

Bulletin No.19

Bulletin No. 19 requires that all builders of high-rise and low-rise condominiums are required to provide security to the Ontario New Home Warranty Program (ONHWP), prior to the commencement of construction of these projects, and therefore prior to the beginning of any construction warranties that may arise with respect to such projects.

One of the justifications for Bulletin No.19 is that vendor/builders who are pre-selling condominium units may be taking deposits; therefore part of the security required by ONHWP is to off-set any risk of deposit refund claims that may arise if the project never comes to fruition.

In my opinion what ONHWP is doing by the provisions of this Bulletin, is requiring builders to provide partial or total security for construction warranty claims, at a time when there may only be some deposit refund risk.

The enrolment of a condominium project and the payment of enrolment fees are proper payments to the guarantee fund under the Act; these payments provide risk protection to ONHWP and in particular, they finance the guarantee fund which exists to pay claims builders cannot or will not pay. The security requirements of Bulletin No. 19 are in addition to enrolment fee obligations. The effect of the Bulletin No. 19 security requirement is to protect the guarantee fund's exposure to financial risk, even though the guarantee fund was created to underwrite the risk of warranty and deposit refund claims.

With respect to Bulletin No. 19, if no arrangements are made between ONHWP and the builder limiting what, if any, deposits may be taken by the builder, then the builder will have to provide by way of security, \$20,000.00 per unit times the number of units he intends to build.

For example, if a builder is building a 100 unit condominium project, it will be obliged to place with ONHWP, security in the amount of \$2,000,000.00 which ostensibly covers the risk to ONHWP of deposit refund claims of \$20,000 x 100 units.

However, in many instances the builder may not be taking deposits, or it may be holding deposits in trust, or it may be obliged to lodge the deposits with a financial institution as security for a letter of credit, or it may be taking much less than \$20,000.00 per unit for deposits. Without such specific information being known or discussed between the builder and ONHWP, the latter requires builders to place the \$2,000,000.00 on the 100-unit project by way of security even though it may be that no deposit monies are held or utilized by the builder to fund the construction.

Each builder should decide how much it is intending to require from purchasers by way of deposits, and whether or not those deposits are going to be held in trust, or held as security by a financial institution, to finance the ONHWP security. Where the deposits are used as security for a bank's letter of credit, or the deposits are held in trust by a builder, or minimum deposits are taken, little or no security may be required.

Indeed, to the extent that deposits are going to be held in trust, there may be no need for any deposit security to be provided to ONHWP because there is no risk to its guarantee fund. If the builder is only going to be asking for modest deposits (say \$1,000 to \$5,000 per unit) then \$20,000.00 per unit by way of security should not be required.

Secondly, when condominium units begin to close, the risk of deposit refund claims begins to decline. ONHWP may return a portion of the \$2,000,000.00 to which I have made reference, keeping another portion for what it believes to be the risk of warranty claims in the first year.

The builder does not control how much money will be refunded once the units begin to close; rather, ONHWP determines such amount, and sometimes returns a portion of the security to the builder and sometimes not.

In any event, any portion of the security that is held for warranty claims is held by ONHWP for longer periods than are required. The warranty on units only commences when the unit is occupied and the warranty for the common elements only commences on the registration of the Declaration and Description. The warranty on the units themselves is usually not significant because units are only the inside skin of each unit; they rarely amount to claims of substance. The substantial claims which can arise with respect to condominiums are with respect to common elements. Therefore a large portion of the money that is being held by way of security is for potential common element claims.

In as much as such claims cannot arise until after the registration of the Declaration and Description, ONHWP will often be holding security for long periods of time prior to any exposure to ONHWP by way of common element warranty claims, and the builder does not have access to those funds during that period.

In our example, if a builder is financing a project and has to provide ONHWP with a letter of credit for \$2,000,000, this reduces his construction financing with the financial institution with whom the builder is dealing, by the amount of the letter of credit.

If the builder has made arrangements with a financial institution to borrow \$5,000,000.00 in construction financing but provides security to ONHWP pursuant to Bulletin No. 19 in the amount of \$2,000,000.00, then the actual construction financing available is only \$3,000,000.00 because \$2,000,000.00 is ear marked by the financial institution, for security requirements under Bulletin No. 19.

If ONHWP can request security for common element warranty coverage, then this request should not arise until the registration of the Declaration and Description. Indeed it may not arise even then, as recent regulations prescribe that warranty security requirements only arise when a warranty claim or a potential warranty claim, actually arises.

Registration of the Declaration and Description does not give rise to a claim or potential claim nor does it give rise to a claim that may be payable in the future. Therefore there appears to be no reason why construction deficiency security under Bulletin No. 19 is required at the point of the registration of the Declaration and Description much less years earlier, when the project is being enrolled and the building permit is being taken out by the builder.

Every builder should be aware of the provisions of Bulletin No. 19 before providing ONHWP with substantial amounts of security, because in many instances the security they are providing may not be required or may be in excess of any risk to ONHWP; additionally, the builder may be providing security long before any warranty risk comes into effect, and in excess of any deposit refund risk.

Generally speaking the security requirements of Bulletin No. 19 form an additional cost. The Program already receives enrolment and registration fees from builders which are the premiums for the risk associated with deposit refunds and construction warranty claims. That being the case the requirement for security pursuant to Bulletin No. 19 appears to transfer the risk to the builder. To the extent that security is in place, ONHWP reduces or eliminates any deposit refund risk or construction warranty exposure it may have.

The Bulletin is only a guideline; it is not a regulation or a provision of the Act. Therefore builders may be at liberty to question ONHWP as to what security is required pursuant to the Bulletin and question the amount, if any, of such security in each individual case.

In addition, when reviewing Bulletin No. 19, it may be argued that the builder is being obliged to duplicate security and other requirements already imposed by Municipalities.

For example, pursuant to Bulletin No. 19 the builder is obliged to retain an independent consultant to provide progress reports to ONHWP, as well as a final report as to compliance with architectural plans and specifications and the provisions of the Ontario Building Code, all of which is required by the Municipality pursuant to the provisions of the Ontario Building Code Act and Regulations.

Most developers have already placed with the Municipality large amounts of security for various aspects of development; ONHWP is asking for security for the construction itself, in circumstances where the warranty on such construction may not have commenced.

The security referred to in Bulletin No. 19 obviously relates in part to construction, because why else would ONHWP require certificates from independent professional consultants regarding construction in order to release security provided pursuant to Bulletin No. 19?

My advice to builders of high-rise and low-rise condominiums regarding the Bulletin No. 19 security issue is to ask ONHWP to explain how the security can be reduced and/or eliminated, and why ONHWP requires so much interaction from third party professional consultants prior to the registration of the Declaration and Description and therefore the release of security. The construction warranty risk for ONHWP and the vendor only really begins after the registration of the condominium.

ONHWP is not mandated to monitor the construction of every project or home in the Province of Ontario, but to pay out claims that are made within the warranty period, which warranty commences after possession of the unit or home in question.

Indeed the construction monitoring that ONHWP undertakes might expose it to liability should it miss structural problems that may occur in the construction of a project. Subsequently a Condominium Corporation might pursue ONHWP for having given its stamp of approval on a

project that is structurally unsound. Thereafter, ONHWP assumes this risk and requires the builders to cover this new risk by requiring security from the builder.

Conclusion

Provisions of security and comprehensive reports under Bulletin No. 19 have become the policy of ONHWP. The provisions of this Bulletin may lead to higher costs for the builder by way of terms and conditions of registration to accommodate security requirements, which reduces the builder's financial resources, and may thereby increase the price of the commodity being sold.

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