



NORTH CAROLINA  
Environmental Quality

ROY COOPER  
Governor

MICHAEL S. REGAN  
Secretary

December 1, 2018

Environmental Review Commission  
16 W. Jones Street  
Raleigh, NC 27601

Re: Mitigation Bonding Reform

Dear Members of the Environmental Review Commission:

The Department of Environmental Quality-Division of Mitigation Services (DMS) is submitting the attached report to comply with Section 8 of Session Law 2018-114. This legislation directs the DMS to review, and if needed, to revise its bidding and contracting procedures for mitigation procurement regarding its bonding policies in the following areas:

1. Bonding or other financial surety required for the construction of a mitigation project shall reflect only the minimum amount necessary to secure State funds provided through a contract between the Division (DMS) and a private mitigation provider.
2. Post-construction bonding periods and amounts shall reflect the minimum length of time necessary to determine with a reasonable degree of certainty project success and the reasonably determined level of financial risk to the State from total or partial failure of the mitigation project.

The first section of the report (Introduction) provides a short summary of the DMS's contracting procedures to procure mitigation credits. The second section (Methods) explains how DMS determines bonding amounts for its projects and the bond duration timelines required in the mitigation contracts. The final section (Actions) discusses any changes that DMS needs to make to comply to this law.

If you have any follow-up questions, please contact me at [john.lucey@ncdenr.gov](mailto:john.lucey@ncdenr.gov) or (919) 609-0989 at your convenience.

Sincerely,

John Lucey  
Legislative Liaison



NC Department of Environmental Quality-Division of Mitigation Services Mitigation Bonding  
Reform Report to the NC Environmental Review Commission

December 1, 2018

Pursuant to S.L. 2018-114 Section 8, the Division of Mitigation Services in the Department of Environmental Quality is required to review and revise its bidding and contracting procedures for procurement of mitigation services and report to the Environmental Review Commission regarding the review and revisions, including the following policies:

1. Bonding or other financial surety required for the construction of a mitigation project shall reflect only the minimum amount necessary to secure State funds provided through a contract between the Division and a private mitigation provider.
2. Post-construction bonding periods and amounts shall reflect the minimum length of time necessary to determine with a reasonable degree of certainty project success and the reasonably determined level of financial risk to the State from total or partial failure of the mitigation project.

## **I. Introduction**

The NC Division of Mitigation Services (DMS) provides cost-effective mitigation alternatives that improve the state's water resources. DMS operates four In-Lieu-Fee programs in which individuals, businesses, or state and federal agencies can purchase mitigation credits to satisfy their federal/state compensatory mitigation permits. DMS assumes the mitigation responsibility and uses the monies collected to produce mitigation projects or purchase mitigation credits from private mitigation banks.

DMS mitigation projects provide credits to offset the development permits. These projects are typically funded in a procurement method called a Full-Delivery project. Full-Delivery projects are contracted through a Request for Purchase of mitigation credits, resulting in mitigation providers submitting technical proposals and sealed bids for projects delivering mitigation credits. The contracts entered into by the mitigation providers require them to acquire the project site, convey a conservation easement for long term site protection, project design, onsite construction and seven years of monitoring. The contract is payable in thirteen milestones, paid by task, based on the number of mitigation credits that the site will provide.

Mitigation projects cover multiple mitigation types, such as stream, wetland restoration, riparian buffer and nutrient offset. Development of natural systems can be costly and have an inherent risk for total credit delivery. DMS's contracts stipulate that the provider will only be paid for credits delivered, thus the private mitigation provider assumes the financial risk for delivering the credits. It is typical that the construction portion of the project is required to carry financial assurances that protect the owner from a contractor going bankrupt or abandoning the project. These financial assurances are usually in the form of performance bonds or other forms of assurance.

## II. Methods

One of the earlier procurement methods for contracting that DMS used is the Design-Bid Build (DBB) process. A project is completed by contracting separately for design, construction, and monitoring. In North Carolina, DBB is administered through the State Construction Office and the contractor bidding the construction portion of a formal construction project is required to get both performance and payment bonds equal to the amount of the construction contract.

Alternatively, the Full-Delivery procurement process is administered through the North Carolina Purchase & Contract Section and does not identify the cost of construction and is bid and contracted as a cost per mitigation credit. Full Delivery procurement has proven to be much a more cost effective and efficient procurement process for DMS and mitigation providers.

Considering the State's potential financial risk, DMS requires financial assurance (Bonding or other approved financial method) from the mitigation provider of 55% of the total Full-Delivery contract. The financial assurances may be retired when the As-Built Design and Baseline Monitoring Plan are submitted and approved by DMS. The 55% was calculated from the typical milestone payment schedule (see below):

### PAYMENT SCHEDULE AND DESCRIPTION OF MILESTONES

Project Milestones and Payment Schedule		
Task	Project Milestone	Payment^ (% of Contract Value*)
1	Categorical Exclusion Document	5
2	Submit Recorded Conservation Easement on the Site	20
3	Mitigation Plan (Final Draft) and Financial Assurance	15
4	Mitigation Site Earthwork completed	15
5	Mitigation Site Planting and Installation of Monitoring Devices	10
6	Baseline Monitoring Report (including As-Built Drawings) <sup>1</sup>	10
7	Submit Monitoring Report #1 to DMS (meets success criteria*) <sup>1</sup>	5
8	Submit Monitoring Report #2 to DMS (meets success criteria*) <sup>1</sup>	2
9	Submit Monitoring Report #3 to DMS (meets success criteria*) <sup>1</sup>	2
10	Submit Monitoring Report #4 to DMS (meets success criteria*) <sup>1</sup>	2
11	Submit Monitoring Report #5 to DMS (meets success criteria*) <sup>1</sup>	2
12	Submit Monitoring Report #6 to DMS (meets success criteria*) <sup>1</sup>	2
13	Submit Monitoring Report #7 to DMS and complete project Close- Out process (meets success criteria*) <sup>1</sup>	10
TOTAL		100

^Vendor is only eligible for payment after DMS has approved the task/deliverable.

\*If site fails to meet success criteria, as indicated in any monitoring report, payment of the monitoring task may be made if a suitable contingency plan is submitted to and accepted by the DMS.

<sup>1</sup>For any year, beginning with delivery of Task 6; if credits are withheld by the regulatory agencies or credits are lost for other reasons, and deliverable payments must be adjusted, then all future yearly payments will be made following IRT yearly release of the credits.

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The financial assurance is due at the Task #3 milestone (Mitigation Plan (Design)). The mitigation provider has an option to produce the mitigation plan before closing on the property

(Task #2, conservation easement) and get paid before task #2 is completed. This allows them to make sure they have their construction area designed before they finalize the conservation easement boundaries. Tasks 4, 5 and 6 make up the construction period and the payout for those milestones totals 35%; adding in the 20% for the property acquisition increases the total payment before construction completion to 55% of the total contract (see highlighted tasks in table above). Riparian buffer and nutrient offset projects typically require vegetative planting only and not heavy construction (financial assurances are on 15% for these types of projects), which reduces financial risk substantially. Once mitigation sites are constructed, sites are monitored and maintained for seven years until all mitigation credits are developed. While mitigation site monitoring can be expensive, less risk exists with an established site.

There is no current requirement for financial assurance during the Post-construction (Monitoring) portion of the project. The financial risk is generally lower during monitoring. If the mitigation provider had to be replaced during monitoring, the balance left in the contract would cover the remaining cost.

### **III. Action**

DMS is in compliance with this law, therefore no action is to be made at this time. DMS will continue to monitor its financial assurance (bonding) method for its mitigation projects and make changes if necessary. DMS also meets with the mitigation providers (engineering firms, consulting firms and private mitigation bankers) on a regular basis to exchange ideas and listen to issues that may affect the procurement of mitigation credits. DMS has always valued the mitigation provider community and considers their partnership a critical part of its success.