



SUMMARY OF LAMBDA ALPHA INTERNATIONAL WEBINAR

HOME OWNERSHIP IN TRANSITION – A CANADA-CALIFORNIA COMPARISON

October 26, 2023

Introduction:

Moderator Tim Youmans, a former LAI president and LAI Sacramento Chapter President, introduced the topic of the webinar, “Home Ownership in Transition: a Comparison between Canada and California.” The event was presented by the Lambda Alpha International Global Initiatives Committee.

The webinar focused on the challenges surrounding the building of condominiums in California and other states. Condominiums became a popular home option for those who wanted to own a home but couldn’t afford single family home ownership or didn’t want some of the responsibilities involved.

Condos are also high-density housing options that provide numerous homes within one footprint, addressing some of California’s smart growth policies.

In California, there are several challenges to overcome:

- Maneuvering stringent building codes and regulations.
- Environmental, zoning, and land use regulations.
- NIMBY (not in my backyard) attitude of residents.
- High costs for both land and construction.
- Affordable housing requirements.
- Other economic factors.

There are few condos built in California except those that are very high end. In Canada, condominiums are a key force in housing. This is not the case in California and many other states.

This webinar focused on two key areas that can be addressed through public policy and legislation.

- Construction defect risks and litigation.
- Project financial risk.

Discussing these topics were the following presenters:

- **Ken Cameron** has held numerous planning and intergovernmental relations positions in Ontario, British Columbia, and Vancouver. Cameron was the chief executive officer of the Homeowner Protection Office, a provincial Crown Corporation. The corporation, now a part of BC Housing, was dedicated to maintaining consumer confidence in the residential construction industry. His role in the seminar was to present an overview of the differences between Canada and California.
- **Tami Boeck** is a real estate and construction partner at Stoel Rives LLP. She is the former chairperson of the firm's Real Estate Development and Construction Group. Boeck has over 30 years of experience representing clients in construction law and project development. She presented the issues surrounding construction defect litigation in California from both the developer's and homeowners' point of view.
- **Wendy Moir** is the CEO and Registrar of the Home Construction Regulatory Authority in Toronto. Previously, Moir was the Vice President/Registrar at the British Columbia Housing Corporation. Her work has led to the implementation of important initiatives to increase the quality of residential construction and enhance consumer protection. Moir outlined Canada's approach to home warranties and construction defects and how they may apply to California.
- **Kerry Nagy:** Kerry has over 20 years of experience with Travelers Insurance Company of Canada. He is responsible for several home real estate products in Western Canada. Nagy has been instrumental in developing warranty legislation and deposit protection insurance. His topic was financial risk and the use of deposit proceeds to finance insurance and construction projects.

Ken Cameron:

For many years, the North American dream has been to own a secure single family home where you can raise a family without being ruled by a landlord. It is also a good financial investment but is not the housing solution for everyone in every stage of their life. Young families and seniors often cannot afford a single family home due to elevated costs.

The construction and sale of homes is a big economic driver in the North American economy. Areas where more people own their homes offer a higher level of stability. Single family home sprawl is a key issue in North American cities and runs counter to many smart growth goals. It is also increasingly difficult for many residents to afford single family homes:

- In California, the percentage of homeowners between age 25 and 75 decreased from 50% in 2000 to 44% in 2021.

- In Canada, the percentage of households that are owner occupied declined from 69% in 2011 to 66.5% in 2021.

Condominiums may be a solution for many potential homeowners as they offer the benefits of home ownership at a lower entry cost. They are attainable for a broader range of households who are excluded from buying due to the rising cost of single family homes. And yet, between 2011 and 2021, the percentage of new condos built in California was just 3%; in Canada, it was 38%.

Part of the explanation is the fact that there are different risk profiles between the two countries in two respects.

The first is construction defect risk for consumers. In California, building projects are not backed by performance bonds, and quality depends on the builders meeting building codes and standards. In Canada, most provinces have a builder licensing system and a third-party home warranty programs covering construction defects for up to 10 years.

The second is financial risk for builders, investors, and insurers. In California, any down payment of more than 3% of a home's sale price is refundable. This enables homebuyers to put money down on several properties, even if they only plan to purchase one, which jeopardizes project financial stability. In Canada, buyers initially put down 10% of the sale price, which is non-refundable after 7 days and escalates to 10 % and higher as the development proceeds. Builders can also get insurance on these deposits, which allows the deposits to be used to help finance the project.

Multi-family home ownership offers benefits, including ownership choices for smaller households, lower-priced ways to build household equity on the ladder of financial stability, improved security of tenure, and more equitable access to the tax and other benefits of home ownership choices. Smart growth benefits include more mixed-use developments, smaller and more compact developments more easily served by transit, higher levels of community safety and the attainment of green building and sustainability goals.

A key question is whether there is a role for government, which usually arises when the market is not producing needed goods and services. Previous examples of such intervention include involvement in the automobile industry to respond to quality and safety issues in the 1960s and 1970s, mandatory deposit insurance for banks, and mandatory flood hazard insurance in coastal zones.

Tami Boeck:

Californians increasingly find it difficult to afford single family homes, so alternative forms of ownership housing are needed.

As a result of her practice in California, Nevada, and Idaho Boeck is familiar with how each state approaches construction defect disputes. California has passed two statutes to regulate the relationship between homebuilders and homeowners. The first statute is the Home Builder's Right to Repair (SB800). The second is the Calderon statute.

Right to Repair (SB800) applies to individual residential units built after 2003 and specifies that homeowners can bring an action for valid construction defects. The **Calderon statute** states that homeowner associations with more than 20 units have the right to sue a developer to correct construction defects if efforts to resolve the matter are not successful. In most cases, the provisions of these statutes run concurrently.

Here is how these two statutes are viewed by different participants.

Homeowner perspective: Consumer protection in California is a top priority. Home purchases are the largest financial investments many people make. Many felt that homebuilders were not addressing their concerns regarding construction defects. With litigation being so expensive, the legislature felt there was a need to support homebuyers by forcing builders to repair a defect or resolve the issue before it ends litigation.

Builder perspective: Frivolous lawsuits increase the cost of insurance and housing. There have been no clear standards for defects and no third-party entities to ensure that the applicable standards and codes are adhered to. With the cost of litigation so high in these matters, builders often add extra charges to the cost of a project. to cover all or part of the cost of potential litigation.

Developer perspective: Developers are responsible for financing building projects and have many of the same financial concerns as the builder; they have all the financial risk. Under California law, if the buyer backs out of a purchase the buyer is protected, not the seller. Developers can now purchase bonds as a hedge against this eventuality and can use this money to help finance their project.

The legal perspective: Builders must be licensed, but adherence to construction standards is not monitored and enforced, beyond compliance with building codes. Insurers do not cover warranty claims, and there is no guide defining what qualifies as a defect, so there is a lot of grey area. Builders should use quality materials and expert workmanship to avoid litigation in the future. Homebuyers should purchase the best insurance they can afford to cover construction defects that may arise in the future.

Wendy Moir:

Looking at the experience in Canada may assist in finding new protection processes for California. The four most populated provinces in Canada (British Columbia, Alberta, Ontario, and Quebec), have legislated licensing and warranty programs that protect both parties. The other provinces have voluntary programs. These programs contain some or all of the following protections:

- Warranty/warranty insurance
- Licensing and enforcement
- Research and continuing education

British Columbia has a rigorous program offering warranty coverage up to 10 years on some components and Ontario has a 7-year builder warranty program. There are variations in each program, but they all have the goal of regulating the relationship between builders and homeowners. In most cases, issues with the building envelope or severe structural issues are apparent long before the warranty term is up. There is no equivalent system in California.

In many Canadian provinces, there are government-mandated programs that support consumers. This came as a result of British Columbia's systemic building failure, "The Leaky Condo Crisis," which required the government to step in. The Canadian experience has been about restoring, maintaining and/or enhancing consumer confidence as an essential ingredient in a healthy home ownership industry.

The construction industry is a big contributor to the British Columbia economy, but the Leaky Condo Crisis threatened the social and economic well-being of thousands of households when the voluntary home warranty program was overwhelmed by the financial impact of the building envelope failures. As a result, condo construction ground to a halt. Today there is warranty insurance, strict licensing, and ongoing research and educational programs to reduce systemic failures and the industry has fully recovered.

During this crisis, the government learned that consumer confidence was essential and that condo purchasers were an important sector of Canadian home ownership. Everyone stepped up to the plate to ensure the crisis wouldn't happen again. Home warranty insurers provided backing for builders to correct defects. Purchasers understood they were protected from defects by home warranty insurance at no additional cost to them. Developers understood the need to build better homes and avoid the defects altogether.

Kerry Nagy:

Deposit Protection Insurance plays an important role in multi-family housing in Canada. It helps to level the playing field in the financial relationship between new home buyers and developers by ensuring that risk is shared fairly at the various stages in the marketing and development of new condominium projects. Canada has several safeguards to protect condo buyers and owners:

- Ontario has had the Condominium Act in place since 1998.
- British Columbia passed the Real Estate Development and Marketing Act in 2005.
- Alberta has had the Condominium Property Act since 2018.

A few of the key requirements of Deposit Protection Insurance include presale and deposit requirements, capital stack reconfiguration, construction lender commitment, and consumer protection. The deposit insurance is used to lower financing costs during presale and construction periods.

Q&A

Q: Does the construction defect litigation environment in California affect the number of homes built in total or just the rental properties? Can it have an impact in total?

A: Tami Boeck:

We see investors shifting to rental apartments not for individual sale, like condos. They were deemed not as risky with less litigation due to the presence of savvy investors and lenders in the project. There has been a shift in the last 15 years as more people are retiring to California from different states. Many individual investors are buying multi-family apartments, which may lead to the incidence of litigation increasing.

Q: How could a warranty program be set up?

A: Wendy Moir:

There are a couple of options in use by home warranty programs in Canada. One way is to set it up as a nonprofit organization, as Ontario has done. It has brought in enough capital to cover claims not fixed by the builder. It could also be set up as a product of insurance, as British Columbia has done. It is a competitive insurance market with builders able to choose from multiple insurers providing home warranty insurance to fix defects. The insurance option would probably be the easiest to implement in California. The infrastructure is already set up and there are insurance companies that can take on a program like this.

Q: Are there costs to the government for home warranty insurance products or are they self-funded?

A: Wendy Moir

They are completely self-funded through the enrollment fees paid by builders for home warranty insurance. California is very regulated, so it may be possible to add on the cost to the existing regulatory scheme and set up the framework with multiple insurers offering the same products so the warranty offered to the homeowner would be the same no matter what builder is used. There should be an overall standard in the coverage and the defects covered.

Q: If additional costs are incurred, will it be a financial burden to buyers and reduce home purchases? One of the goals of this group is to see a broader spectrum of buyers entering the market. What are the costs to the builders and homebuyers of the self-funding insurance programs?

A: Wendy Moir, Tami Boeck, Kerry Nagy:

The costs are much lower than getting involved in expensive litigation. It is an efficient system. People buy insurance for a myriad of reasons, but when you look at the cost of the warranty insurance, builders and their clients are getting a lot of value from a 10-year warranty. It can be in the low thousands but will differ based on the type of project. (In Ontario, for example, home

warranty insurance premiums run from \$330 per unit for homes selling for \$100,000 or less up to \$1,745 per unit for homes selling at \$1,500,000 or more.) Also, a big benefit in Alberta is that there is no deductible. A 10-year warranty would cost less for a typical multi-family unit than for a single family home.

Q: Kerry, can you explain how an insurer will evaluate a claim to verify that the owner is properly maintaining the property? How does that work?

A: Kerry Nagy:

Every province is different, but in British Columbia, the owner has the responsibility to maintain the property. If a dishwasher is leaking for three weeks, that is an owner issue, not a builder error.

One of the issues in Alberta is that some believe they do not have a responsibility to maintain the property, which can get challenging. Homeownership is expensive, especially for those who own a big single family home.

In many provinces, there are relationships between the developer and builder, which helps them navigate through claims issues. The underlying responsibility is to ensure the claim is satisfied or at least responded to within 30 days. There is a residential performance person who makes sure that claims representatives have answers for the different types of claims. They make sure that representatives know what differentiates a valid claim from a frivolous one.

Canada heavily relies on building codes; these codes change frequently and continually raise the bar for builders to build to the highest standard and ensure that all codes are maintained.

Q: There are some weak standards in California. What is the difference in standards between California vs. Canada?

A: Wendy Moir

There are two sets of building codes in Canada, national building codes and provincial building codes. They are part of the legislative framework for buildings. The warranty programs are different. Typically, they provide that in the first year or two of coverage, homes should be defect-free. In Canada, insurers, builders, and homeowners have a clear understanding of the legislative building code. It is very concise, and everyone has the same information.

California has more standards than other states; they are very robust. They include the California building code, green building code requirements and sustainability rules. California standards are minimal, yet they are much higher than in other states. There is still a lot of room for argument with many grey areas, which can lead to litigation in some cases. Most builders, if they are aware of liability exposure, prefer to catch issues early when they are cheaper to fix.

There was a guide developed around 2010 that offered a common sense approach to what a construction defect is. The builders would use this as a guide, and it was often given to

homeowners as it also had explanations on how to maintain the property. It was a way to set some standards and guidelines that made it clear to both the builders and homeowners what legitimate defects were.

Q: In the States, we do not have someone, like the insurer, come out and check during key steps of the build-out and check the warranty process as you do in Canada. We fall short, I'd like to know more about that.

A: Kerry Nagy

When I got into the industry 25 years ago, I worked with someone who lived through the “leaky condo” project; he vowed that there would never be another leaky condo in our warranty program. Mandates were developed to be proactive instead of reactive.

In Canada, there are insurance professionals involved in every step of the project’s development. They work with engineers, architects, builders, and other professionals who sign off that builders are constructing a project up to code and standards. Each stage of the project would be reviewed and approved or fixed. There were also tech reps who would monitor and review things again to ensure all installations were proper to avoid claims in the future.

In multi- and single family units, the fit and finish of the home is what people see. Travelers’ warranty program recognizes nothing is perfect, especially when building wood frame and drywall homes in different climates. When a claim is submitted to Travelers or another warranty company, it remains open until the claim is satisfied. If the claim is denied, there are different resolution processes, such as mediation, to help settle the issue before it goes to litigation.

Q: Wendy, can you give us some information on warranty programs that are either mandatory or voluntary in the Canadian provinces?

A: Wendy Moir:

It is interesting because all the warranty programs started off being voluntary, and in some provinces they still are. It doesn’t seem to matter if they are voluntary or mandatory, there are protections in place to deal with construction defects. Since the leaky condo crisis, the British Columbia government has realized that more coverage is better than less, and it was the builders who decided to opt into the programs because they benefit multi-family home purchasers and builders.

What started as a voluntary program in some Canadian provinces was soon recognized as very valuable with many builders opting in. British Columbia has made it mandatory, not just for condos but for single family homes as well. This may very well be a program that could work in California.

Conclusion

Tim Youmans thanked all the participants and presenters.