



A ROAD LESS TRAVELED - THE PURPOSE BEHIND PERFORMANCE BONDS

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Whispering Farms is a sprawling, upscale, residential development in suburban Cincinnati. The neighborhood boasts spectacular views of the Great Miami River, wooded lots and large homes. What Whispering Farms doesn't have, however, might surprise you: *Roads*.

That's right, for as long as eight years, the 44 homeowners at Whispering Farms have lived without paved roads. Now, Hamilton County taxpayers are paying the \$150,000 needed to complete the neighborhood's infrastructure. A controversial resolution to what has become a longstanding problem at Whispering Farms.

This result is controversial because such improvements would typically be covered by a performance bond. However, when the developer abandoned the Whispering Farms project, Hamilton County did not immediately execute on the performance bond. By the time Hamilton County went to execute on the bond, the bank that provided the letter-of-credit on the development's infrastructure failed, and there were no available assets to install paved roads. Taxpayers in Hamilton County were forced to bear the burden of this mishap.

Under Ohio law, community developers are required to post a performance bond. The performance bond ensures that the monies to complete public subdivision improvements, such as roadways, are available. In lieu of actually completing all of the improvements at once, the developer may use cash, real property, surety, or a letter-of-credit as a guarantee.

If a cash bond is used, the cash is deposited in an escrow account or with the local government's chief financial officer. Because they tie up a lot of money, cash bonds are used for small projects, such as the completion of sidewalks. If real property is used, the local government usually requires that it be appraised for at least the value of the improvements and be free and clear of encumbrances. If a surety is used, then the developer purchases an insurance policy and pays a premium to cover the cost of the improvement. Should the developer fail to complete the required improvements within a certain period of time, the local government may turn to the insurer to cover the cost of the improvements. If a letter-of-credit is issued by a bank, usually for a fee, to guarantee that the developer has adequate financing to complete the subdivision; the bank then assumes part of the risk of completing the development.

For most developments, a developer also must post a maintenance bond. A maintenance bond extends for a period of time after the subdivision improvements have been completed (usually a year) and represents a portion of the cost of the original performance bond. A maintenance bond guarantees that the developer will maintain the improvements until they are accepted for public use by the local government. These bonds ensure the quality of workmanship and materials used in the subdivision's improvements once they have been constructed. Unfortunately, in the case of Whispering Farms, the roads were never built in the first place; any available maintenance bond would have been useless in this circumstance.

What has happened at Whispering Farms serves as a reminder of the importance and need for performance and maintenance bonds. No matter who is to blame for the \$150,000 roadway debacle, the now-evaporated performance bond should have been executed when it became apparent that the developer would be unable to complete the project. While Whispering Farms may eventually become the picturesque neighborhood that owners and developers once envisioned, the burden it has placed on Hamilton County taxpayers speaks for itself.