

## The Increase in Deposit Protection

The Warranty Program announced in a news release dated December 11, 2002 that as of February 1, 2003 deposit coverage for single family dwellings will be increased from \$20,000 to \$40,000.

ONHWP states that: “Doubling deposit coverage to \$40,000 gives new home purchasers even more protection if a builder fails to close a sale or fails to substantially complete construction.”

This above statement is only applicable if the prospective purchaser has provided in excess of \$20,000 in deposits or installment payments to the builder.

In the majority of purchase agreements, nowhere near \$40,000 is required to be paid by purchasers by way of deposits. Therefore the increased coverage provided by the Warranty Program is illusiary and will rarely be paid out to purchasers of contracts breached by builders, as few if any prospective purchasers pay out \$40,000.00 as a deposit to buy a home. Before this change few purchasers were prepared to provide greater deposits than were guaranteed by the fund. The change merely increases the likelihood that greater deposits may be requested by builders.

What is not dealt with in this “news release” is that ONHWP does not pay for this increased deposit coverage.

Rather ONHWP requires that the builders finance the cost of any increase in deposit refund risk, likely by imposing additional security requirements on builders, similar to those required regarding condominiums under Bulletin No. 28.

By factoring in a “potential” increase in deposit refund risk, ONHWP will add such risk to its requirements concerning builder equity under Bulletin No. 28 with the result that builders may find it even more likely they will be required to provide increased security when they seek to obtain and maintain registration.

To avoid the likelihood of having to provide additional security for larger deposits, builders will have to disclose more information about their annual construction targets than is now the case. They may have to promise, through agreement with ONHWP, not to take significant deposits in order to avoid providing additional security. They may have to disclose the actual purchase price of all of their projected home construction, or the actual deposit amounts they propose to take, so that ONHWP can calculate its potential risk and impose increased security requirements on the basis of this increased risk. This is what currently happens with condominium deposit refund coverage.

This new policy of increasing deposit coverage for single family homes, will make it harder for many builders to maintain their registration, and it will discourage the smaller and medium size builders from entering and staying in the market, because the security requirements for entry and maintenance of registration will be too high.

There is no real benefit to the homeowner by increasing deposit coverage to \$40,000. Few, if any, homeowners who knew that deposit refund coverage was limited to \$20,000 would provide

the builder with more than \$20,000 as the excess over \$20,000.00 would not be protected by ONHWP. Increasing the amount of deposit protection to owners allows builders, who qualify, to use these funds for construction. However the increase in such funding for construction purposes is not really helpful to builders as they must provide the security for such increase, as it increases ONHWP's risk.

Most new home purchaser may not have \$40,000 in cash to provide by way of a deposit or down payment; in addition there is no incentive on the part of homeowners to place so much cash with the builder.

While ONHWP's potential risk may increase, regarding refunding up to \$40,000.00 in deposits instead of up to \$20,000.00, its actual risk does not. For example, if the Warranty Program decided to increase deposit coverage to \$100,000 tomorrow it would not necessarily increase its risk, because it could require security from the builder to cover the risk so that the cost to the builder increases, while the risk to the Warranty Program remains the same.

To deal with this increase in deposit refund coverage from \$20,000 to \$40,000, builders must insist that because ONHWP is increasing this deposit coverage, that they as builders on an individual basis may be entitled to be excluded from consideration, if they do not intend to take deposits any larger than \$20,000.

Any time ONHWP increases coverage either by way of deposit coverage or increased warranty coverage, even though such increases in coverage are unilaterally imposed by the Warranty Program, the builder must pay for that increased coverage by increased costs of registration and renewal through more onerous terms and conditions of registration.

It becomes more difficult for builders to obtain and retain registration as the warranty and deposit coverage expands. The Guarantee Fund held by the Warranty Program and comprised of enrollment fees, registration and renewal fees, is becoming larger while the amount paid out for claims remains modest in comparison to the size of the fund. This is because when coverage expands, the security requirements, which are not part of the Guarantee Fund, are correspondingly increased. This will be the same with respect to the increased deposit refund coverage.

When the Warranty Program increased warranty coverage from \$20,000 to \$100,000 for single family homes and from \$20,000 to \$50,000 for condominium units, it knew the actual risk had not changed, as few claims for single family homes are anywhere near \$100,000 and even fewer claims for condominium units are \$50,000. The increased risk on paper was not one in actuality. The builder was building the same product, therefore the risks associated with it remained the same.

Similarly, by increasing deposit coverage to \$40,000 from \$20,000 the risk to ONHWP may not increase. What will happen is that if such increased deposits are taken by the builder, the Warranty Program will require more information from the builder as to the homes being built in a particular registration period and the dollar amount of specific deposits proposed to be taken.

This being the case, builders will have to become diligent about their own risk assessments, now that ONHWP believes its overall potential risk for single family homes has gone up. If you as a builder see a change in security requirements, chances are it is because ONHWP will now be factoring in the potential risk of you as a builder taking a \$40,000 deposit on any prospective home.

The only significant result of the Program increasing the deposit coverage, will be even closer monitoring of the builder's activities, because the Program will want to know the actual amounts of deposits being taken by builders of single family dwellings, in the same manner as they require this information when determining the amount and kind of security required with respect to condominiums.

What this means is that builders who have to provide enrollment fees when they commence construction or take out a building permit, may now be obliged to provide security at this time. They may now be obliged to provide deposit refund security upon the execution of purchase agreements, while they are pre-selling the subdivision or new homes in question, the amount of which will be based upon what builders propose to take by way of deposits pursuant to these purchase agreements.

Indeed, ONHWP may reach the stage where builders will have to reveal the purchase prices for which they intend to construct and sell their homes at the building stage, so that the Program can calculate security on the basis of deposits being taken and require it to be provided at that time, long before construction commences.

This means that security is being provided in advance of the crystallization in any risk to ONHWP.

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