

# Builder Bulletin 28F

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Tarion Guidelines for  
Receipt and Release of Security  
for OBC Part 9 Freehold Homes

## What This Guideline is All About

This guideline describes how Tarion sets the amount of security collected from freehold builders and the timing of the return of that security. We expect it will apply in most cases. There will, however, be situations where the security we assess and the timing of the return of that security may differ from these guidelines.

## The Security Assessment

Our security assessment for freehold registrants focuses on two key questions:

1. How long you have been a registered builder; and
2. What is your risk assessment rating based on a review of the volume of homes you build (size); the average selling price of those homes; your credit rating; equity; and your history of claims paid.

In general, the longer you have been registered with Tarion and the better your risk assessment rating, the more favourable your security terms will be. The following tables set out how this works:

### Security Model for New Builders and Inactive Builders:

Risk Assessment Rating	Security Required per Home			
	Tenure of 0	Tenure of 1 to 3 years	Tenure of 4 to 6 years	Inactive (0 possessions in past 4 years)
<b>0-20</b>	**	**	**	**
<b>21-40</b>	**	\$20,000	\$15,000	\$10,000
<b>41-60</b>	Up to \$40,000	\$15,000	\$10,000	\$7,500
<b>61-70</b>	\$20,000	\$10,000	\$5,000	\$5,000
<b>71+</b>	\$10,000	\$5,000	\$5,000	\$5,000

**\*\*NOTE: A case by case review will occur for any registrant where the risk assessment rating is at this level.**

## Security Model for Experienced Builders:

Risk Assessment Rating	Security Required per Home			
	Tenure of 7 to 10 years	Tenure of 11 to 15 years	Tenure of 16 to 20 years	Tenure of 21+ years
<b>0-20</b>	**	**	**	**
<b>21-40</b>	\$20,000	\$15,000	\$7,500	\$5,000
<b>41-60</b>	\$10,000	\$7,500	\$5,000	\$0
<b>61-70</b>	\$5,000	\$5,000	\$0	\$0
<b>71+</b>	\$0	\$0	\$0	\$0

**\*\*NOTE: A case by case review will occur for any registrant where the risk assessment rating is at this level.**

### How Tenure Works:

We have grouped builders into three categories: **New, Inactive and Experienced.**

- **New builders** are builders with less than 7 years on the Tarion registry
- **Inactive builders** are builders who have 7 or more years on the Tarion registry but who have not had any possessions in the past 4 years; and
- **Experienced builders** are builders who have been on the Tarion registry for 7 or more years.

Tenure is calculated based on the number of whole years you have been registered with Tarion. So, a builder registered on September 1st, 2017 will have a tenure of 0 years until September 1st, 2018, at which point its tenure will become 1 year.

We may adjust the tenure calculation in cases where it is appropriate to do so. For example, a new registrant with principals who have a long history with a registered builder may be credited with more tenure or have security requirements otherwise reduced. This kind of situation would be dealt with on a case by case basis as a specific security adjustment which would form part of the terms and conditions of registration for the applicant.

### Explanation of Risk Assessment Rating:

In addition to your tenure, we also examine five criteria to determine your base security position: size, average selling price, credit rating, equity and claims paid history. Points are allocated based on your position in respect of each criteria, with more points implying a lower risk to Tarion.

The criteria and point scoring are outlined below and described in more detail in the appendices to this document:

- **Size** (5 to 20 points) – Volume of homes in general is correlated with risk of loss to Tarion. Builders are broken out into 4 size categories for the purpose of this criteria. See appendix 1, “*Determining your Size points*” for more details.
- **Average Selling Price (ASP)** (0 to 20 points) – Claims risks tend to be higher on higher priced homes (for example, deposit risk is higher, and repair costs may be higher). For more details, please refer to the appendix 1, “*Determining your Average Selling Price points*”.
- **Credit** (0 to 20 points) – This criteria awards points for overall creditworthiness based on credit scores of the registrant and indemnitors. See appendix 1, “*Determining your Credit points*” for more details.
- **Equity** (0 to 30 points) – This criteria awards points based on available equity at the time of assessment to meet warranty obligations. We look at the ratio of equity you have per [planned homes plus unclosed homes], and rate it relative to your maximum warranty liability (in most cases that is \$300,000 per home). See appendix 1, “*Determining your Equity points*”, and appendix 2, “*Assessing Reported Equity*” for more details.
- **Claims Paid** (0 to 20 points) – We take your Claims Paid history relative to your peers into account when computing your overall Risk Assessment Rating. See appendix 1, “*Determining your Claims Paid points*” for more details.
- Your overall Risk Assessment Rating is the sum of points assigned to you for Size, Average Selling Price, Credit, Equity, and Claims Paid history.

### Security Adjustments:

The approach outlined above is a guideline. We expect it to apply in most cases, but sometimes there will be unique factors which change the assessment. When that happens we will adjust security terms to more accurately reflect your risk profile. Your security terms, both in terms of the amount of security required and the release terms may be adjusted at any time based on new information.

Examples of factors which could lead to a securities adjustment include:

1. Your customer service track record, including
  - a. Chargeable conciliations, claims paid, and records of delays
2. Your financial situation, including
  - a. Changes to your lender, or lending terms
  - b. Deterioration in your financials, credit rating and/or unusual lien activity
3. Your management/business structure, including
  - a. Changes to your principals, or key management team
  - b. Changes in business product type
  - c. Rapid expansion of your business
4. The nature/status of the project, including:
  - a. The use of new technology
  - b. The use of unusual design elements
  - c. Whether the project is a custom contract home

### When is security taken?

In general security is taken at enrolment. For builders that are **New** or **Inactive** and who are proposing to build 2 or more homes, we may require security to be provided at the time of registration.

### When is security returned?

In general Tarion will return your security once the highest risk claim timeframes have passed and you can show that there are no outstanding problems with the homes under warranty. In practice this means that the return of your security will be tied to the 1<sup>st</sup> and 2d year warranty periods. How long we will hold your security before making a release assessment will depend on your tenure:

- **New** builders with Tenure 0-3 years and **Inactive Builders**: The first release assessment will occur 24 months after the warranty start date. This means your security will be held until we have the opportunity to see (a) if any 1<sup>st</sup> or 2<sup>d</sup> year deficiencies are raised in connection with the home; and (b) how the homes perform over the course of at least two freeze thaw and seasonal cycles.
- **New** builders with Tenure 4-6 years: The first release assessment will occur 18 months after the warranty start date. This means your security will be held for at least 1 year, at which point we will assess release with regard to 1<sup>st</sup> year claims experience.
- **Experienced** builders: The first release assessment will occur 12 months after the warranty start date.

The release assessment will occur within 45 days of the relevant return window. It is important to remember that our release assessment may include a review of the claims status of all enrolments associated with you. We may consider all warranty forms, chargeable conciliations, administrative compliance including compliance with any of the terms and conditions of your registration, and other factors, in determining whether and how much security to release.

Based on the assessment, security will either be entirely or partially released, or retained. In some cases it is possible that security requirements may be increased if the existing claims risk is considered high. If we decide not to release the full amount of security at the appropriate window we will notify you of our decision in writing with an explanation.

### Application of Security:

The security you provide may be used to pay for any warranty default in respect of any of the homes which you have built, sold or enrolled. For example, if you are required to post \$5000 per home for 6 homes, the total amount of security would be \$30,000, and that \$30,000 could all be used in respect of claims on a single home if needed.

### How often Security Requirements reviewed:

The security assessment will be reviewed and updated annually, at the time of your license renewal. You may also request an interim review if you feel there has been a material change to your circumstances that may change the assessment. Tarion may also review your security requirements at any time.

## Form of Security

We will accept the following kinds of security:

- a) Irrevocable Letter of Credit (Tarion format);
- b) Surety Bond (Tarion format); and



Cash security may be acceptable on a case by case basis. If you provide cash security we may require additional security instruments to be registered securing our interest in the cash security at your cost.

Deposit Trust Agreements for freehold projects may also be acceptable on a case by case basis.

### **Collateral Security:**

In certain cases we may accept or require collateral security such as a mortgage of real property. Collateral security options can be discussed on an individual basis. If collateral security is accepted, you will have to assume all of the administrative costs in setting the security up.

### **Blanket Umbrella Level Security**

In general, the security which is provided is specific to the registration and can apply to all projects or units within that registration. For developers who have ongoing and multiple registrations within a single “umbrella”, Tarion may, at its sole discretion, allow for the security to be posted at the umbrella level as an alternative to registration specific security. In this arrangement a global bond will be posted which may be drawn down upon in respect of any warranty defaults within the umbrella. The use of this kind of consolidated security arrangement may result in administrative and security level savings.

## **Appeals**

If you do not agree with the security assessment you may request a management review. If after that review occurs you remain unsatisfied, the security terms will be issued in a form that will allow for an appeal to the independent License Appeal Tribunal.

## Appendix 1 – Determining Your Risk Assessment Score

### 1. Determining your Size Points (0-20)

Your size will be categorized based on average annual possessions over the past five years plus the proposed possessions; as follows:

- You are a **Small** builder if your average annual possessions is between 1 and 10;
- You are a **Medium** builder if your average annual possessions is between 11 and 100;
- You are a **Large** builder if your average annual possessions is between 101 and 300;
- You are a **Very Large** builder if your average annual possessions is greater than 300.
- You are considered **New** if you have never had any possessions before.

Points are allocated as follows:

Builder Size (Unit Count)	Size Points
<b>New (0)</b>	0
<b>Small (0-10)</b>	5
<b>Medium (11-100)</b>	10
<b>Large (101-300)</b>	15
<b>Very Large (301+)</b>	20

### 2. Determining your Average Selling Price Points (0-20)

The Average Selling Price is based on the average selling price for your proposed construction. Once we have your Average Selling Price, we refer to the following table to arrive at your ASP point score:

Average Selling Price	ASP Points
<b>\$1,000,000 or greater</b>	<b>0</b>
<b>\$700,000 to \$999,999</b>	<b>10</b>
<b>\$400,000 to \$699,999</b>	<b>15</b>
<b>under \$400,000</b>	<b>20</b>

Additional security may be required independent of the point scoring where the average selling price is more than \$1,000,000 and/or where the home is a contract home.

### 3. Determining your Credit Points:



To compute your Credit points score, we do the following:

We determine your credit score (by reference to a third party credit rating agency);

If you do not have a credit score (or for some reason we are unable to determine your credit score), we determine the average credit score for all of your guarantors

The resulting credit score (the greater of yours, or the average of all your guarantors) is converted into your Credit point score by reference to the following table:

Credit Score	Credit Points
0-660	0
661 to 759	15
760 +	20

#### 4. Determining Your Equity Points:

To compute your Equity points score, we do the following:

- First we determine your Suggested Minimum Equity (SME) by reference to the following table (units refers to proposed units plus unclosed units):

Equity Unit Count	Suggested Minimum Equity per Unit
First 10 units	\$45,000
Next 90 units	\$30,000
Next 200 units	\$22,500
All remaining units	\$12,000

- Second we calculate your Reported Equity based on the financial information you have provided (more detail on this is set in Appendix 2 *Assessing Reported Equity*)
- We compute your Equity Ratio by dividing your Reported Equity by your SME
- We then determine your Equity points score by reference to the following table:

Ratio to Suggested Minimum Equity	Equity Points
less than 0.39	0
0.4 to 0.6	6
0.61 to 0.8	9
0.81 to 1	12
1.01 to 1.2	15
1.21 to 1.4	18
1.41 to 1.6	21
1.61 to 2.6	24
2.61 to 3.6	27
3.61 +	30

**5. Determining Your Claims Paid Points:**

A “claim paid” means a warranty claim paid out of the Tarion guarantee fund on your behalf. To compute your claims paid points we review your claims paid history over the past 10 years and assign points based on:

- Your tenure & possessions – if your tenure is less than 3 years or you do not have any possessions in the past 7 years the maximum points you can get are 10 for having a clean record. If you have tenure greater than 3 years the full range of points are available.
- Whether you have no claims paid history at all or a “clean” record
- Whether you have claims still outstanding
- If you have claims, we look at your level of claims compared to the average for your peer group (small, medium and large builders) and determine if you are above or below the average. Points are assigned accordingly.

The score is then computed by reference to this table:

Classification	Tenure 0 to 3 Years, or Inactive	Tenure > 3 Years
<b>You have claims outstanding</b>	<b>0</b>	<b>0</b>
<b>Your claims are above avg</b>	<b>0</b>	<b>5</b>
<b>Your claims are below avg</b>	<b>0</b>	<b>10</b>
<b>You never had a claim</b>	<b>0</b>	<b>20</b>

## Appendix 2 – Assessing Reported Equity

We determine your Reported Equity based on the information you provide about your financial position. The information may relate to individuals or companies. **Individuals** include builders who are sole proprietors or part of a partnership, and any person that provides an indemnity or guarantee in support of the registration to Tarion. **Companies** include builders who are corporations, joint ventures or limited partnerships, and any company that provides an indemnity or guarantee in support of the registration to Tarion.

**Individuals** are required to complete a Personal Net Worth Statement annually, summarizing all of their assets and liabilities. We may request that these statements are updated at any time.

Assets include a personal residence, real estate, cash, investment accounts (i.e. Stocks, Bonds, RRSPs, TFSA, GIC, etc.) and the percentage ownership of equity and/or loans in businesses owned. Tarion does not count assets held outside of Canada, or personal property such as automobiles, boats, recreational vehicles, jewelry, artwork, antiques, etc.

Assets owned by someone else or through a company, will not be accepted towards an individual's equity. If an asset or liability is held jointly, we will only count the individual's percentage share of the asset or liability in calculating their equity. All supporting documentation provided to Tarion must show proof of ownership.

Builders who are registered as corporations must provide externally prepared financial statements at each renewal for the most recent fiscal year-end. Tarion may require builders to provide reviewed financial statements. For **companies** that are indemnitors or guarantors, externally prepared financial statements with Review Engagement may be required. New corporate indemnitors or guarantors must meet certain requirements and be approved by Tarion (please contact us for details) prior to acceptance. In certain circumstances Tarion may also require audited financial statements.

Tarion will include the total shareholder's equity of the company in its equity calculation. The analysis of financial statements may also include various financial tests to determine debt load, profitability, sales growth and other changes in financial position or status.

Liabilities include any mortgages on a personal residence or real estate properties, lines of credit, personal loans, credit card debt, and any other monies owed.

At each annual renewal, current supporting documentation must be provided for all assets and liabilities listed. All supporting documents must clearly show the owner's name, date, and current value. If backup documents are not provided or if they are unacceptable, Tarion will not include the value of the asset listed. Third-party appraisals from an accredited appraiser may be considered by Tarion to support current market values. Based upon the Personal Net Worth Statement and backup documents provided, Tarion will calculate the equity of the individual.



Tarion may modify these requirements where appropriate, for example waiving requirements or requiring additional information. Tarion also reserves the right to give less weight to equity that is provided by way of indemnity. This recognizes our historical experience of less than full recovery where our claim is based solely on an indemnity.