



CERHA HEMPEL

CONSTRUCTION PAPERS



What Happens to Guarantees and Warranties When a Property is Sold?

This article is the third and final part of our three-part series, in which we address frequently arising questions concerning warranty and guarantee rights. In this final article, we examine what happens to warranty and guarantee rights when real property is sold. In the first part of the series, we analysed the practical differences between statutory warranty and guarantee rights. In the second article, we examined the impact of alteration and renovation works on guarantee rights.

1. The issue

[1] In housing estate projects, it is often questionable who can assert guarantee and warranty rights against contractors once the developer has sold the homes to their new owners. The root cause of the problem is that the transfer of guarantee and warranty rights is governed by different rules. This can, and in most cases does, result in a situation where guarantee rights and warranty rights are not held by the same person. Therefore, it is possible that different persons will seek to enforce different statutory warranty rights against a contractor on different legal grounds – for the same defect. This can have particular importance because the enforcement of guarantee rights and statutory warranty rights are typically subject to different conditions and deadlines.

[2] The purpose of this article is to give you a better understanding of these complex matters.



2. Transfer of guarantee rights

- [3] The transfer of rights existing under guarantees is addressed by Section 6:172 of the Hungarian Civil Code in general terms. The Civil Code states that when the ownership of a property subject to a guarantee is transferred, the new owner will be entitled to enforce the relevant rights against the obligor, i.e. the person or entity that provided the guarantee. It is important to note that this provision equally applies to contractual and statutory guarantees, with the key difference that the parties are free to deviate from the applicable default rules of the Civil Code in the case of contractual guarantees.
- [4] Government Decree No. 181/2003 (XI. 5.) on mandatory guarantees in home construction imposes a specific guarantee obligation on contractors in the case of homes. Section 3(2) of the Government Decree essentially repeats the provisions of the Civil Code and states that guarantee rights can be exercised by homeowners. The Government Decree also makes it clear that until the ownership of a building is transferred to its new owners, i.e. practically until the apartments are given to their possession, guarantee rights against the contractor can be enforced by the developer. These rules are mandatory, i.e. the parties may not deviate from them.
- [5] Consequently, guarantees are not tied to the person of the contracting parties but to the subject matter of the underlying contract; in the case of a construction contract, this is the newly built property itself. That is why no specific legal act is needed for the transfer of the guarantee: it happens automatically with the transfer of ownership.
- [6] In the case of apartment buildings or condominiums, the transfer of guarantee rights can create an interesting scenario where every owner can enforce guarantee rights with respect to their own apartment individually, whereas the owners can exercise their guarantee rights with respect to commonly owned areas via the homeowners' association collectively. Therefore, the guarantee rights that were originally held by a single entity, the developer, are splintered and, depending on the situation, the contractor may have guarantee obligations vis-à-vis hundreds of individual obligees (i.e. holders of the guarantee rights). The situation can be even more complicated if the warranty rights are not transferred to the homeowners in the absence of a specific agreement and the entitlement to exercise such rights remains with the developer. In such a case, it is a realistic scenario that the owners, the homeowners' association and the developer might all seek to enforce separate claims against the contractor.

3. Transfer of warranty rights

- [7] As opposed to guarantees, warranty rights are closely linked to the underlying contract. Warranty rights apply between the contracting parties, regardless of what happens to the property later. Therefore, warranty rights, unlike guarantee rights, will not be transferred automatically upon the sale of the property. If there is no specific agreement on warranty rights, it is possible that guarantee rights will be asserted against the contractor by the homeowners individually or by the homeowners' association, while the developer will continue to enforce warranty rights.
- [8] If the parties want the warranty rights to transfer to the new owners so that both warranty and guarantee rights are held by them, an agreement about the transfer of the warranty rights will have to be made when the ownership of the property is transferred. This requires a specific legal act: the transfer of rights. The agreement on such a transfer can be included in the sale and purchase contract concerning the property, but in a separate contract as well.
- [9] It is important to note, however, that the conclusion of a contract on the transfer of rights will not in itself be sufficient to settle the matter completely. The transfer of rights is governed by Section 6:202 of the Civil Code, which states that the transfer of rights is subject to the rules on assignment, as applicable. The extent to which the rules of assignment will apply will depend on the structure of the relevant right. The transfer of warranty rights consists of three steps. The first is the transfer itself, which takes place in the form of a specific legal act.
- [10] The second step is a notice given to the obligor. The transferor is responsible for informing the obligor about the transfer and the identity of the new obligee. However, the new obligee may also send the notice to the obligor if they can prove that the transfer has taken place. This step is relevant because once it takes place, any agreement between the obligor and the original obligee regarding the modification or termination of their contract is invalid, and the obligor may only rely on defences and set off counterclaims vis-à-vis the new obligee if these were available to it against the original obligee on the basis of reasons that existed at the time when the notice was given.
- [11] The third step is what is known as a performance instruction. Under the general rule, the contractor has to perform its obligations to the original obligee until it receives the performance instruction. Although the contractor will find out from the notice that there is a new obligee and that it can expect future defect notifications from the new obligee, the real significance of the performance instruction is that the contractor will be released from its liability if it performs its obligations to the original obligee before its receipt of the performance instruction.



[12] The question is what happens if the contractor transfers its warranty rights to the buyers but then does not notify the contractor. In our view, the transfer of warranty rights between the original and the new obligee takes effect as soon as the relevant contract is concluded, which means that from that point, the original obligee (the developer) no longer has any legal basis for asserting warranty claims, and therefore, any lawsuit that it might file will have to be dismissed on the basis of its lack of standing.

4. Recommendations

[13] As shown above, the treatment of guarantees and warranties can be different, because they can be, and in most cases are, subject to different sets of conditions and different timeframes, and therefore contractors are well advised to examine carefully who makes a claim against them, e.g. for repairs, and on what basis.

[14] As for developers and homebuyers, the contract between them should clearly state the rights that are transferred by the developer to the buyers, and specifically whether in addition to guarantee rights, warranty rights are also held by the new owners. It is also advisable to remind the buyers of these matters when the apartments are given to their possession. We believe that creating a transparent and uniform system for defect notifications is also important. Our experience suggests that this is the only efficient way to manage the logistical and communication issues that arise in connection with apartment buildings from having a large number of guarantee and warranty rights holders.

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