

Modular Construction Contracts: Key Considerations for a Successful Project

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Modular construction is rapidly evolving to meet the needs of a variety of stakeholders on all sorts of projects. Modular construction involves assembling a structure on-site using components or modules made off-site.^[1] It is gaining popularity in Canada. As of 2024, it encompassed 4-6% of all construction in Canada.^[2]

Using modular construction in the right circumstances can benefit a project, including by providing greater predictability in pricing, better quality control, shorter schedules, and improved safety.^[3] Modular projects, however, have unique features that must be accounted for. It would be a mistake to assume that a standard form construction contract will adequately address these sorts of projects. Parties planning a modular project should consider the following key areas when preparing and negotiating their contracts:

1. Upfront Payments and Milestones

Modular projects require a significant upfront investment of funds before anything arrives on-site. Modular contractors often require early payments to cover costs related to, among other things, factory setup and material procurement. Traditional contracts often assume payment as work progresses, which does not necessarily align with modular processes. To keep the contractor's cash flow healthy (and the work on schedule) while protecting the owner's interests, consider the following approaches:

- **Milestone Payments:** Structure the payment schedule around tangible and measurable production milestones rather than relying solely on on-site progress. In some cases, a deposit on signing may be appropriate to provide the contractor with funds to start fabrication.
- **Advance Payment Security:** If advance payments are made before modules are delivered, this increases risk for the owner, including if the contractor goes insolvent. The contract should clearly address when and how ownership of the materials and modules transfers to the owner. In addition, the owner should consider requiring performance security such as bonding or an irrevocable, standby letter of credit. Prior to agreeing to any advance payments, it is important that they are discussed in advance with sureties and lenders, to ensure that they approve.

2. Factory Inspection and Quality Assurance Rights

Quality control is critical on a modular project. On traditional projects, owners inspect work on the job site, but with modular projects, much of the work happens at a remote facility. Contracts should address how and when the owner (and its consultants) can inspect the fabrication facility to monitor progress and quality. This might include periodic inspections during production and a final factory acceptance check before modules ship. This must be balanced, however, with the contractor's ability to perform the work without excessive disruption, and the requirement that visitors respect factory rules, such as those addressing confidentiality of trade secrets and safety requirements.

The parties should agree on a plan to inspect and test work at the factory prior to delivery, and how to address any observed deficiencies. Contractors may require inspection and sign-off at the factory for each module, subject to any damage that occurs during shipment. Getting owner approval before shipping modules can be beneficial, since it is easier to fix deficiencies in the factory rather than on-site. The contract will also need to establish a plan for inspection after installation on-site, and clear guidelines on when the owner's final acceptance of the work will happen.

3. Delivery Schedule and Storage

Delivering large modules requires careful coordination. Delays in site readiness or other scheduling hiccups could result in completed modules sitting in the factory (or in storage yards) longer than anticipated. It is wise to address storage and delivery timing in the contract to avoid disputes over who bears cost and risk if modules are not delivered promptly when ready. Parties should consider the following in their contract:

- **How long finished modules can remain at the factory:** The parties may agree on a set number of days that the modules can remain at the factory, and how compensation will work if the modules need to be stored for longer than expected.
- **Storage location and conditions:** Owners will also want to make sure that the conditions and security at the storage site are appropriate, considering the investment they have made in the modules.
- **Separation of modules within the factory:** Factories or storage locations may have modules from different projects and owners. Modules should be labelled and separated.

In addition, the parties should address risk of loss during storage and transit. Transportation of modules is complex and carries with it risk, such as potential moisture damage.^[4] The parties should be clear on who retains risk for modules between the factory and the site. The parties should discuss insurance considerations for storage and transit with their respective insurance advisors, and this should be reflected in the contract.

4. Other Considerations

Payment terms, inspection and quality assurance, and delivery and storage, are all important considerations for any modular project, but there are many more. For example:

- **Permitting and approvals:** How will these responsibilities be divided up amongst the parties? Separate permits and approvals may be needed for fabrication and on-site construction. Overall, the goal is to avoid confusion or finger-pointing by explicitly stating who handles each required permit or approval in the contract.
- **Differences between jurisdictions:** The parties should give thought to potential issues that may arise when manufacturing and on-site assembly take place in different jurisdictions. For example, laws, codes, regulations and approval processes may vary by province and municipality. Parties should adhere to all necessary requirements for all jurisdictions that are relevant to the project.^[5]
- **Project requirements:** All stakeholders should be familiar with project requirements before construction begins. These requirements should be clearly stated and incorporated as contract documents. Collaboration should begin early in the design process to maximize the likelihood of project success.^[6] These processes and expectations should be reflected in the contract.
- **Transportation Logistics:** Building the modules is half the battle. Once fabricated, they need to be delivered to site. Aside from risk of loss during transportation, which is discussed earlier, transporting modules over potentially long distances carries with it logistical challenges, such as potentially requiring specialized vehicles and permits. The complexity may be compounded if the contractor is transporting the modules between provinces or countries. The parties should prepare for these challenges as soon as possible and reflect the appropriate requirements in their contract.^[7]
- **Tariffs:** It is essential to consider the impact of tariffs on any project where materials may be imported from other countries.

The parties should set out in their contract how changes in tariffs will be managed and who bears the risk.

- **Insurance:** As mentioned above, parties should consult with their insurance advisors to determine specific insurance requirements for modular projects, including with respect to fabrication, materials, transportation, and assembly.

Conclusion: Setting the Stage for Success

The increase in modular construction is an exciting development for project delivery that provides the opportunity for significantly improved outcomes on construction projects. It also carries with it the potential to address societal issues such as the need for affordable housing.^[8] Stakeholders should resist the urge to shoehorn their modular project into their existing contract forms. By addressing the timing of payments, factory inspections, storage logistics, and the other issues discussed above, parties can reduce risk on their modular projects and set the stage for success. While the above article focuses on prime contract rights between an owner and contractor, many of the same considerations will apply for modular subcontractors of all tiers.

To date, while certain organizations have put out standardized contract forms for modular and prefabricated projects, the Canadian Construction Documents Committee (“CCDC”) and the Canadian Construction Association (“CCA”) have not. This means that for parties who use these forms, robust supplementary conditions will need to be prepared. Whether an organization has its own form of contract or prefers to use standardized forms, they should work with experienced legal counsel who understands the unique needs of modular construction.

Starting a modular project with a well-developed contract ensures that both owner and contractor interests are protected. It will help keep the project on track and on budget, and it will improve quality from the factory floor to final installation on-site. With the right contractual framework in place, parties can fully reap the benefits of modular construction while confidently managing its unique challenges.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

[1] Carolyn Whitzman, Lauren Shiga & Priya Perwani, *Scaling Up Modular Construction* (Toronto: School of Cities, University of Toronto, August 2024), online: < https://schoolofcities.utoronto.ca/wp-content/uploads/2024/11/Scaling-up-Modular-Construction-EN-August-2024_1.pdf>, page 3.

[2] *Supra* note 1, page 5.

[3] *Supra* note 1, page 6.

[4] *Supra* note 1, page 15.

[5] *Supra* note 1, page 10.

[6] *Supra* note 1, page 14.

[7] *Supra* note 1, page 16.

[8] *Supra* note 1, page 7.

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