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HOMEOWNER WARRANTIES: TAKING THE MYSTERY OUT OF THE "2-5-10"

By [Samantha Ip](#) August 3, 2007

Most folks in the construction business have heard about "mandatory warranties" for residential construction. They may know that the Homeowner Protection Office is involved in enforcing the requirements. They may even know that the [Homeowner Protection Act](#) contains the specific requirements for residential builders in B.C.



In my experience, however, many are surprised when they are advised of the specifics of the warranty program, and the responsibilities of the involved parties. The purpose of this article is to shed some light on what this warranty regime is all about.

The Inception and Purpose of the Warranty Regime

Statutory regulations governing mandatory residential builder licensing and home warranty insurance for new homes were passed in January 1999, and implemented July 1, 1999. Since that time, builders are generally required to register with a warranty provider before they can develop and construct residential housing. In turn, a warranty provider promises to warrant the housing built by the builder in accordance with the requirements of the applicable legislation.

Mandatory warranties are in place to protect the end user of residential housing – the homeowner. The warranty requirements are intended to guarantee a certain quality of construction, and to ensure that when defects covered by the warranty are discovered they are corrected at no expense to the homeowner.

Who Does the Warranty Requirements Apply To?

To understand the specifics of the warranty regime, we must look to the *Homeowner Protection Act* and the related [regulations](#).

Those entities that fall under the definition of a "Residential Builder" under the Act must comply with the warranty requirements under the Act. A Residential Builder is defined in the Act as "a person who engages in, arranges for or manages all or substantially all of the construction of a new home, and includes a developer and a general contractor".

Note that the definition of "general contractor" in the Regulation specifically includes a construction manager and project manager, and, depending on the size and type of contract, could include contractors who contract with the owner under a construction management project delivery system.

If a party falls within the definition of a Residential Builder, then this entity must obtain a Residential Builder Licence from the Homeowner Protection Office before carrying on business as a Residential Builder and provide certain warranties to owners of new homes. Securing a license is not automatic upon application by a builder, however, and a builder must satisfy certain requirements and conditions before the HPO will grant a licence.

What are the Requirements for Obtaining a Licence?

The Regulation sets out the requirements which a "Residential Builder" must meet before a license will be issued by the HPO. Generally, these requirements include disclosure of certain information pertaining to a builder's corporate make-up, work product history, training and accreditation of the members of the builder, and criminal convictions or other offences by members of the builder. In addition, the builder is required to provide certain undertakings to ensure integrity of the warranty regime.

The required warranty protection for new homeowners is offered by a handful of insurance companies offering this product in the local market, and prequalification by these insurers of Residential Builder is another condition, perhaps considered the most important requirement, of both receiving and renewing the licence from the HPO.

Upon acceptance of the Residential Builder, the home warranty provider issues a Warranty Certificate, which a developer or builder may provide to each new homeowner.

What is Involved in Securing Warranty Coverage?

Before a warranty provider will agree to provide warranty coverage for a project, it will require a builder to fill out an application which will include information that allows the warranty provider to better understand the risk they are underwriting. This application is similar to, but is a separate process from, the [Licence Application and Agreement](#) required by the HPO.

The successful builder must then enter into an agreement with the warranty provider which sets out the obligations of the builder under the warranty. Note that while the definition of "Residential Builder" under the Act for the purposes of licensing requirements is broad, industry norm has developed such that the "builder" that enters into the agreement with the warranty provider has generally been the developer of the project.

In addition to signing a Builder Agreement with the warranty provider, a builder must also provide indemnities to the warranty provider which will require the builder to compensate the warranty provider for any future expenditures under the warranty.

Finally, the builder will be required to pay certain fees to the warranty provider for writing the warranty coverage.

Obligations under the Builder Agreement and Indemnity

It is beyond the scope of this article to enunciate in detail the obligations of a builder (generally the developer) under a Builder Agreement. The reader should be aware that

these obligations are extensive and typically remain in place for the duration of the warranty.

Typically, a builder has obligations under a Builder Agreement to repair covered defects, or reimburse the warranty provider for repairing covered defects, or otherwise respond to a claim by a homeowner, for the duration of the 10-year warranty program and potentially beyond.

Under an indemnity, the builder (usually the developer) allows the warranty provider to recover any amount paid out by the warranty provider to remedy a default by the builder under the warranty program, along with all reasonable expenses incurred. A warranty provider's ability to recover against the builder will typically endure for as long as the builder has obligations under the warranty program and the Builder Agreement.

So What Exactly is Covered?

Many have heard of the "2-5-10". The "2-5-10" reference is derived from the specific warranty coverage which a homeowner is entitled to under the regime.

According to the Act and the Regulation, warranty insurance must include the following coverage:

1. defects in materials and labour for a period of at least 2 years after the date on which the warranty begins;
2. defects in the building envelope, including defects resulting in water penetration, for a period of at least 5 years after the date on which the warranty begins; and
3. structural defects for a period of at least 10 years after the date on which the warranty begins.

As with most insurance policies, however, there are exceptions to the general rule.

The Regulation contains "Minimum Standards of Coverage" which further defines the specific *minimum* warranty coverage for each of the 2, 5, 10 warranty coverage. In other words, within the 2-5-10 coverage under a warranty, the legislation provides insurers with some flexibility on what may or may not be covered within each category. So, for example, the minimum two-year materials and labour coverage does *not* require coverage for all such defects for the full two years. Under the 10-year structural warranty coverage, "structural defects" is specifically defined and, unless the defect falls under that definition, it is not considered a "structural defect" and will not be covered under the warranty.

Most if not all of the warranty programs available today have taken advantage of the leeway provided under the Act and the Regulation, and a careful reading of each warranty document must be conducted to determine the specific coverage afforded by each warranty. What you thought was a straightforward 2-5-10, may in fact not exactly be, 2-5-10.

Finally, the reader should be aware that the Act and the Regulation have provisions relating to mandatory warranty conditions, "permitted warranties" and allowable exclusions have been adopted by the warranty providers.

Are There Any Exceptions to the Warranty Regime?

The answer is "yes". Here are some examples of when the warranty regime may not apply:

Owner Builders

If an individual wants to build a home to live in it, or to renovate the home he or she lives in, then generally, the warranty requirements of the Act and the Regulation will not apply. There are exceptions to this general rule, however, and consideration must be given to each case individually.

Certain Classes of Homes

Certain classes of new homes that are not strata titled may be exempt from the definition of "new home" and may, therefore, be exempt from the requirements of the warranty regime, such as hotels and motels, dormitories, care facilities or floating homes.

While the referenced exceptions are not defined terms under the Act or the Regulation, the reader should be aware that each building must be analyzed in accordance with all requirements of the Act and Regulation. If any of these exceptions can be interpreted as a "dwelling unit", then the warranty requirements will apply notwithstanding its classification as a motel, dormitory, care facility or floating home.

For example, a "dormitory" built by a learning institution will be exempt from the warranty regime as long as the concept is of students living in a number of rooms which do not have sanitary or cooking facilities in the rooms themselves, and the students are required to share sanitary facilities which are located outside of the dorm room. However, if the dormitory is more akin to apartment living (with cooking and sanitary facilities within each dorm or unit), then the building will likely be classified as a "dwelling unit" under the Regulation and the warranty regime will apply.

Rental Purpose

Finally, multi-unit buildings constructed for rental purposes (either owned under a single legal title or strata-titled units held under single ownership) are exempt from the requirements of the warranty regime. However, this exemption is only available if a restrictive covenant, restricting the sale or disposition of any dwelling unit in the multi-unit building for 10 years from the date of first occupancy of a dwelling in the building, is registered against the title of the building.

Practical Implications of the Warranty Program – What Should a Builder Know?

One issue which I have had to consider on behalf of clients is what practical risk management implications the mandatory warranty program has on the construction industry and, in particular, on owner developers.

Parties who sign on as the builder with a warranty provider will typically be exposed to claims arising out of warranties provided under the Act and the Regulation for a period of up to 10 years depending on the type of defect being claimed. In fact, a builder's exposure can extend beyond 10 years since a builder must warrant repairs to covered defects. If a repair is done within the last year of the warranty, then a builder will be on risk after the 10-year period.

In light of the long term risk that a developer may assume by being the "builder" in a warranty program, it would be prudent for developers to consider that risk at the planning stages of a project. It may be possible to assign some of that risk to other parties in the

project by adding supplementary conditions in all owner contracts. Developers should also ensure that the necessary insurance is in place and communicate with their insurance broker on the types of insurance products that may be available. Finally, developers should consider obtaining additional warranties that may be available through the subtrades and product manufacturers which can respond in the event of a defect.

Conclusion

It is clear that the warranty regime provides protection to the British Columbia homeowner. The result, most would say, is better quality residential construction, and that is a positive outcome of a well intended program. That protection, however, does have a price, and the price of protection is borne by many players in the construction industry. It does appear that developers, by signing on as the "builder" under the warranty, bear a significant portion of that burden. It is essential for residential developers falling under this regime to be aware of the requirements of the legislation, to understand the risk and to plan ahead.

Currently, the requirements under the applicable legislation are not considered overly onerous and, generally, as long as a builder is able to qualify with a warranty provider for warranty insurance, the HPO will issue a license to the builder. Amendments to the existing legislation are expected in the near future which will allow the HPO to administer more stringent licensing requirements under the Act and the Regulations. We expect these amendments to be in place before the end of this year.

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