RECOMMENDATION:

(a) That the City of Hamilton adopt a pay assurance process for a two (2) year trial period for all Subdivision and External Works Agreements executed by the City after September 6, 2010, to administer and facilitate payments to prime contractors in the event of default of payment by a developer for municipal services constructed under development application through the City’s Subdivision and External Works Agreements.

(b) That the Director of Development Engineering be authorized and directed to:

(i) Include the pay assurance provisions in the City’s Standard Form Subdivision and External Works Agreements; and

(ii) Amend such pay assurance provisions in the City’s Standard Form Subdivision and External Works Agreements as may be required from time-to-time,

all in a form and content that is satisfactory to the City Solicitor. Such pay assurance provisions have been generally outlined for information under Appendix “A” to Report PED10095.
SUBJECT: Incorporation of Pay Assurance Provisions into the City’s Standard Form Subdivision and External Works Agreements (PED10095) (City Wide) Page 2 of 8

(c) That the City Solicitor be authorized and directed to amend and enhance the indemnity clauses under the City’s Subdivision and External Works Agreements, to address any and all liability issues that may arise from the City’s processing and administration of pay assurance claims on behalf of the contractor.

(d) That upon conclusion of a two (2) year trial period, the Director of Development Engineering be authorized and directed to review the need and impact of a pay assurance process and prepare a recommendation report to the Economic Development and Planning Committee, to adopt or reject pay assurance by the City of Hamilton on a permanent basis.

(e) That the City Solicitor be authorized and directed to amend the City’s Fees and Charges By-law, to include a fee of five thousand dollars ($5,000) for the City to process and administer pay assurance claims, which fee shall be paid by the prime contractor at the time it files a claim for pay assurance under the Subdivision or External Works Agreements.

(f) That the Item on the Economic Development and Planning Committee Outstanding Business List regarding ‘OSWC issues respecting subdivision agreement conditions and Pay Assurance’, be considered completed and removed from the list.

EXECUTIVE SUMMARY

This report has been prepared by staff following a request and presentation by the Ontario Sewer and Watermain Construction Association (OSWCA) and the Hamilton and District Heavy Equipment Association to include pay assurance clauses in the City’s Standard Form Subdivision Agreement. The OSWCA is an association that represents prime contractors in Ontario who are largely responsible for constructing roads, sewers and watermains in new development. This matter was referred to staff by the Economic Development and Planning Committee, to report back with a recommendation on their proposal.

Pay Assurance is a term which describes a type of conditional guarantee made by the City and a developer that a prime contractor who has been hired by the developer to construct municipal works under the City’s subdivision agreement in new development will be paid in the event of default of payment by the developer. The concept of pay assurance places provisions in the City’s Standard Form Subdivision Agreement to allow the City to function as an ultimate guarantor of payment when there is a default of payment from developer to contractor. Under the pay assurance provisions, a developer permits the City to draw on the developer’s security, held by the City, to pay a prime contractor for works constructed under the subdivision agreement, where it can be demonstrated by the prime contractor that a developer has in fact defaulted on its payment to the prime contractor for those works.
SUBJECT: Incorporation of Pay Assurance Provisions into the City's Standard Form Subdivision and External Works Agreements (PED10095) (City Wide) Page 3 of 8

Pay assurance has been proposed in other municipalities in southern Ontario and adopted by several including: The Town of Aurora; Town of Newmarket; City of Oshawa; Region of Halton; Region of Durham and City of Brampton to name a few. At this time, staff are proposing that the City of Hamilton adopt a pay assurance process for a two (2) year trial period to allow staff the opportunity to assess the impact to the development community and City administration, in order to determine the appropriateness for pay assurance to continue on a permanent basis. Upon conclusion of a two (2) year trial period, a recommendation report will be forwarded to the Economic Development and Planning Committee, to adopt or reject continuing the pay assurance process.

FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial - In order to account for additional administrative costs to the City to process pay assurance claims, staff are proposing that a fee in an amount sufficient to compensate for staff time cost to administer this process, be determined and collected from the prime contractor at the time a claim for pay assurance is made.

Staffing - None

Legal - In considering Alternative 2 referenced on page 7, it will be necessary for the City to add additional wording to its Standard Form Subdivision Agreement indemnity clauses to absolve the City of any legal implications resulting from adjudication of pay assurance claims on behalf of a prime contractor.

HISTORICAL BACKGROUND (Chronology of events)

On December 8, 2008, the City of Hamilton received a written request by Mahoney International, to appear before the City's Economic Development and Planning Committee, to present a proposal to include provisions for pay assurance clauses in the City's Standard Form Subdivision Agreement. The proposal was brought before Committee at its meeting of February 3, 2009, by representatives of the Ontario Sewer and Watermain Construction Association (OSWCA) and the Hamilton and District Heavy Equipment Association.

The committee referred the matter to staff with direction to meet with the affected parties, review options available to the City and prepare a recommendation report in response to OSWCA's proposal, for consideration by the committee. In following through with the Committees' direction, staff has met with members of the Hamilton-Halton Home Builders' Association, the local banking industry, the construction association and have received input from other municipalities to assess the pay assurance proposal and recommend options to be considered by the City.
POLICY IMPLICATIONS

There are no existing policies affected by the recommendations in this report. This report will, however, expand the purpose for which a developer’s security is retained and used by the City. Historically, a developer’s security has been retained by the City, in order to ensure that the developer’s obligations to the City as required by the City’s subdivision agreement are fulfilled by the developer. Under the pay assurance process, the purpose of the security will be extended to ensure that a developer’s contractual obligations regarding payment to the prime contractor are fulfilled as well.

RELEVANT CONSULTATION

Hamilton-Halton Home Builders’ Association

At the Committee meeting of February 3, 2009, the City received a letter from the Hamilton-Halton Home Builders Association (HHHBA) attached as Appendix “B” to Report PED10095, expressing their opposition to OSWCA’s proposal for pay assurance clauses in the City’s subdivision agreement. The HHHBA advised that pay assurance would place all developers in the same risk category and, as a result, pricing discounts would be lost to reputable developers who pay their bills on time. In addition, the HHHBA does not want to see the City in a position of adjudicating private agreement disputes between their members and prime contractors. They see pay assurance as a form of interference in private contractual agreements. One concern raised by the development industry, is that prime contractors could use the threat of “pay assurance” as leverage to negotiate contract extras in their favour. This threat would give a contractor an unfair advantage over the developer, in the event of a contract dispute. It is for these reasons that staff feel a trial period for pay assurance would be warranted to validate and assess these concerns.

City’s Legal Services Division

Upon review of the proposed pay assurance process, the City’s Legal Services Division has recommended that certain control mechanisms be implemented, as generally described in Appendix “A” to Report PED10095, to ensure that the purpose of the security which is to ensure the developer’s obligations to the City are fulfilled and protect the tax payer, and are not compromised. For this reason, additional clauses will be added to the City’s Standard Form Subdivision Agreement to limit draw under the pay assurance process, so that the security held by the City always represents one hundred percent (100%) of the value of incomplete works, and the full value of the developer’s warranty obligations under the subdivision agreement.
SUBJECT: Incorporation of Pay Assurance Provisions into the City's Standard Form Subdivision and External Works Agreements (PED10095) (City Wide) Page 5 of 8

In addition, the Legal Services Division has recommended inclusion of indemnification clauses to protect the City against any liability, as a result of administration of pay assurance claims, on behalf of a prime contractor from a developer's security. The attached pay assurance clauses set out in Appendix "A" to Report PED10095, are an example of requirements for inclusion in the City's Standard Form Subdivision and External Works Agreements, subject to final review by the City Solicitor.

Other Municipalities

Of the municipalities surveyed by the City regarding the inclusion of pay assurance clauses in their subdivision agreements, the following responded:

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>City of Brampton</td>
<td>Town of Halton Hills</td>
</tr>
<tr>
<td>City of Oshawa</td>
<td>City of Cambridge</td>
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<tr>
<td>Region of Halton</td>
<td>Town of Georgia</td>
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<tr>
<td>Town of Newmarket</td>
<td>City of Niagara Falls</td>
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<td>Town of Aurora</td>
<td>City of London</td>
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<td>Town of Markham</td>
<td>Town of Milton</td>
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<td>City of Vaughan</td>
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The municipalities which did not include pay assurance clauses in their subdivision agreements did so for the following reasons:

(i) The municipalities did not want to become involved in or arbitrate contractor/developer disputes;

(ii) The municipalities felt that the securities under the subdivision agreement should only be used to ensure that the terms of the municipality’s subdivision agreement are fulfilled by the developer, not third party agreements;

(iii) The municipalities did not want to assume any liability and responsibility administering or arbitrating pay assurance disputes; and

(iv) The municipalities did not want the additional administration associated with managing pay assurance in their subdivision agreements.
SUBJECT: Incorporation of Pay Assurance Provisions into the City's Standard Form Subdivision and External Works Agreements (PED10095) (City Wide) Page 6 of 8

The municipalities which have included pay assurance clauses in their subdivision agreements, have done so by incorporating a list of requirements which must be fulfilled by the developer and prime contractor before the City will exercise a draw on the developer’s security, in order to ensure the services have been properly completed and to protect the municipality against any future liability, as a result of exercising pay assurance.

Financial Industry

City staff met with representatives from several of the major banks (Scotia Bank and TD Canada Trust) that provide the City with letters of credit for local developers. Representatives of the Financial Industry advised that from their point of view, they can assume the risk of a security draw by the City. The only way in which the developer’s relationship with the bank would be affected, is if the developer were unable to replace or re-secure the funds that had been drawn by the City.

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

OSWCA’s proposal attempts to add provisions to the City’s Standard Form Subdivision Agreement for the purpose of imposing a legal obligation upon the City to intervene and adjudicate on any contract dispute resulting in a default in payment from a developer to the prime contractor for its cost to install municipal works required by the City’s subdivision agreement. Intervention by the City would take place by way of exercising a draw on the developer’s security, held under the subdivision agreement, to directly compensate the prime contractor for the unpaid cost of completed works within a subdivision.

The pay assurance process has been proposed by OSWCA as an alternative to the present method within the Construction Lien Act. Under the lien system, when there is a default of payment for municipal works on public highway land, a prime contractor may place a lien against the works up to the value of the ‘holdback’, which represents only ten percent (10%) of the value of the works. As a result, a prime contractor’s only recourse for full payment is to initiate litigation against the developer, and at the same time, file a claim with the City against any funds owed by the City to a developer under the subdivision agreement. Upon receipt of such claim, the City withholds payments and security releases to the developer until the disputed payment for the works between developer and prime contractor is resolved in court. This is often a cumbersome, costly, risky and lengthy process for the prime contractor to undertake.
SUBJECT: Incorporation of Pay Assurance Provisions into the City's Standard Form Subdivision and External Works Agreements (PED10095) (City Wide) Page 7 of 8

The purpose of the security held under the City's subdivision agreement is to protect the City and the public by ensuring that sufficient funds are always available to the City, in the event a developer were to default on its agreement with the City to complete installation of municipal services and fulfill warranty obligations within a development. To ensure that the intent of the developer's security is not compromised, in all cases under the pay assurance process, the security held by the City will not be reduced below the value of incomplete works, as well as, the value of all warranty obligations of the developer under the subdivision agreement. In addition, under the pay assurance process, any draw on a developer's security for payment to a prime contractor by the City, will be conditional upon certification by the developer's consulting engineer, that the works to which the payment relates, is completed and also accepted by the City. As well, pay assurance will only be available to prime contractors whose companies operate at "arms length" from the company of the developer.

ALTERNATIVES FOR CONSIDERATION:

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

In reviewing OSWCA's request, staff considered the following alternatives:

Alternative 1

Recommend against inclusion of pay assurance clauses in the City’s Standard Form Subdivision and External Works Agreements and rely on the provisions within the Construction Lien Act, as a course of action for prime contractors to pursue in resolving default of payment issues with a developer. This allows the City to remain distanced from disputes arising out of private contracts, which the City is not party to and forces the contractor to resolve its dispute using the existing legislation in Ontario.

Alternative 2

Adopt a pay assurance process for a two (2) year trial period to assess the impact of pay assurance on the development community and its effect on the City to administer such a process. Administration of a pay assurance process by the City, will involve reviewing and confirming that the requirements shown in Appendix “A” to Report PED10095, have in fact been compiled with by the Contractor and Developer. The City will ultimately be required to make a decision regarding payment to the prime contractor from the developer's security in accordance with these provisions. This alternative provides the City with an opportunity to apply the pay assurance provisions to its development process and assess the potential impacts before permanent adoption of the process. In addition, the pay assurance process should allow default payments to be resolved more quickly than through the court system. A possible disadvantage to the City is the amount of staff time that may be involved to administer the pay assurance process. However, in Hamilton there have been very few instances where a developer has defaulted on payment to its prime contractor. Of the municipalities

Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities.
Values: Honesty, Accountability, Innovation, Leadership, Respect, Excellence, Teamwork
canvassed who have adopted pay assurance, none have yet to administer or adjudicate on a payment default.

Based on the foregoing, staff feel it is within reason to adopt a pay assurance process on a trial basis, as described in Alternative 2 above, which is modelled after pay assurance processes adopted by other municipalities in Ontario.

**CORPORATE STRATEGIC PLAN** (Linkage to Desired End Results)

In keeping with the corporate strategic plan, the recommendations in this report attempt to provide delivery of municipal services in a sustainable, innovative and cost effective manner.

**APPENDICES / SCHEDULES**

Appendix “A” to Report PED10095 “Pay Assurance Provisions for Inclusion in the City’s Standard Form Subdivision and External Works Agreements”

Appendix “B” to Report PED10095 'Letter from the Hamilton-Halton Home Builders Association (HHHBA)

MJt tl
Attach:(2)
Pay Assurance Provisions for Inclusion in the City's Standard Form Subdivision and External Works Agreements

(a) Where the Owner is required under this Agreement to construct Works to service the Land as described under Schedule "B" of this Agreement and where the Owner is required to provide financial security to the City for such Works and where the Owner has entered into a written contract with a contractor, who is operating at "arms length" to the Owner and is not otherwise under the control of, or an affiliate of, the Owner (within the meaning of the Securities Act (Ontario)) to carry out construction of the Works required by this Agreement for which the Owner's security has been placed with the City, the Owner acknowledges and agrees that the City may, over the objections of the Owner, make payments from the Owner's security to the contractor or in to escrow in the case of a dispute between the Owner and contractor, for construction of the Works, subject to fulfilment of the following requirements:

(i) The Works which relate to the outstanding invoice are the Works to be installed under this Agreement and the installation of such works has occurred on a date after the date of registration of this Agreement;

(ii) The contractor has delivered to the City true copies of its written contract and an invoice, addressed to the Owner, for payment of installation of the Works in which the unpaid amount on the invoice is in excess of twenty five thousand dollars ($25,000);

(iii) The contractor has certified that payment of the invoice has been owing to the contractor for a period of at least ninety one (91) calendar days or such longer period of time as may be set out for payment in the contract between the Owner and Contractor;

(iv) The contractor certifies that a written demand for payment has been made to the Owner and a response has not been received by the contractor from the Owner for a period of time that is thirty (30) calendar days beyond the ninety one (91) calendar days from the point in time when the payment for the works was due;

(v) The Consulting Engineer has certified that the Works, which relate to the outstanding invoice, are complete in accordance with the Owner's obligations under this Agreement and has certified the date upon which the contractor's invoice became due and payable under the Owner's contract with the contractor;

(vi) The Director of Development Engineering has accepted the Works which relate to the outstanding invoice as complete in accordance with the Owner's obligations under this Agreement;
(vii) The contractor has executed a Release and Indemnity, in a form satisfactory to the City Solicitor, releasing the City from any and all claims the contractor and Owner may have against the City, and indemnifying the City against any and all claims for loss arising from any source whatsoever resulting from the City’s payment of monies pursuant to this section;

(viii) The contractor has paid a fee of five thousand dollars ($ 5,000) to the City for administration of security payments under the pay assurance provisions of this Agreement.

(ix) The contractor has provided the City with a statutory declaration declaring that all of its sub-contractors and suppliers have been paid in full in relation to the Works which are subject to overdue payment by the Owner; and

(x) The contractor has provided the Owner with a notice, within thirty (30) calendar days from the time a contractor has made a claim to the City, stating that a claim for pay assurance has been filed with the City.

(b) The Owner covenants and agrees to be bound by the above clauses in any contract it enters into with a contractor to carry out construction of the Works required by the City to service the Land under Schedule “B” of this Agreement.

(c) In the instance where a contractor or a sub-contractor or supplier to the contractor exercises its rights under the *Construction Lien Act*, R.S.O. 1990,c C.30, the City shall not process any payments unless the contractor, sub-contractor or supplier first releases any liens and obtains the necessary court orders to dismiss any actions arising out of those liens including any claims which may shelter the contractor’s lien.

(d) Where it is determined that there is a dispute between the Owner and Contractor, then:

(i) Any monies from the Owner’s security deemed to be paid to the Contractor shall be paid by the City into escrow;

(ii) The Owner and Contractor shall submit to arbitration pursuant to the *Arbitration Act*, S.O. 1991,c. 17, as amended; and

(iii) The City shall pay monies out of escrow in accordance with the final award under the *Arbitration Act*, S.O. 1991,c. 17, as amended.

(e) The City shall have no obligation to pay the contractor and where the City makes payment to the contractor from the Owner’s security, at no time will the security be reduced below the value of incomplete Works, plus the full value of the Owner’s maintenance obligation for the Works under this Agreement.
February 3, 2009

City of Hamilton
Economic Development and Planning Committee
c/o Alexandra Rawlings, Clerks Department

Re: Contractor Pay Assurance
Delegation by Ontario Sewer and Watermain Construction Association (OSWCA)

Dear Committee Members:

Today you will hear a delegation from the Ontario Sewer and Watermain Construction Association asking you to consider adding clauses to the Subdivision Agreement and other development agreements for the sole purpose of assuring that members of their association who enter into private construction contracts with land owners in Hamilton are paid in a timely manner for the services which they provide. The Hamilton-Halton Home Builders’ Association (HHHBA) would also be in delegation today were it not for a scheduling conflict with an annual event with Mayor Eisenberger and Mayor Cam Jackson of Burlington. In lieu of delegation, we ask that you please accept this letter for consideration.

The HHHBA believes “Pay Assurance” has no place in a Subdivision Agreement between the city and a private developer. The Construction Lien Act provides protection for contractors and sub-contractors and is tried and proven legislation that has been law in Ontario for more than twenty years. Currently, those developers who pay their bills in a timely manner enjoy an advantage over those who don’t through preferred pricing discounts. This is because of the lack of risk associated with their reputation. “Pay Assurance” puts all developers in the same risk category. In fact it will likely mean the reputable developer incurs additional cost acquiring Letters of Credit where “Pay Assurance” clauses appear in agreements since there would be perceived extra risk to the issuing bank.

The City of Hamilton would become the ultimate payment administrator for servicing contracts. With this responsibility would come risk. Who would be adjudicator should there be a dispute between the parties?

The City of Hamilton’s policy already requires a receipt of payment from the developer’s contractor before securities can be reduced for the respective contract work. This is a strong tool the city can use in case of a dispute between the contractor and the developer without having to cash the security resulting in cost to the developer for additional carrying expense and possible damage to his reputation with the city and financial institutions.

Again, it is our opinion that “Pay Assurance” would be an unnecessary intrusion by a third party into the agreement between the city and a private land owner. Should the committee wish to take any action with regard to the delegation by the OSWCA today, we ask that you refer it to staff for consultation with all stakeholders.

On behalf of the HHHBA, I thank you for the opportunity to voice our concerns on the matter.

Sincerely,

Steve Spicer, HHHBA President