



Montgomery County Government

AN EVALUATION OF THE NEW HOME WARRANTY AND BUILDER LICENSING LAW

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EXECUTIVE SUMMARY

County Code Chapter 31C, New Home Warranty and Builder Licensing, was enacted in 1986 as legislation to improve consumer protection for buyers of new homes in the County. In particular, Chapter 31C was structured to improve upon the State's limited requirement for a one-year implied warranty on new homes; and the County's new home builder licensing procedures, which at the time required builders to demonstrate financial security only by posting a \$2,000 bond, regardless of the number of homes constructed.

Chapter 31C provides County consumers with one of the most comprehensive new home warranty and builder licensing programs in the country. The law requires ten year warranty coverage for all new homes, establishes a County-run Warranty Plan, provides a mechanism for approval of private warranty plans operating in the County, and establishes a link between builder licensing and warranty performance.

The Office of Consumer Affairs administers the County's warranty law, manages the County's New Home Warranty Plan, and provides staff support to the Board of Registration, which is a five-member citizen board authorized to issue, deny, and revoke new home builder licenses. As a prerequisite to becoming licensed, builders of new homes have the option of enrolling either in the County's New Home Warranty Plan or in a private warranty plan that has been approved by the Office of Consumer Affairs. The law establishes a builder's failure to perform warranty obligations as one of the grounds for license revocation.

This evaluation recommends that the County continue to maintain the builder licensing system and basic mandatory new home warranty requirements outlined in Chapter 31C. However, the report also recommends a significant change in the County Government's role away from administration of a County-run warranty plan, and towards increased oversight of the private warranty plans approved by the Office of Consumer Affairs to operate in the County. In addition, the report recommends some additional legislative and administrative changes to improve the effectiveness of the builder licensing and mandatory warranty requirements. Major recommendations include:

- Phase-out operation of the County-run New Home Warranty Plan within the next three years;
- Readjust staff assignments within the Office of Consumer Affairs (OCA) to increase oversight of the private warranty plans approved by OCA to operate in the County;
- Improve enforcement of the statutory requirement that all new homes be enrolled in an approved warranty plan;
- Take steps to address problems identified in the warranty claims dispute settlement process;
- Revise the current practice of renewing new home builder licenses as a routine staff function; and
- Reorganize and amend the sections of Chapter 31C that outline the powers and duties of the Board of Registration.

I. **AUTHORITY, SCOPE, AND METHODOLOGY**

A. **Authority**

Council Resolution No. 12-144, CY 1991 Work Program of the Office of Legislative Oversight, adopted March 26, 1991.

B. **Scope and Organization of Report**

This report evaluates the substance and implementation of County Code Chapter 31C, New Home Warranty and Builder Licensing*. This law, enacted by Bill 69-85, has been in effect since July 1986.

Chapter II, **BACKGROUND**, defines a new home warranty; reviews the legislative history and legislative intent of Chapter 31C; reviews the applicability of Chapter 31C in the County's 17 municipalities; and explains the relationship of the County's warranty law to State law and recently issued federal regulations.

Chapter III, **EVALUATION**, is divided into five sections:

Section A: The Board of Registration and Builder Licensing;

Section B: The County's New Home Warranty Plan;

Section C: The Alternate (Private) New Home Warranty Plans;

Section D: Perceptions of Builders and Homeowners; and

Section E: Program Costs and Revenues.

Chapter IV, provides OLO's **CONCLUSIONS**, and Chapter V sets forth OLO's **RECOMMENDATIONS**.

C. **Methodology**

This project was conducted during July-September 1991 by Karen Orlansky, OLO Program Evaluator, with assistance from Debra Cammer, OLO Public Administration Intern.

The research design included: document and file reviews; quantitative analysis of program data; examination of legislative records; consultation with a Risk Management Consultant (on contract to the Department of Finance); and phone interviews with homeowners and builders who have been affected by the new home warranty and builder licensing law. In addition, some comparative information was obtained through interviews with local government officials in other jurisdictions.

* Unless otherwise indicated, all County law citations reference the Montgomery County Code (1984), as amended.

OLO conducted interviews and obtained information from numerous County Government and other County agency staff, including: the Office of Consumer Affairs; the Office of Management and Budget; the Department of Finance; the Department of Environmental Protection; the Department of Housing and Community Development; and the Maryland-National Capital Park and Planning Commission (M-NCPPC). OLO also consulted with current and former members of the Board of Registration, and representatives from: private warranty plans operating in the County; the Suburban Maryland Building Industry Association (SMBIA); the Montgomery County Board of Realtors; and the Montgomery County Builders' Association.

D. Acknowledgements

Throughout this study, OLO received cooperation from all parties. In particular, OLO appreciates the time spent by Office of Consumer Affairs (OCA) staff providing information and working with OLO. A special thanks is owed to: Barbara Gregg, Director of OCA; George Rose, OCA Administrator; Joe Giloley, OCA Administrator and other OCA staff members Clare Fadden, Marina Gaffney, Susan Cohen, and Eric Friedman. In addition, OLO appreciates the housing data provided by the Research Division of M-NCPPC's Planning Department, and the building permit data provided by DEP. Finally, OLO appreciates the advice provided by Thomas H. Stanton, author of the Case Western Reserve Law Review article on new home defects that helped to initiate the introduction of warranty legislation in the County.

II. BACKGROUND

A. What is a New Home Warranty?

1. Overview. In general, a new home warranty is a guarantee by the builder or a warranty company to repair or replace items that are defective in a home. As is the case with other types of warranties, a new home warranty shifts the financial risk of repairing defects from the homebuyer to the warrantor in return for a premium. In addition, it is argued that a new home warranty provides the producer (builder) with an incentive to improve the quality of the product (new house).

The basic economic theory behind a new home warranty is to shift the financial risk of repairing defects away from the homebuyer. In the extreme, if a consumer purchases a home without a warranty, any cost of repairing defects falls upon the consumer. The financial risk can range from relatively low cost repairs to very high cost repairs for major structural defects. With a new home warranty, at least some of the financial risk is shifted away from the homebuyer because the costs of repairing defects covered by the warranty are paid for by either the builder or a third party warranty company.

A December 1977 survey indicated that consumers are willing to pay upfront for a new home warranty in order to reduce the risk of long-term costs. Specifically, the survey found that 70 percent of consumers

interviewed would be willing to spend an additional \$1,000 at construction time to cut down on future maintenance costs, with some willing to pay even larger amounts.*

New home warranties can improve the quality of homes built by providing builders with an incentive to improve their product. Ideally, a warranty program provides builders with an incentive to prevent defects, by forcing the builder to balance the costs of building a high quality home in the first place against the costs of repairing defects later.

Another way that a new home warranty can act to improve the quality of homes built is the incentive of third party warranty companies to warrant only well-built homes, so as to maximize the premiums received while minimizing the amount of claims paid. In addition to wanting to enroll builders who build high quality homes, warranty companies have an incentive to oversee their enrolled builders to ensure that they build only high quality homes.

Finally, third party warranty plans can reduce the total long-run costs of a home for both builders and homebuyers. Since warranty plans come with administrative (out of court) mechanisms for settling disputes, the homeowners' and builders' costs of getting problems resolved can be reduced. In addition, an insured warranty fund serves the function of distributing the risk of repairing defects among many homebuyers, thereby minimizing the chance of catastrophe for a single one.**

B. The Origin of Mandatory New Home Warranty Legislation in the County

1. Background. A nationwide study released in 1980 by the Federal Trade Commission and Department of Housing and Urban Development indicated that defects in new homes were a widespread problem for consumers. Specifically, 62 percent of the 1,812 new homes sampled had at least one problem costing \$100 or more to repair that had not been resolved by the builder. The average repair cost for homebuyers with problems not resolved was \$1,411.***

During the early 1980's, the idea of introducing local legislation to mandate some type of warranty for all new homes sold in the County was discussed at length by representatives of both the public and private sectors, including the Suburban Maryland Building Industry Association. In addition, the Council's 1984 Task Force on Homeowner

*Report of the U. S. General Accounting Office, New-Home Buyers and Federal Agencies Benefit from Improved Warranty Protection, May 26, 1981.

** In 1974, the National Association of Home Builders developed the nation's first private third party new home warranty program.

*** A Survey of Homeowners Experience with New Residential Housing Construction, U. S. Department of Housing and Urban Development and the Federal Trade Commission, August 1980.

Associations specifically supported the enactment of mandatory new home warranty legislation. During this time, several different new home warranty proposals were drafted; and in 1985, local legislation to establish a County warranty program was introduced.

2. New Home Warranty Legislation is Introduced. Bill 69-85, New Home Warranty and Builder Licensing, was introduced in October 1985, at the request of the County Executive. The bill was drafted by the County's Office of Consumer Affairs (OCA) after extensive consultation with members of the building industry. It was modeled after mandatory new home warranty legislation enacted by the State of New Jersey in 1977.

At the public hearing on Bill 69-85, OCA staff testified that their support for mandatory new home warranty legislation resulted from an internal study of new home complaints received by OCA during a three-year period. OCA staff reported frustration at not being able to resolve and remedy the numerous complaints received from consumers concerning inadequate warranty performance by their builders. OCA concluded that there was a need to improve consumer protection for new homebuyers by improving upon the existing legal warranty requirement for new homes; at that time, in Montgomery County and throughout Maryland, the only legal warranty requirement was a State law requiring an implied one-year warranty on everything in the house.*

OCA staff argued that the State's implied one-year warranty law was inadequate because:

- Under the State's implied warranty law, there were no specific standards or guidelines for what the warranty covered;
- A one-year new home warranty is not a sufficiently long time period;
- There was no mechanism to ensure that a builder would honor the warranty and complete the warranty obligations;
- There was no time limit for the performance of warranty work; and
- There was no remedy for a consumer if the builder went out of business.

In addition, the County's procedures for issuing and revoking builders' licenses were seen as inadequate. At that time, the one \$2,000 bond that builders were required to post (no matter how many homes the builder constructed) was seen as insufficient security for consumers; and there was no provision to suspend or revoke a builder's license for failure to perform warranty obligations. OCA also criticized the fact that a majority of the Board of Registration (the entity charged with issuing and revoking new home builder's licenses) were persons active in the building industry; and that the law did not specify the qualifications of persons appointed to serve on the Board.

* Annotated Code of Maryland, Real Property Article, Title 10, Subtitle 2, Express and Implied Warranty.

2. Major Provisions of the County's New Home Warranty and Builder Licensing Law. Bill 69-85, New Home Warranty and Builder Licensing, was enacted on April 1, 1986, with an effective date of July 9, 1986. Bill 69-85 was codified as County Code Chapter 31C. To date, the only amendment to this law has been to extend the term of Board of Registration members from two to three years.*

The major provisions of the new home warranty and builder licensing law are as follows:

- For every new home sold in the County, the builder must warrant that:
 - For one year, the new home is free from any defect in materials or workmanship as defined by minimum performance standards;
 - For two years, the new home is free from any defect in the electrical, plumbing, heating, cooling, ventilating, and mechanical systems; and
 - For ten years, the new home is free from any major structural defects.

Executive regulations detail the warranty standards, and list what items are excluded from warranty coverage.**

- A County-run new home warranty security plan is established. The County's Warranty Plan is administered by the Office of Consumer Affairs and the Warranty Fund is maintained by the Department of Finance. The County is not required to contribute money to the Warranty Fund, and if the Fund is insufficient to satisfy awards, the Director of OCA is authorized to require additional payments from participating builders.

- Alternate (privately-run) new home warranty plans operating in the County must be approved annually by the Office of Consumer Affairs. OCA may investigate any complaints against a private warranty plan for failing to honor warranty terms.

* This change was part of Bill 46-90, Boards, Committees, and Commissions, enacted in October 1990.

** Method (2) executive regulations associated with Chapter 31C, New Home Warranty and Builder Licensing, were developed during the six months following the enactment of Bill 69-85, and went into effect December 18, 1986. In October 1990, under the quadrennial review procedures for executive regulations, the Council re-approved executive regulations for the program; the only change made to the original regulations was an increase in the biennial builder licensing fee from \$200 to \$300.

- All new home builders must be licensed by the Office of Consumer Affairs every two years. The Board of Registration (composed of five members appointed by the County Executive and confirmed by the Council) is charged with certifying to the Director of OCA whether applicants should be licensed.

- All licensed builders in the County are required to participate in a new home warranty plan, with the option of either joining a private warranty plan (which is approved by OCA) or the County's Warranty Plan.

- OCA may conduct an investigation into allegations made against any builder who is required to be licensed; listed among the reasons that the Board of Registration can deny, suspend, or revoke a builder's license is a builder's failure to perform work required under the new home warranty.

- The Director of OCA is charged with administering the chapter, and reasonable costs for administration of the County's Warranty Plan must be covered through both licensing fees and the warranty fund.

3. The Legislative Intent of the New Home Warranty and Builder Licensing Law. The new home warranty and builder licensing law does not include a specific statement of legislative intent. However, it is possible to interpret the intent of the warranty legislation based upon a review of the legislative record and interviews with individuals who were involved in the legislative debate.

As discussed above, the Office of Consumer Affairs advocated the passage of mandatory new home warranty legislation as a way to improve consumer protection, which was seen as inadequate under: the existing State's implied one-year warranty law; the County's builder licensing system; and the warranty standards utilized by most private warranty plans. The legislative record indicates that Bill 69-85, New Home Warranty and Builder Licensing, was enacted with a number of specific goals:

- To provide consumers and builders with a common set of written standards that clarify which items in a new home are covered by a warranty and for how long;*
- To provide consumers with a more effective remedy for resolving new home warranty complaints in a timely manner;
- To provide a recourse for consumers on warranty items in situations where the builder has gone out of business; and
- To establish a builder licensing system in which a builder's failure to perform warranty obligations can affect the builder's ability to remain licensed.

* In addition, the written warranty standards adopted by the County raised the quality of the standards previously used by private warranty plans.

In addition to improving consumer protection for new homebuyers, a number of those supporting new home warranty legislation argued that it would also serve to improve the quality of homes being built and the level of new homebuyer satisfaction in the County. If builders of new homes are all required to belong to approved warranty plans as a condition of becoming licensed, then it is argued that builders will be forced to meet the level of quality that the third party warranty companies demand.

In 1988, the County's new home warranty and builder licensing program won a National Association of Counties (NACO) Achievement Award. It was subsequently selected by NACO as the subject of a special feature in NACO's bi-weekly publication County News.

C. The Applicability of the New Home Warranty and Builder Licensing Law in Municipalities

Table 1 (page 7a) indicates the applicability of Chapter 31C, New Home Warranty and Builder Licensing, and Chapter 11, Consumer Protection, in each of the County's 17 municipalities.

Chapter 31C has been adopted by nine municipalities (Barnesville, Brookeville, Chevy Chase Section 3, Chevy Chase Section 5, Glen Echo, Kensington, Martin's Addition, Somerset, and Takoma Park), and has not been adopted by eight municipalities (Chevy Chase Village, Town of Chevy Chase, Gaithersburg, Garrett Park, Laytonsville, Poolesville, Rockville, and Washington Grove).

Chapter 31C specifies that its provisions do not limit the investigative powers of the Director of OCA under any other law. As listed on Table 1, all but one (Laytonsville) of the County's 17 municipalities have adopted Chapter 11, Consumer Protection, which provides the Office of Consumer Affairs with its overall authority to investigate deceptive or unfair trade practices. In terms of pursuing consumer complaints related to new homes, the OCA staff at times uses its authority under Chapter 31C, and other times uses its authority under Chapter 11.

Two of the eight municipalities that have not adopted Chapter 31C (Rockville, Gaithersburg) administer their own building permit and inspection functions. A potential problem does exist, however, in the six municipalities that rely upon the County Government to perform building code inspections, but who have not adopted Chapter 31C. In these municipalities, the County Government has the responsibility to issue building permits and conduct inspections (under Chapter 8, Building Code), but not the authority to issue or revoke licenses for new home builders.

D. Relationship of Chapter 31C to State's New Home Warranty Laws

County Code Section 31C-3(d) states that, "The statutory warranties provided for in this chapter shall be in addition to all other implied or express warranties imposed by law or agreement."

Table 1

Adoption by Municipalities of County Code Chapter 11,
Consumer Protection, and Chapter 31C,
New Home Warranty and Builder Licensing

<u>Municipality</u>	<u>Chapter 11, Consumer Protection, Adopted</u>	<u>Chapter 31C, New Home Warranty and Builder Licensing, Adopted</u>
Barnesville	Yes	Yes
Brookeville	Yes	Yes
Chevy Chase Village	Yes	No
Chevy Chase, Section 3	Yes	Yes
Town of Chevy Chase	Yes	No
Chevy Chase Section 5	Yes	Yes
Gaithersburg	Yes	No
Garrett Park	Yes	No
Glen Echo	Yes	Yes
Kensington	Yes	Yes
Laytonsville	No	No
Martin's Addition	Yes	Yes
Poolesville	Yes	No
Rockville	Yes	No
Somerset	Yes	Yes
Takoma Park	Yes	Yes
Washington Grove	Yes	No

Source: Montgomery County Municipal League chart indicating adoption of County laws by municipalities, as of July 1991.

As noted earlier, at the time the County's new home warranty and builder licensing law was enacted (1986), the only legal requirement for a new home warranty in Montgomery County and throughout the State was a State law requiring a one-year implied warranty on everything in a new house. In 1990, this law was amended to extend the implied warranty on structural defects from one to two years.* The State's implied warranty law continues to apply throughout Montgomery County in addition to Chapter 31C.

During the 1990 session of the General Assembly, an additional subtitle concerning express and implied warranties for new homes was added to the State's Real Property Article.** Within Montgomery County, this new subtitle applies only in those municipalities that have not adopted the County's New Home Warranty law. (The eight municipalities which have not adopted 31C are listed on Table 1.) This new State law, effective January 1, 1991, requires builders to disclose in writing to the homebuyer whether the home is or is not enrolled in a new home warranty plan; and provides the buyer with the option of rescinding the contract based upon the builder's disclosure. In addition, the law outlines minimal terms for new home warranty plans that are provided, including a list of items that must be warranted for one, two, and five years respectively.

E. Relationship of Chapter 31C to U.S. Department of Housing and Urban Development's Approval of New Home Warranty Plans

Last year, the U.S. Department of Housing and Urban Development (HUD) published a final rule that establishes administrative criteria for acceptability of insured ten-year protection plans covering dwelling units insured under HUD's single family mortgage insurance program. (24 CFR Parts 200, et al.) Adoption of this new rule (effective November 6, 1990) means that any home purchased with HUD financing must be enrolled in a ten-year warranty plan that has been accepted by the HUD Secretary. The HUD rule does not preempt either the County's or the State's warranty laws.

All warranty plans that want to be accepted must file certain information with HUD every two years. HUD will review the warranty plans to ensure that they meet certain criteria related to: the requirements and limitations of the plan; plan coverage and obligations; and financial strength.

III. EVALUATION

This chapter is organized as follows:

Section A: **Board of Registration and Builder Licensing**, reviews the record of issuing, renewing, and revoking new home builder licenses and new home building permits since 1986;

* Annotated Code of Maryland, Real Property, Title 10, Subtitle 2, Express and Implied Warranties.

** Annotated Code of Maryland, Real Property, Subtitle 6, New Home Warranties.

Section B: **The County's New Home Warranty Plan**, examines the operation of the County's New Home Warranty Plan, to include: builder and home enrollment procedures; the record of warranty claims and fund reimbursement; and financial viability.

Section C: **The Alternate (Private) Warranty Plans**, focuses on the private warranty plans approved by OCA to operate in the County; this section includes: summary data on enrollment, dispute settlements, and claims paid by the private plans, and discussion of OCA's oversight role.

Section D: **Perceptions of Builders and Homeowners**, summarizes the views of builders and homeowners interviewed by OLO during the course of this study.

Section E: **Program Costs and Revenues**, discusses the projected and actual fiscal impact of the new home warranty and builder licensing legislation.

A. Board of Registration and Builder Licensing

1. Legal Requirements. Code Section 31C-4 establishes the Board of Registration (Board). The Board consists of five members appointed by the County Executive and confirmed by the County Council for three-year staggered terms.* The law requires that no more than two Board members can be active in the residential construction field at the time of their appointment. Board members do not receive compensation, but may be reimbursed for actual expenses.

The Office of Consumer Affairs (OCA) provides staff support to the Board, and the County Attorney serves as the Boards' legal counsel. Section 31C-4(d) requires the Board to: keep minutes of its proceedings; put its decisions in writing; and submit an annual report to the Director of OCA. By regulation, the Board of Registration is required to meet at least once a month.

As outlined in several sections of Chapter 31C and Executive Regulation No. 20-90, the Board is authorized to make decisions regarding the issuance and revocation of builder licenses in the County. By law, a builder must not engage in the business of erecting or otherwise creating a new home, unless licensed with the Office of Consumer Affairs.** The Board's role is:

● To certify to the Director of OCA whether an applicant for a builder license should be licensed, and that the applicant's organization is "qualified to comply with the building code and laws of the County and State", (Section 31C-2(4)); and

* Bill 46-90, Boards, Committees, and Commissions, enacted October 16, 1990, extended Board terms from two to three years.

** By regulation, a person who construct a new home for their own personal use, a so-called "owner/builder", is exempt from the builder licensing requirement.

- To deny, suspend, refuse to renew, or revoke the license of a builder, based upon a finding that the builder has violated one of the provisions listed in Section 31C-8(b).* An applicant who is denied a license may appeal the Board of Registration's decision to the Board of Appeals.

In addition, executive regulations issued for Chapter 31C establish an appeal role for the Board for decisions made by the County's Warranty Plan dispute settler. Specifically, after complying with the dispute settler's decision, a builder can appeal the decision by posting an appeal fee (\$250) with OCA within ten days of the decision. The appeal is then decided by a dispute settlement appeals panel composed of two dispute settlers and a member of the Board who is selected by the Board.

2. The Board of Registration in Practice

a. General. There have been ten members of the Board of Registration since the staffing of the Board was transferred from the Department of Environmental Protection to the Office of Consumer Affairs (OCA) in 1986. Expertise on the Board has included: home inspectors, attorneys, builders, a professor, and a building consultant.

The Board meets the first Tuesday of every month, and the typical Board meeting lasts one to two hours. Action minutes of Board meetings are taken by OCA staff, and approved by Board members at the following meeting. The Board submitted an annual report (as required by law) to the OCA Director in 1988, but has not submitted an annual report since then.

b. Issuing and renewing builder licenses. Applicants for a new home builder license must submit a completed application form to OCA, accompanied by a non-refundable \$300 licensing fee.** Information requested from applicants includes:

- References from at least three material suppliers, two general business references, and the name of a bank where the builder has a business account;

- A summary of building experience, and disclosure of any present or prior relationship with any other licensed builder; and

- Either proof of participation in an approved private new home warranty plan or designation that the builder will participate in the County's New Home Warranty Plan.

* This section lists 14 reasons why a builder's license can be denied or revoked, e.g., the builder violated the building code or law of the County or State; the builder failed to continue participating in a warranty program; the builder failed to correct or settle a warranty claim after the dispute settlement procedure establishes responsibility; the builder incurred an excessive number of awards against the County's Warranty Plan.

** Effective November 8, 1990, the licensing fee was increased from \$200 to \$300.

OCA staff reviews each application for completeness, and informs each applicant where additional information is needed. Completed applications for new licenses are forwarded to Board members the week before their monthly meeting. At Board meetings, Board members review and vote on each application separately; applicants are welcome to attend Board meetings, but are not required to be present. At times, the Board has requested additional information be provided, but has only rarely deferred voting on the applications before them.

The law provides the Board with the general authority to certify to the Director of OCA whether:

- a. The applicant and the organization of the applicant are qualified to comply with the building code and laws of the county and state, and to fully perform building contracts; and
- b. The applicant should be licensed. (Section 31C-2(a)(4))

In 1988, the Board devoted time to discussing the need for more detailed criteria upon which the Board could base its decision as to whether an applicant is qualified to receive a new home building license. The Board decided against recommending any changes, and there continue to be no specific standards outlined in either the law or in regulation that the Board must follow when approving or disapproving builder license applications.

An applicant who is approved by the Board generally receives his/her new home builder license from the County within ten days of the Board's meeting. Since 1989, builders participating in the County's Warranty Plan must sign and return enrollment documents before receiving their license. Applicants who are disapproved by the Board receive a letter from the OCA Director that cites the reason that the application was denied. As noted above, applicants can appeal a denial to the Board of Appeals.

Builders' licenses are issued for a two-year period. Between 30 and 60 days before a builder's license expires, OCA sends the builder a renewal application. The renewal application, which is a shortened version of the original license application, must be returned to OCA along with the \$300 licensing fee. The renewal application does not require the builder to provide updated financial data or current references, but does require the builder to report any pending court cases that they are involved in. When asked their opinion of the current renewal process, Board of Registration members responded that they believe it provides homebuyers with an appropriate level of consumer protection.

Renewals are handled routinely at the staff level. Although the builder's OCA complaint record is generally reviewed, staff's review of renewal applications has not consistently included checking whether all new homes built by the builder during the past two years have in fact been duly enrolled in a warranty plan. In a select number of cases, license renewals have been discussed with the Board of Registration.

Table 2 (page 11a) shows the record of new builder licenses issued, the number of licenses renewed, and the number of new builder licenses disapproved annually by the Board. Due to the large number of renewals in odd-numbered years, the number of builder's licenses issued

Table 2

**Number of Builder Licenses Issued and Applications Denied
FY88 - FY91**

	<u>FY88</u>	<u>FY89</u>	<u>FY90</u>	<u>FY91</u>
Number of New Licenses Issued:	99	106	50	76
Number of Licenses Renewed:	19	435	51	401
Number of License Applications Denied:	3	2	3	1

Source: OCA builder licensing records.

fluctuates in two-year cycles.* The total number of active builder licenses has declined during the past two years from 659 (FY88-FY89) to 578 (FY91-FY91).

Between FY88 and FY91, the Board approved 97 percent of new builder license applications. The letters sent to the nine applicants who were denied indicate that the most common reason cited by the Board was the applicant's "failure to demonstrate adequate construction experience to be certified as a builder contractor." In several cases, the applicant's complaint record was given as a reason for disapproval, and one applicant was denied because he submitted a false reference with his application. One applicant filed an appeal of his license denial with the Board of Appeals, but later withdrew the appeal before the hearing.

The Board of Registration, with staff assistance from OCA, has consistently met the statutory deadlines set for action on builder license applications. The law requires that the Board must act upon license applications within 60 days after a completed application is submitted; and OCA is given an additional 15 days (75 days total) within which to notify the applicant whether his/her application has been approved or denied. In practice, because the Board meets monthly, most completed applications are acted upon within 30-45 days after they are submitted.

c. Builder license revocations. Since 1986, the Board has revoked four and suspended one new home builder licenses. In addition, the Board held a show cause hearing that did not result in any formal revocation action. All six of these actions were taken between March 1987 and July 1988. Since July 1988, although the Board has not formally suspended or revoked any builder's license, a number of builders have chosen to either surrender or not renew their licenses instead of facing formal enforcement action by OCA.

A review of Board records indicates that a primary reason behind license revocation was the builder's failure to perform his warranty obligations. For example, in one case, a license was revoked from a builder for failure to reimburse the County's New Home Warranty Plan for the sum awarded to the consumers; and in another case, a license was suspended for a builder's failure to correct warranty defects identified by an arbitrator.

Although it did not result in actual license revocation, the link between a builder's license and warranty performance was also demonstrated in 1987 when the Board held a show cause hearing concerning a builder's application for license renewal. In this particular case, OCA staff raised concerns about renewing the builder's license because of the builder's record of consumer complaints, multiple code violations, and failure to correct specific items covered by the builder's new home warranty. This case was significant because the unresponsiveness of the builder with respect to warranty obligations resulted in the Board questioning the renewal of the builder's license.

* This fluctuation dates back to when the County changed the builder license from a one-year to a two-year license in 1985.

According to OCA staff, within the past three years, there have been between five and ten cases where new home builders chose either to surrender or not renew their licenses instead of facing formal license revocation proceedings. The Board of Registration has not been involved in these cases, in which interactions have taken place between the builder and OCA staff. The circumstances leading to license surrendering included a builder's failure to respond to warranty-related complaints, and failure to reimburse the County's Warranty Plan. In some (but not all) of these cases, a record of the builder's decision to surrender or not renew his license was recorded in the builder's licensing file.

d. Enforcement. In practice, enforcing the provision in Chapter 31C that, "a builder must not engage in the business of constructing new homes unless the builder is licensed", is a shared responsibility of the Office of Consumer Affairs (OCA) and the Department of Environmental Protection (DEP). While OCA is responsible for maintaining current records of who is a licensed builder, DEP is responsible for issuing new home building permits. The system works as follows:

- OCA maintains a current data base that lists all of the builders (by name and license number), who are licensed to construct new homes in the County; because this data base is maintained on the County's mainframe computer, DEP staff have on-line access to OCA's builder licensing data.
- The application for a new home building permit includes a space for the builder to provide his/her current County's new home builder license number.
- When DEP receives a completed new home building permit application, DEP checks OCA's data base to ensure that the builder is currently licensed with OCA. (The only exception to this is building permits applications submitted by owner/builders, who are exempt from the licensing requirement.)
- If the builder is not licensed with OCA, then DEP will not issue a new home building permit.

According to DEP and OCA staff, the system works almost all of the time. The major limitation is that the system cannot easily stop someone from fraudulently using the name and license number of another builder. Another problem is that the system cannot easily distinguish between a legitimate owner/builder (someone who constructs a home for his own personal use and is not required to be a licensed builder), and someone who is applying as an owner/builder but who really intends to sell the home once it is completed. To address this issue, since January 1990, OCA staff have routinely reviewed all owner/builder new home building permits in order to detect possible fraud. According to DEP's records, between FY87-FY91, 1,004 owner/builder permits were issued.

The law clearly provides that a builder must be licensed by OCA in order to obtain a new home building permit. The law, however, does not specify how to handle the status of a building permit that is issued to a

licensed builder whose license is either suspended, revoked, or expired before the house is completed. According to OCA staff, based upon a specific case that occurred several years ago, it is the County Attorney's view that DEP has the authority to issue a stop work order on a building permit issued to a builder whose license is suspended or revoked.

B. The County's New Home Warranty Plan

1. Overview of the County's New Home Warranty Plan. As reviewed earlier in this report, Chapter 31C, New Home Warranty and Builder Licensing, requires that for every new home sold in the County on or after July 9, 1986, the builder must warrant that:

- For one year, the new home is free from any defect in materials or workmanship as defined by minimum performance standards;
- For two years, the new home is free from any defect in the electrical, plumbing, heating, cooling, ventilating, and mechanical systems; and
- For ten years, the new home is free from any major structural defects.

Executive regulations (method (2)) detail the warranty standards and list what items are excluded from warranty.

A prerequisite for becoming a licensed builder in the County is proof of participation either in the County-run New Home Warranty Plan, or participation in an approved alternate (private) new home warranty plan. Specific requirements for operation of the County's Warranty Plan and the private funds doing business in the County are outlined in law and further detailed by executive regulation.

By law, the County's Warranty Plan is administered by the Office of Consumer Affairs (OCA). A review of the legislative files and interviews with those involved with the original warranty legislation indicate that the rationale behind establishing a County-run new home warranty plan was as follows:

- The County's new home warranty law proposed requiring that all licensed builders be enrolled in an insured warranty plan;
- Due to a lack of building experience or a poor track record, it was anticipated that not all licensed builders would be accepted by private warranty plans;*

* At the time Bill 69-85 was enacted, the private warranty plans operating in the County rarely accepted inexperienced or non-rated builders.

- Therefore, the County Government should administer a self-supporting warranty plan to serve as the warranty plan of last resort for builders who could not be accepted by a private plan.

The law (Section 31C-5(b)) states that the purpose of the County's Warranty Plan is "to provide sufficient funds to pay claims by owners against builders who participate in the fund for any defect in new homes covered by the new home warranty." The OCA Director is responsible for establishing the amount payable by participating builders, and is authorized to change the amount from time to time. The law explicitly limits the County Government's financial responsibility to the County's Warranty Plan by stating:

The County is not required to contribute money to the fund. The County does not have any liability to a person who has received an award when the amount in the fund is insufficient to pay the award. (Section 31C-7(d)(8))

The law also provides that if the Fund is insufficient to satisfy outstanding awards and anticipated awards for the succeeding year, the OCA Director may: require participating builders to pay additional amounts to replenish the Fund; and require payment of surcharges by the builders who are responsible for an unreasonable number of awards against the Fund. Builders belonging to the County's Warranty Plan are held financially responsible for new home warranty defects for the full ten years of the warranty. Neither the law nor executive regulations for Chapter 31C provide the County with the authority to refuse to enroll a builder in the County's Warranty Plan.

The remainder of this chapter examines in more detail the major aspects of the County's New Home Warranty Plan; it is organized as follows:

Section 2: Enrolling Builders and Homes in the County Warranty Plan

Section 3: Warranty Claims in the County Plan: The Process and the Record

Section 4: Financial Viability of the County Fund

Section 5: Miscellaneous Issues

2. Enrolling Builders and Homes in the County Warranty Plan

a. In Practice: Enrolling builders in the County's Warranty Plan. As noted earlier, a prerequisite of becoming a licensed builder in the County is proof of participation in an insured new home warranty plan. The builder has the choice of joining either the County's New Home Warranty Plan or a private warranty plan that is approved by the Office of Consumer Affairs. The builder licensing application includes a statement that applicants pending acceptance by a private plan are automatically enrolled in the County's Warranty Plan.

The County's Warranty Plan (in contrast to the private warranty plans) does not require builders to pay an initial application or enrollment fee. From July 1986 until April 1989, a builder was able to join the County's Warranty Plan simply by checking a box on the new home builder licensing application. During that time period, the only requirement for enrolling a home in the County's Warranty Plan was to pay the home enrollment premium at least ten days prior to the date of settlement or occupancy, whichever occurred first. (The premium, established by executive regulation, is 0.3 of one percent of the purchase price of the home.)

Neither the law nor the executive regulations governing the County's New Home Warranty Plan provide the County Government with specific authority to refuse to enroll a builder. However, during 1989, recognizing that there was a need to screen the homes being enrolled in the County's Plan, the Office of Consumer Affairs administratively instituted a number of prerequisites for builders participating in the County's Plan. Under current procedures, a builder participating in the County's Plan must:

- Sign a letter agreeing to adhere to certain pre-enrollment inspection procedures (described below);
- Sign an affidavit (for each home enrolled) that affirms the builder is not aware of any warranty defects or code violations, and that there are no adverse financial considerations which will prevent the builder from performing his warranty obligations; and
- Provide a copy of the Certificate of Potability issued by the County Health Department for each home enrolled for which water is supplied by a well.

Since June 1989, OCA staff has required pre-enrollment inspections for the first three homes built by all new builders joining the County's Warranty Plan. In addition, at the discretion of the OCA Housing Group Administrator, pre-enrollment inspections have been required for homes that are enrolled late, and homes that are constructed by builders who owe the County Fund for a claim.

The procedure for a pre-enrollment inspection is as follows:

- OCA assigns a qualified independent home inspector to conduct a detailed inspection of the home to be enrolled;*
- The inspector prepares a report listing any warranty defects found in the house, and the estimated costs of repair;
- The builder must place in escrow 1.5 times the estimated repair costs, and is given a period of time (normally 60 days) to complete the warranty repairs; and

* See page 25 for a discussion of OCA's use of consultants.

- After completion of repairs, the home is reinspected by the independent inspector. If repairs are satisfactory, the escrow is released to the builder; and if repairs are not satisfactory, OCA negotiates an agreement to divide the escrow in an appropriate manner between the builder and the homeowner.

The cost of the initial inspection (average cost \$350-\$500) and any necessary reinspections (average cost \$150) are paid for by the builder. After completing the process with three homes, OCA staff reviews the results to see whether the pre-enrollment inspection requirement should be terminated or extended.

As of July 1, 1991, approximately 20 (3.5%) of the 572 homes enrolled in the County Fund had been subject to pre-enrollment inspections. To date, no builder participating in the County's Warranty Plan has refused to adhere to the pre-enrollment inspection requirements.

b. In Practice: Enrolling homes in the County's Warranty Plan. The amount that builders must pay to enroll a home in the County's Warranty Plan is established by executive regulation. The payment, which is based upon the purchase price of each home enrolled, has not been changed since it was first established in 1986. Specifically, for each home enrolled in the County Plan, a builder must pay 0.3 of one percent of the purchase price of the home.* For example: the premium for a \$100,000 home is \$300; the premium for a \$200,000 home is \$600.

According to OCA staff, in 1986, the pricing system of 0.3 of one percent of the purchase price was recommended based on an average between the pricing system used in the private plans and the pricing system used in the State of New Jersey for its new home warranty plan. Based upon the logic that the County's Warranty Plan was intended to be the warrantor of last resort for builders who could not gain acceptance in a private plan, the fees for the County's Plan were initially established to be somewhat higher than the fees charged by the private warranty plans. The purpose of this was to prevent the County's Plan from taking business away from the private plans, and to provide builders with the financial incentive to apply for membership in the private plans.

During the past five years, the fee structures in the private plans have evolved and most private plan now have complex rate structures with premiums that vary according to factors such as: a builder's experience; the location of a builder's construction activity; the volume of homes a builder

* The regulations provide that, if there is no good faith sale of the home, then the fair market value of the home on its completion data is used as the base upon which the premium is calculated.

has enrolled in the plan; and the volume of homes a builder expects to enroll in the future. Several years ago, a number of the private plans doing business in the County also established special programs for entry-level or novice builders. Today, while the County's Warranty Plan rates remain higher than the rates charged by the private plans for most high volume builders, the County's rates are equal to and even lower than the rates charged by the private plans for many other builders.

Late enrollments. By law, the payment for each home enrolled in the County Plan must be submitted to the OCA at least 10 days prior to the date of settlement or occupancy. The regulations provide that a late payment fee will be assessed for any home that a builder fails to enroll on time. The fee is set at \$50 for the first 30 days (or for any part thereof) and \$500 for each subsequent 30-day period.

According to OCA staff, approximately \$5,000 has been collected in late payment fees for homes enrolled in the County's Warranty Plan. Depending upon the circumstances surrounding each late enrollment, the full payment of the late enrollment fee sometimes has been waived by OCA staff.

Failure to enroll. At present, there is no procedure in place that tracks whether all new homes sold in the County are enrolled in a warranty plan. A new home building permit is only issued to licensed builders who are enrolled in a warranty plan; however, the regulatory process is not set up to prevent a home that is not duly enrolled in a warranty plan from going to settlement.

In order to find out whether builders participating in the County's Plan are in fact enrolling all of the homes that they build in the County's Warranty Plan, OLO drew a random sample of 50 builders, who are listed by OCA's licensing files as County Warranty Plan members.* OLO obtained a print-out from the Department of Environmental Protection that indicates the status of all new home building permits issued since 1986 to each of these 50 builders. The next step was to check whether all homes that had received a final building permit inspection were enrolled in the County Plan.

The initial findings of OLO's sample indicated the following:

- 31 (62%) out of the sample of 50 builders had received at least one new home building permit since 1986;
- As of July 1991, 61 (47%) of the new home building permits issued were listed as having been approved at a final DEP inspection; and
- 27 (44%) of the 61 homes were enrolled in the County Plan and 34 (56%) were not.

* 50 builders represents approximately 16 percent of the 304 builders enrolled in the County's Warranty Plan as of July 1, 1991.

Additional investigation by OCA staff suggests that in the County's Plan, based upon sample data, there is an estimated ten percent rate of non-compliance with the requirement to enroll all new homes in the plan. Specifically, OCA's further investigation indicated that all but seven of the 34 homes not enrolled in the County's Plan were legally exempt from the warranty requirement, e.g., owner/builder homes; homes not yet sold. The remaining seven homes not enrolled should have been enrolled, and OCA staff have already taken steps to gain compliance.

c. Profile of builders and homes in the County's Warranty Plan.

Table 3 (page 19a) shows, as of July 1, 1991, the number of builders and homes enrolled in the County's Warranty Plan and in each of the six private warranty plans approved by the County. The data indicate that the 304 builders enrolled in the County's Warranty Plan represent 53 percent of the licensed builders in the County. The number of builders enrolled in the County's Warranty Plan is more than three times the number enrolled in any of the private plans operating in the County.

Table 4 (page 19b) lists the number of builders in the County's Plan according to the number of homes enrolled since the warranty plan was established in July 1986. The data indicate that the County's Plan has attracted primarily low volume builders as well as builders who are not currently building homes in the County. Specifically:

- o Of the 304 builders enrolled in the County Warranty Plan, only 170 (56%) have actually enrolled one or more homes;
- o 110 (36%) of the 170 builders who have enrolled homes in the County Plan have each enrolled a total of only one or two homes; and
- o 162 (95%) of the 170 builders who have enrolled homes in the County Plan have enrolled fewer than ten homes apiece.

Presumably, 134 builders enrolled in the County's Warranty Plan have reasons for retaining their status as a licensed County builder, even though they are not currently building homes in the County. For some, a current builder's license is maintained as a credential; for others, an active builder's license is maintained to provide the builder with the option of building a new home in the future if the opportunity presents itself, without need for repeating the initial licensing process.

Table 5 (page 19c) shows the number of homes enrolled in the County's Warranty Plan as a percent of the total number of homes completed during the 1986-1990 time period. (Note: Complete 1991 data are not yet available.) The data indicate that the 572 homes enrolled in the County Plan represent only 2.1 percent of the 26,676 homes completed during this five year time period. These data show that although a relatively large number of County builders are enrolled in the County's Warranty Plan, compared to the total volume of homes completed, the actual number of homes enrolled in the County Plan has remained relatively small; this is consistent with the legislative intent of the County's warranty legislation that most new homes would be enrolled in a private warranty plan.

Table 3

**Number of Licensed Builders and Homes Enrolled in the
County's Warranty Plan and Approved Private Warranty Plans
as of July 1, 1991**

<u>Warranty Plan</u>	<u>Number of License Builders Enrolled</u>	<u>Number of Homes Enrolled*</u>
County	304	572
Private Plan (A)	40	1,825
Private Plan (B)	102	9,834
Private Plan (C)	61	1,412
Private Plan (D)	69	5,497
Private Plan (E)	1	2,728
Private Plan (F)	1	727
	-----	-----
Totals:	578	22,595

* Includes only those homes enrolled since the County's mandatory new home warranty law went into effect in July 1986.

Source: OCA records and reports from private warranty plans.

Table 4

**Number of Homes Builders Have Enrolled
in County's Warranty Plan, as of July 1, 1991**

<u>Number of Homes A Builder has Enrolled</u>	<u>Number of Builders</u>
None	134
One home	75
Two homes	35
Three homes	16
Four homes	15
Five homes	10
Six to nine homes	11
Ten to twenty homes	5
Twenty or more homes	<u>3</u>
Total:	304

Source: County Warranty Plan records.

Table 5

**Number of Homes Enrolled in the County's Warranty Plan
Compared to the Total Number of Homes Completed
1986-91**

<u>Calendar Year</u>	<u>Total Homes Completed</u>	<u>Number of Homes Enrolled in County Plan</u>	<u>As Percent of Total Homes Completed</u>
1986	7,465	114	1.5%
1987	6,952	203	2.9%
1988	5,739	161	2.8%
1989	4,158	47	1.1%
1990	2,362	35	1.4%
1991*	<u>n/a</u>	<u>12</u>	<u>n/a</u>
Total:	26,676	572	2.1%

* Through June 30, 1991.

Sources: Montgomery County Planning Department, Research Division; and County Warranty Plan records.

Table 6 (page 20a) shows the average (mean and median) price of the 572 homes enrolled in the County's Warranty Plan for each of the past five fiscal years, and Table 7 (page 20b) categorizes the homes enrolled according to sales price intervals of \$100,000. The sales price of homes enrolled in the County Warranty Plan ranges from less than \$100,000 to more than \$1,000,000. Of the 572 homes enrolled in the County's Warranty Plan as of July 1, 1991, the average (mean) sales price was \$312,000, and the median sales price was \$259,000. The data also indicate that the number of homes enrolled each year has declined, while the average sales price of homes enrolled in the Plan has increased.

3. Warranty Claims in the County's Warranty Plan: The Process and the Record

a. The warranty claims process. The warranty claims process for the County's Warranty Plan is outlined both in law and executive regulation. Chart I (page 20c) summarizes the County's Warranty Plan claims process. All specific time frames listed on Chart I are required by executive regulation; the shaded areas identify steps in the process that have no minimum or maximum time limit set in law or regulation.

A sample of individual County Warranty Plan claims files indicates that the average* time from warranty start date to receipt by OCA of a written warranty complaint is approximately 12 months, with the earliest written complaint being lodged one month after the home is enrolled. The length of time between receipt of a written complaint by OCA and actual claim payment has ranged significantly with an average time interval of 12-14 months. In the typical case, the conciliation phase has taken an average of four to six months; and the dispute settlement phase has taken an additional three to seven months.

Based upon a review of claims files and interviews with OCA staff, it is evident that the length of time to resolve a warranty case depends upon multiple factors, including: the complexity of the homebuyer's complaint (e.g., the number and type of defects); the responsiveness of the builder; the time that the homeowner can devote to resolving the problem; and each of the party's understanding of the warranty process. For example:

- Homeowners can spend many months trying to get their builder to correct a problem before filing a warranty claim;
- In some cases, a builder can extend the process by agreeing to make certain repairs but then never getting around to actually making them;

* All averages computed here are medians based upon sample data collected on 50 of the 56 County Warranty Plan claims filed between August 1986 and June 1991.

Table 6

**Mean and Median Price of Homes Enrolled
in County's Warranty Plan by FY87 - FY91**

<u>Fiscal Year</u>	<u>Number of Homes Enrolled</u>	<u>Mean Price</u>	<u>Median Price</u>
FY87	224	\$278,000	\$230,500
FY88	174	276,000	232,500
FY89	102	355,000	320,000
FY90	40	418,000	358,000
FY91	<u>32</u>	<u>483,742</u>	<u>475,000</u>
Totals:	572	\$312,372	\$259,500

Source: Data compiled from County Warranty Fund records, FY87 - FY91.

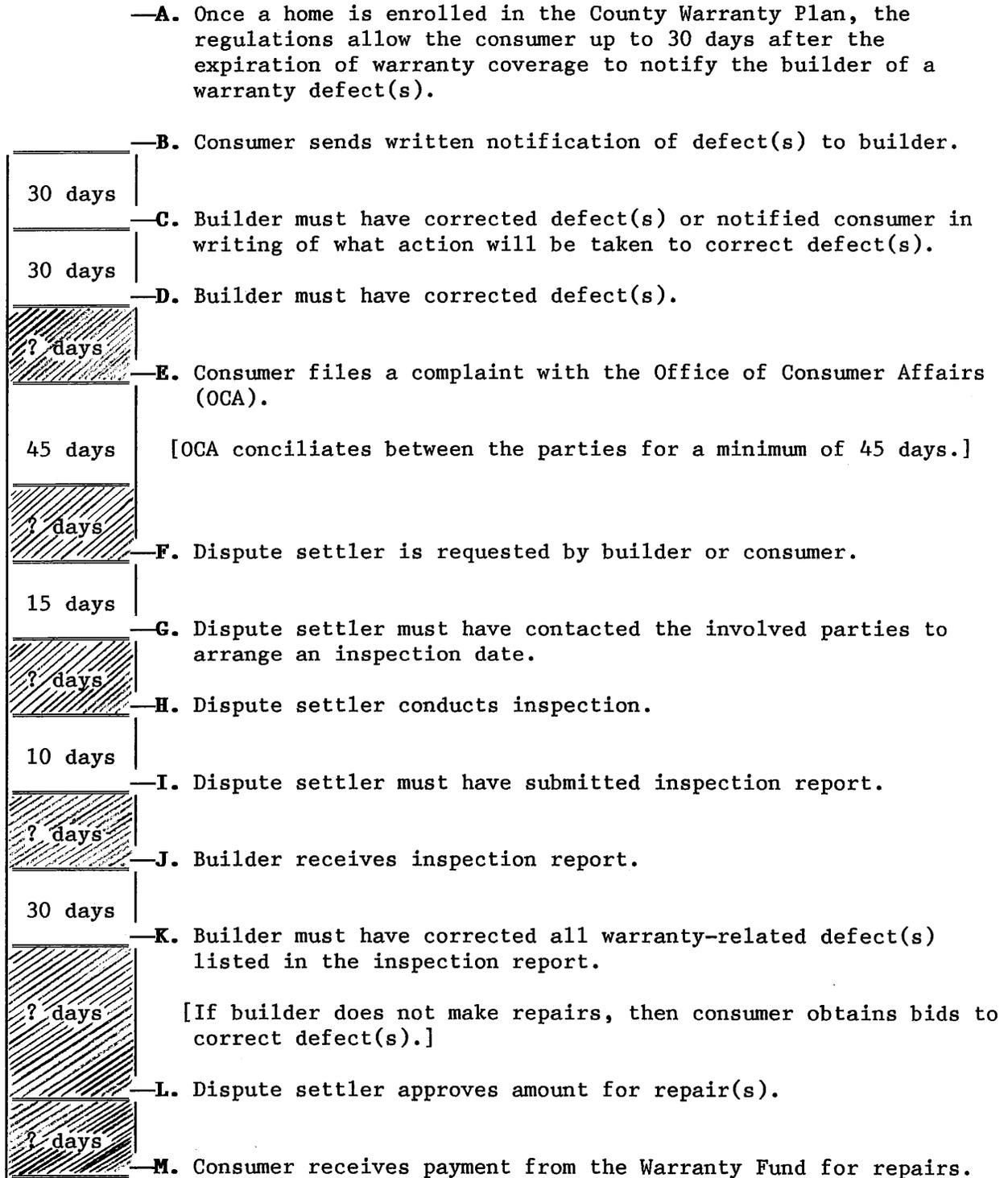
Table 7

**Number and Average Price of Homes Enrolled
in County's Warranty Plan
as of July 1, 1991**

<u>Price Category</u>	<u>Number of Homes</u>	<u>Mean Price</u>	<u>Median Price</u>
<\$100,000	25	\$ 73,538	\$ 66,758
\$100,001-200,000	188	146,679	135,900
\$200,001-300,000	112	244,944	246,500
\$300,001-400,000	101	355,439	355,000
\$400,001-500,000	64	446,725	439,950
\$500,001-600,000	27	553,178	555,000
\$600,001-700,000	30	600,578	625,000
\$700,001-800,000	16	748,333	740,450
\$800,001-900,000	6	868,541	874,000
\$900,001>	6	\$1,069,195	\$1,035,500
Total:	572		

Source: Data compiled from County's Warranty Fund Records.

Timeline for New Home Warranty Process: County Plan*



* All specific time frames listed are from Executive Regulation 20-90, New Home Warranty and Builder Licensing. Steps in the process that have no minimum or maximum time limit set in law or regulation are shown in the shaded area.

- Most new home complaints are complex in that they involve both warranty and non-warranty defects; and
- It often takes homeowners a long time to obtain estimates (bids) of the cost of repairs.

b. The record of warranty claims paid by the County's Warranty Plan. Analysis of the County Warranty Plan's record of claims payments indicates that from the establishment of the Fund in July 1986 through June 30, 1991:

- The County's Fund paid out \$321,400 for 56 claims that individually ranged in amount from \$225 to \$35,000;
- The 56 claims involved a total of 43 homes built by 14 builders; 30 of the 56 claims were paid on a subdivision of homes built by one builder, and the other 13 builders averaged two claims each; and
- The 14 builders who built homes for which claims were paid represent 8 percent of the 170 builders enrolled in the County Plan who have enrolled one or more homes; the 43 homes represent 7.5 percent of the 572 homes enrolled in the County Plan.

A review of claims files suggests that rarely is there only one defect involved in a warranty complaint, and often a complaint filed by a homeowner involves a combination of first, second, and sometimes even 3-10 year warranty items. Typical first year warranty claims have involved: poor painting, bad grouting, bad caulking, improper land grading, inoperable windows, damaged drywall, and/or leaky roof or basement. Common second year warranty claims have involved: inadequate heating/cooling; a faulty water heater; and leaky plumbing. Although most warranty claims involve first and second year warranty items, structural problems submitted to the County Warranty Plan have included: inadequate support for a floor; a weak truss member; and missing deck footings.

Tables 8 and 9 (pages 21a and 21b) show the number and amount of claims paid according to the year in which the homes (for which the claims were paid) were enrolled. In addition to demonstrating that most warranty claims are paid within the first several years of plan enrollment, the data indicate that most of the claims paid have been on homes enrolled during FY87 and FY88; only two homes enrolled since July 1, 1988 have had claims paid from the County's Warranty Plan.

The downward trend in claims paid out of the County's Warranty Plan is likely explained by two major factors. First, the County's Warranty Plan has enrolled substantially fewer homes within the past two years; and second, during 1988 (see page 16) the Office of Consumer Affairs instituted more careful procedures for enrolling homes in the County's Plan. In particular, requiring pre-enrollment inspections has resulted in known warranty defects being corrected before homes are allowed to be enrolled in the County's Plan.

Table 8

**Number of Claims Paid by County's Warranty Plan
by the Year Homes Were Enrolled**

<u>Enrollment Date</u>	<u>Number of Claims Paid by Year*</u>			
	<u>FY88</u>	<u>FY89</u>	<u>FY90</u>	<u>FY91</u>
FY87	6	3	6	3
FY88	--	1	17	5
FY89	--	--	1	1
FY90	--	--	0	0
FY91	--	--	--	0

* Thirteen homeowners had more than one claim. Included are the first claims paid to the homeowner.

Source: Data compiled from County Warranty Fund records, FY87 - FY91.

Table 9

**Amount of Claims Paid From County's Warranty Fund
by the Year Homes Were Enrolled**

Enrollment Date of Homes	Amount of Claims Paid by Year			
	FY88	FY89	FY90	FY91
FY87	\$6,850	\$90,639	\$70,259	\$0
FY88	---	\$32,307	\$106,240	\$11,277
FY89	---	---	\$540	\$3,300
FY90	---	---	---	\$0
FY91	---	---	---	---

Source: Data compiled from County Warranty Fund records, FY87 - FY91.

c. Correlation between the purchase price of homes and the number and amount of claims paid. The data on Table 10 and Table 11 (pages 22a and 22b) illustrate the following relationships between the price of a home enrolled in the County Plan, the number of claims paid, and the amount of claims paid:

- Homes that sold for more than \$400,000 accounted for 13 percent of the number of claims paid, and 15 percent of the total amount paid out; this group of homes represents approximately one-fourth of all homes enrolled and has brought in almost half (49%) of all premium revenue.
- Homes that sold for between \$200,000 and \$300,000 accounted for 34 percent of the number of claims, and 43 percent of the total amount paid out; this group of homes represents 20 percent of the total number of homes enrolled and has brought in 16 percent of all premium revenue.

4. Financial Viability of the County's Warranty Plan

a. The County Government's legal responsibility. As reviewed earlier, the law governing the County's Warranty Plan limits the financial responsibility of the County Government by stating that:

The County is not required to contribute money to the Fund. The County does not have any liability to a person who has received an award when the amount in the Fund is insufficient to pay the award. (Section 31C-7(d)(8)) *

The intent of establishing the Fund as a self-supporting enterprise is further supported by Section 31C-7(d)(5), which states that if the Fund is insufficient to satisfy outstanding awards, the OCA Director may:

- Require participating builders to pay additional amounts to replenish the Fund; and/or
- Require payment of surcharges by the builders who are responsible for an unreasonable number of awards against the Fund.

b. The Fund's Record. Table 12 (page 22c) outlines the flow of funds into and out of the County's Warranty Fund during the past five fiscal years. The data indicate that from the time the Fund was established in July 1986 through June 30, 1991:

* At the present time, the County Warranty Plan documents provided to homebuyers does not state that the County's Warranty Plan is backed only by funds in the Fund itself, and not by the full faith and credit of the County Government.

Table 10

**Number of Claims Paid Out From County's Warranty Fund
by the Price of Homes Enrolled**

<u>Purchase Price of Home</u>	<u>Number of Claims</u>	<u>Number of Homes in County Plan</u>
< \$100,000	6 (11%)	25 (4%)
\$100,001-200,000	14 (25%)	185 (32%)
\$200,001-300,000	19 (34%)	112 (20%)
\$300,001-400,000	10 (18%)	101 (18%)
\$400,000 +	<u>7 (13%)</u>	<u>149 (26%)</u>
Totals:	56 (100%)	572 (100%)

Source: Data compiled from County Warranty Claims records, FY87 - FY91.

Table 11

Amount of Warranty Fund Premiums Received
and Claims Paid by the Price of Homes Enrolled

<u>Purchase Price of Home</u>	<u>Amount of Premiums Received</u>		<u>Amount of Claims Paid</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
<\$100,000	\$ 3,865	1%	\$14,636	5%
\$100,001-200,000	72,229	15%	55,173	17%
\$200,001-300,000	78,721	16%	138,146	43%
\$300,001-400,000	89,269	19%	64,349	20%
\$400,001 +	<u>238,947</u>	<u>49%</u>	<u>49,109</u>	<u>15%</u>
Totals:	\$483,031	100%	\$321,413	100%

Source: Data compiled from County Warranty Fund records, FY87 - FY91.

Table 12

**The County's New Home Warranty Fund: Flow of Funds
FY87 - FY91**

Fiscal Year	Funds Paid In				Funds Paid Out	Fund Balance
	Premiums	Interest	Other*	Builder Reimbursements**	Claims	
FY87	\$112,069	\$ 3,003				\$115,072
FY88	161,695	13,277			(\$ 49,119)	240,925
FY89	106,314	27,530		\$16,650	(82,994)	308,425
FY90	60,297	24,799	\$12,500	25,443	(150,619)	280,845
FY91	55,754	26,634		14,750	(40,935)	337,048
Total:	\$496,129	\$95,243	\$12,500	\$56,843	(\$323,667)	\$337,048***

* This represents a separate \$12,500 payment made by a builder as part of a warranty claim settlement.

** These are the amounts that the County has collected in builder reimbursements for claims paid out of the Warranty Fund.

*** Fund balance as of July 1, 1991.

Source: County Warranty Fund and Department of Finance records, FY87-FY91.

- The Fund received: \$499,367 in premiums; \$95,243 in interest; and \$12,500 in a separate payment from a builder as part of a warranty settlement;
- The Fund paid out a total of \$323,667 in claims, of which \$56,843 has been collected in reimbursements; and
- The Fund balance, as of July 1, 1991, was \$337,048.

In order to assess the financial viability of the County Warranty Fund, OLO sought the advice of the Department of Finance's Risk Management Division. In turn, the Risk Management Division requested the professional opinion of Mr. Owen Miller, Senior Risk Management Consultant with the Insurance Buyers' Council. A copy of Mr. Miller's report is attached as Appendix A.

Mr. Miller judged the element of risk in the County Fund from the standpoint of the adequacy of funds in relation to the homes already enrolled, and the current premium rate of 0.3 of one percent of the purchase price of the home. Mr. Miller concludes that the funds maintained by the County are, at this point in time, adequate to meet expected loss conditions; and he does not recommend any change in the premium structure at this time. Mr. Miller's conclusion, however, comes with the caveat that there is only limited program data available, i.e., we have no experience data from the program to estimate the claims that might arise for guarantee years three through ten in which only the more expensive major structural defects are covered. In addition, Mr. Miller suggests that a contingency for worse than average loss should be considered.

Finally, Mr. Miller points out that his assessment cannot be considered an actuarial study, which would be a more detailed and more reliable forecast. He recommends using his report as an interim risk manager's estimate, and recommends that the County secure an actuarial determination.

FY92 Projection. Mr. Miller's assessment of the Warranty Fund was based upon Warranty Plan data available through May of 1991. Although it is only an estimate, some projection of the County's Warranty Fund balance through FY92 is possible.

Since July 1, 1991, OCA reports collecting an additional \$20,000 in reimbursement payments from builders. In terms of premium income, the FY92 budget projects that an additional 35 homes will be enrolled in the County's Warranty Plan. If the average purchase price of new homes enrolled ranges between \$300,000 and \$400,000 (based upon the experience of the past two years), then an additional 35 homes will generate somewhere between \$30,000 and \$40,000 in premium income.

The exact amount of claims paid from the Fund during FY92 is unknown; however, it is known that \$53,200 will be deducted in FY92 from the Warranty Fund to support one investigative position in the Office of Consumer Affairs. This expenditure was included in the County Executive's Recommended FY92 Operating Budget, and was approved by the Council as a one-time

expenditure of monies from the Fund. This represents the first time that monies from the Warranty Plan are being used to support OCA staff costs associated with administration of the Fund. (The costs of administering the Fund are discussed in more detail later in this report, see page 37.)

At this point in time, as long as claims payments do not exceed \$50,000 in FY92, then it can be projected that the County's Warranty Fund balance will remain somewhere between \$300,000 and \$320,000 for the next year. However, if claims payments increase during FY92, then the Fund balance could easily drop below the \$300,000 level. In addition, the balance in the Fund could be even lower if it is relied upon again in FY93 to help fund OCA staff costs.

c. The Record of Fund Reimbursement. According to Executive Regulation 20-90, when a payment is made from the County's Warranty Plan, the Director of OCA may take action against the builder to recover the amount of the total claim plus interest. In addition, the law authorizes the Director to proceed against the builder under Section 31C-8, which is the section that outlines the process for revoking a builder's license; and the County Attorney to initiate legal action against the builder.

Table 13 (page 24a) shows the record of builder reimbursement to the County Warranty Plan as of July 1, 1991. Out of the 14 builders involved, two reimbursed the Fund in full; seven made at least partial payments; and five made no payment at all. The two builders who have paid in full represent only five percent of the total amount of claims paid; while the five who have paid no reimbursement account for approximately half of the total amount paid out in claims.

Overall, the County's Warranty Plan has been reimbursed for \$56,843 out of the total amount of \$323,667 paid out in claims; this represents a reimbursement rate of 18 percent, or one dollar for every \$5.50 paid out. Almost two-thirds of this reimbursed amount has been obtained through payment plans negotiated by OCA staff with builders who have outstanding claims. If honored, current payment plans will result in an additional reimbursement of approximately \$90,000. While OCA staff is optimistic about receiving at least some of these funds, there is nothing to insure that the County will receive this money.

As of July 1991, the status of the 14 builders who had claims paid out by the County Fund was as follows:

- 10 of the 14 builders no longer had active County builders' licenses. Of these 10 builders: one had his new home builder's license revoked; one voluntarily surrendered his license; one was disapproved by the Board of Registration for license renewal; and the remaining seven did not apply for renewal when their licenses expired.
- Five of the 14 had declared bankruptcy.

Table 13

**Reimbursement to the County Warranty Fund
by Builders as of July 1, 1991**

<u>Reimbursement Status</u>	<u>Number of Builders</u>	<u>Amount of Claims</u>	<u>Percent</u>	<u>Amount Reimbursed</u>	<u>Percent</u>
Paid in full	2	\$ 17,888	6	\$17,888	31
Partial Payment	7	137,089	42	38,955	69
No Payment	5	168,690	52	-0-	-0-
Totals:	14	\$323,667	100.0	\$56,843	100.0

Source: Data were compiled from County Warranty Plan records, and were adjusted to reflect Department of Finance end of year reports.

- Four of the 14 builders who had claims paid out by the County Fund continued to hold active County builders' licenses; each of these four has entered into a reimbursement payment plan with the County, and the homes built by the three that continue to belong to the County's Warranty Plan are subject to pre-enrollment inspections.

The County has filed a lawsuit against one of the 14 builders who owes the County's Warranty Plan money for claims paid. In February 1990, the County Attorney filed a \$1.2 million lawsuit against this builder for failure to perform warranty work. The lawsuit alleges that the builder failed to provide the warranty required to at least two purchasers, failed to correct violations of the building code, and failed to honor an agreement to complete repairs to the common areas of the subdivision. The lawsuit asks for more than \$110,000 in repayment of warranty awards made out of the County Fund; more than \$100,000 in civil penalties and investigative costs; \$1 million in punitive damages; and restitution for those consumers not protected by the warranty plan.

5. Miscellaneous Issues. This section discusses two additional issues related to the County's New Home Warranty Plan: the use of consultants and the relationship between building code violations and warranty defects.

a. The Use of Consultants. As part of administering the new home warranty law, the Office of Consumer Affairs uses consultants to perform two functions:

- To act as dispute settlers to resolve claims brought by new home purchasers against builders who enrolled their home in the County's Warranty Plan; and
- To conduct detailed pre-enrollment inspections on certain homes to be enrolled in the County's Warranty Plan (see page 16).

The consultants that OCA uses to perform these functions are independent home inspectors, who are certified by the American Society of Home Inspectors (ASHI). Because of the problems with scheduling and the legally imposed time limits regarding the dispute settler's decision, OCA has found it advantageous to employ a number of different consultants.

With inspections related to County Warranty Plan dispute settlements, the home inspector is paid out of the general operating budget of the Office of Consumer Affairs. In the case of pre-enrollment inspections, the home inspector is selected by OCA, but paid by the builder whose home is being inspected prior to Plan enrollment.

The dispute settlement function involves conducting an initial inspection, submitting a written report with recommendations, and conducting any required compliance inspections. The average fee for a dispute

settlement is \$200-\$350. The fee for a pre-enrollment inspection varies according to factors such as the size of the house and the number of amenities, with an average cost of \$350-\$500.

At various times during the past five years, OCA staff have met with County Purchasing Office staff to discuss methods of payments to the consultants paid for by OCA. In 1989, because of the number of claims being filed against the County's Warranty Plan, the OCA entered into two separate under-\$10,000 professional services contracts with dispute settlers, and three under \$3,000 professional services "mini-contracts." The two under-\$10,000 contracts have not been renewed since FY89, and current practice has been to hire consultants and submit invoices on a direct pay basis.

b. The relationship between building code violations and warranty defects. Based upon interviews with staff and a review of claims files, a recurrent issue of dispute is the relationship between a building code violation and a warranty defect. In particular, the question that comes up is whether a building code violation should sometimes, always, or never be considered a violation of a warranty standard.

The executive regulations for the warranty program require that before a home is enrolled in a warranty plan, a builder must provide to a purchaser at the time of occupancy or settlement (whichever first occurs) a statement that the key County building code inspections have been performed by the Department of Environmental Protection, e.g., footing, foundation, electrical, plumbing, septic, and final building permit inspections.

It is the view of the OCA staff that there should be a rebuttable presumption that a building code violation is evidence of a warranty defect. The other point of view is that a code violation should be separated from the determination of warranty defects; the rationale for such separation is that it is possible to have a technical code violation which does not result in any noticeable physical deficiency in the construction of the house.

C. The Alternate (Private) Warranty Plans Operating in the County

1. Overview of Legal requirements. In order to do business in the County, alternate (private) new home warranty plans must be approved annually by the Office of Consumer Affairs (OCA). The law (Section 31C-6) authorizes the OCA Director to establish regulations for the approval of private warranty plans, and to charge a reasonable fee to cover the costs incurred in reviewing and approving applications.

The law authorizes the OCA Director to revoke or suspend the approval of a private warranty plan if, in the opinion of the Director, the private plan becomes financially unable to meet its warranty obligations, or is administered in a way that denies owners the warranty coverage required by law or regulation. Decisions by the OCA Director can be appealed by a private warranty plan to the Board of Appeals.

Executive regulations outline the annual approval process and quarterly reporting requirements for the private warranty plans desiring to do business in the County. The regulations establish a \$2,000 non-refundable annual application fee for private warranty plans.

In order to receive or maintain approval, a private warranty plan must conform to all the requirements established by regulation, which include:

- Demonstrating financial security adequate to cover the total amount of claims that the program may reasonably anticipate to be filed against participating builders;
- Administering a complaint, claims, and payment procedure which provide: a period of conciliation between the builder and homeowner; dispute settlement by an independent third party; and timelines similar to those established for the County's Warranty Program; and
- Providing the homeowner with written materials that detail warranty coverage and dispute settlement procedures in plain language.

By regulation, the private warranty plans' annual application for OCA approval must include information such as: the rate schedule of charges or fees; a breakdown of proposed plan expenses for the warranty administrator; a certified, audited financial statement of income and expenses; a full description of the complaint and claims process (including the name and address of the agency that will provide dispute settlement services); samples of the forms used in the claims and dispute settlement process; copies of any contractual agreements between members builders and the warranty administrator; and an affidavit that the warranty guarantor and administrator are fully aware of all of the requirements and conditions of the County's new home warranty law.

On a quarterly basis, private plans approved to do business in the County must submit specific data to OCA, to include: the names and addresses of new builders and new homes enrolled; and information about specific warranty claims. Once every six months, private plans are required to investigate all homes constructed by an enrolled builder to determine instances of non-payment of warranty premiums or non-enrollment of homes. In addition, private warranty plans must submit an annual report that shows the total number of builders participating; the total number of homes enrolled; and the total number of claims paid during the reporting period.

Finally, the regulations require the private warranty plans operating in the County to notify OCA in all cases where a builder's enrollment is terminated. The private plans must notify OCA within 10 days after the plan discontinues a builder's enrollment, and must provide sufficient information on the reason for termination.

2. In Practice: The Private Warranty Plans Approved by OCA

a. General. As of July 1991, there are six private warranty plans approved by OCA to operate in the County.* This OLO report will reference the six plans currently operating in the County as Private Plan A, B, C, D, E, and F.

As reviewed in the previous chapter (see Table 3, page 19a), there are more builders enrolled in the County's Warranty Plan than in any one of the private warranty plans. Two of the private plans operating in the County each have only one builder member; these two plans were established by individual builders to warrant only that builder's homes. The other four plans each have between 40 and 101 builders enrolled.

Table 3 also shows the number of homes enrolled in the County's Warranty Plan and in each of the six approved private plans. The data indicate that 20,329 (97%) of the 20,901 homes enrolled since July 1986 have been enrolled in an approved private warranty plan. The homes are unevenly distributed among the six plans, with one plan standing out with 40 percent of all homes enrolled since July 1986.

As discussed earlier in this report (see Table 5, page 19c), it is estimated that approximately 26,700 new homes in the County were completed between 1986 and 1990. Combining this statistic with the data contained in Table 3 (page 19a) suggests that an estimated 8.5 percent of new homes sold since July 1986 have been sold without being enrolled in either the County's Warranty Plan or an approved private warranty plan.**

b. Similarities and Differences Among Private Warranty Plans. Because the basic features of private warranty plans approved by the County are statutorily imposed, the plans operate similarly in many respects. For example, the law requires all private warranty plans doing business in the County to: adopt the warranty standards established by the County regulation; provide for dispute settlement of any warranty claim dispute by an independent third party; and adhere to certain timelines set forth by regulation.

However, the private warranty plans differ on factors such as: application procedures; builder acceptance criteria; the level of fees and premiums charged to builders; and the process for filing and investigating complaints. For example: four of the approved warranty plans

* A seventh warranty plan approved to operate in the County withdrew its operations from the County in 1988; this plan continues to warrant the homes still covered under its ten year warranty. In addition, it should be noted that during this past year, administration of one of the six plans was taken over by one of the other approved plans in the County.

** This estimate is not far from OLO's County Plan sample, which indicated a ten percent rate of non-compliance; see page 19.

provide for internal investigation prior to proceeding to third-party dispute settlement; and two plans initiate dispute settlement directly after receiving a warranty complaint and verifying the builder's unwillingness or inability to perform repairs.

All of the private warranty plans approved in the County list either the National Association of Conciliators (NAC) and/or the American Association of Arbitrators (AAA) as the third party that will conduct their dispute settlements. Two of the warranty plans use NAC, three use AAA, and one uses both NAC and AAA. Both NAC and AAA are recognized by the federal government as legitimate third party dispute settlement organizations.

3. The Office of Consumer Affairs' Oversight Role. The Office of Consumer Affairs (OCA) has had limited staff resources available to oversee the operations of the private warranty plans approved to do business in the County. Based upon interviews with OCA staff, it appears that the demands of managing the County's Warranty Plan and responding to individual new home complaints have precluded more time from being spent on general oversight of the private warranty plans' activities.

Currently, the job of overseeing the private warranty plans is shared between the Administrator of OCA's Housing Group and one part-time (24 hours per week) OCA investigator. The staffing situation was even more limited during this past year because the part-time investigator assigned to the private plans was on personal leave from February-September 1991. The part-time investigator returned to work during the first week of October 1991, and is currently assigned exclusively to handling issues related to the private warranty plans.

OCA's oversight role with respect to the annual approval process and review of quarterly reports can be described as follows:

The annual private warranty plan approval process. As reviewed earlier (see page 27) private warranty plans desiring to do business in the County must apply annually to OCA for approval. During FY91, the renewal dates for the six plans all occurred between October and March.

OCA staff reviews each of the annual plan approval submissions to determine whether all of the requisite data has been provided, and whether the warranty plan is structured to comply with all of the County's criteria. The task of reviewing the annual plan submissions is extremely time-consuming due to the length and complexity of the material submitted by the private warranty plans. OCA staff has, on several occasions, sought the advice of the County's Finance Department with respect to evaluating the financial information submitted by the private warranty plans.

While OCA has not denied approval to any private warranty plan that has applied to the County, OCA staff has sought additional data and required certain changes to be made as a condition of plan approval. The annual renewal process provides OCA with an opportunity to learn more about how the private warranty plans are operating, and where modifications to their procedures are needed. Examples of what OCA staff discovered through the annual renewal process and complaint investigations include:

- One of the private plans was not consistently taking homeowner claims on major structural defects to dispute settlement;
- One of the private warranty plans was not providing the correct warranty documents to their homeowners;
- In two cases, private warranty plans were charging homeowners for dispute settlement (a practice which is prohibited by County regulation); and
- In several instances, private warranty plans were not consistently adhering to the County's warranty standards.

As a result of these findings, OCA required the respective warranty plans to change their practices in order to gain approval by OCA to operate in the County.

Quarterly reports. As explained above, (see page 27) the private warranty companies doing business in the County are required to submit quarterly reports to the Office of Consumer Affairs. These reports include data on builders and homes enrolled, dispute settlements, and amount of claims paid out for homes enrolled in Montgomery County. A number of warranty plans also submit copies of all correspondence related to pending warranty claim cases in the County.

It takes significant staff time to review these quarterly reports, which, similar to the plans' annual filings, can be lengthy and complicated. According to OCA staff, these reports are inspected in order to identify any irregularities in how warranty claims are being handled by the private warranty plans.

Based upon complaints received from homebuyers who did not report warranty claims within the required time periods, during the past year OCA initiated an effort to better educate new homebuyers about their rights and responsibilities under the County's new home warranty law. Using the lists of new homebuyers provided quarterly by the private warranty plans, OCA now sends a letter to all new homebuyers before the end of the first year that their home is enrolled in a private warranty plan. The letter strongly encourages the homebuyer to read his/her warranty documents carefully and reminds homebuyers that there are certain time limits that they must adhere to under the terms of the warranty. During the past year, OCA estimates that 900 of these letters were sent; OCA staff has received approximately 15 telephone calls in response to these letters.

Because OCA has not had the staff resources to develop a data base for the information submitted by the private plans, there is currently no formal system to track basic activity in the private plans, such as: the number of warranty claims being filed; the number of dispute settlements taking place; or total number/amount of claims being paid by the private warranty plans. (As part of this evaluation, OCA staff assisted OLO in compiling some summary data about activity in the private plans, see Table 14, page 32a.)

4. OCA's Involvement with Specific Warranty Claims in the Private Plans. If the owner of a home enrolled in a private warranty plan contacts OCA with a warranty-related complaint, then it is OCA's general practice to advise the homeowner how to best pursue the issue with his/her builder and warranty plan. To handle such complaints efficiently, OCA developed a standard letter that is sent to homeowners who have contacted the office about a problem they are having with a home enrolled in a private warranty plan. The letter advises the homeowner that in order to secure the benefits of their warranty, they must follow the procedures established by their warranty plan. The letter offers some specific advice to homeowners in terms of what to expect and how to proceed; and closes with the following explanation of the Office of Consumer Affairs' role:

It has been our experience that the warranty process outlined above resolves most warranty complaints and disputes. If you are not satisfied at the conclusion of the warranty process with the manner in which your claim has been handled by your builder or the warranty company, please let us know. While we do not have the authority to overrule a dispute settlement warranty decision, we will be happy to review this matter with you at that time to determine what further recourse may be available to you.

In recent years, OCA staff has become extensively involved in only a relatively small number of cases involving homeowners' warranty claims against builders enrolled in a private warranty plan. According to OCA staff, the Office has become directly involved in an estimated 10-12 private warranty plan cases during the past two years.

Based upon their involvement with specific cases, OCA staff has identified a number of recurrent problems with the resolution of private warranty claims by the private warranty plans. In particular, according to OCA staff, their experiences evidence some problems with the dispute settlement procedures and dispute settlers employed by a number of the private plans. Specifically, according to OCA staff:

- The private warranty plans do not consistently adhere to the statutorily established timelines for conciliation, investigation, and dispute resolution;
- Private warranty plan staff are not always familiar with how the dispute settlement process is supposed to work in Montgomery County;
- The dispute settlers used by the private warranty plans are not always knowledgeable about how to evaluate a homeowner's warranty complaint;
- The dispute settlers are not always familiar with the warranty standards as they are defined by executive regulation for homes located in Montgomery County; and
- The private warranty plans do not consistently allow for partial acceptance or partial rejection of arbitration awards (a procedure that is required by County regulation).

In addition, OCA staff have encountered some resistance from the private plans when it comes to obtaining copies of a dispute settler's report.

5. Record of Dispute Settlements and Claims Paid out for County homes enrolled in Private Warranty Plans. As indicated above, data on dispute settlements and warranty claims paid by the alternate plans are reported on a quarterly basis to OCA. However, because OCA has not had the staff resources to develop a data base for this information, there is no system in place to track the overall number of claims filed, number of dispute settlements, or number/amount of claims being paid by the private warranty plans.

Compiled with assistance from OCA staff, Table 14 (page 32a) provides some data on the number of homeowner complaints filed, the number of dispute settlements, and the total number of claims paid out on County homes enrolled in private warranty plans since the new home warranty law went into effect in July 1986. The primary sources for these data are the quarterly and annual reports from the private warranty plans to OCA. As noted on Table 14, these data are incomplete due to difficulties encountered in obtaining accurate and consistent data.

Based upon data that are available, the six plans collectively report receiving 809 warranty complaints from owners of County homes enrolled in the respective plans, and report taking 355 of these complaints to dispute settlement. Two of the plans report never taking a complaint to dispute settlement. Additional investigation that is beyond the scope of this OLO report is needed to explain exactly what has occurred with the complaints that are filed, but not taken to dispute settlement. Possible explanations include: that the complaints are being resolved by individual builders without need for a dispute settler; or that homeowners are choosing not to pursue their complaint for some reason or another.

Minimal data are available on the amount of warranty claims paid out by the private warranty plans on County homes enrolled since July 1986. The data on Table 14 indicate that only three of the private plans report paying warranty claims; and that together these three plans have paid a total of \$227,727 for 68 separate claims. Similar to the record on dispute settlement, additional investigation is needed before conclusions or judgments are made on the claims record of the private plans.

6. Perceptions of OCA's role offered by representatives of the Private Warranty Plans. OLO's interviews with representative from all six of the private warranty plans currently doing business in the County revealed a range of perceptions of the Office of Consumer Affairs' role.

In general, representatives of the private plans perceive OCA staff as competent and professional. A number of individuals involved since the warranty law went into effect in 1986 noted that the relationship between OCA and the private plans is significantly better today than it was five years ago.

A majority of representatives of the private plans voiced their view that the County's quarterly and annual data requests are onerous. In particular, several individuals questioned whether the County was reviewing and using all of the information that it received.

Table 14

**Number of Complaints Filed, Dispute Settlements, and
Claims Paid by Approved Private Warranty Plans
July 1986 - July 1991**

	Number of Warranty Complaints Received	Number of Dispute Settlements	Warranty Claims Paid	
			Number	\$ Amount
Private Plan (A)	57	1	0	0
Private Plan (B)	570	324	46	\$126,259
Private Plan (C)	29	14	20	\$ 31,324
Private Plan (D)*	93	16	2	\$ 70,144
Private Plan (E)*	33	0	0	0
Private Plan (F)*	27	0	0	0

* As of this writing, due to difficulties encountered in obtaining accurate information, data from these plans are incomplete.

Source: OCA records and reports from private warranty plans.

A majority of private plan representatives interviewed felt that OCA staff was performing a very appropriate and effective oversight role with respect to specific private plan warranty cases. However, one plan representative commented that OCA staff has not consistently followed-up on issues, and another plan representative noted that OCA staff has not always responded to letters or returned telephone calls in a timely manner during the past year.

D. PERCEPTIONS OF BUILDERS AND HOMEOWNERS

1. Overview. In addition to consulting representatives of the Suburban Maryland Building Industry Association, the Montgomery County Builders' Association, and the Montgomery County Board of Realtors Builder/Broker Committee, OLO conducted indepth phone interviews with a sample of 25 builders and homeowners who have been directly involved with the builder licensing and new home warranty law.

The sample included builders enrolled in the County's Warranty Plan as well as builders enrolled in private warranty plans; approximately half of the builders interviewed built homes which were the subject of a warranty claim within the past five years. The homeowners interviewed represented a sample of homeowners who had purchased a new home in the County since the mandatory new home warranty law went into effect, and who had filed a warranty complaint with either the County's Warranty Plan or one of the approved private warranty plans operating in the County.

OLO's sample size is too small to draw definitive conclusions about the views of all builders and homeowners in the County. However, OLO's interviews revealed some recurrent perceptions that are summarized below.

2. Summary of Builders' Comments. OLO's interviews with licensed County builders included questions about: how they learned about the mandatory new home warranty requirement; how they decided which warranty plan to join; their experiences with resolving warranty complaints; and their general views about the County's new home warranty and builder licensing law.

Most of the builders interviewed had not enrolled a home in a warranty plan before it became a legal requirement in the County. The reasons most often cited for not enrolling homes prior to the mandatory warranty law were that: the fees for enrollment raise the sales price of the home; a warranty does not cover some of the problems most frequently experienced by homeowners (e.g., driveways, landscape work); and the builder felt no need to join a warranty plan because he would correct the defects on his own anyway. The few builders interviewed who had enrolled homes in a warranty plan before it was required by County law explained that they had chosen to do so because it was a good marketing tool and gave their consumers a sense of security.

All of the builders interviewed were aware that County law requires all new homes to be enrolled in a warranty plan. Builders reported they had learned of the requirement either through a builders' organization newsletter, or a County Government notice. Several builders had learned of the requirement when they had gone to obtain a new home building permit.

When asked how they decided which warranty plan to join, builders who belong to a private plan tended to respond differently than builders who belong to the County's Plan. In particular, County Plan builders reported they joined the County's Warranty Plan because: it was the least expensive alternative for them; it involved less paperwork than joining a private plan; and/or they had never gotten around to applying to a private warranty plan. One builder reported that he enrolled in the County's Plan because he didn't think he would be able to gain acceptance by a private plan; and one builder reported joining the County's Plan because he perceived that the County's Plan would give the consumer a better deal.

Similar to County Plan builders, private plan builders also cited price as a primary consideration for them in choosing a warranty plan. (Note: the private warranty plans tend to be less expensive per house for high volume builders.) In addition, private plan builders explained they had decided to enroll in a private plan because of the name recognition that the private plan provided; and because they preferred going with a privately-run as opposed to a government-run warranty plan.

When questioned about the process for resolving warranty claims, private plan builders responded that they felt the process was fair, and in particular, noted the advantage of involving a third party in resolving a warranty complaint. One private plan builder commented, however, that the dispute settler in his particular case was not very knowledgeable about building a house.

Many of the builders interviewed questioned the utility of the mandatory warranty legislation. A recurring comment was that good builders are going to take care of any problems without a mandatory warranty, while bad builders are going to cause problems with or without the warranty legislation. A majority of builders interviewed felt that the legal connection between a builder's license and performance of warranty obligations was less important than a builder's reputation and personal interest in being known as a good tradesman and responsive builder.

3. Summary of Homeowners' Comments. OLO's interviews with homeowners included questions about: how homeowners had learned that their new home came with a warranty; their experience with reporting and resolving a warranty defect; and their general views about the County's new home warranty and builder licensing law. The reader is reminded that all of the homeowners selected for interview had experienced some problems with their newly purchased homes during the past five years.

Almost all of the homeowners interviewed voiced general support for continuing to mandate that new homes sold in the County come with a warranty. Although some of the homeowners interviewed expressed frustration with certain aspects of the warranty claims process, most of them said they were satisfied with the final outcome of their warranty complaint, and a number specifically commented that the OCA investigators were helpful and responsive.

The majority of homeowners interviewed recalled learning prior to settlement that their new home would come with a warranty, but do not recall receiving a warranty document at the time of settlement. About half of the homeowners reported that they understood what the warranty covered before they purchased the home, and the other half reported focusing on the substance of the warranty only after experiencing problems with their homes.

A number of homeowners noticed some problems with their new homes prior to settlement, and the rest noticed problems within the first year of owning their homes. All of the homeowners interviewed reported that once a problem with their house had been identified, their first response was to contact their builder. About half of the homeowners described their builder as responsive to their concerns; the other half described their builder as generally unresponsive.

A sense of frustration with the complexity and length of the warranty claims process was reported by a number of homeowners with homes in the County's Warranty Plan as well as by homeowners with homes in private warranty plans. In particular, homeowners voiced frustration with delays caused by their builders' promises to perform work, and by the time consuming process of obtaining bids on the cost of repair work. (Note: The law requires a 45-day conciliation period between the builder and homeowner).

The one thing that homeowners consistently said they would do differently in the future is not go to settlement until they are assured the house meets their expectations. Suggestions voiced by individual homeowners included:

- Homeowners should receive better information about their new home warranty;
- OCA should appoint a staff member as the official liaison between the County and private warranty plans;
- The County should establish more stringent licensing standards for new home builders; and
- The County should be more aggressive in terms of revoking the licenses of builders who are constructing homes with defects and/or failing to respond to consumers' problems.

E. Program Costs and Revenues

1. Legal Requirements. Code Section 31C-10, Administration, assigns the Office of Consumer Affairs (OCA) with the overall responsibility for administering Chapter 31C, New Home Warranty and Builder Licensing. Section 31C-5 assigns "administration" of the County's New Home Warranty Plan to OCA, and "maintenance" of the Fund to the Department of Finance.

The following sections of Chapter 31C identify certain activities to be paid for by specific revenue sources:

- Section 31C-2(3) authorizes that builder licensing fees be "sufficient to cover the costs of administration of this chapter";
- Section 31C-6 authorizes the OCA Director to charge a reasonable fee to cover the costs incurred in reviewing and approving applications from private warranty plans; and
- Section 31C-10 states that, "Reasonable costs for administration of the fund must be covered through both licensing fees and the fund."

Note: Based upon these three statements about program costs and revenues, it is unclear exactly what activities the law intends will be paid for by which fees. In particular, it is unclear whether builder licensing fees are intended to cover the costs of administering the entire New Home Warranty and Builder Licensing chapter; and/or whether funds from the County's New Home Warranty Plan itself were intended to be drawn upon to cover ongoing staff costs associated with administration of the Fund.

As discussed earlier in this report, the law (Section 31C-7) limits the financial responsibility of the County Government towards the County's New Home Warranty Plan. The law explicitly states that the County Government is not required to contribute money to the fund, and specifies that if the Fund is ever insufficient to satisfy outstanding claims, then the OCA Director may require additional payment from builders participating in the Fund. In addition, the law authorizes the OCA Director to pursue reimbursement from builders for claims paid out of the County Fund.

2. Projected Fiscal Impact of Bill 69-85. A formal fiscal impact statement for Bill 69-85, New Home Warranty and Builder Licensing, was prepared by the Office of Management and Budget in December 1985. OMB's fiscal impact statement was based upon OMB's understanding that the legislation intended the County's entire builder licensing and new home warranty program to be "self-supporting and non-profit making".

OMB projected that the licensing and warranty program would cost an additional \$100,000 in staff and operating costs, but would generate sufficient revenues to be self-supporting by the third year of implementation. OMB identified three sources of revenue associated with Chapter 31C: builder licensing fees; administrative fees for OCA's approval of private warranty plans; and interest income generated by the County's Warranty Fund. OMB's revenue projections assumed that:

- Builder licensing fees would generate \$125,000 every two years, based upon an estimated 625 builders each paying \$200 for a two-year license;

- Private warranty plan approval fees would generate \$8,000 the first year and \$2,000 in subsequent years, based upon the assumption of four private plans each paying initial application fees of \$2,000 and annual renewal fees of \$500; and
- The Warranty Fund would generate an average of \$42,000 in interest revenue, based upon an assumed interest rate of seven percent and a Fund balance of \$600,000 after the first year. (This projection assumed that 2,000 homes would be enrolled each year in the County's Fund, with an average purchase price of \$100,000 and a premium of 3/10 of one percent of the purchase price.)

3. The Record of Actual Program Costs and Revenues

a. The Costs of Program Administration. In July 1986, the Office of Consumer Affairs (OCA) assumed responsibility for overall administration of Chapter 31C. In the approved FY87 budget, for administration of the builder licensing and mandatory warranty law, OCA received funding for: one additional full-time investigator; one part-time administrative aide; plus the transfer of a full-time program specialist from the Department of Environmental Protection (DEP) to handle builder licensing and staffing of the Board of Registration.

Since the Fall of 1987, the Office of Consumer Affairs' investigative staff has been organized into three major functional groups: Housing, Automotive, and General Practices. The function of administering the new home warranty and builder licensing legislation is assigned to the Housing Group, which has responsibility for all consumer complaints and other issues related to: new homes, new home warranty, building contractor licensing, home improvement/repair, and cable television.*

According to the approved FY92 Personnel Complement, the Housing Group currently contains eight full-time and one part-time positions:

- One Consumer Affairs Administrator (Grade 27);
- Five full-time and one part-time Investigator II's (Grade 23);
- One Program Specialist I (Grade 18); and
- One Principal Administrative Aide (Grade 13).

In discussing the allocation of their time, OCA staff emphasized that it is difficult to quantify the amount of staff time dedicated exclusively to the builder licensing and new home warranty law because the new home complaints handled by the Housing Group are often complicated cases,

* In addition, until FY92, the Housing Group also handled homeowner association dispute resolution; in 1990 that function was transferred by law to the Office of Landlord Tenant Affairs.

which involve both warranty and non-warranty related issues. OCA staff explain that the mandatory warranty law provides an additional tool for resolving certain types of new home complaints; and the absence of the warranty law would not make consumers' problems with newly purchased homes disappear. OCA staff maintain that they would undoubtedly spend time on new home complaints with or without the new home warranty law, and that the Housing Group would likely be faced with an even larger volume of new home complaints without the mandatory warranty law.

Based upon interviews with OCA staff, it appears that the most time-consuming aspect of the builder licensing and new home warranty program has been the administration of the County's Warranty Plan. Especially during the past three years, managing the County's Warranty Plan has demanded much of the Housing Group Administrator's time. In particular, establishing procedures for enrolling homes, resolving claims, and attempting to collect from builders who owe the County's Warranty Plan, have turned out to be very staff intensive activities. However, OCA's Housing Administrator projects that the management of the County's Fund will take significantly less staff time in the future because most of the procedures now in place.

For FY92, the total budget for personnel costs (salaries plus fringe) in the Housing Group is \$441,300. While acknowledging that it has taken significantly more staff time in previous years, the Housing Group Administrator estimates that approximately two workyears in the Housing Group (equal to approximately \$100,000 in staff costs) will be spent in FY92 on: builder licensing; administration of the County's Warranty Plan (to include enrollment of builders and homes; the resolution of warranty claims filed against builders enrolled in the County Fund); and oversight of the private warranty plans operating in the County. In addition, an estimated \$3,000-\$5,000 will likely be spent on hiring consultants to serve as dispute settlers for resolution of County Fund warranty claims, or to inspect some other aspect of a new home warranty complaint.

In sum, OCA's \$100,000 staff cost estimate for FY92 comes close to the \$100,000 in incremental costs projected by OMB in 1985 for administering the new home warranty and builder licensing law.* Based upon interviews with OCA staff, it appears that what was not predicted in 1985 was how time consuming it would be for the County to set up procedures for administering its own warranty plan; and how difficult it would be to identify staff time spent exclusively on new home warranty issues.

b. Program Revenues. As reviewed above, the fiscal impact statement for Bill 69-85 identified three sources of revenue associated with the enactment of Bill 69-85: builder licensing fees, plan approval fees, and interest earned on the County's Warranty Fund balance.

* It should be noted that due to the extra staff time dedicated to establishing procedures for administration of the County's Warranty Plan and resolving warranty claims, the incremental costs of implementing Chapter 31C were likely higher than \$100,000 before this year.

- Builder licensing fees. In FY90 and FY91, \$107,000 was collected through builder licensing fees. The revenue generated from builder licensing fees here is less than the \$125,000 that OMB projected in 1985 would be generated by builder licensing fees every two years. However, the \$100 increase in the fee that went into effect in November 1990 is expected to generate an additional \$20,000-\$40,000 during the next two-year licensing cycle.

- Private plan approval fees. With six private warranty plans operating in the County, \$12,000 has been collected annually in program approval fees. This exceeds OMB's 1985 projection, because the fee was set at \$2,000/year, and not reduced to \$500 for plan renewal.

- Warranty Fund interest. Warranty Fund records show interest earnings of \$13,000-\$27,530 per year between FY88 and FY91 (see Table 12, page 22c). The actual interest earned is about half of what OMB projected in 1985 that the Fund would be earning. The difference is that OMB projected a Fund balance of \$600,000 by FY88, while the end-of-year Fund balance has instead ranged between \$240,000 and \$337,048 between FY88 and FY91. In 1985, OMB overestimated the number of homes that would be enrolled each year in the County's Fund, but underestimated the average purchase price of homes enrolled.

Until this fiscal year (FY92), the cost of administering the builder licensing and warranty plan program was paid for as part of OCA's general operating budget, which is funded through General Fund revenues. Although it was not projected by OMB as a revenue source, it is important to note that in FY92, one OCA investigator position (\$53,200) is being funded out of the County's Warranty Fund itself, rather than out of General Fund revenues. This change in funding was proposed by the Executive and approved by the Council during the FY92 operating budget deliberations as a one-time expenditure of monies from the Warranty Fund.

In sum, the two sources of General Fund revenue associated with Chapter 31C (builder licensing fees and plan approval fees) have generated an average of \$75,000 per year.* If interest earned by the Warranty Fund is counted, then Chapter 31C has generated annual revenue close to the \$100,000 that had been projected by OMB in 1985.

* This assumes that builder licensing fees collected during a two-year licensing cycle are divided equally between those two years.

IV. CONCLUSIONS

General

1. Bill 69-85, New Home Warranty and Builder Licensing, was enacted in April 1986 with an effective date of July 9, 1986. The legislation was advocated by the County's Office of Consumer Affairs as a way to improve the level of consumer protection for buyers of new homes in the County. In particular, Chapter 31C was structured to improve upon the State's limited requirement for a one-year implied warranty on new homes; and the County's new home builder licensing procedures, which at the time required builders to demonstrate financial security only by posting a \$2,000 bond, regardless of the number of homes constructed.

2. Chapter 31C, New Home Warranty and Builder Licensing, provides County consumers with one of the most comprehensive new home warranty and builder licensing programs in the country. It requires ten year warranty coverage for all new homes, provides a mechanism for approval of private warranty plans, establishes a County-run warranty plan, and establishes a link between a builder's license and warranty performance.

3. The history and substance of the legislation indicate that it was enacted with a number of specific goals:

- To provide consumers and builders with a common set of written standards that clarify which items in a new home are covered by a warranty and for how long;
- To provide consumers with an effective remedy for resolving new home warranty complaints in a timely manner;
- To provide a recourse for consumers on warranty items in situations where the builder has gone out of business; and
- To establish a builder licensing system in which a builder's failure to perform warranty obligations can affect the builder's ability to remain licensed.

3. Since 1986, there have been only two minor changes made to Chapter 31C and its associated executive regulations. In October 1990, Bill 46-90 extended the term of members appointed to the Board of Registration from two to three years; and in November 1990, the regulations were amended to increase the builder licensing fee from \$200 to \$300.

4. The County's new home warranty and builder licensing law does not currently apply in eight of the County's 17 municipalities; the State's new home warranty law applies in these eight municipalities. Six of these eight municipalities rely upon the County Government to perform building code inspections. The potential problem in these six municipalities is that the County Government has the responsibility to issue building permits and conduct building inspections (under Chapter 8, Buildings), but not the authority to issue or revoke licenses for new home builders (Chapter 31C, New Home Warranty and Builder Licensing).

Builder Licensing and the Board of Registration

1. The law provides the Board of Registration with only very general criteria upon which to base their decision to grant or deny a new builder license application. In 1988, the Board discussed the need for more detailed criteria, but decided against recommending that more specific standards be established at that time.

2. The powers and duties of the Board of Registration are not outlined clearly in one section of the law. As currently written, the Board is established in one section (Section 31C-4), and the responsibilities and powers are found in the middle of two other sections of the law (Section 31C-2, Licensing; Section 31C-8, Investigation and Hearing), and in Section 7, Warranty Claims, of Executive Regulation No. 20-90.

3. Section 31C-4 requires the Board of Registration to submit an annual report to the Director of OCA. The Board submitted an annual report in 1988, but has not submitted one since then.

4. Between FY88 and FY91, the Board approved 97 percent of all new home builder license applications. Only one appeal of a license denial was filed with the Board of Appeals; however, it was withdrawn before hearing.

5. The Board of Registration, with staff assistance from OCA, has consistently met the statutory deadlines set for action on builder license applications. Most applications are acted upon within 30-45 days after they are submitted, which is less than the 60 days required by law.

6. As of July 1, 1991, there were 578 licensed new home builders in the County. During the past two-year licensing cycle, OCA collected \$107,000 in licensing fees. (The fee was increased from \$200 to \$300 in November 1990.)

7. Builder licenses are issued for a two-year period, and with Board concurrence, renewals are handled routinely at the staff level without review by the Board of Registration. Only rarely is a renewal application discussed with the Board. Under current procedures, a builder is not required to submit updated financial information at the time of renewal, and compliance with the requirement that all new homes be enrolled in a warranty plan has not been consistently researched before a license is renewed.

8. The Board of Registration has revoked four and suspended one builders' licenses since the builder licensing function was transferred to the Office of Consumer Affairs from the Department of Environmental Protection (DEP) in 1986. The Board held an additional show cause hearing that did not result in any formal revocation action. All six of these formal Board actions were taken between March 1987 and July 1988; and in most of these cases, a builder's failure to perform his warranty obligations was a primary factor cited behind license revocation.

9. According to OCA staff, during the past three years, there have also been between five and ten cases where builders choose either to surrender or not renew their licenses instead of face formal enforcement action by OCA.

The Board of Registration has not been involved in these cases, in which interactions have taken place between the builder and OCA staff. In some (but not all) of these cases, a builder's decision to surrender his license was recorded in the builder's licensing file.

10. The Department of Environmental Protection (DEP) and OCA staff have developed reasonable procedures to enforce the requirement that a builder must be licensed by OCA in order to obtain a new home building permit from DEP. The major limitation is that the system cannot easily stop someone from fraudulently using the name and license number of a legitimate licensed builder, or inappropriately applying for an owner/builder new home building permit. To address this issue, OCA staff now review all owner/builder permits in order to detect possible fraud.

11. The law does not specify how to handle the status of a building permit that is issued to a licensed builder, whose license is either suspended or revoked before the house is completed. According to OCA staff, based upon a specific case that occurred several years ago, it is the County Attorney's view that DEP has the authority to issue a stop work order on a building permit issued to a builder whose license is suspended or revoked.

The County's New Home Warranty Plan: General

1. The legislative intent of the County's New Home Warranty Plan was to establish a warranty plan of last resort for builders who could not be accepted by a private warranty plan. By law, the Fund was intended to be self-supporting, and the County Government is not required to make any contributions to the Fund.

2. The record of the past five years indicates that although the total number of homes enrolled has been relatively small, the County's Warranty Plan has not turned out to operate as a warranty plan of last resort for only those builders who could not be accepted by a private plan. Instead, builders have chosen to participate in the County's Plan for reasons other than being rejected by a private warranty plan. Although it is not known at this time exactly how many County Plan members could have (or could now) be accepted by a private plan, many builders who belong to the County's Warranty Plan joined apparently because it was either: logistically the most convenient plan to join, or less expensive than joining a private warranty plan.

Although initially established to be more expensive than the private plans, the County's premium has, except for high volume builders, turned out to be equal to or less expensive than the premiums charged by the private plans. In addition, unlike the private warranty plans, the County does not charge builders for dispute settlement, and does not charge either an application or annual enrollment fee.

3. The marketplace for private warranty plans has evolved during the past five years, and one of the primary arguments for establishing a County-run warranty plan no longer exists. At the time Bill 69-85 was being considered, the private warranty plans doing business in the County generally would not accept members without a proven track record of building homes; and

it was therefore argued that a County-run warranty plan was needed to serve as a warranty plan for those entering the new home construction business. During the past five years, however, the private warranty plan business has become more competitive; and at this point in time, three of the six plans approved in the County have special programs for accepting entry level builders.

4. Neither law nor regulations provide OCA with specific authority to refuse to enroll builders or homes in the County's Warranty Plan. During 1989, recognizing that there was a need to screen the homes being enrolled in the County's Warranty Plan, OCA staff administratively instituted a number of prerequisites for builders participating in the County's Warranty Plan. The most significant change was to require new builders participating in the County's Plan to agree that the first three homes that they enroll will be subject to pre-enrollment inspections, to be conducted by an independent home inspector selected by OCA.

5. Analysis of the County's Warranty Plan records indicates that as of July 1, 1991:

- a. 304 builders and 572 homes were enrolled in the County's Warranty Plan. This represents more than half of all licensed builders in the County, but only 2.1 percent of new homes completed since 1986. Less than half of the builders participating in the County Plan have actually enrolled one or more homes; the remaining are licensed builders who are not actively building homes at this time. Only eight builders have enrolled ten or more homes in the County Plan.
- b. The number of homes enrolled in the County's Warranty Plan has declined each year, while the average (median) purchase price of homes enrolled in the County's Warranty Plan has increased. As of July 1, 1991, the average (median) purchase price of all homes enrolled in the County Plan was \$259,000.
- c. The County's Warranty Plan has paid out a total of \$321,400 for 56 claims that individually ranged in amount from \$225 to \$35,000. The paid claims involved a total of 43 homes and 14 builders. 30 (53%) of the claims were paid on a subdivision built by one builder.
- d. There is a downward trend in the number of claims paid on homes enrolled during the most recent three year period; 54 (96%) of the 56 County Warranty Plan claims paid were paid on homes enrolled prior to July 1988. This trend is likely explained by: the substantial reduction in the number of homes enrolled in the County Plan since 1988; and the implementation during 1989 of more careful procedures for enrolling homes in the County's Warranty Plan, e.g., pre-enrollment inspections.

- e. Homes that sold for more than \$400,000 account for almost half (49%) of all premium revenue into the Fund, but only 15 percent of the total amount of claims paid out.
- f. Sample data indicate that the average (median) length of time between receipt of a written complaint by OCA and actual claim payment from the County Fund has been 12-14 months. The length of time is effected by factors such as: the complexity of the problem (both the number and type of defects); the responsiveness of the builder; and the time that the homeowner has to devote to resolving the problem.

6. The law requires homes to be enrolled in the County's Warranty Plan at least 10 days prior to the date of settlement or occupancy, and the regulations require that a late payment fee will be assessed for any home that a builder fails to enroll on time. According to OCA staff, approximately \$5,000 has been collected in late payment fees; depending upon the circumstances surrounding each late enrollment, the full late enrollment fee has sometimes been waived by OCA staff.

7. Although new building permits are only issued to licensed builders, there is no regulatory procedure that prevents a home from going to settlement without being enrolled in a warranty plan. Available warranty plan data suggest that an estimated eight to ten percent of new homes completed have failed to be enrolled in either the County's Warranty Plan or an approved private warranty plan.

The County's Warranty Plan: Financial Viability

1. At the end of FY91, the County's Warranty Fund balance was \$337,048. To date, the Fund has received \$496,129 in premiums; \$95,243 in interest; and \$12,500 in a separate payment from a builder as part of a warranty settlement.

2. The County's Warranty Plan has paid out \$323,667 in claims, of which \$56,890 has been collected in reimbursement payments from builders. This represents a reimbursement rate of 18 percent, or one dollar for every \$5.50 paid out. In 1990, the County Attorney filed a lawsuit against one of the 14 builders who owe the County's Warranty Plan for claims paid.

3. The continued operation of the County's New Home Warranty Plan poses a potential future financial risk to the County Government. The potential risk must be recognized despite the fact that the funds maintained in the County's Warranty Fund appear to be, at this point in time, adequate to meet expected loss conditions. If losses are worse than expected (which could occur with several unanticipated major structural defects) and the Fund were to be depleted, it is conceivable that pressure would be placed on the County Government to help replenish the Fund. This pressure would likely occur despite the statutory language in Chapter 31C that limits the financial responsibility of the County Government.

The County's Warranty Plan: Staffing

1. The County's Warranty Plan has taken a disproportionate amount of staff time to administer. Managing the County's Warranty Plan (which contains only 2.5 percent of all new homes completed since July 1986) has demanded significant staff effort from the Administrator of the Housing Unit as well as from individual OCA investigators. The staff time needed to enroll homes and resolve warranty claims for the County's Warranty Plan has precluded more time from being spent on oversight of the private warranty plans, which contain almost all new homes enrolled in warranty plans since the mandatory warranty law went into effect in 1986.

2. Although OCA staff have, to date, performed their difficult role with skill and good judgment, administration of the County's Warranty Plan continues to place OCA staff in the potentially conflicting roles of managing a warranty plan and advocating for consumers who own homes warranted by that fund. While the use of independent dispute settlers and adoption of written warranty standards mitigate the potential for conflict, if the balance in the Fund ever became insufficient to pay outstanding claims, OCA staff could still feel torn between their fiduciary responsibility to the County's Warranty Plan, and their responsibility to assist consumers collect a valid claim from the Plan.

The Private Warranty Plans: General

1. By law, in order to do business in the County, alternate (private) warranty plans must be approved by the Office of Consumer Affairs. Executive regulations outline certain information that must be provided by the private plans on a quarterly and annual basis. The regulations establish a \$2,000 annual private warranty plan approval fee.

2. As of July 1, 1991, six private warranty plans were approved by OCA to operate in the County. The County collects \$2,000/year in plan approval fees from each of the six approved plans. In 1990, the administration of one of the six plans was taken over by another one of the approved plans in the County. In addition, another warranty plan approved in 1986 no longer operates in the County, but continues to warranty homes enrolled for the duration of their ten-year warranty.

3. According to OCA's builder licensing files, as of July 1, 1991, 274 (47%) of the County's 578 licensed builders are enrolled in one of the six approved private warranty plans. Two of the plans were established by individual builders and are structured to accept only homes built by those individual builders. The other four each have between 40 and 102 builders enrolled.

4. Based upon data filed by the private warranty plans, between July 1986 and July 1991, 22,595 homes sold in the County were enrolled in private warranty plans. This represents approximately 98 percent of all new homes enrolled in a warranty plan between July 1986 and July 1991.

5. In addition to having a significantly larger volume of homes enrolled, data available from the private warranty plans indicate a strikingly different pattern of complaints and claims paid than that experienced by the County's Warranty Plan. Although additional investigation is needed before conclusions or judgments are made, it appears that relative to the number of homes enrolled, the private plans report fewer complaints, fewer dispute settlements, and significantly lower amount of claims paid compared to the County's Warranty Plan.

6. The six private plans approved by the County are similar in many respects, but different in others. For example, all plans operating in the County are required: to adopt the warranty standards established by executive regulation; provide for dispute settlement of any warranty claim dispute by an independent third party; and adhere to certain timelines set forth by Regulation. However, the plans differ on characteristics such as: the fees/premiums charged to builders for application and enrollment; builder enrollment criteria; the process for filing and investigating claims; and the organization hired to conduct any third-party dispute settlement.

7. Based upon their involvement with a number of specific cases, OCA staff have identified several recurrent problems related to the resolution of warranty claims in the private plans. Specifically, according to OCA staff, their experience evidences some problems with the expertise of individual dispute settlers used by the private warranty plans, their knowledge of the County's warranty standards, and the private plans' familiarity with how the dispute settlement process must (by law and regulation) work in the County.

Private Warranty Plans: OCA's Oversight Role

1. OCA has had limited staff resources to devote to general oversight of the private warranty plans. Based upon interviews with OCA staff, it appears that the demands of managing the County's own Warranty Plan plus responding to individual consumer complaints have precluded more time from being spent on reviewing the activities of the private warranty plans. The staffing situation was exacerbated during this past year when the part-time investigator assigned primarily to oversight of the private plans was on personal leave from February through September 1991.

2. Although OCA has not denied approval to any private warranty plan that has applied, OCA staff has sought additional data and required certain changes be made as a condition of approval. The annual plan approval process has provided OCA with the opportunity to learn more about how the private plans operate and where modifications to their procedures are needed.

3. However, as a result of limited staff time available, OCA has been unable to accomplish what ideally should be done to oversee the private warranty plans approved to do business in the County. In particular, activities that have received only minimal staff attention include: analysis of the quarterly data filed by the private warranty plans (see below); and scrutiny of the private plan's financial statements. In addition, OCA has not had the time to develop a system for routinely obtaining feedback from homeowners with homes enrolled in the private plans.

4. Executive regulations promulgated for Chapter 31C, New Home Warranty and Builder Licensing, outline specific information that must be provided by the private plans to OCA on a quarterly and annual basis. Based upon interviews with OCA staff and some direct review of the reports filed with OCA, there is evidence that the private plans provide a large volume of data to the County. There is currently no data base system set-up to monitor basic activities in the private plans, e.g., number of claims, number of dispute settlements, types of defects, amount paid out.

5. Representatives of the private plans (interviewed by OLO during the course of this study) perceive OCA staff as competent and professional in their attitude; and several individuals commented that the working relationship with the Office of Consumer Affairs has improved during the past several years. However, a majority of the private plan representatives interviewed also voiced their view that the County's quarterly and annual data requests are onerous. Several individuals questioned whether the County was really reviewing and using all of the data that were submitted; and one representative noted their concern that the phone calls and letters to OCA were not being responded to in a timely manner.

Perceptions of Builders and Homeowners

1. Based upon OLO's interviews conducted with a sample of licensed builders in the County, it appears that:

- Licensed builders are aware of the County's mandatory warranty legislation;
- At least some builders enrolled in the County's Warranty Plan because it was the most convenient and least expensive alternative for them;
- Other builders are attracted to the private warranty plans because they are less expensive for them and offer some name recognition to potential homebuyers;
- Some builders have found the County Plan's warranty claims process to be fair, while others report that it seems poorly managed and biased towards the homebuyer; and
- Many of the builders interviewed feel that their personal interest in being known as a quality builder, who is responsive to consumers, provides a greater incentive, to respond to homebuyers, than does the mandatory warranty requirement.

2. Based upon OLO's interviews conducted with a sample of homeowners who purchased new homes within the past five years and who experienced some problems with their homes, it appears that:

- Homeowners support continuation of the County's mandatory warranty law;

- Despite voicing some frustrations with certain aspects of the warranty claims process, most homeowners interviewed were satisfied with the final outcome of their warranty complaint;
- Not all homeowners understand what their new home warranty covers before they purchase their home; and
- The one thing homeowners consistently said they would do differently in the future is not go to settlement on a new home until they are assured that the home meets their expectations.

Program Costs and Revenues

1. The statutory language in Chapter 31C is confusing as to exactly what activities are intended to be paid for by what specific fees. In particular, it is unclear whether the law intends builder licensing fees to cover the administration of the entire chapter; and/or whether the law directs or authorizes funds from the County's New Home Warranty Fund be spent to cover OCA staff costs associated with administration of the Fund.

2. When Bill 69-85 was being discussed in 1985-86, the County's Office of Management and Budget (OMB) developed a fiscal impact statement for the proposed legislation. OMB's statement was based upon the interpretation that the law intended the entire new home warranty and builder licensing chapter to be self-supporting from three sources of revenue: builder licensing fees; private warranty plan approval fees; and interest earned on the County's Warranty Fund itself. OMB projected that the program would cost approximately \$100,000/year in personnel and operating expenses to implement; and by its third year of implementation would bring in at least that much revenue.

3. In practice, it has proved difficult to quantify the incremental staff costs associated with Chapter 31C. This is because staff within OCA's Housing Group would spend time on new home complaints with or without the warranty legislation, and it is often the case that new homebuyers' problems involve both warranty and non-warranty matters.

4. Based upon interviews with OCA staff, it appears that the most time-consuming aspect of the builder licensing and new home warranty program has been administration of the County's Warranty Plan. Especially during the past three years, managing the Plan has demanded much of the Housing Group Administrator's time, specifically to establish procedures for enrolling homes, resolving warranty claims, and pursuing builders who owe the County Fund for claims paid out.

5. While acknowledging that it took more staff time in previous years, OCA estimates that approximately two workyears (\$100,000 is staff time) will be spent in FY92 on: builder licensing, administration of the County's Warranty Plan, and oversight of the private warranty plans. This estimate comes close to the incremental amount projected by OMB in 1985.

6. The \$100,000 in FY92 staff costs estimated by OCA exceeds the \$75,000 in General Fund revenue projected to be collected in FY92 from builder licensing fees and private warranty plan approval fees. It is approximately equal to the revenue generated through Chapter 31C if the additional \$25,000 in Warranty Fund interest is counted, although this money is reinvested back in the Warranty Fund itself.

7. The approved FY92 budget includes a \$53,200 payment from the County's New Home Warranty Fund to support one OCA investigator position associated with administration of the County Fund. This was presented as a one-time expenditure of County Warranty Fund monies.

V. RECOMMENDATIONS

During its first five years of implementation, Chapter 31C, New Home Warranty and Builder Licensing, has served as a tool for helping to resolve problems encountered by buyers of new homes in the County. In particular:

- The law established a builder licensing system that improves the linkage between a builder's failure to perform new home warranty obligations and ability to remain licensed;

- For every new home sold in the County since July 1986, the law has mandated the builder to warrant that certain items are free from defect for specified time periods, (i.e., for one, two, and up to ten years for major structural items); and

- The requirement that all licensed builders belong to either the County's Warranty Plan or an approved private new home warranty plan has meant that more homeowners now have access to a process for resolving disputes and recourse in situations where their builder has gone out of business.

The Office of Consumer Affairs (OCA) staff has accomplished much in five years, and OLO recommends that the County continue to maintain the builder licensing system and basic mandatory new home warranty requirements outlined in Chapter 31C. However, OLO also recommends a significant change in the County Government's role, away from administration of a County-run warranty plan, and towards increased oversight of the private warranty plans doing business in the County. OLO also recommends some additional legislative and administrative changes be implemented to generally improve the effectiveness and efficiency of the builder licensing and mandatory new home warranty requirements.

Summary of Recommendations

The following is a summary list of OLO's recommendations; the remainder of this chapter then explains each recommendation in greater detail. At the end of each recommendation is some combination of an "L", "R", "A", and/or "\$". "L" indicates that the recommendation requires a change in the law; "R" indicates that the recommendation requires a change in executive regulation; "A" indicates that the recommendation requires an administrative change; and "\$" indicates that the recommendation carries a potential positive or negative fiscal impact.

1. Phase-out operation of the County-run New Home Warranty Plan within the next three years. (L,R,A,\$)
2. For every year that the County continues to administer a New Home Warranty Fund, require an annual actuarial assessment of the Fund. (R,\$)
3. Readjust staff assignments within OCA to increase oversight of the private warranty plans approved to conduct business in the County. (A)
4. Establish a process to detect non-compliance and enforce the statutory requirement that all new homes sold in the County be enrolled in an approved warranty plan. (R,A,\$)
5. Take steps to address problems identified in the warranty claims dispute settlement process. (R,A,\$)
6. Institute a periodic review of the County's new home warranty standards contained in executive regulation. (R,A)
7. Request the Board of Registration to re-visit the question of establishing more specific new home builder licensing requirements. (A)
8. Revise the current practice of renewing builders licenses as a routine staff function. (A,\$)
9. Reorganize and amend the sections of Chapter 31C that outline the powers and duties of the Board of Registration. (L)
10. Amend the law requiring that the Board of Registration submit an annual report to the Director of OCA. (L)
11. Amend the law to clarify that the Department of Environmental Protection has the authority to issue a stop work order on a building permit that is issued to a builder whose license is either suspended or revoked. (L)
12. Amend the sections of the law that identify certain activities to be paid for through builder licensing fees, plan approval fees, and the County's New Home Warranty Fund itself. (L,R, possible \$)
13. Strongly urge all municipalities that rely upon the County for building code inspections to adopt Chapter 31C, New Home Warranty and Builder Licensing. (A)
14. Amend the law to provide OCA with expanded enforcement authority. (L)

Recommendation 1: Phase-out operation of the County-run New Home Warranty Plan within the next three years. (L,R,A,\$)

There are multiple reasons for the County to seriously consider phasing out operation of the County-run New Home Warranty Plan. As discussed in OLO's conclusions:

- Continued operation of the County's New Home Warranty Plan poses a potential financial risk to the County Government;
- Administration of the County's Warranty Plan (which contains less than three percent of all new homes sold since July 1986) has taken a disproportionate amount of OCA staff time, with the result being insufficient staff time available to oversee activities of the private warranty plans doing business in the County;
- During the past five years, the marketplace for private warranty plans has evolved such that one of the primary arguments behind establishing a County-run warranty plan is no longer valid; specifically, during the past several years, three of the private warranty plans currently operating in the County developed programs for enrolling entry-level or novice builders; and
- Administration of the County's Warranty Plan continues to place OCA staff in the potentially conflicting roles of managing a financially viable warranty fund and assisting homeowners collect valid claims to correct defects in homes enrolled in the fund.

Finally, it must be recognized that one of the factors contributing to the current financial viability of the County's Warranty Plan is that it has not been administered (as originally intended) as the warranty plan of last resort exclusively for licensed builders who are unable to be accepted on their own by a private warranty plan. If the County's Warranty Plan were to enroll only those builders who pose too great a risk for the private warranty plans then the financial liability to the County Government of continuing the operation of the warranty plan would be greater than today.

While OLO believes that continuing to administer a County-run new home warranty plan poses more disadvantages than advantages, OLO recognizes that discontinuing the County's Warranty Plan poses a number of questions, potential problems, and options that need to be researched, discussed, and addressed. In particular, there is the question of how to handle the homes already enrolled in the County's Warranty Plan, and the question of how to handle the potential problem of licensed builders who are not able to be accepted on their own by a private warranty plan.

Therefore, in order to provide for a careful and orderly transition, OLO recommends that the Council request the County Executive to develop a plan for phasing out operation of the County's New Home Warranty Plan. The plan should be reviewed by the Council and considered prior to making the legislative changes that are required to discontinue operation of the County's Warranty Plan.

OLO recommends that the first step towards phasing out operation of the County's Warranty Plan should be to provide builders currently participating in the County's Warranty Plan with the financial incentive to seek enrollment in an approved private plan. In addition to reducing County Fund activity, this will serve to help identify how many (if any) builders currently enrolled in the County's Warranty Plan cannot be accepted on their own by a private warranty plan.

Providing licensed builders with the financial incentive to join a private warranty plan instead of the County's Warranty Plan can be implemented by revising the County Plan's current enrollment and dispute settlement practices, to include:

- Increase the premium for enrolling homes in the County's Warranty Plan so that the County's premiums are higher than those in the private plans;*
- Make pre-enrollment inspections (paid for by the builder) a prerequisite for enrolling any home in the County's Warranty Plan;*
- Start charging builders the full penalty amounts for late enrollments;**
- Start charging interest on builder reimbursements to the Fund;** and
- Begin charging builders for the costs of dispute settlement (a current practice of some private warranty plans).*

As noted above, phasing out the County's Warranty Plan poses a number of potential problems, solutions to which should be thought out before a final decision is made to discontinue the County's Fund. In particular, the Council should request that the Executive's plan for phasing out the County's Warranty Plan include recommendations on the following two issues:

- How to handle the 572 homes already enrolled in the County's Warranty Plan. The issue here is whether OCA should continue to administer the County's Warranty Plan for the remainder of the ten-year warranty on homes already enrolled in the Plan, or attempt to contract or sell the management of these homes to a private warranty plan.

- How to handle the potential problem of builders, who are approved by the Board of Registration to receive a license but who are not able to be accepted on their own by a private warranty plan. Solutions to this potential problem will depend upon the number of licensed builders who are not able to be accepted by a private warranty plan. As mentioned above, providing incentives for builders to enroll in private warranty plans will help identify the magnitude of this problem.

* This would require a change to Executive Regulation 20-90.

** Explicit authority to do this is already contained in either Chapter 31C and/or in Executive Regulation 20-90.

Working in consultation with representatives from the private warranty plans approved to do business in the County, the options to be considered for licensed builders who cannot be accepted by a private warranty plan include: "assigning" these builders either on a pooled or individual basis to one or more private warranty plans; requiring the private plans doing business in the County to develop programs for enrolling these builders; prohibiting these builders from building new homes until they are accepted by a private warranty plan; and/or waiving the mandatory warranty requirement for these builders with disclosure to the consumer.

Recommendation 2: For every year that the County continues to administer a New Home Warranty Fund, require an annual actuarial assessment of the Fund. (R,\$)

As outlined above (see Recommendation No. 1), OLO recommends immediate steps be taken towards phasing out operation of the County's New Home Warranty Plan. However, OLO recognizes that the County's Warranty Plan will not be eliminated precipitously, and recommends that during the interim period where the County continues to manage the Fund, that actions be taken to safeguard the financial viability of the Fund.

OLO recommends that for every year that OCA continues to administer the County's Warranty Fund, an annual actuarial assessment of the Fund should be conducted. Based upon discussions with the Department of Finance's Risk Management Division, the actuarial assessment of the County's Warranty Fund could probably be added as a contract amendment to the annual actuarial assessment of the County Government's self-insurance fund.*

The purpose of an annual actuarial assessment of the County's New Home Warranty Fund is to evaluate the financial viability of the Fund, and to recommend whether the Fund balance is adequate for expected losses. If the actuarial assessment concludes that the Fund balance is insufficient, then the OCA Director should exercise the authority (already outlined in Chapter 31C), to either require participating builders to pay additional amounts to replenish the Fund, or require payment of surcharges by the builders who are responsible for an unreasonable number of awards against the Fund. (It should be noted, however, that collecting surcharge payments from builders responsible for a large number of claims may not be a realistic source of revenue.)

To further minimize the potential financial risk to the County posed by continued operation of the Warranty Plan, the Executive Branch should also explore purchasing re-insurance. Although any warranty plan re-insurance policy would likely have a very large deductible, it could serve as a safeguard against an unforeseen drain on the County's Warranty Fund caused by a larger than expected number of claims paid on any of the homes already enrolled in the County's Plan.

* An issue to be resolved before conducting the actuarial assessment is whether the staff costs of administering the Fund are supposed to be paid for out of the Fund itself. See Recommendation No. 12.

Recommendation 3: Readjust staff assignments within OCA to increase oversight of the private warranty plans approved to conduct business in the County. (A)

Additional staff effort is needed to increase oversight of the private warranty plans, which by law must be approved on an annual basis by OCA. As discussed earlier in this report, the demands of managing the County's New Home Warranty Plan and responding to individual consumer complaints have precluded more time being spent on monitoring the activities of the private warranty plans approved to operate in the County. Since the County's mandatory warranty law went into effect in July 1986, 98 percent of all new homes enrolled in a warranty plan have been enrolled in one of the private warranty plans approved by OCA.

As the County phases out operation of its own warranty plan (see Recommendation No. 1, additional OCA staff time should be available to monitor the private warranty plans. In particular, the following activities are in need of more staff attention:

- Quarterly and annual data requests. OCA staff, in consultation with representatives from the private warranty plans, should reconsider the data requested from the private plans on both a quarterly and annual basis. At the present time, not all of the private plans are consistently providing what the law and regulations require; and OCA should either enforce or modify the current requirements.

OCA should identify the major activities in the private plan that the Office wants to monitor (e.g., number of claims filed, number of dispute settlements, amount of claims paid, length of time taken to resolve claims, substance of warranty claims). A data base should be established to assist OCA staff track these major variables, and the private plans could be requested to provide these data in a consistent format that is most usable by OCA. At this point in time, the lack of a data base makes it extremely difficult for OCA staff to identify significant trends or changes in the level of activity occurring in the private warranty plans.

- The annual private plan reapproval process: The annual private warranty plan approval requirement provides OCA with an opportunity to assess the past year's activities, and recommend changes to each of the private warranty plans doing business in the County. At a minimum, before OCA staff approve a warranty plan for another year, staff should ensure that all required information has been submitted, and that the plan continues to meet all of the County's standards, as established by law and regulation.

As part of the annual reapproval process, the County should enhance its review of the private plans' financial statements. With assistance from the Department of Finance's Risk Management Division, a more careful assessment of each plan's financial situation should be made to ensure that (as the law requires) any private plan approved by the County demonstrates "financial security adequate to cover the total amount of claims that the program may reasonably anticipate be filed against participating builders."

- Feedback from builders and homeowners with homes enrolled in the private warranty plans. OCA should routinely be seeking feedback from builders and homeowners with homes enrolled in private plans. For example, OCA should survey a sample of homeowners and builders in order to find out how things are working (or not working) in the private warranty plans. The sample should include those who have been involved with warranty claims and those who have not. Any problem areas identified through the survey could then be discussed with the representatives of the private warranty plans.

Recommendation 4: Establish a process to detect non-compliance and enforce the statutory requirement that all new homes sold in the County be enrolled in an approved warranty plan. (R,A,\$)

In coordination with the Department of Environmental Protection (DEP), OCA staff should develop procedures for enforcing the basic mandatory warranty requirement outlined in the New Home Warranty and Builder Licensing law. As discussed in the report, there is currently no system in place that prevents a new home from going to settlement without being enrolled; and no consistent procedure for identifying homes that are sold without being enrolled in a warranty plan.

OLO recommends that this compliance issue be addressed in one of two ways. The first approach would be to amend the executive regulations governing building code inspections to make proof of enrollment in a warranty plan a prerequisite for final code inspection sign-off. (OCA has already met once with DEP to explore this possibility.) The other approach would be to systematically check compliance with the mandatory warranty law for each builder at the time of his/her license renewal; specifically, before renewing a builder's license, OCA staff would check whether all homes built by the builder during the two-year licensure period had been enrolled in an approved warranty plan. (See Recommendation No. 8.)

Recommendation 5: Take steps to address problems identified in the warranty claims dispute settlement process. (A,R,\$)

As discussed earlier in this report, based upon the past three years of experience, OCA staff has identified some recurrent problems with the dispute settlement of warranty claims in the private warranty plans. In particular, OCA staff are concerned about the expertise of the third party dispute settlers used, and the private plans' knowledge of how the dispute settlement process is supposed to work in Montgomery County.

OLO recommend the following course of action to respond to the concerns raised by OCA staff:

- OCA staff should compile a detailed list of the recurrent problems with the private plans' dispute settlement process identified during the past three years;
- OCA staff should arrange to observe a sample of dispute settlements of private plan warranty claims in the County;

- OCA's observations and concerns (including specific case examples) should be shared with the appropriate representatives of the private plans and third-party dispute settlement organizations involved; and
- OCA (with input from representatives of the private warranty plans and dispute settlement organizations working in the County) should consider developing standards for dispute settlers who would be certified to conduct dispute settlements in the County.

In addition, OCA staff should conduct an annual training seminar for individuals who will be conducting dispute settlements for warranty claims in the County. The annual training session should include explanation of how the dispute settlement process must (according to law and regulation) work in the County; and a review of the warranty standards that must be followed here. As noted in the report, the County's mandatory warranty law and associated executive regulations require the private warranty plans to operate somewhat differently here than they do in other parts of the country.

Recommendation 6: Institute a periodic review of the County's new home warranty standards contained in executive regulation. (A,R)

OCA staff should periodically review and recommend needed changes to the substance of the County's warranty standards. The documented experience of warranty claims filed in the County (involving homes in either the County's warranty plan or private warranty plans) is a valuable source of information about perceived and real problems with newly constructed homes in the County. The data gathered should provide OCA with the needed evidence for recommending additions, deletions, or modifications to the County's warranty standards, which are established by executive regulation.

In analyzing the substance of warranty claims filed in the County, OCA may also be able to identify other areas in need of change or improvement. For example, a pattern of warranty claims may suggest the need to pursue changes to the building code, methods of code inspections, and or changes to the County's site plan approval requirements. Future changes to the new home warranty standards should clarify the relationship between building code violations and the County's warranty standards.

Recommendation 7: Request the Board of Registration to reconsider the question of establishing more specific builder licensing standards. (A)

The OCA Director should request the Board of Registration to reconsider the question of establishing more specific standards for becoming a licensed new home builder in the County. At the present time, the only builder licensing criteria is a very general statement in the law that the Board of Registration must determine whether an applicant and the organization of the applicant are "qualified to comply with the building code and laws of the County and State, and to fully perform building contracts."

If the Board concludes that more specific licensing standards would be useful, then the Board should provide its recommendations for specific changes to the law, executive regulations, and/or license application procedures.

Recommendation 8: Revise the current practice of renewing builders' licenses as a routine staff function. (A,\$)

The current practice of renewing builders' licenses as a routine staff function should be changed. Ideally, the renewal of a builder's license is the appropriate time to review significant factors such as a builder's current financial situation, responsiveness to consumer complaints, and performance of warranty obligations. In particular, no builder's license should be renewed until it has been documented that all new homes built by the builder during the two-year licensure period have been enrolled in an approved warranty plan.

Any irregularities identified by OCA staff should be shared with the Board of Registration, so that the Board can decide whether to take additional action before approving a builder's license renewal. For example, the Board might decide to request additional written information; a meeting with the renewal applicant; or decide to conduct a formal investigation.

OLO recognizes that increasing the attention given to the renewal of builders' licenses will take additional staff time, and potentially more time of the Board of Registration. If necessary, to improve the renewal process without an increase in staff, OLO recommends that OCA (at least initially) enhance its review of only a sample of license renewals. OCA should then evaluate the results of its efforts and recommend a course of action for future years.

Recommendation 9: Reorganize and amend the sections of Chapter 31C that outline the powers and duties of the Board of Registration. (L)

The powers and duties of the Board of Registration should be outlined clearly in one section of the Code. Under current law, the Board of Registration is established in one section of Chapter 31C (Section 31C-4), and the responsibilities and powers of the Board are found in two other sections of Chapter 31C (Section 31C-2, Licensing, 31C-8, Investigation and Hearing), and in Section 7, Warranty Claim, of the Executive Regulation 20-90.

In addition, the following changes to the powers and duties of the Board of Registration should be considered:

- Amending the law to clarify whether the Board is authorized to deny an application for a builder's license without holding a show cause hearing.

- Amending the law to enable a licensed new home builder to surrender his/her license in lieu of facing formal license revocation action. The Board of Registration should be kept apprised of all such actions, and the builder's licensing file should include a written record of when and under what circumstances a builder chose to voluntarily surrender his/her license.

- Providing the Chair of the Board of Registration with the authority to suspend a builder's license on an emergency basis in situations where the public's health, safety, or welfare is threatened. (The Chair of the State's Home Improvement Commission has similar authority.)

Recommendation 10: Amend the current requirement for the Board of Registration to submit an annual report to the Director of OCA. (L)

The law should require the Board of Registration to submit a report of its activities once every two years to the County Executive and County Council, who are responsible for appointing and confirming members to the Board. This biennial report would replace the current requirement (Code Section 31C-4(3)(c)) for an annual report to the Director of OCA. As noted earlier, the Board has not prepared an annual report since 1988.

It would be useful for the Board's report to the Executive and Council to include a summary of its activities, to include data on: the number of new home builder license applications received; the number of licenses approved and denied by the Board; and the primary reasons that licenses were denied. The Board should also explain any license revocation activity taken during the most recent two-year time period, e.g., the number of show cause hearings; the number of licenses suspended or revoked, the reasons that licenses were suspended or revoked. It would also be useful for the Board's report to include any changes to the law or regulations that the Board recommends.

Recommendation 11: Amend the law to clarify that DEP has the authority to issue a stop work order on a building permit that is issued to a builder whose license is either suspended or revoked. (L)

Current law does not specify how to handle the status of a building permit that is issued to a licensed builder, whose license is either suspended or revoked before the house is completed. The law should be amended to explicitly authorize the Department of Environmental Protection to issue a stop work order on a building permit issued to a builder whose license is suspended or revoked. In the alternative, the County would be continuing to approve work being done by a builder who the County has determined should not be constructing homes at this time.

Recommendation 12: Amend the sections of Chapter 31C that identify certain activities to be paid for through builder licensing fees, plan approval fees, and the County's Warranty Fund itself. (L, R, possible \$)

The statutory language in Chapter 31C is confusing as to exactly what activities are intended to be paid for by what specific fees. In particular, it is unclear whether builder licensing fees are intended to cover the administration of the entire New Home Warranty and Builder Licensing chapter; and/or whether funds from the County's New Home Warranty Fund were intended to be withdrawn to cover staff costs associated with administration of the Fund.

OLO's primary recommendation here is that the law be made clear and consistent, so that the appropriate licensing fee, plan approval fee, and home enrollment premium rates can then be established. If it is decided that the Fund itself should pay for annual staff costs associated with administration of the Fund, then the actuarial assessment of the Fund must be adjusted to account for this expenditure. (In FY92, the Council approved a \$53,200 one-time payment from the Fund to support one OCA investigator position.)

In attempting to link revenues collected to administrative costs, it is important to remember that, as discussed in this report, it is difficult to quantify how much staff time is dedicated to new home warranty vs. non-warranty related items. In addition, throughout this evaluation, OCA staff emphasized that the Office would handle the same (if not a larger) volume of new home complaints with or without the law.

Recommendation 13: Strongly urge all municipalities that rely upon the County for code inspection to adopt the County's New Home Warranty and Builder Licensing law. (A)

As noted in the report, Chapter 31C has not been adopted by eight of the County's 17 municipalities. Six of these eight rely upon the County's DEP to issue new home building permits and conduct inspections; the other two, Rockville and Gaithersburg maintain their own permit and inspection functions.

The County Executive and County Council should jointly urge all municipalities that rely upon the County for building code inspection to adopt the County's New Home Warranty and Builder Licensing law. The current problem is when a municipality relies upon the County's Department of Environmental Protection to conduct building code inspections but does not adopt Chapter 31C. In such cases, the County Government is left with the responsibility to conduct inspections, but not the authority to issue or revoke licenses for new home builders in that municipality.

Recommendation 14: Amend the law to provide OCA with expanded enforcement authority. (L)

Under current law, Section 31C-13, Violations and Penalties, provides that a builder is subject to punishment for a Class A violation for violating any provision of the new home warranty and builder licensing law. This section should be amended to enable OCA to cite any "person" for violating any provisions of Chapter 31C. This change would provide OCA with an additional tool to use with other entities (e.g., private warranty plans; dispute settlers) also subject to provisions of Chapter 31C, in order to gain compliance with the law.

VI. DEPARTMENT/AGENCY COMMENTS ON REPORT DRAFT

On October 21, 1991, OLO circulated a draft of this report to appropriate Executive Branch staff, the Planning Board Chair and the M-NCPPC's Montgomery County Planning Director, and Council staff. All technical corrections received either orally or in writing are incorporated into this final report.

Written comments received on the draft report are included in their entirety beginning on page 61. While the comments indicate general concurrence with most of OLO's recommendations, they also evidence differing views on a number of important issues including: phasing out operation of the County's New Home Warranty Fund, the process of renewing new home builders' licenses, and how to best enforce compliance with the warranty law.

Based upon feedback received during the comment period, OLO added a recommendation (No. 14) to provide the Office of Consumer Affairs with the clear authority to impose civil fines upon any "person" who violates a provision of Chapter 31C. The intent here is to clarify that OCA is authorized to impose civil penalties upon persons other than builders (e.g., private warranty plans) in order to gain compliance with Chapter 31C.

In response to OMB's suggestions, OLO will compile some more information about the pricing structures of private warranty plans, and the premiums paid by the 14 builders against whom claims were filed. OLO will also do some refinement of the estimated fiscal impacts of specific recommendations. This additional information will be available by the time this report is discussed in detail by the Council.

OLO once again expresses thanks to the many individuals who cooperated with this evaluation and who contributed to the development of findings and recommendations.



Montgomery County Government

ROCKVILLE, MARYLAND 20850

M E M O R A N D U M

November 22, 1991

TO: Andrew Mansinne, Jr., Director
Office of Legislative Oversight

FROM: William H. Hussmann
Chief Administrative Officer 

SUBJECT: DRAFT OLO Report #91-4, An Evaluation of the New Home Warranty and
Builder Licensing Law

Thank you for the opportunity to comment on the Draft OLO Report #91-4, An Evaluation of the New Home Warranty and Builder Licensing Law. This report provides a comprehensive review of the implementation of Chapter 31C. The comments from the Office of Consumer Affairs, Department of Environmental Protection, the Office of Management & Budget, and the County Attorney's Office are attached.

The Executive Branch looks forward to discussing OLO Report #91-4 upon its release by the County Council. Thank you again for the opportunity to comment.

WHH/rm

Attachments



Montgomery County Government

MEMORANDUM

November 14, 1991

TO: Andrew Mansinne, Director, Office of Legislative Oversight

FROM: Barbara B. Gregg, Executive Director, Office of Consumer Affairs *BBG*

SUBJ: Draft OLO Report #91-4, An Evaluation of the New Home Warranty and Builder Licensing Law

The New Home Warranty and Builder licensing Law, which was modeled after a similar New Jersey law, requires ten year warranty coverage for all new homes, establishes a County Warranty Plan, provides a mechanism for approval of private warranty plans, and creates a direct link between builder licensing and performance. It also protects the consumer whose builder declares bankruptcy.

The Office of Consumer Affairs (OCA) administers the law and the County Warranty Plan. OCA is also in charge of the approval procedure for private plans and a special dispute settlement program for any disputes that arise under the County plan.

When the new law was enacted, the only warranty coverage required by state law was a very limited one-year implied warranty. In addition, the County had an extremely limited new home builder licensing procedure. It required a builder to demonstrate financial security by posting only a \$2,000 bond--a "drop in the bucket" compared to the cost of a home--and only one bond was required regardless of the number of homes a builder constructed. It was also very difficult to access the bond.

Here's how the new program works. A builder must enroll either in a County-approved private sector warranty plan or a County-sponsored warranty program. There are strong performance standards for all warranty plans, including:

- Blanket one-year warranty coverage on all materials and workmanship;

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- Two-year coverage on the electrical, plumbing, heating, cooling, ventilating, and mechanical systems;
- Ten-year coverage on any major structural defects.

The County warranty program is funded by requiring builders who enroll in it to contribute 3/10 of one percent of the selling price of each new home they build to a New Home Warranty Fund (for example, \$300 on a \$100,000 home.) Homeowners can access the fund to pay for warranty work if their builder fails to perform warranted repairs in a timely manner or goes out of business before warranted repairs are made.

The new home buyer also gets (1) major coverage for secondary damage to the property resulting from conditions covered by the warranty and (2) reimbursement for the cost of shelter if the homeowner has to vacate the house for repairs.

A requirement that the Board not be dominated by builders was a systemic change from the way the licensing function had historically been administered. This change has been a catalyst for heightened awareness by the builders of their legitimate warranty obligations.

Consumers in Montgomery County have substantially greater protections than do consumers in all but a small number of jurisdictions throughout the country.

We are proud to have developed and administered a law which not only received an award from the National Association of Counties in 1989 but was featured in an issue of that organization's publication "County News," an honor received by less than 10 percent of award winners.

We are pleased to have had the benefit of the OLO study. We have sought to refine and improve enforcement of this law over the years and have implemented, or will be implementing, most of OLO's recommendations.

Please find the following comments of the Office of Consumer Affairs to the recommendations enumerated in the OLO Draft Report #91-4, An Evaluation of the New Home Warranty and Builder Licensing Law.

Recommendation # 1: Phase out operation of the County-run new home warranty plan within the next three years.

OCA proposes a phase-down of participation in the county warranty plan over the next three years and a reevaluation of the plan at the conclusion of that time. The Office will phase down participation by implementing a number of the steps suggested in the OLO Report but will maintain the plan in order to manage the problems enumerated in the OLO Report to which no solutions have yet been found. For example, there is currently no way to handle the potential problems of builders who are approved by the Board of Registration

to receive a building contractor's license but who are not able to gain acceptance into a private warranty plan, or of procuring warranty coverage for those homes which are later discovered to have been conveyed by the builder without the required warranty protection. At the conclusion of the three year period, we will be in a better position to determine whether alternative solutions are available and whether complete cessation of the county warranty fund is advisable.

Recommendation # 2: For every year the County continues to administer a New Home Warranty Fund, require an annual actuarial assessment of the Fund.

OCA supports this recommendation.

Recommendation # 3: Readjust staff assignments within OCA to increase oversight of the private warranty plans approved to conduct business in the County.

OCA supports this recommendation. To this end, the Office has, for the past two years, already instituted changes to lessen the time spent by staff administering the County warranty fund. The further phasing down of the plan should provide additional staff time to devote to oversight of the private plans' activities.

Recommendation # 4: Establish a process to detect non-compliance and enforce the statutory requirement that all new homes sold in the County be enrolled in an approved warranty plan.

OCA supports this recommendation, and believes that requiring builders to show proof of warranty enrollment prior to issuance of a Certificate of Final Inspection may be the best process, even though logistical problems remain. While these problems are being worked out, OCA will institute a program to check compliance on a systematic basis at the time a builder applies for renewal of the building contractor's license.

Recommendation # 5: Take steps to address problems identified in the warranty claims dispute settlement process.

OCA concurs generally with this recommendation and specifically recommends that a certification process for dispute settlers, involving a training program and orientation by OCA, be established.

Recommendation # 6: Institute a periodic review of the County's new home warranty standards contained in executive regulation.

OCA supports this recommendation and believes that a review is needed to extend warranty coverage to encompass additional items.

Recommendation # 7: Request the Board of Registration to re-visit the question of establishing more specific new home builder licensing requirements.

OCA does not disagree with requesting the Board to reconsider this issue but believes that the Board's concerns regarding the need for more specific licensing requirements were adequately addressed by OCA's policy of requiring either approval by a private warranty plan or requiring pre-enrollment inspections on new houses built by new builders in the county warranty plan.

Recommendation # 8: Revise the current practice of renewing builders licenses as a routine staff function.

OCA believes that elevating this function to the Board would have a definite adverse fiscal impact on the operations of OCA and would require additional significant staff time spent on the licensing function. The Board is always made aware of significant complaints or litigation against a builder and OCA does not believe that routine renewal requires Board attention. The Office is not aware of any instance where problems would have been prevented by Board attention to a renewal application and notes that the Maryland State Home Improvement Commission has routinely delegated the task of issuing new licenses and renewals to its staff with good success.

Recommendation # 9: Reorganize and amend the sections of Chapter 31C that outline the powers and duties of the Board of Registration.

OCA supports this recommendation. OCA proposes that in this reorganization that the Board be granted the power to impose emergency suspensions.

Recommendation # 10: Amend the law requiring that the Board of Registration submit an annual report to the Director of OCA.

OCA supports this recommendation.

Recommendation # 11: Amend the law to clarify that the Department of Environmental Protection has the authority to issue a stop work order on a building permit that is issued to a builder whose license is either suspended or revoked.

OCA supports this recommendation.

Recommendation # 12: Amend the sections of the law that identify certain activities to be paid for through builder licensing fees, plan approval fees, and the County's New Home Warranty Fund itself.

OCA supports this recommendation.

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November 14, 1991
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Recommendation # 13: Strongly urge all municipalities that rely upon the County for building code inspections to adopt Chapter 31C, New Home Warranty and Builder Licensing.

OCA supports this recommendation and further suggests that the County consider ceasing code inspections in municipalities where Chapter 31C is not in effect.

BBG/jls

MR 1115
R2



Montgomery County Government

MEMORANDUM

November 4, 1991

TO: Deborah J. Snead, Assistant for Audit and Evaluation
Office of the County Executive

FROM: Robert Seely, Chief *R Seely / DMS*
Division of Construction Codes Enforcement
Department of Environmental Protection

SUBJECT: Comment on Draft OLO Report #91-4, An Evaluation of New Home
Warranty and Builders Licensing Law.

The following are the comments of the Division of Construction Codes Enforcement, Department of Environmental Protection, on the above referenced report:

Recommendation #4 (page 55) is intended to coordinate this Department's final inspection sign-off with better enforcement of the warranty program. The proposed procedures would place an additional requirement on this Department. We suggest another approach. Our proposed procedure would ensure the house is enrolled in the warranty program prior to settling on the house. A document of proof of enrollment in the warranty program would be required to be presented to the purchaser by the builder at the time of settlement. The settlement attorney would enforce this procedure without any additional cost in administration to DEP. The amendment to provide such a procedure could easily be incorporated into revisions to Chapter 31C.

Recommendation #11 (page 58) recommends a change in Chapter 31C to grant DEP the authority to issue a stop work order on a building permit that is issued to a builder whose license is either suspended or revoked. This Department agrees that the recommendation would be helpful because such an amendment would provide DEP with additional enforcement power over unlicensed builders.

Please contact Mr. Donald Boswell, 738-3087, to discuss the comments in detail.

RS:DB:flh:4257f

-67-

cc: Edward Graham
Department of Environmental Protection, Division of Construction Codes Enforcement

M E M O R A N D U M

November 12, 1991

TO: Andrew Mansinne, Jr., Director
Office of Legislative Oversight

FROM: Robert K. Kendal, Director 
Office of Management and Budget

SUBJECT: OLO Report Number 91-4, An Evaluation of the New Home Warranty and
Builder Licensing Law

Thank you for the opportunity to respond to this OLO report. As usual, your staff has presented a straightforward and thorough discussion of this government function.

On page 18, the draft report indicates that while the County's Warranty Plan rates are higher for some builders, these rates may be equal to or less than the private plan rates for other builders. Given that the intent of the County Warranty Plan was to serve as a last resort, it would be useful to have more specific information on this issue. Is there any pattern to the pricing of the County plan versus the private plans? Are there any builder characteristics that could be predictive in terms of pricing? Such information, if readily available or easily obtainable from a sample, would guide the implementation of Recommendation 1 (pages 51-53), should it be determined that the County plan should be phased out. If it is decided that the County plan should be phased out, higher fees during the transition would likely support the plan's intended role as a last resort for builders who could not otherwise obtain warranty coverage.

While the concept of phasing out the County's plan is well documented and presented in the report, the policy question of whether or not the plan should be phased out must be addressed. The County began providing this service to meet an articulated community need, and this report, as comprehensive as it is, does not exhaustively examine why the County began its own program, rather than pursuing other policy alternatives. If higher rates and other administrative mechanisms make the County's plan the option of last resort that it was intended to be, the plan's potential financial vulnerability may be less problematic, but would it ultimately solve the problem that resulted in the establishment of the County's plan in the first place? Any solution must deal both with the County's financial risk as well as the provision of services to protect the public.

On page 20, there is a discussion of the sample used to describe the warranty claims process and record. It would be useful to know the size of the sample and whether it appears that the sample was representative of the larger population of data from which it was drawn.

In describing the record of claims paid (page 21), in addition to the percentages describing the builders who built homes for which claims were paid, it would be useful to know the amount of premiums paid for homes constructed by the 14 builders against whom claims were filed. This information might be useful to the Director of OCA as part of the process of increasing recovery of claims paid by the County Warranty Plan. The County must find a way to ensure that the fund is reimbursed by builders in order to ensure its solvency, whether it is to be phased out or not.

I find the symbols regarding administrative, regulatory, legal, and fiscal implications of recommendations to be a useful tool for summarizing the impact of recommendations (beginning on page 49). Having read the recommendations, however, I find that it may be useful to distinguish between positive fiscal impact and negative fiscal impact, perhaps by using "+" and "-" in conjunction with "\$" to indicate the direction of the fiscal impact.

Use of the terms "potential" or "minimal" may also be useful in that fiscal impacts often depend upon the way in which a recommendation is implemented. In the case of some of the recommendations, such as those discussed below, it is not clear where the fiscal impact would occur, because unlike the regulatory and administrative impact, the nature of the fiscal impact is not explicitly discussed. The fiscal impact of Recommendation 4 (establish a process to detect non-compliance and enforce enrollment in a warranty plan), Recommendation 5 (address problems found in dispute settlement process), and Recommendation 8 (revise the current practice of renewing licenses as a routine staff function) should be more explicitly described. This would assist in determining if additional activities such as a training program or additional staff functions are suggestions left to the discretion of the department, in which case the fiscal impact would should be described as "potential." If such activities could be absorbed, then use of the phrase "minimal" would be more appropriate.

M E M O R A N D U M

November 7, 1991

TO: Andrew Mansinne, Director
Office of Legislative Oversight

VIA: Joyce R. Stern *Joyce R. Stern*
County Attorney

FROM: Marc P. Hansen *Marc Hansen*
Senior Assistant County Attorney

RE: Draft OLO Report No. 91-4, New Home Warranty and Builder
Licensing Law

This Office has reviewed Draft OLO Report No. 91-4, New Home Warranty and Builder Licensing Law. The report does not appear to raise any substantive legal issues. Accordingly, we have no comments regarding the report at this time.

MPH:ban
0788.MPH



THE MARYLAND-NATIONAL CAPITAL PARK AND PLANNING COMMISSION

8787 Georgia Avenue • Silver Spring, Maryland 20910-3760

(301) 495-4605

Montgomery County Planning Board
Office of the Chairman

November 4, 1991

Andrew Mansinne, Director
Office of Legislative Oversight
100 Maryland Avenue
Rockville, Maryland 20850

Andy
Dear Mr. Mansinne:

Thank you for the opportunity to evaluate the Office of Legislative Oversight's Report No. 91-4, An Evaluation of the New Home Warranty and Builder Licensing Law. Unfortunately, the demands of the General Plan Refinement and other housing efforts as well as current budgetary restraints mean that staff does not have the capacity to pursue all of the worthwhile projects that come to us.

Choosing among projects is always difficult, as I'm sure you know, and especially in this case, because we enjoy reviewing your well-prepared studies. Since the Planning Board does not have responsibility for new home warranties or builder licensing, however, it makes sense for us to concentrate on other priorities. Consequently, we will not be commenting on this study.

I know staff was glad to be of assistance in providing data for this study and would be happy to offer the same support in the future. The Board also looks forward to working with you at the appropriate times.

Sincerely,

Gus Bauman
Chairman

GB/SR:lm

cc: Karen Orlansky, Program Evaluator, OLO



Montgomery County Government

MEMORANDUM

August 19, 1991

TO: Karen Orlansky, Program Evaluation
Office of Legislative Oversight

FROM: Ray Gulhar, Insurance Specialist
Division of Risk Management

Ray G.

SUBJECT: New Home Warranty Fund

In response to your request of June 26, 1991, I have attached a copy of the opinion received from Mr. Owen D. Miller, Senior Risk Management Consultant, Insurance Buyers' Council, Inc., regarding the financial viability of the County's Home Warranty Fund. Mr. Miller has concluded in his recommendations that the funds maintained by the County on this program are adequate to meet expected loss conditions and that the rate per \$100 at \$.30 is adequate. He does not recommend any additional amounts to be funded for contingency loss.

If you need additional assistance in this matter, please let me know at 217-7237.

RG/bb
(orlansky.819)

Attachment

cc: D. Terry Fleming, Chief, Division of Risk Management
Andrew Mansinne, Director, Office of Legislative Oversight

INSURANCE
BUYERS'
COUNCIL,
INC.

9690 Deereco Road
Suite 650
Timonium, Maryland
21093

TELEPHONE
(301) 561-9200

FACSIMILE
(301) 561-9351



July 30, 1991

Mr. Ray Gulhar
Insurance Specialist
Montgomery County, Maryland
Risk Management Division
101 Monroe Street, 4th Floor
Rockville, Maryland 20850

RE: New Home Warranty Fund

Dear Ray:

We have analyzed the data included with your letter to us of July 9.

We have been asked to evaluate the financial risk of the warranty program to the County. We have judged the element of risk from standpoints of adequacy of funds in relation to homes already enrolled, and pure premium (rate per \$100) for newly accepted homes.

We have used basic statistical techniques that would be familiar to a risk manager. Our analysis cannot be considered as an actuarial study. If you need actuarial evaluation, including high probability forecast, we suggest that you obtain an actuarial study from a firm such as E. James Stergiou.

FUND BALANCE

We have analyzed the fund balance from the standpoint of:

1. Future amounts that will be needed for payment of claims from homes now enrolled in the program (comparable to incurred but not reported or loss development considerations);
2. Expected (average) loss; and
3. A high confidence loss forecast for unusually bad years.

ABC

Mr. Gulhar
Page 2
July 30, 1991

We developed the table of paid factors (see Exhibit I enclosed) beginning with nine months and ending at sixty months to use in developing grouped loss payments, by year, to ultimate.

As an example, we said that fiscal year ending 1987 claims have an average age of 51 months. Using the table we developed, we said that after 51 months, 97 percent of such claims were paid. Dividing the total losses paid for the period of \$167,749 by .97 produced an ultimate of \$172,937, and, an IBNR or loss development amount of \$5,188 (difference between actual and projected ultimate).

In developing 51 months, for example, as the age of the 1987 policy year, we took into consideration the fact that homes were completed at various times throughout the year. To develop the average age of 51 with respect to the policy year ending 1987 claims, we weighted the number of months by the amount of the claim paid. Similarly, 40 months was developed as the average age of the 1988 year claims. We did not attempt to develop 1989 or later year claims because information was inadequate.

Exhibit I enclosed shows the application of the factors to the total of losses paid for 1987 and 1988, under which developed paid losses are \$172,937 and \$178,574 respectively.

Our next step was to consider the substantial downward trend noted in the exposure from the beginning of the program through July, 1991 (reported as of the end of May, 1991). To note this trend, we examined both the total construction dollars by year, and numbers of homes registered by year, finding that both exposures have decreased dramatically from 1987 through 1991. By the process of relative and compound factoring, we produced an exposure index for construction and for numbers of units, and then averaged them. For example, the average index of .227 suggests that your current level of exposure is only 22.7 percent of what it was during the 1987 year. These factors were then used to



Mr. Gulhar
Page 3
July 30, 1991

equate projected ultimate paid claims for the two policy years used, to the current exposure level. By the process, we converted 1987 and 1988 year end ultimately projected claims payments to \$39,297 and \$52,328 respectively.

To develop an average loss, we averaged the two years considered credible (1987 and 1988), and decided upon \$50,000 as a conservative acceptable amount for expected loss, for the current year.

To estimate 1989 year losses, we reversed the process using the \$50,000 expected loss divided by an average index of .435 for the 1989 year. We chose to use \$50,000 for 1990 and 1991 years.

We have no industry data, and we have no experience data from your program to estimate the claims that might arise for guarantee years three through ten in which only major structural defects are covered. We used a strictly judgmental factor of 20 percent of the first two year ultimate. Accordingly, we have developed a 10 year ultimate claims payment of \$207,525 for policy year ending 1987, and \$214,289 for the policy year ending 7/1/88.

To summarize thus far, in the top row of boxes, years one and two are the ultimate amounts we think will be paid from the policy years completed as the result of the first two years of guarantee requirements. The column entitled Years One to Ten Ultimate are years one and two ultimate increased by 20 percent to include the structural risk. Ultimate losses for years 1989 through 1991 are based upon \$50,000 projected expected loss.

The only other consideration we made in judging the adequacy of funds is the interest factor. We chose eight percent, and then used the usual method of compounding and weighting with the estimated pay-out factors. The column entitled Present Value is the present value factor for the remaining amount to be paid from each corresponding policy year.

IBC

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The final results of this calculation are shown in the third row of Exhibit I, the result being \$305,364. We conclude that there will be an additional \$305,364 paid, on a present value basis, as the result of the exposure from registration of houses through July, 1991.

As a further bit of detail about Total Development: we applied the corresponding present value factor to each year for payments remaining from guarantee years one and two. We arbitrarily selected an average of five years for years three through ten and used that corresponding present value factor, to produce a present value estimate of the amounts paid for those years as the result of structural defects. The total of the two components is \$305,364.

Noting that the fund balance through May 31, 1991 is \$320,879, we conclude that the amount is sufficient to pay claims from houses registered through that date, assuming expected loss experience.

While we conclude that funds are adequate for expected (average) loss, a contingency for worse than average should be considered. Given the conservative nature of our estimates for future payments from already constructed homes (Total Development of \$305,364) and the decrease in program activity, we are not recommending any additional amount for contingencies.

PURE PREMIUM RATE

We have a total measure of risk in terms of dollars of construction insured under the program. The pure premium rate is calculated as total losses paid plus estimates of payments yet to be made (\$305,364) plus \$321,413. The total loss figure divided by the total construction value produces a rate of \$.35 per \$100. We believe you are currently charging \$.30 per \$100, and we are not prepared to state that our findings are so accurate as to require adjustment to \$.35.

IEE

Mr. Gulhar
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CONCLUSION

We have attempted to evaluate the risk of homeowner warranty program to the County in terms of adequacy of funds to pay future claims from houses already constructed, and the adequacy of the rate level. We conclude that funds are adequate to meet expected loss conditions and that the rate per \$100 at \$.30 is adequate. We have suggested that no additional amounts be funded for contingency loss.

We suggest that the foregoing can be used as an interim risk manager's estimate but that the program should secure an actuarial determination. Please let us know if we can be of further assistance.

Very truly yours,



Owen D. Miller, CPCU, ARM
Senior Consultant

ODM/m

EXHIBIT I

Months After	Paid Factor	Policy Year Ending	Policy Year Losses Paid	Paid Factor Applicable	Yrs 1 & 2 Ultimate	Yrs 1-10 Ultimate
9	0.050	7/1/87	167,749	0.97	172,937	207,525
12	0.120	7/1/88	149,824	0.84	178,574	214,289
15	0.185	7/1/89	3,840		115,012	138,015
18	0.250	7/1/90	-0-		50,000	60,000
21	0.335	7/1/91	-0-		50,000	60,000
24	0.420					
27	0.500					
30	0.583					
33	0.667					
36	0.750					
39	0.817					
42	0.883					
45	0.950					
48	0.960					
51	0.970					
54	0.980					
57	0.990					
60	1.000					

Year (n)	Average Months	8% Compound factor	Payout In Year	Relative Weight	Avg. Compnd. Int Factor	Present Value 1 ÷ a.c.i.f.
1	6	1.041	12%	0.125	1.041	0.961
2	18	1.127	30%	0.338	1.102	0.907
3	30	1.221	33%	0.403	1.154	0.866
4	42	1.322	21%	0.278	1.191	0.840
5	54	1.432	4%	0.057	1.201	0.833
5-year weighted = 1.201						

Policy Year Ending	Year (n)	Years 1 & 2 Development	Years 1 & 2 Present Value	Years 3 - 10 Development	Years 3 - 10 Present Value	Total Development
7/1/87	1	5,188	0.961	34,587	0.833	33,792
7/1/88	2	28,750	0.907	35,715	0.833	55,827
7/1/89	3	111,172	0.866	23,002	0.833	115,462
7/1/90	4	50,000	0.840	10,000	0.833	50,309
7/1/91	5	50,000	0.833	10,000	0.833	49,973
Total development =						305364

Policy Year Ending	Construction Exposure \$'s	Exposure \$'s Index	Construction Exposure Units	Exposure Units Index	Average Index	Trended Developed
7/1/87	62,249,429	0.271	223	0.184	0.227	39,297
7/1/88	48,070,292	0.350	174	0.236	0.293	52,328
7/1/89	36,032,047	0.468	102	0.402	0.435	
7/1/90	16,845,432	1.000	41	1.000	1.000	
7/1/91	14,400,426	1.000	30	1.000	1.000	
Expected Loss =						50,000