

White Paper: Revisions to Performance Bond Requirement of the D.C. Green Building Act

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On March 8, 2007, Washington D.C.'s Green Building Act went into effect. With this Act, D.C. became the first major U.S. city to require LEED certification for private projects. The key to any regulation mandating LEED certification is the enforcement mechanism. As currently written, the Act requires that "commercial applicants"¹ post a "performance bond" that serves as a guarantee of LEED certification. The "performance bond" requirement is problematic because no security or bond instrument has been created to guarantee LEED certification. Two options will be proposed for replacing the "performance bond" requirement: (1) financial security; or (2) a D.C. Feebate.

I. The Act's "Performance Bond" Requirement

Under Washington D.C.'s Green Building Act of 2006, after January 1, 2012, non-residential, privately-owned buildings 50,000 square feet or greater must fulfill or exceed LEED for New Construction 2.2 or LEED Core and Shell 2.0 standard at certification level.² Importantly, the Green Building Act also requires "commercial applicants" who must comply with the LEED certification requirement to also submit a "performance bond." If the building fails to meet the LEED certification requirements, "all or part of the performance bond shall be forfeited to the District."

Unfortunately, as written, compliance with the performance bond requirement of the Green Building Act will be extremely difficult, if not impossible for commercial applicants. There are two reasons why compliance will be a problem. First, a "performance bond" is not a security instrument used to ensure compliance with a regulation. Suretyship is a "contractual relationship whereby one person engages to be answerable for the debt or default of another."³ In terms of a performance bond, a surety agrees to guarantee satisfactory completion of a construction project by a contractor. If the contractor fails to build according to the plans and specifications, the surety must (1) complete the project; or (2) allow the owner to complete and the surety then pays the related costs to complete. The D.C. Green Building Act's "performance bond" is, instead, a guarantee that the project will achieve LEED certification.

¹ While not the focus of this white paper, "commercial applicants" needs to be clearly defined. "Commercial applicants" should be defined as the developer of the regulated project because developers are the party with the most control over the LEED certification process. A developer decides at the outset whether to seek LEED certification and has the ultimate decision making authority to determine which green building strategies to include and exclude throughout the design and construction process.

² While not the focus of this white paper, LEED 3.0 will be implemented in 2009. The Green Building Act should be revised to incorporate this new rating system.

³ Sterns, *The Law of Suretyship* 1 (1951)

There is no bond or security instrument that can be substituted for the “performance bond” requirement. During my review of the Green Building Act performance bond requirement, I spoke with international sureties, the Surety and Fidelity Association of America, the National Association of Bond Producers and bond brokers. The individuals I spoke with knew of no bond instrument that exists which could be substituted for the “performance bond” requirement.

Additionally, as part of my work for Green Building Law Update, I have closely monitored major green building regulations. To my knowledge, no municipality has successfully required a “bond” as a guarantee of certification. Interestingly, Arlington County, through its bonus density program, requires “financial security (in the form of a bond or letter of credit or other form approved by the County Attorney)” as a guarantee that LEED certification will be obtained. To date, two developers have had to comply with the Arlington County “financial security” requirement. A copy of one “financial security” was obtained from Arlington County and clearly is a letter of credit.

II. Enforcement Mechanism Options

There are two options for replacing the “performance bond” requirement with a new enforcement mechanism. The first option is to replace “performance bond” with “financial security.” Under Sec. 6 (c) of the D.C. Green Building Act, two alternative instruments are permitted in lieu of a performance bond: a letter of credit or cash in escrow. Thus, if “performance bond” was replaced with “financial security,” then “financial security” can be defined as an “irrevocable letter of credit from a financial institution authorized to do business in the District or evidence of cash deposited in an escrow account in a financial institution in the District in the name of the licensee and the District.” Additionally, (c) under Sec. 6 can be struck under the proposed rule.

While creating a “financial security” requirement is the easy answer, it may not be the best solution. Recent economic turmoil has created financing and cash flow problems for many developers. As a result, it may be extremely difficult and burdensome for developers to provide letters of credit or escrow in amounts up to \$3,000,000 (the maximum requirement under the Green Building Act). For comparison, under the current “performance bond” requirement, a developer of a 72,500 square feet privately owned nonresidential building that costs \$28,000,000 would be responsible for a \$560,000 “financial security” or “performance bond.”

The second option is to replace “Sec. 6 Performance Bond” with a new enforcement mechanism: the Feebate. Portland, Oregon is currently in the final stages of implementing a Feebate green building regulation. Essentially, under the Portland Feebate, projects that do not achieve LEED certification are charged a fee. The proposed fee will be in the range of \$0.51 to \$1.03 per square feet. If a project achieves LEED Silver certification and implements specific green building strategies, the fee is waived. If a project achieves LEED Gold or Platinum certification and implements specific green building strategies, the project receives a rebate that increases with the level of certification.

A Feebate properly incorporated into the D.C. Green Building Act would resolve two problems. First, the Portland Feebate fee amount is less onerous than the current “performance bond” fee. For comparison, under Portland’s proposed fee structure, a developer of a 72,500 square foot privately owned nonresidential building that costs \$28,000,000 would be responsible for a fee between \$36,975 and \$74,675.

Additionally, a Feebate would contribute directly to green building development. An additional criticism of the current “performance bond” requirement is that the enforcement mechanism creates an inherent conflict of interest because those that would determine forfeiture of bonds would also directly benefit from the forfeiture. If forfeited, performance bond funds are to be “deposited in the Green Building Fund.” Under Sec. 8 of the Act, the Green Building Fund is to be used, in part, for “staffing and operating costs to provide technical assistance, plan review, and inspections and monitoring of green buildings.” If Green Building Funds are used strictly for the Feebate, or even for a combination of the Feebate and education purposes, the conflict of interest will be eliminated.

III. Conclusion

The D.C. Council should be commended for the forward-thinking Green Building Act. By simply passing this important Act, D.C. has become a leader in the green building industry. As stricter requirements are phased in over the coming years, certain revisions are necessary to ensure a smooth transition for D.C. and the green building industry. The D.C. Green Building Act’s “performance bond” requirement, as written, is unworkable. Simply put, this type of security instrument does not exist and will not exist for some time, if at all. There are two alternative options: (1) “financial security” or (2) a Feebate system. The latter option is preferable because it is less onerous on developers, will lead to more green buildings and removes the inherent conflict of interest in the current regulation.

If you have any questions, I am available to speak on this very important issue. Thank you for your consideration.

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