents declare, however, that reputation and 'family background' would not be an important factor except in borderline cases. Largest bond made in 1952 was for a subdivision whose developers paid nothing to the landowner, their father, until all houses were sold.

"Bonding agencies are extremely cautious in writing bonds to assure improvements in new subdivisions. One agency must submit applications for such bonds to its home office in City J for close scrutiny. Bonds apparently would be executed more readily for curbing and sidewalks, say, than for street pavement or underground utilities."

F. "The practice in connection with required permanent improvements for land subdivision in F has been installations by the proprietor, or in lieu thereof, petitions filed for such improvements. These include pavements with curb and gutters, sewer, water, sidewalks, street trees and street signs. Proprietor must enter into an agreement with the city that no property will be conveyed unless it is written into the conveyance that the improvements for which petitions have been filed are agreeable to and approved by the consignee.

"If the proprietor elects to have the city install the sewers, the proprietor must install certain temporary improvements such as graded streets and gravel or stone surfacing after the sewer has been installed.

"In practice, most subdividers prefer to have the city install the major permanent improvements, but they want to put in street trees, street signs and temporary roads themselves. It is for these temporary improvements that performance bonds are required. In the first subdivision since 1946, there was some difficulty in getting performance bonds. Corporate bonding companies still don't like to bother with them. However, it is becoming less difficult and it is suspected that bonding companies are furnishing the bonds because the local insurance and bonding companies want them to. I think it would be quite another thing, however, if such bonds were to cover installation of permanent improvement mentioned."

G. In the community of G, the planning director arranged for interviews with two of the most prominent developers in the area who gave him information based on their own experience in obtaining bonds and their knowledge of the experience that other developers have had in trying to obtain bonds for subdivision improvements. Following is a slightly paraphrased report of the interview with each developer:

Developer No. 1. "This developer spoke from his own experience and supplemented that information by inquiring of other developers concerning the matter of obtaining bonds to cover the cost of housing development improvements. He said that it was virtually impossible for the average developer to obtain a bond, and the only developers who find it at all possible are those who are quite wealthy and have an outstanding reputation in the building industry. For the average developer, the bonding houses require that he have as much collateral in the way of negotiable bond or first-class stock to cover the amount which they would write any bond for the surety of the completion of improvements within a development. The conditions to their bonding would be:

1. That there be a performance bond based on a given length of time for the completion of the work.

2. That both the developer and the contractor would have to be bonded in order to insure the risk.

3. That there be a maintenance bond on the improvements for a period of three years.

An example of a developer considered wealthy was a developer in the area who is estimated to be worth $2 or $3 million. The bonding company will write a bond for such a person in the amount of $400,000 or $500,000 without the same requirements as those imposed upon the average developer. Generally speaking, however, the developer whom I was interviewing maintains that it is virtually impossible for the average developer to obtain a bond, and that it is much better for him to raise the money and deposit a certified check and provide for arrangements with the municipality to release sums from this deposit as the improvements are installed."

Developer No. 2. "The second developer verified all the information that had been obtained from the developer in the first interview. He gave me, in addition, some personal opinions as to the reasons why bonding companies are hesitant about issuing bonds on developments. This man happens to be a very close friend of the head of the K insurance company, and learned from this insurance official that their company has adopted the policy of not issuing any more bonds on developments. Apparently, it is rather hard to obtain from the official the reasons for such a policy, but the developer is of the opinion that it is based upon the uncertainty of the approval of subdivisions that are granted by municipalities, which results in the time in which the developer is able to carry the project to completion being very uncertain, and in many cases, running from three to seven years.

"This developer, for instance, gave examples of two tracts of land he has that have been held up by the municipality since 1946, because of a technicality for extension of sewer facilities into the tract. He indicated to me that he has had over $70,000 tied up in this tract for that length of time. The subdivision for the tract had been approved subject to the utilities being satisfactory to the town and the town engineer, but the developer was never able to carry out the development because of the town's and the town engineering department's inability to arrive at a decision to extend a trunk line sewer into the area.

"A second tract which this developer owns was approved by the planning board, and he was then prepared to go ahead with the development. However, he has been delayed three years on this project because of a state highway right-of-way which, as proposed, will affect the project in some particular way.

"The developer believes that examples such as these are the reasons behind the bonding company's opposition to bonding development improvements because of the many various ways municipalities can delay the completion of a development after it has been approved by the planning board. In many cases such action by the municipalities has seemed purely arbitrary. The time element for completing a project is one of the basic factors that concerns a bonding house.

"In answer to one of the questions, 'Is it easier to secure bonds for certain types of improvements such as water, compared with sidewalks?' the developer's answer was that it is easier to secure bonds for improvements which are the last to be installed in the development, such as a pavement and curbs. Even when a developer can get a bond, the high rate of interest he must pay, plus the conditions of requiring additional bond to cover the sub-contractor and a maintenance bond for a period of three years, makes it extremely impractical even to conisder bonding the improvements. This results in the developer having to deposit a large sum of money in escrow in a bank which, in the opinion of the developer, is not good business, and is extremely hard for the majority of the builders to comply with.

"He indicated that the planning board has cooperated with the builder in permitting a developer to deposit a certified check and release sums from this deposit as the improvements are made, is as good as any arrangement that he is

aware of. The developer made the statement that in his opinion the bonding restrictions, plus the rather prevalent arbitrary manner in which most urban municipalities treat a developer, has resulted in their going farther into the suburban areas to find tracts in municipalities where such requirements are not in existence, and there attempt to work out arrangements with the municipality for carrying out a development."

H. "Do not believe the type of improvement is considered. Depends on reputation of developer."

I. In this community, performance bonds are not required in lieu of actual installation, but maintenance bonds are. The observation was made that "water and sanitary sewer bonds are not too difficult to obtain when the city water and sewer department is involved. Street pavement bonds, on the other hand, are subject to much question and scrutiny before issuance. Reputation is important, but a financial balance sheet is even more so. Local lumber companies often play an important part in I with respect to subdivision development. They are the silent partners in providing funds to the individual developer."

Although the community of I was not able to include a provision for peformance bonding in the subdivision regulations when they were adopted several years ago, considerable investigation was made into that possibility at the time. The local subdividers and home builders objected strenuously to a performance bond provision and many of them stated that one of the reasons they were against the bond was because they felt it would put them out of business. They also admitted that they could not put up the security for the bond. Several of the local bonding companies checked with their national associations and affiliates. After evaluating the local subdividers, the local bonding companies indicated that they would want "blue chip" collateral in the greater number of cases. It is observed that the wisdom of doing this was further emphasized by the information they received from other bonding companies.

Our correspondent has made available some of the correspondence between the local bonding company in I, and their affiliated association. Certain portions of this correspondence have been extracted and paraphrased with the view to making available information of especial interest. In all cases the identity and location of the firms concerned have been disguised.

From local insurance agency L:

> "In accordance with our conversation some time ago, we made some inquiries from our bonding companies as to the rates and requirements for furnishing a subdivider's or developer's bond, should the I Planning Board pass such an ordinance. The M casualty company advised that they would consider each bond on the application and financial statement of the principal; that the rate would be $15.00 per $1,000 on the cost of the improvements for any term up to twenty-four months, or less; but if bond actually guaranteed the actual con-

struction, it would have to be rated on the class of work to be done; they consider them hazardous, and the experience of the principal desiring the bond, as well as his financial position, would be important."

The L agency then went on to say that they were enclosing a letter from N company, who represented two or three big bonding companies. The portion of the letter from the N company stating its policy on performance bonds for new subdivisions is quoted below:

"We have contacted our bonding companies, and they have advised that this type of bond is considered very hazardous because most of the applicants required to furnish such bond are real estate operators who, in order to sell the lots, must guarantee to the municipality that they will put in the necessary improvements required. In cases of that kind, the principal on the bond has to pay for all the cost of the improvements with his own money, and it is, therefore, unlike contract bonds, because under the latter the contractor receives payment for doing the work.

"The rate for this type of bond is $15.00 up per $1,000, based upon the cost of the improvements.

"However, we wish to advise that none of our bonding companies will accept this type of bond unless the real estate operators or promotors own the property with no loan against it and who have sufficient funds on hand with which to pay the cost of all the improvements to be installed."

The O insurance company, operating in an active area where municipalities had, for a number of years, required the installation of improvements, and where, as a consequence, there had been considerable experience with performance bonding, also submitted their observations.

"The city and/or county will not approve the map for subdivision until such a performance bond has been posted. Generally, they set the amount of the bond in accordance with estimate of the engineer of the city and/or county, plus 20 per cent, and this cost is generally based on what the engineering department computes that it would cost them to do the job. We have not had any experience where they have given any latitude to the subdivider because of any special arrangements or type of machinery which he has available. Our practice has been to accept the figure of the engineer as the price of improvement, and charge our premium thereon.

"Our underwriting of the last decade has been based primarily upon funds for the cost of improvement being available before the bond is written, and either placed in escrow or deposited as collateral to be released as progress payments are to be made, except in cases of highest caliber contractors. We have deleted entirely from our underwriting the prospective profit anticipated from the sale of lot and/or houses, even though commitments have been made.

"It has been the practice locally here over a long period of years to take out these subdivision bonds and install improvements in certain portions of the subdivision and then await receipt of proceeds of the sale of that portion before progressing with the balance of the subdivision improvements, and if this balance never materialized to permit further improvements to lie dormant until it is called to the public official bodies' attention.

"Our most unsatisfactory experience occurred in this vicinity in the subdivision boom of 1927 and 1928 followed by the crash of 1929. We found at that time many subdivisions started in the outlying areas and then just as soon as the bottom fell out of the price of real estate, the work ceased, and nothing more was heard regarding the completion of the job maybe for a period of four to six years. Then someone who had acquired ownership of the land found that improvements were supposed to have been put in prior thereto, and local sureties improved numerous subdivisions in this vicinity."

A final letter of advice comes from P company in a city located in an entirely different part of the country from the previous writer, but which also has experienced a great deal of subdivision activity in the last three decades.

"We would like to call your attention to the fact that the law states that in lieu of the completion of such work previous to the final approval of the plat, the commission may accept a bond in that amount and with surety and conditions satisfactory to it. Both in the city and county, the commission requires a bond equal to 50 per cent of the estimated cost of the improvements. The city estimates the cost at $10.00 per foot for streets and $20.00 per lot for sewers. In some cases the city constructs sewers; however, in many recent cases the city has required the subdivision contractor to construct sanitary sewers along with the other improvements.

"The home office keeps reminding us of the terrible experience which they have on bonds of this type; however, we have discussed this with the city engineer who has been in office for twenty-five years, and not once during his term of office has the city ever made demand on the surety company under one of these bonds. You will note that

the contract states that the contractor will make all of the improvements outlined, but there is nothing in the bond or agreement to the effect that the contractor must pay for all labor and materials in connection with the work.

"In this section, the developer usually owns the land here, and makes arrangement for the mortgage loan company for temporary financing, which usually amounts to approximately 70 per cent of the FHA guarantee. Arrangements are made so that the property can be closed out in the name of the contractor in the event it cannot be sold so that the final loan can be made and temporary financing returned to the mortgage loan company. The permanent loans cannot be made until all of the off-site improvements have been completed."

Group IV. Communities where performance bonding has been considered, but is not now in force. Other methods described.

In the following group of communities the proposal to provide for a performance bonding alternative to actual installation was considered and discarded as being inexpedient at that time. The reasons for the rejection of the performance bond is given in all cases and a description of the method currently in force.

Little Rock, Arkansas - At the time of the adoption of the subdivision regulations the local bonding houses expressed great reluctance to handle performance bonds and recommended that this alternative not be included in the regulations. Of the four plats recorded in 1952, three were approved in view of the past record of the subdivider and on the basis of an oral agreement.

Baltimore County, Maryland - At the time that a bonding provision was under consideration in new subdivision regulations, the member of the planning commission charged with investigating this technique arrived at the conclusion that if a developer's credit was satisfactory he could borrow sufficient funds to enable him to undertake an adequate section of his development; if not, he probably could not get a performance bond anyway.

Baltimore County was the scene of considerable subdivision activity in 1952, with a total of 125 plats recorded, comprising 4,607 lots. The average number of 37 lots per subdivision reflects the policy of permitting a relatively small proportion of the approved preliminary plan to be submitted as a final plat, which is often done in order to cut down the amount of tax deposit required of the developer.

Instead of performance bonds, Baltimore County requires a public works agreement which involves the deposit of actual cash covering a portion of the prospective improvements. The deposit shall be in cash or certified check in amount equal to the aggregate cost of the proposed work plus overhead charges. The amount of

this deposit will be based on the following formula:

(A) Estimated principal deficit for water main extensions (if any).

(B) Estimated principal deficit for sanitary sewers (if any).

(C) Cost of water services.

(D) Cost of sanitary sewer house connections.

(E) Estimated cost of storm drains and connections.

(F) Estimated cost of curbs and gutters and street paving.

This agreement must be negotiated before the approval of the final plat by the planning commission and the county roads engineer. The agreement covers water mains and services, sanitary sewers, house connections, storm drainage facilities, and the construction of roads or streets. When the public works agreement has been approved, the developer can proceed with his building construction without having to wait until all the public improvements have been installed. The planning director reports that with minor variations this public works agreement set-up has been in effect for nearly five years, and in one only very minor instance, involving a one street subdivision in which no houses had been constructed, has a developer defaulted on his contract.

Sewer and water installations are accomplished through the Baltimore County Metropolitan District which is really a sanitary district organized for this purpose. The city of Baltimore furnishes water to the metropolitan district and provides maintenance for the district's water distribution system. The district enabling act empowers the county commissioners to fix an annual front-foot assessment on all properties abutting on a water main, sewer or drain, for the purpose of paying the interest and providing a sinking fund for the bonds issued. The act also empowers and directs the commissioners to make charges for connections to the water supply, sewerage or drainage systems. There are three arrangements that private developers may use. The act states that each new project shall be self-supporting within a reasonable time after its completion. If estimates of the expected revenues show that assessments and charges will not support the cost of construction, the project cannot be undertaken unless the residents requesting the extension of new lines agree to finance the deficit. Under the service extension agreement, the developer deposits with the metropolitan district the full cost of the utility extensions before houses are built in the subdivision. After the construction of the utilities and houses, the developer is given a refund to the extent that the project is self-supporting. calculated on the basis of the proportionate cost of the utility for each property connected and normal assessment levied.

The second arrangement is often used when houses are partially constructed before utilities are installed. By this method the developer makes up any deficit

resulting from the lack of sufficient normal revenue.

A third procedure enables developers to procure all public improvements under a single agreement. After bids have been received on water, sewerage and storm drainage, the developer deposits with the department of public works the deficit, if any, on water and sewage main extensions, plus the total cost of storm drains, street paving, curbs and gutters. Formerly, the developer petitioned for the return of one-third of the cost of storm drainage and one-third of the cost of paving, curbing and gutters upon completion of the project. Since January 1, 1953, however, the procedure has been modified so that the developer has to pay all of the street paving costs with no eventual one-third rebate as previously allowed. The county, however, now pays all the costs of storm drainage up to 48 inch drains where conditions call for piping the surface water. Where conditions are suitable for leaving an open channel, the county will require that the developer give up to 10 per cent of his property for adequate control of water courses. The county will pay for anything needed above the 10 per cent.

Baltimore City, Maryland - The city of Baltimore likewise is obligated to work very closely with the private developers in the paving of streets and the installation of water, sanitary and storm mains and sewers. The procedure in Baltimore is outlined below. It should be noted that Baltimore is a very densely built-up area with no new subdivisions reported for the year 1952.

A. Procedure for Paving of Streets in Builders Developments

1. Builder must make application to enter into agreement for street paving where the builder and the City each pay 50% of the cost of paving.

2. After the agreements have been made, the bureau makes all necessary surveys, draws plans and profiles and advertises contracts for bids.

3. When bids have been received, the builder's share of the cost is estimated by the bureau, and the builder must deposit his share of the cost of the work plus 10% for overhead in advance of the contract being let.

4. The bureau supervises the construction work and after final acceptance the street becomes the property of the City and is maintained by the City.

B. Procedure for Installing Water Supply in Developments

A developer of residential property should make application with the Bureau of Water Supply for the necessary water main extensions well in advance of the time service is desired. Upon completion of the bureau's plans for the installations, the applicant is required to make a deposit of $1.50 per linear foot of main from the nearest existing main to the most remote lot. This deposit is subject to refund at the rate of $100.00 for each house erected within the limits of and supplied

from the extension before the expiration of 10 years from the date of the deposit, at which time the unrefunded balance becomes the property of the City. Before actual work is started the streets must be graded to within one foot of the grade officially established by the City Surveyor.

C. Procedure for Installing Sanitary Sewers and Storm Water Drains in Builders' Developments

1. Builder must make application, asking the bureau to design sanitary sewers to serve his development. He must furnish all pertinent data, such as cellar elevations and corner stakes.

2. The bureau then makes all necessary surveys and prepares the plans at no expense to the builder.

3. Builder must then arrange to have a bonded drain layer or master plumber install the sewer at the builder's expense.

4. The bureau supervises the installations of the sewer, and after final acceptance it becomes the property of the City by a previous agreement signed by the builder. The bureau then maintains the sewers. The bonded drain layers are bonded in the amount of $2,500.

5. The City pays for installation of all street drainage, but if a builder creates a sump in an alley or in private property, he must then provide the necessary drainage structures and connect them to the City drains at his expense."

Raleigh, North Carolina - At the time of drafting the subdivision regulations in this city (1952) the planning commission interviewed bonding companies and found that they would not issue performance bonds to any but the largest construction companies with sufficient collateral. The idea was therefore dropped from the regulations. The director reports that the best control is the fact that all builders want to do business with the commission again; and because the commission can withhold water connections and reimbursement, there has been little difficulty regarding the installation of improvements. The developer must install all improvements, including water, sewer and paving. If he is inside the city limits, he is reimbursed for water and sewer as tap-ons are made. He would not be reimbursed if improvements were not properly installed. According to the local regulations, no improvements are required unless water is desired.

Austin, Texas - Sixty plats were recorded in this city in 1952, none of which contained completed improvements or provided for performance bond prior to approval of final plat. In all cases, cash deposits were made to cover utilities only. In 1946, when the regulations were adopted the planning officials discussed with several subdividers and bonding companies the advisability of using a performance

bond instead of the presently required cash deposit, and at that time it appeared that the easier of the two ways was to use the cash deposit. The subdivision regulations are being re-studied at the present time with the goal in mind of requiring more of the subdivider than is being done at the present time. One of the points under consideration is that of requiring the subdivider to furnish a performance bond covering the installation of water mains, sanitary sewer mains and/or sewage disposal, streets, drainage, paving, sidewalks and grading.

Manitowoc, Wisconsin - Despite the fact that the platting regulations state that certain improvements shall be made by the subdivider, in actual practice neither the improvements nor a surety bond have been required. Currently, special assessments are used for some improvements, but this is not completely satisfactory because it takes quite a while for the public utility commission to amortize its investment in a new subdivision. The director reports that he is of the opinion that it is unfortunate that the regulations have not been enforced because, as a result, there have been unnecessary costs to the city and a considerable number of premature subdivisions.

CONCLUSIONS

PLANNING ADVISORY SERVICE undertook this survey of experience with performance bonds in part because of reports of dissatisfaction from several cities. Examples of the dissatisfaction have been described in the comments quoted earlier in this report.

Before we try to draw conclusions from the answers to this questionnaire, we should recall the reasoning that led up to the use of the performance bond. Unbridled land subdivision as a get-rich-quick scheme has left ugly scars on nearly every major city and many of the smaller cities in the United States.

We are apt to date the heydey of this ruinous speculation as of the twenties -- just before the great depression. Many of the dead subdivisions have revived since World War II, and the outlook has improved. Yet, as most planners know, there are still older subdivisions that lie as obstacles in the path of normal city growth. In one city of 20,000 population, 10 per cent of the area of the city - 50 per cent of the best residential topography -- is tied up in a dead subdivision recorded in 1890, more than sixty years ago. Planners point out that dead land can be brought back to life through urban redevelopment. This is an expensive solution, and even though the recent Illinois decision gives strong support to the legality of the use of urban redevelopment funds for this purpose, the system of "killing" land through premature platting is not one that we want to perpetuate.

In short, cities have had long experience with uneconomic subdividing, and it must be considered gross negligence if they fail to do everything within their power to prevent it in the future.

On the other hand, it has been the experience that no developer will invest in utilities, streets and other land improvements unless he feels relatively sure that he can sell the property. The city can most simply and directly protect itself from premature subdividing by insisting on assured land improvements. The performance bond is one means of assurance.

The decision then must be made as to where the responsibility for land improvements should be placed -- with the city or with the developer. As it was also pointed out earlier in the report, there is risk involved in land development. The profit to the developer is payment for the risk he takes. It is illogical for the government to assume the risk for which the developer receives payment.

If the government is willing to assume the risk in land development, then, of course, there is no need for performance bonds or any other method of assuring the installation of improvements. In actual practice, nearly all cities do assume part of the risk. Few subdivision regulations include requirements for all improvements and amenities that are needed in a completely developed urban neighborhood.

In commenting on the performance bond then, we must assume that (a) the city has responsibility to prevent premature subdivision s; (b) assured installation of improvements is aproved method for carrying out this responsibility; and (c) some part or all of the risk should be assumed by the developers.

In the subdivision regulations examined a developer is offered at least two, and usually three options for meeting improvement requirements. In every case, he is permitted to construct and install the improvements prior to final approval. If this is done, there is no need for the type of performance bond discussed here.

In lieu of actual installation, the developer is permitted either to put in escrow money to cover the cost of improvements, or to furnish a bond guaranteeing the installation.

On the basis of our premises, the first alternative, complete construction of improvements, is the clearest and simplest for the city to follow. But this may require, in a large development, tying up a great deal of capital for a long time before the developer gets back his first return. Complete improvement costs may run from $1,000 to $2,500 or more per building lot. To reduce this cost of tied-up capital to the developer, the other alternatives are offered.

The cash in escrow (or the certified check) requires the same amount of initial cash as installation of improvements prior to approval. However, if it is administered equitably, the city releases portions of the security deposit as work progresses. The city also gives full approval to the subdivision before the land improvements are installed. In this way, the developer is free to sell lots about as rapidly as he gets them in shape to be sold. He is able to realize part of his profit as he goes along. His costs of development are not tied up until the entire sub-

division is completed.

The final alternative is the performance bond. Under this method, theoretically, the developer buys insurance that the work will be completed. Here also, theoretically, the developer is even better off because he deposits no money as security. The security is furnished by a professional bonding company.

In the first place, it should be pointed out that although no statistical validity has been claimed for the table in this report, over half the cities using performance bonds report no difficulties by the developers in securing bonds. From this we must conclude that the performance bond procedure is workable. Any city in which performance bonds are being proposed for the first time is not justified in pushing it aside because of mere claims that it is unworkable.

On the other hand, we have cities in which there has been trouble. PLANNING ADVISORY SERVICE is grateful to the several members from these cities who have all done a lot to run down the source of the difficulty. The question becomes: Is the difficulty inherent in performance bonds, or are there other reasons?

The complaint that runs like a refrain through the comments is that only developers whose assets are equal to the bond required are able to get a bond. How general this is -- to what extent this is true in those cities reporting no trouble -- we do not know. However, it is not at all unreasonable for a corporation extending credit -- and that is what the bonding company is doing -- to require security.

It may be that in some places, the bonding company is asking for excessive security. But performance bonds are written principally by insurance companies, operating with their customers' funds and under strict insurance laws. It is the company's duty to make prudent investments. To compare, we find it also true that an insurance company lending money on a building mortgage -- without benefit of FHA mortgage insurance -- requires security equal to 150 to 200 or more per cent of its loan. Even with FHA insurance, under the most favorable terms conceivable, the value of the security is equal to or greater than the value of the loan.

Obviously, what the fly-by-night developer would like to have is a chance to get $100,000 credit with $10,000 security. Just as obviously, this is the type of operation which has already given us the vast areas of dead land we have in our cities today.

As a corollary to the complaint against heavy security requirements, we have the statement that the "little developer" doesn't have a chance, only the "big developer" can subdivide. To this objection, we must answer that the little developer is "little" because either (1) he is just beginning his career as a developer and has no experience, (2) he has always been a little developer and has had no experience with large-scale developments, or (3) his large-scale developments have not been successful enough to give him assets or credit acceptable to the bonding

company. In any of the three cases he is turned down by the bonding company as a poor risk.

It is unfair to assume that every small developer has disreputable motives when he asked to be allowed to expand. He is probably completely sincere in wishing to produce a creditable and successful subdivision. Nevertheless, it takes more tangible assets than sincerity and good intent for a developer to weather some of the adverse conditions that he may run into. Without security and experience, the small developer is a poor risk. If he wishes to become a large-scale developer, he might grow into that position by easy stages, not by an overnight jump.

The cost of a performance bond is cited as a disadvantage. The figure of $15.00 per $1,000 is quoted. This is 1.5 per cent. An insurance premium of this rate does not seem excessive. The developer must pass this cost on to the ultimate purchaser of the lot, where it would increase the price of the lot $15.00 to $30.00. Again, this does not seem excessive.

We might compare this performance bond premium with the cost of constructing improvements under special assessment financing. In some areas, public works can be financed by special assessment without penalty. However, in many cities and states where special assessment bonds are not backed by the full credit of the city, special assessment warrants and bonds are discounted heavily. Ten per cent and even up to one-third are not uncommon discounts. Even at 10 per cent, the cost to the lot owner of $1,000 in improvements is $1,100, compared with $1,015, the increased cost due to the performance bond.

Before this survey was started one planner had asked whether or not there had been a recent trend against performance bonds. The tabulation from the questionnaires does not indicate any recent concerted refusal by the bonding companies. At the same time, some of the comments indicate that the availability of performance bonds is dependent upon economic conditions.

This is best illustrated by the comment received from Montgomery County, Ohio:

> "Recently the bonding companies have raised another consideration, and that is the area in which development is taking place. This consideration has arisen because of the saturation of housing in certain areas of the county. As a consequence, the companies will not bond improvements in those areas."

This reaction seems to be exactly the one we would wish to have. It is an automatic functioning of the system to slow down development as the market for lots becomes more speculative. The same controlling function of the market, in reverse, can also be interpreted from the experience in such cities as Santa Monica. Here, the supply of lots is short and quick sale is so nearly certain that no

developer has any trouble getting a performance bond.

Finally, the returned questionnaires and comments led us to the conclusion that there are local factors entering into the picture. Most important of these local considerations is the local market indicated above. There also seem to be sometimes prejudices regarding local and outside contractors.

In a few instances there are unfavorable opinions held by the bonding companies regarding the action and faith of the local government. This certainly merits attention.

In the first place we must not forget that the reason for using cash deposits or bonds in lieu of pre-approval installation is to lessen the tie-up of funds. To secure this advantage, the city must exert every effort to see that the developer's funds and the bonding company's responsibility are released as rapidly as possible. Unless there is an honest effort to cooperate with the developer, there is no reason to require the bond or escrow funds.

There must also be faithful and expeditious processing of subdivision approval by the plan commission and the city council. This is an elementary consideration in good government and needs no discussion. It is not possible, from the little evidence we have, to judge the merits of the two cases quoted in City G. However, we cannot blame the performance bond per se for the adverse opinion a bonding company holds of an individual city.

To summarize the impressions we get from this survey:

Performance bonds in lieu of construction of improvements have proved workable. The bonds are most easily obtained in those localities where the mark et for new lots is good, and are most easily obtained by developers whose credit is high and whose experience is good. Difficulty in getting performance bonds is in direct prop ortion to the risk involved, either because of the uncertainty of the market or the poor credit or lack of experience of the developer. The performance bond does serve a useful purpose in reducing the cost of land development, where there is the sensible requirement that subdivided land must be improved. The bond serves to lessen the cost of tied-up capital, but it can only do this if the city exerts every effort to expedite subdivision approval and to release security promptly.

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