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Optimizing Performance Guarantees



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Optimizing Performance Guarantees

By Wayne Feiden, FAICP

Cities, towns, and counties use performance guarantees in the regulatory permitting and entitlement process to ensure that what gets approved gets built in accordance with all permit conditions. Guarantees ensure that projects meet community standards and requirements even when a developer defaults due to insolvency, bankruptcy, or neglect.

Planners often rely on their attorneys to avoid mastering arcane financial guarantees and, fortunately, few projects fail. However, this means that practitioners may not be prepared to help local officials pick up the pieces when, inevitably, some project stalls or goes bust. Besides the immediate challenges, this reduces social trust in government when trust is already low.

This issue of *Zoning Practice* explores how planners and local officials can leverage performance guarantees to improve development outcomes. It begins with a primer on distinct types of non-financial and financial guarantees before highlighting key challenges and recommended practices for regulatory design and implementation.

A residential subdivision under construction near Tracy, California
(Credit: Jason/Doiy/iStock/Getty Images Plus)





Nonfinancial Tools

Nonfinancial performance guarantees are sufficient for many uncomplicated projects. These tools all limit use and financial returns until a project is completed, which usually creates a compelling incentive for the developer or their successor to complete the project.

Certificates of Occupancy

Certificates of occupancy (CO) can be withheld until a project is complete (permanent CO) or safe to occupy and nearly complete (temporary CO). This is the most common guarantee for ensuring a building is complete and safe. COs, especially temporary COs, however, may not ensure compliance with many approval conditions (e.g., landscaping, infrastructure, ongoing performance, and warranties). For many projects with phased completions (e.g., a subdivision or a large building where the first unit is sold or leased long before the project is complete) and for ongoing permit and performance conditions (e.g., restoration of a gravel pit after use or ongoing drainage facilities performance), reliance on COs may not provide the level of assurance that local governments, investors, and innocent purchasers and renters seek.

Street and Utility Acceptance

Street and utility acceptance can also be withheld until a project, or at least all of the public infrastructure, is complete. Like COs, however, this does not ensure that other conditions are completed.

Covenant Not to Sell

A covenant not to sell is an agreement that the landowner cannot sell any portion of a project (e.g., building lot or condominium) until the covenant is released. A covenant on the entire project prevents a developer from phasing their project, which is critical to financing many projects. A partial covenant, preventing the sale of some lots or units, can provide a strong incentive for a developer to complete the project, but it does not finance the project if the developer defaults. A minor variation is to structure these as liens.

Sequential Approvals

Sequential approvals withhold permits for additional phases of a project. This is similar in many respects to a covenant not to sell. In a sequential approval process, a developer cannot move onto an additional phase of a project until the first phase is fully completed and accepted.

Vision for the multi-phased redevelopment of the Jordan Downs public housing development in the Watts neighborhood of Los Angeles
(Credit: [Urbanist471/Wikimedia](#))

Financial Tools

Financial tools are designed to ensure that there are funds to complete a project if a developer defaults and to incentivize the developer to complete the project even if they are losing money. These tools are essential when nonfinancial tools are insufficient to ensure the completion of a project or when there are severe consequences if a project fails.

Nonfinancial tools do not work well on phased projects, like subdivisions and large complexes, whose early phases are sold or rented to innocent third parties

before full project completion. These projects would not be financially viable if occupancy had to wait for full project completion to generate income. Even in small projects, landscaping and other amenities may not be installed until after the rest of the project is complete. In some cases, conditions may extend for years, such as requirements to maintain drainage

facilities and parks, remove a structure at the end of its useful life, restore a gravel pit or rock quarry, or provide performance and warranty periods.

Furthermore, if a developer defaults or fails to meet their obligations, a project may be held up for long periods of time while legal and financial issues are sorted out. This can create blight and unstable environmental conditions, harm innocent purchasers, and damage public infrastructure.

Financial performance guarantees are straightforward and used both by governments and in commercial transactions. However, the details mean the difference between project failure and success. Typically, the developer posts collateral with a financial institution (grantor) who then grants a financial guarantee to the government or other parties (beneficiaries). They are not, however, guaranteeing project completion.

Irrevocable Standby Letters of Credit

Irrevocable standby letters of credit (LC) are guarantees from a bank or other financial institution to pay a third-party

beneficiary (e.g., government or other third parties) if the developer defaults, with the bank then allowed to collect whatever collateral the developer posted. They are “irrevocable” because the bank’s obligations remain even in the event of a developer bankruptcy, other default, or souring market conditions. These are “standby” because the beneficiary only draws funds when the developer defaults. LCs from well-capitalized and low-risk developers can be inexpensive because it is the expectation that they will never be drawn.

Letters of credit have been around for many centuries. For example, Thomas Jefferson issued a virtually unlimited letter of credit to the Lewis and Clark expedition. These promises were the only practical way that an unknown person could make purchases in an era before wire transfers and credit cards. Furthermore, letters of credit have traditionally been the most popular financial regulatory approval performance guarantee for local governments.

Tripartite Agreements

Like a letter of credit, in a tri-party or tripartite agreement, sometimes referred to as an improvement credit agreement, a developer provides collateral to a bank who then grants the beneficiary, for our purposes the municipality or county, a guarantee of payment if the developer defaults. The primary difference from an LC is that the community must approve payments to the contractor and other vendors and then the principal of the tripartite agreement is automatically reduced by an agreed amount. The developer is still obligated to pay the bank if their collateral is not sufficient, if they exist and haven’t defaulted, but the government has no involvement in that process.

Performance or Surety Bonds

Performance or surety bonds are similar in many respects to LCs. The essential differences are that they are posted by surety companies instead of banks and the surety has a choice when funds are drawn of paying off the face value of the bond or completing the project themselves. Completing a project themselves can be attractive if the surety thinks that they can complete it at a lower cost than the bond

Letters of credit have been around for many centuries.

and any additional amount the local government would spend, but it is very risky since they are responsible for the full cost of the completion, even if it is at a higher cost. Surety bonds tend not to expire or have longer expiration dates than LCs. Sureties have a reputation among local governments for being more aggressive about fighting the drawing of funds from a bond, often requiring legal action to prove a developer is in default.

Statutory creation of performance or surety bonds in the U.S. dates back to the late 19th century (Myers and Najafi 2011), but surety guarantees date back at least to the Code of Hammurabi, c. 2250 B.C. ([*Burdette v. Lascola*](#), 40 Md. App. 720, 1978). In agreeing to pay the bond principal, performance bonds act as if they are a cousin of insurance.

Performance bonds are the dominant financial tool for ensuring that public buildings and projects are built correctly and that bidders and suppliers working with local governments stand by their bids and their construction and supply contracts. They are commonly used for the same purpose in the private market.

Cash Escrows

Cash escrows are a deposit of money with an escrow agent to provide sufficient funds to complete a project if the developer defaults. They are impractical for most projects since they require a developer to fund the project twice, once with cash in the escrow and once as they pay their bills. They are very popular, however, once a project is in its final stages (e.g., final landscaping, time-limited warranties, or small project details) because the cash is on hand, the structure is simple, and the developer is earning at least some limited interest on the escrow principal.

Interest on Lawyers' Trust Accounts

Interest on lawyers' trust accounts (IOLTA) is a variation on escrow where the developer gets no interest and any interest earned supports legal aid. They are attractive because the accounting is simple, but because of the lack of interest return, they are only used for extremely small principals (e.g., funding a few street trees) or very short periods (e.g., when a lot sale is

happening in a few weeks and the IOLTA is guaranteeing some final step).

Property Escrows

Property escrows are another variation where, instead of cash, the escrow agent holds property (ranging from real property or land to the developer's gold bullion). Because property is less liquid, harder to value, and has higher transaction costs, property escrows are less attractive and are unacceptable to most governments. (It remains to be seen if the rise in interest in cryptocurrency will eventually lead to crypto escrows, but currently they are too volatile.)

Financial Performance Guarantee Selection

In many states, especially under their state subdivision control statutes, the developer and not the local government selects the kind of financial performance guarantee they provide. Even under those circumstances, however, governments can detail exactly what format that guarantee is in to protect government interests (see [Best Management Practices](#)).

Outside of subdivision law, where many states require guarantees and establish acceptable forms, a local government may have the flexibility to determine when it wants guarantees (e.g., under zoning for larger projects) and acceptable guarantee types. Unfortunately, since many governments have relatively limited

Infrastructure installation for a residential subdivision in Florida (Credit: halbergman/E+)



Table 1. Factors Influencing Performance Guarantee Selection

Guarantee	Benefits	Challenges
Certificates of occupancy, street & utility acceptance, covenant not to sell, and sequential approvals	Lowest cost to developer; easy to understand; easy to administer	Doesn't ensure full performance of failed projects
Performance bond, letter of credit, and tripartite agreement	Low cost; finances failed projects; easy to collect	Must be well written to work; worthless if expired; no protection if bank fails
Cash escrow and interest on lawyers' trust accounts	High cost; finances failed projects; extremely easy to collect	Must be well written to work; only practical for small costs
Property escrow	Flexible to developer needs	Not a liquid asset

experience in guarantees outside of their use for public buildings, often what they want is based on a single story of a failed guarantee and may not reflect their actual risk. Any kind of guarantee can work when well crafted, and any kind can fail if not carefully crafted ([Table 1](#)).

Performance Guarantees in Practice

Performance guarantees have often, but not always, protected municipalities, counties, and the public. Understanding when things have gone well or not provides lessons to apply to practice. Most planners have their own examples or borrow from those of other communities to explain why performance guarantees are critical, even when they add a couple of percentage points to construction costs.

When Things Go Wrong

The construction of a 60-story residential building at 161 Maiden Lane, in Lower Manhattan, New York City, stopped in 2020 when it was clear that the foundation was unstable and the building leans too much to make it habitable (Lorenzini 2026). There is no clear cost-effective solution to make the building useable, so an investment of hundreds of millions of dollars sits empty, wasting valuable real estate, and creating an embarrassing scar on the New York skyline.

The project was subject to a 78.5-million-dollar surety bond designed to protect

the interests of one of the private contractors. However, such a guarantee will not solve the problems if it is insufficient, does not protect the parties who can take action, or does not follow the proper procedures ([Pizzarotti, LLC v. FPG Maiden Lane LLC](#), 2025 NY Slip Op 35087(U), Sup. Ct. N.Y. County).

When Things Go Right

In 2020, the developer of the Northview Subdivision at Village Hill in Northampton, Massachusetts, defaulted on their obligations to complete the infrastructure in the small residential subdivision, and contractors filed mechanics liens and claims for unpaid infrastructure costs. As a result, homeowners already living in the subdivision experienced localized flooding and a lack of promised streetscape improvements.

Because of that default, the City of Northampton called, or demanded payment on, the tripartite agreement. The city also refused to release covenants not to sell on two lots without sufficient infrastructure to serve them. After a negotiation with the bank that provided the financial guarantees and held mortgages on the covenants not to sell lots, the bank paid the guarantee principal and additional funding for the release of the covenants to the city. This allowed the city to hire designers and contractors to complete the vast majority of the subdivision infrastructure. After a little over two years of angst and suffering among the early residents,

the financial performance guarantees ensured a successful outcome.

When the Outcome Is Mixed

A consortium of municipalities in Western Massachusetts created the regional ValleyBike Share. They obtained transportation funding for capital equipment but understood from the start that operating and future capital equipment replacement funding was uncertain. They were prepared to take a risk and proceed with no guarantee of the program's long-term success. As a result, in negotiating with the first vendor, the consortium had limited leverage to obtain vendor-provided financial performance guarantees.

The largest guarantee that the vendor could obtain was \$250,000 to support a program with \$1 million in government-funded capital improvements. The consortium agreed since there were no other viable vendors and because the consortium would own the capital equipment and the software if the vendor failed.

Unfortunately, the vendor defaulted on their obligations and entered receivership. The consortium then collected the full

principal. With only limited funding, however, the program went on hold for two years until a new vendor and new financing could be obtained. The financial guarantee helped with the transition and protected the capital investment, but it was not enough to avoid the break in service.

Financial performance guarantees are only as useful as the credit of the institution behind them and the ability to collect. The ValleyBike Share letter of credit, issued by a Canadian bank with an excellent credit rating, included a provision that allowed it to be governed and interpreted by Massachusetts law, where ValleyBike is located. The LC declared that the bank would allow the lead municipality to draw the funds simply by declaring that the vendor had defaulted, without the bank asking for any proof. A beneficiary is still vulnerable to claims that funds were unlawfully collected (Klein 2007), but diligent care can minimize this risk while ensuring that funds are immediately available to address a default.

Minimizing Government Risks

Financial performance guarantees can

The Northview Subdivision in Northampton, Massachusetts, in default (Credit: Wayne Feiden)





A ValleyBike bike-share docking station in Northampton, Massachusetts (Credit: Wayne Feiden)

be negotiated for many government purposes, even when not required by law. The City of Northampton wanted to purchase development rights on a parcel of agricultural land, but it didn't have the funds to commit to the purchase until a grant came through, and the seller was not willing to wait for an irrevocable commitment. When faced with that circumstance, the city sometimes partnered with land trusts who would provide a guarantee to the seller that the sale would go forward regardless of future grants. When land trust partners were not available, a private party was willing to provide a guarantee.

The private party requested that their bank grant an irrevocable letter of credit. That allowed the city to sign a binding purchase and sale agreement, knowing that, if the grant was not awarded, the city could fund the purchase with the letter of credit principal. Fortunately, the grant was awarded, and there was no draw on the letter of credit. That guarantee, provided at a significant risk but with a low out-of-pocket cost to the private party, ensured that valuable agricultural land was preserved forever.

The Challenges

Performance guarantees are powerful devices to ensure that what is promised gets delivered. All guarantees, however, come with some risks. These risks can be mitigated, if not virtually eliminated, by optimizing performance guarantees to protect local government and minimize exposure for innocent parties.

Nonfinancial Tools Provide No Funding

Nonfinancial performance guarantees do not provide funding to complete a project if a developer defaults. They rely on incentivizing an insolvent developer or their successor in interest by providing a bigger return to the developer to complete the project than to walk away. Unfortunately, developer defaults can be messy, sometimes leading to years of delays while those holding interest in the land fight their legal battles. During these years of delay, the condition of partially constructed infrastructure and buildings may be on a downward spiral, and market conditions and construction costs may be changing. As a result, these methods are often not adequate other than for relatively small

projects and projects whose failure poses little risk to a local government.

Financial Tools Are Seldom Insured

Financial performance guarantees are generally not protected by FDIC or state banking deposit insurance. If a bank, surety, or escrow agent is insolvent or has their assets frozen in litigation, guarantees can become virtually worthless at the end of a long line of unsecured creditors (Klein 2007). Communities mitigate this risk by accepting guarantees only from those with the best credit ratings.

Predicting Inflation Rates Is Difficult

Predicting the rate of inflation, especially in the volatile construction and housing market sectors, is extremely difficult as costs typically rise during construction. Many communities who have drawn on guarantees report that, while those guarantees covered most of the costs, they typically had some shortfalls. Communities mitigate this risk by adding a conservative inflation or safety factor.

Defaults Often Happen at a Bad Time

Since developers rarely default when everything is going well, they are typically

defaulting during periods of market turmoil, when costs are rising or the market for their product is contracting. When the value of lots and units is declining, especially in unpredictable ways, a developer is less likely to find new investors and more likely to default. Communities mitigate this risk by requiring guarantees even for projects that appear to have a low risk of failure.

Government Construction Often Costs More

Many governments have higher project costs than the private sector. For example, many states require governments to pay prevailing wage rates for construction projects or have cumbersome bidding laws. Furthermore, governments often have a greater need for legal counsel and a lower appetite for risk. Communities mitigate this risk by requiring that guarantee principals are calculated based on public construction costs, not developer construction costs.

Guarantees Don't Protect All Innocent Parties

Finally, there is often a perception that the local government should be the watchdog of developers and be solely responsible for protecting innocent buyers and renters. Performance guarantee programs are often primarily designed, however, to reduce risks to government, such as from half-finished roads, and only secondarily to protect innocent purchasers and renters. When there is any hit to innocent parties, however, governments face a reputational risk and a loss of social trust and capital.

Understanding risks and risk assessments are an essential part of crafting a financial performance guarantee program. Fortunately, in most states, communities are only responsible for covering costs to the extent they have guarantees in hand, and they do not need to fund any shortfalls. The reality is that most construction projects do not fail, so considering when and how large a performance guarantee is requires a risk assessment or a benefit-cost analysis, minimizing the risk of failure while avoiding adding costs and overburdening a project, which can restrain investment and create its own failure risks (Myers and Najafi 2011).

*Evidence of shortcuts, potentially indicating a developer on the verge of default
(Credit: Wayne Feiden)*



Table 2. Examples of Financial Guarantees in Local Codes

Municipality	Requirements
Fort Worth, TX	Bond, cash/escrow, letter of credit, or completion agreement for any public infrastructure necessary to support a private development. Principal covers 125% of the developer's share of costs to cover change orders. (§9-308 et seq.)
Gainesville, FL	Bond from surety with high credit rating, money/escrow, letter of credit from Florida bank, or construction loan agreement for subdivisions. Principal covers 120% of all estimated costs. (§30-3.39)
Northampton, MA	Bond, cash/escrow, tripartite agreement, letter of credit, or negotiable securities plus a minimum of a covenant not to sell on two lots for subdivisions (other codes authorize performance guarantees for cell towers, stormwater, and wetlands). Agreements must allow litigation to take place in state and allow city to collect simply by declaring that the developer defaulted. Principal covers 120% of municipal cost of project completion. (§290-25.D)
Sebastopol, CA	Bond, cash/escrow, or letter of credit, with the type "at the option" of the city, for subdivisions and selected other code requirements. Principal covers 105 to 110% of all costs plus projected inflation and reasonable expenses. (§16.44.100)

Best Management Practices

Performance guarantees are critical to ensuring that communities get the project that they think they are going to get. A few widely accepted practices can protect both the local government and ease the burden for regulated entities.

Codify Requirements

All best management practices should be included in zoning, subdivision, and any code or regulations that require or allow financial guarantees. Requirements should always be clear to avoid the need to negotiate each guarantee ([Table 2](#)).

Ensure Alignment With State Statutes

Requirements must align with state statutes, while retaining as much local control as possible. For example, in many states, performance guarantees are required for subdivision approval, often with the developer's choice of methods, while zoning and other enabling laws and home rule authority often leave to local governments the decision as to whether and what kind of performance guarantees are required. Dillon's Rule local governments only have the authority in state authorizing statutes.

Home rule local governments often have more jurisdiction but may still be constrained by state enabling statutes, such as subdivision control laws, which limit their discretion.

Establish Clear Triggers for Draws

Code and regulatory procedures should establish two clear conditions that can trigger a draw on any financial performance guarantee:

1. The guarantee is going to expire within a set period (e.g., 90 days).
2. Or the permit authority finds that the developer is in default.

These conditions avoid the need to prove to the bank, surety, escrow agent, or a court that the project is in default. Clear triggers, of course, never replace the need for the permit granting agency to practice their own due diligence and ensure that they are following all requirements.

Require Trustworthy Grantors

Financial performance guarantees should only be accepted from grantors with an excellent credit rating, no problematic litigation, a willingness to accept

the jurisdiction of the courts in the state where the project is located, and a local representative if they are not U.S.-based. Guarantees are usually worthless if the grantor is insolvent or untouchable.

Regulations should establish that the government beneficiary has the sole authority to approve the grantor based on those above criteria. Most communities want to use their own attorneys or an independent agent they approve as escrow agents, not accept an escrow agent who reports to the developer.

Require Indefinite or Auto-Renewal of Guarantee Periods

Performance guarantees should be for unlimited time (common for bonds and escrows), automatically renew (sometimes included in letters of credit and tripartite agreements), or trigger an automatic payout of the principal to the beneficiary if the guarantee is not renewed before the project is completed.

A buyer-beware notice can be added to the chain of title so that during title searches buyers understand that guarantees protect the municipality and not necessarily innocent purchasers.

Require Local Government Approval of Guarantee Language

Code should establish that the local government has the right to approve performance guarantee language. Financial institutions have their own standard forms, and guarantees are a specialized area of law (commercial code) that a general municipal/county counsel may not be an expert in. Consequently, it is critical that local government attorneys analyze the language carefully and ensure all forms, attachments, signatures, and certifications are properly completed.

Ensure Realistic Guarantee Amounts

The cost for a local government to complete

a project when a developer defaults is typically significantly higher than previous independent or private-sector estimates because of inflation, the need to correct any developer shortcuts, and the higher government construction costs. The cost estimates the local government accepts should factor in additional municipal costs, an aggressive inflation factor, and an additional margin of safety. They should be developed in parallel with a government or third-party inspection to catch any problems that may not be obvious.

The guarantee principal must include funds for oversight; insurance for any work the community undertakes; ongoing warranty periods; ongoing performance periods; and final as-built plans, surveys, and legal work. A title search, funded by the developer, and signoffs from utility companies and contractors is critical to ensure mortgages, liens, mechanics liens, and other claims are settled before the performance guarantee or added to the performance guarantee principal.

Periodic reductions in performance guarantees should include all of those margins of safety. The language should be clear that the guarantee will be charged for all the costs of a project default, not only construction but also staff time; legal, engineering, environmental, and survey expenses; bidding costs; and prevailing wages.

Be Transparent About Guarantee Limits

Balancing risk and development costs is part of any project. If a local government does not add the margin of safety discussed above or accepts the developer's consultants cost estimates, it should be transparent about this and acknowledge that government's primary purpose is to protect government infrastructure, and not innocent purchasers, from project failure. A buyer-beware notice can be added to the chain of title so that during title searches buyers understand that guarantees protect the municipality and not necessarily innocent purchasers. Purchasers and lease holders can negotiate with the developer to create their own guarantees when they enter into agreements before a project is complete.

Pair Financial and Non-Financial Guarantees

As a margin of safety, include a covenant not to sell on some number of lots or units (e.g., 25 percent) to provide additional leverage on the developer over and above the financial performance guarantee. All mortgages and liens should be junior or subordinated to the covenant not to sell.

Secure Irrevocable Rights

Obtain an irrevocable right of entry and right, but not obligation, to complete the work on the project and an irrevocable offer of dedication on any streets or utilities, which are intended to eventually become publicly or utility owned. When a developer is in default and missing or there is active litigation, having funding is of little help if there is no right to enter the property and do work.

Prohibit Conflicting Private Restrictions

Ensure that owner association and other private codes, covenants, and restrictions do not have language that will impede the local government from completing the project, such as requiring approval from an owners association to enter or improve

the property. Residents and innocent property owners should have agency in decision-making but not at the risk of the interests of the entire community and the permit conditions.

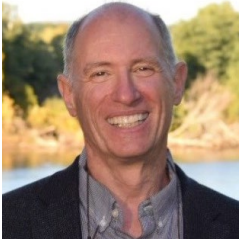
Conclusion

The American Planning Association has issued guidance in the past in this area, most of which is still relevant (Feiden 2016, Feiden and Burby 2002a, Feiden and Burby 2002b, Feiden, Burby, and Kaiser 1989). Unfortunately, as communities try to address competing priorities—including housing, environmental protection, climate change, and economic development—and a loss of public trust, the promise of performance guarantees to ensure the projects fulfil their promises and implement permit conditions has not been fully realized. Communities should implement robust guarantees to protect public interests and follow the best management practices for performance guarantees. At the same time, because guarantees add a small but real cost that drives up the price of housing and economic development, it is critical to balance acceptable risk and reward.



A phased, planned retirement community in McKinney, Texas (Credit: TrongNguyen/iStock/Getty Images Plus)

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The [Center for Resilient Metro-Regions](#), in Landscape Architecture and Regional Planning at the University of Massachusetts, Amherst, works with communities and practitioners on applied research, strategic planning, and design that advance placemaking, sustainability, housing, economic development, and more. The Center advances best practice in planning, exploring new approaches, and refining planning tools and techniques.

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