

Financial Assurances (Performance Securities)

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What are Financial Assurances?

- Mechanism to ensure mitigation project is completed
- Mechanism for ensuring resources are available to correct or replace unsuccessful mitigation
- Long-standing practice in other contexts
 - Construction
 - Mining reclamation
 - Hazardous waste facilities



Why Financial Assurances?

- Mitigation projects are complex and results are uncertain
- Mitigation providers can fail or walk away
 - Bankruptcy
 - Dissolution
- Can enable release of mitigation credits before project success is demonstrated

In other words...

Financial assurances help us to manage
RISK

Risk can be managed
NOT eliminated!

Requirement for Financial Assurances

- “[Corps] shall require sufficient financial assurances to ensure a **high level of confidence** that the mitigation project will be **successfully completed**, in accordance with applicable performance standards.”

33 CFR 332.3(n)(1)

Financial Assurances vs. Long-Term Management funding

- Financial Assurances help guarantee
 - Project is constructed
 - Project meets performance standards
- Long-term management funding
 - Resources for management AFTER performance standards are met
 - Help ensure project is sustainable

Assurances for ILF Programs needed

- To ensure mitigation obligations can be secured on the ground



Funding Financial Assurances for ILF Programs

- ADVANCE credits
 - Through credit prices
- ILF Projects
 - Conventional assurances (MS Coastal)
 - Contingency accounts – pooled (OR DSL) & Project specific (VA ARTF)
- Alternative mechanism:
 - Formal commitment by state agency or public authority (NC EEP)



Allowable Forms of Assurances

- Letter of credit
- Escrow account
- Performance bond
- Casualty Insurance
- Other appropriate mechanisms subject to Corps approval



Performance bond

- Contract between sponsor & surety
- Surety guarantees performance OR payment
- Sponsor pays 2 - 5 % of penal sum to surety & enters into indemnity agreement with surety that includes collateral
- Issues: Limited availability, collateral, limits on coverage, potential for performance disputes, duration

Letters of Credit

- Financial institution (Bank) extends credit / guarantees payment for the sponsor's obligations
- Sponsor pays 0.5 – 1.5% of letter amount to issuer & enters into loan agreement with Bank
- Issues: Limited availability, collateral, provides funds NOT performance, duration

Escrow

- Sponsor deposits entire amount of assurance into an escrow account
- Escrow agreement references conditions or contingencies for fund disbursement.
- Corps reviews/approves proposed disbursements.
- Issues: Cost; provides funds but not performance



Casualty insurance

- Insurance policy specifying conditions for payment
- Contract between sponsor & insurer for claims made against the policy up to specified limit
- Sponsor pays one-time premium of 5-10% of cap and agrees to 100% deductible of insurer costs

Casualty Insurance

- Trigger is Corps determination of default.
- Insurer will satisfy a claim in any way necessary:
 - Payment to beneficiary;
 - Implement replacement mitigation
 - Purchase credits from bank or ILF
- Issues: Untested

Claims & Performance:

- Claims require **original agreement AND documentation of default**
- LOC and escrow assure \$ not performance
- Regulators must identify a beneficiary & contingencies
- Bonds and insurance offer performance not just money

Claims and Miscellaneous Receipts Statute

- *31 USC 3302(b)* - Money collected by Federal agencies **MUST** be placed into the U.S. Treasury
- Once deposited in the Treasury it is lost to the federal agency
- Corps should **NOT** receive assurance payouts **DIRECTLY OR** INDIRECTLY because funds will **NOT** be available for mitigation

Miscellaneous Receipts Statute

- Assurances must be payable to a 3rd party **designee** of the Corps who agrees to complete mitigation work, **or** to a **standby trust**



Standby trust agreement

- Independent third party with fiduciary responsibility to the beneficiary
- Relationship established through a valid but unfunded agreement
- Enduring
- When assurances called, funds are paid into Standby Trust
- Trustee disburses funds to beneficiary

Financial Assurance amounts are

- Determined in consultation with the ILF Sponsor
- Based on FULL COST of providing mitigation
- ON-SITE or OFF-SITE
- Could include costs for:
 - Land
 - Planning, design, and engineering
 - Construction & planting
 - Monitoring & maintenance
 - Reasonably foreseeable remedial work
 - Contingencies
 - Legal & administrative



Based on COST of ON-SITE Replacement

ONLY if there are NO concerns regarding:

- Quality of the site & surrounding landscape
- Site ownership/access issues
- Willingness of suitable third-party to complete work at the site



Determining Assurance Amounts for ON-SITE Replacement

- Cost to complete work & meet performance standards
- Mitigation provider develops component cost estimates
- Information sources that can be used to verify estimates include
 - Corps in-house engineering estimates
 - Independent third party estimates
 - Current ILF & bank credit prices in same service area
 - Others tools (e.g. PAR)

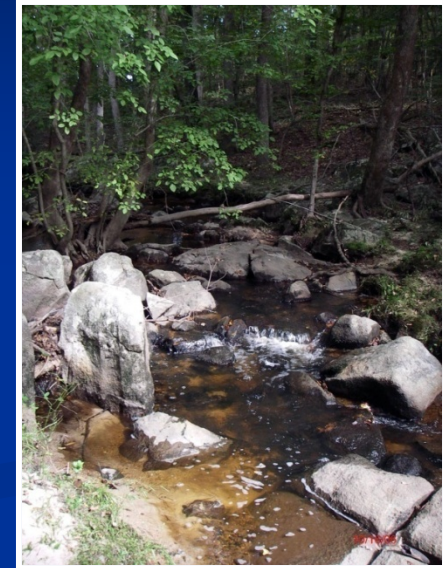
Special Case: Financial Assurances for Preservation Lands

EXCLUDE land costs IF:

- Site is secured
- High value site
- No threats to/from adjoining lands
- No access issues

■ Other costs:

- Physical structures and associated labor
- Surveys
- Legal and administrative costs



Assurances based on OFF-SITE Replacement Costs:

- Project cost at alternative site by a 3rd party
- Includes LAND costs in addition to other project costs
- Sources:
 - Based on estimates for similar projects in the area
 - Others tools



When can Assurances be Released for ILF projects?

- Mitigation Plan MUST specify conditions for release
- Can be reduced/phased-out as project milestones or performance standards are met
- Corps MUST receive notice at least 120 days prior to any termination or revocation

Conclusions

- There are a number of options to assurances
- Assurances guarantee completion or replacement
- Greater the risk, greater the assurance
- Assurances limit risk of failure but CANNOT eliminate risk of failure
- Corps should NOT be beneficiary
- Begin work on financial assurances before finalization of ILF instrument and/or ILF site plan