

**TWELFTH ANNUAL
NORTHEAST SURETY AND FIDELITY CLAIMS
CONFERENCE
SEPTEMBER 20 - 21, 2001**

**HANDLING AND RESOLVING SUBDIVISION BOND
CLAIMS – A BASIC OVERVIEW**

PRESENTED BY:

**LOUIS J. WHITE
THE INSCO/DICO GROUP
17780 Fitch, Ste. 200
Irvine, CA 92614**

HANDLING AND RESOLVING SUBDIVISION BOND CLAIMS – A BASIC OVERVIEW

The Basics

Subdivision bonds

¹ guarantee completion of off-site improvements required by a public entity in connection with approval of a final map or plat to develop residential or commercial real estate. The typical principal is a residential real estate developer and the typical obligee is a city or county².

A developer seeking to subdivide and develop a parcel of land submits a map to the local public entity for approval. If otherwise acceptable, the public entity approves the map but imposes conditions, which are set forth in a subdivision agreement. Common requirements include installation of streets, sidewalks, sewers, landscaping, street lighting and other public improvements. More ambitious agreements may require large items such as construction of parks or schools. The subdivision agreement commonly mandates completion of all work within one year, though the deadline may be extended at the request of the developer with approval of the public entity.

The developer installs the improvements at its expense to a standard specified by the public entity, which also accepts or rejects the work. After acceptance, the developer often maintains and/or warrants the improvements, typically for a year. Once complete, the off-site improvements are dedicated to the public entity which, after any maintenance period expires, assumes responsibility for upkeep, as with any other public improvement.

Subdivision bonds guarantee performance of the subdivision agreement. Penal sums are usually determined by an engineer's estimate of the cost to complete the subject improvements. As work progresses the principal may apply for a reduction of the penal sum to reflect the estimated value of the remaining work.

Once the obligee accepts the work the bond may be reduced, typically to 10% of its original penal sum, to cover any maintenance and/or warranty obligations. As an alternative, the surety may issue a separate maintenance and/or warranty bond.

A bond may cover the entire scope of required improvements or several bonds may cover discrete aspects of the work (e.g. grading, streets or sewers) and/or specific phases of development. In some jurisdictions bonds may be issued after work has started or is even well advanced, to cover the remaining completion cost.

Since the principal is not being paid by an owner to provide the bonded off-site improvements there are no job funds available for use in the event of a default. There is, however, usually a construction loan. Accordingly, sureties often obtain a letter from the

¹ The term "subdivision bond" is used generically to refer to similar bonds which are known by a variety of names, including "plat bonds," depending on the jurisdiction and local preference.

² This short paper cannot, of course, cover all variations and permutations required for a thorough discussion. The intention is to provide a basic outline and orientation only.

lender guaranteeing that adequate funds have been allocated solely for the bonded improvements. The letter further states that, in the event of a default, the surety may access the undisbursed loan funds, without the obligation to repay, to reimburse the cost of completing the improvements. For obvious reasons these letters should indicate the commitment is irrevocable in the event of a loan default or cancellation.

Confronting the Claim

A surety confronts a host of problems with subdivision claims not often faced as acutely, or at all, in other contexts. For example, a project may be years old when a surety receives the claim. The principal has often lost the property, which is now owned by the lender or another developer. Work may have deteriorated due to the elements, subsequent construction or vandalism.

A few obligees are proactive with an organized system of tracking incomplete work and demanding completion promptly after default. More often, claims are made in response to complaints from local homeowners or pressure from members of the obligee's governing board. Consequently, the primary motivation is often political. The surety's contact is commonly the director of public works or city engineer to whom the work is not always as important as appeasing constituents and pleasing superiors. To further complicate matters, the surety's contact often knows little about the nature and scope of the bond, the surety's obligations or the claims process.

Practical tips for resolving the claim

Successful resolution of subdivision bond claims requires a combination of relationship building, clear vision, practicality and creativity. These claims are often difficult to manage by the book or according to a set plan. Accordingly, the following are practical tips for handling and resolving subdivision claims:

1. Establish a good relationship with the obligee from the beginning

Building strong, positive relationships is vital for successful resolution of subdivision claims. Establishing an atmosphere of trust, cooperation, respect, accessibility, responsiveness and professionalism greatly assists the chance of a satisfactory outcome.

2. Give them what they need, not what they want

An obligee often starts by demanding completion of all unfinished work, which might not be the best option. For example, streets and sidewalks built where there are no houses (or even finished lots) will deteriorate, invite vandalism, create an unwanted maintenance obligation for the city and be subject to degradation by heavy equipment used to ultimately build out the lots. It is usually better not to install certain off-sites until a new developer is ready to proceed. Ideally that developer will also sign a new agreement with the public

entity and obtain new bonds. On the other hand, a surety should move quickly to complete or repair those areas which would benefit from immediate attention.

3. Give a little to get a lot

Sometimes the best way to successfully resolve a subdivision claim is to give a bit more than required in one area, providing what the obligee really needs, in exchange for elimination of other (often more expensive) items which are not needed by or particularly important to the obligee.

3. Be flexible

Going strictly by the book can be counterproductive. It is wise for a surety to keep its eyes and ears open, be sensitive to what people are saying, understand what they need (even if they don't realize it) then determine what makes sense under the circumstances. Don't hesitate to suggest reasonable and creative alternatives.

4. Share your expertise

Often the most valuable thing a surety provides is expertise. Obligees are often inexperienced and, therefore, grateful for the surety's assistance and insight. In addition, by working closely with the obligee, the surety can better control the process and can offer a service which lenders, who provide alternative security such as letters of credit, cannot. As a collateral benefit, obligees will sometimes forego a cash payment in exchange for labor and material worth significantly less if the surety procures, oversees and coordinates the work.

5. Pay attention to the inspector

The lowly inspector is often key to successful resolution of a subdivision bond claim since he identifies the scope of the claim and approves all work. Most others, even those for whom he works and to whom he is responsible, will look to him for his expertise and will be guided by his opinion. Respect his role, his expertise and the power he holds.

6. Be prepared, pay attention and make a good impression

Being prepared includes visiting the site ahead of time to locate it, get an idea of the condition of the work and evaluate community standards. The surety should note details such as the sort of patching visible, the type of sidewalk installed, the nature of the surrounding neighborhood and the sort of construction in the area. Finally, the surety should arrive at the meeting early and should attempt to dress in conformity with local practice.