



CONDOMINIUM LIABILITY REFORM

An issue brief by the Master Builders Association of King and Snohomish Counties

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OVERVIEW

The Puget Sound region is experiencing a shortage of condominiums being built and sold, especially those at an affordable price point.

The lack of affordable condominium units is especially concerning given our region's rapid population growth and overall shortage of attainable housing. Limited land supply, increasing regulatory and permitting costs, rising building material prices, and other barriers to new home construction have contributed significantly to rising housing costs and a housing supply shortage. Families and job seekers are finding it increasingly difficult to find attainable housing near employment centers. The lack of affordable condos impedes our region's ability to provide more homeownership opportunities and meet the stated goals of the Growth Management Act¹.

For developers, constructing new condos is seen as risky and unpredictable. The current regulatory and legal environment for condominium construction in Washington state places significant liability on builders, making it prohibitively costly to bring this housing product to market at an affordable price point. The few condos being built are mostly luxury units selling at higher price points. New condos in the city of Seattle are selling for more than \$1,000 per square foot.²

This is noteworthy because condos have traditionally provided a more affordable entry-level housing option for first-time buyers and are an attractive housing option for empty nesters seeking to downsize while staying in their communities. The decline in condos has created a gap in the affordable housing options available in our region.

BACKGROUND

Data from the U.S. Census Bureau's American Housing Survey show that King, Snohomish and Pierce counties averaged more than 25,000 new condominiums built each decade from 1970 to 2009. However, from 2010 to 2015—the most recent timeframe for which this data is available—the three-county area added just 4,400 new condos. This is about one-third the number of condos produced in prior decades, representing a significant drop from the region's historical average.

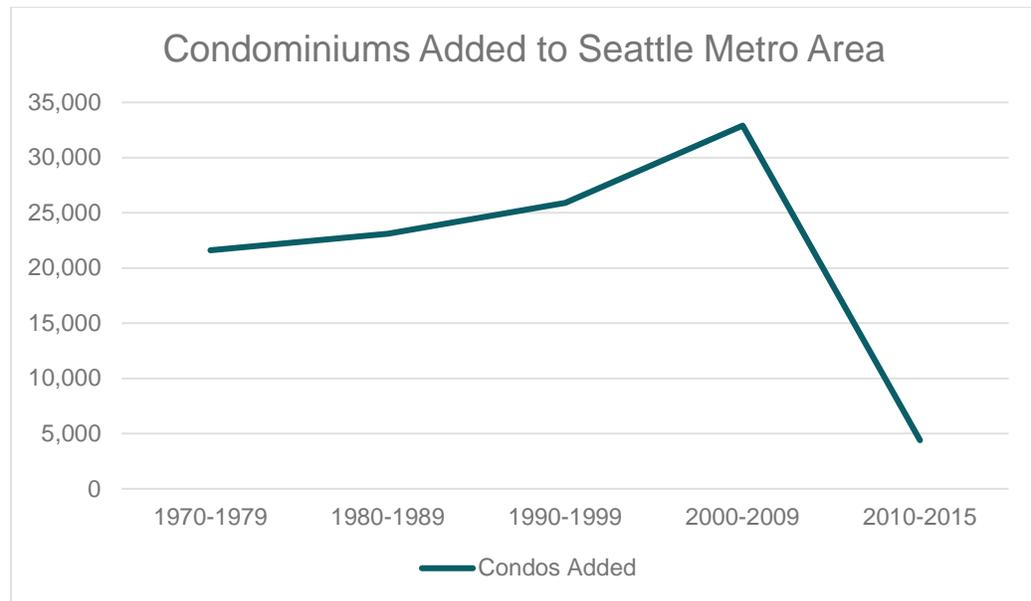
One reason for the decline in condo construction in recent years is that many developers viewed for-rent apartment homes as a more attractive and less risky investment. From 2012-2017, condos made up fewer than 4 percent of all new residential units built in the city of Seattle.³ More than 80 percent were apartments.⁴

¹ Condominiums support several goals of the Growth Management Act, including goals to encourage development in urban areas; reduce sprawl; encourage the availability of affordable housing to all economic segments of the population of this state and promote a variety of residential densities and housing types; and protect the environment.

² Richards, Mike (2018, October 8). Condos stage comeback in Seattle, Bellevue. Lens. Retrieved from thelens.news.

³ Morales, Margaret (2017, August 14). Why Seattle Builds Apartments, But Vancouver, BC, Builds Condos. Sightline Institute. Retrieved from sightline.org.

⁴ Ibid



Source: U.S. Census Bureau American Housing Survey
Seattle Metro Area includes King, Snohomish and Pierce counties.

At the same time, Washington Condominium Act liability has acted as a major deterrent to construction of new condos. The state law, some argue, practically guarantees condo buyers will sue developers for construction defects, leading to lengthy litigation, large settlement payouts, and higher insurance costs.

Now that the apartment market has softened, and condo prices have appreciated, some developers have decided to assume the risk of building condos. The Seattle Times has reported that "...about 6,000 [condos] are in the pipeline for completion in the next few years..." in Seattle and Bellevue.⁵

Despite this shift from apartments to condos among some developers in the Seattle market, concerns about condominium liability remain. As our region grapples with the lack of attainable housing, there has been a growing consensus about the need to remove obstacles to constructing this affordable housing type, while still protecting consumers.

On June 13, 2018, the Senate Law & Justice Committee, chaired by Senator Jamie Pedersen, held a work session on Condominium Act liability to discuss concerns about the law and potential solutions. Members of the home building, real estate and insurance industries, low-income housing providers, and several attorneys involved with condo construction defect claims, testified about the impact Condominium Act liability concerns are having on condo construction. For example, Tony To with HomeSight, said his nonprofit housing organization has not built a condo project since 2009 after having been sued on previous condo developments.

Many argued during the Work Session that the Condo Act does not provide a very clear or workable definition of *construction defect*. Some stated that a defect should be defined as a condition that actually causes damages versus something that could potentially cause a problem in the future.

⁵ Rosenberg, Mike (2018, September 27). A wave of condos is coming to Seattle and Bellevue for the first time since the housing bust. The Seattle Times. Retrieved from seattletimes.com.



At the MBAKS Housing Solutions Breakfast on October 24, 2018, Windermere Chief Economist Matthew Gardner spoke about the importance of embracing density and improving the climate for condos as our region continues to grow. He said that without condominium liability reform, we are unlikely to see significant increases in multifamily ownership housing.

Meanwhile, several local jurisdictions, including Snohomish County and the City of Everett, have passed resolutions supporting changes to the Washington Condominium Act that will address concerns about excessive litigation risk, and encourage construction of affordable condominiums while maintaining consumer protections.

Additionally, the Washington State Affordable Housing Advisory Board has included condo liability reform on its 2019 legislative agenda. Other organizations to do so include the East King Chambers Coalition.

Ultimately, increasing housing supply and providing a wider variety of housing types, including condos, will help make housing more attainable for people of all walks of life, as well as address our region's housing affordability crisis.

LEGISLATIVE HISTORY

The Washington State Legislature adopted the Washington Condominium Act in 1989 to standardize condominium construction and governance based on the Uniform Condominium Act. Condominiums built before 1990 are governed by the Horizontal Property Regimes Act.

Critics argue the warranty requirements of the Condo Act are very unclear, making it easy for condo owners to sue builders for any construction defects (even relatively minor deviations from the building code). Specifically, the warranties imposed by the Condo Act require that each project is:

- Free from defective materials.
- Constructed in accordance with sound engineering and construction standards.
- Constructed in a workmanlike manner.
- Constructed in compliance with all laws then applicable to such improvements.

These broad, open-ended standards have led to excessive construction defect lawsuits and higher insurance premiums, which has had the effect of deterring many builders and developers from considering condominium projects.

Several bills were adopted in the early to mid-2000s to address various concerns with the Condo Act. These include a "Right to Cure" law, requiring homeowners to provide the builder an opportunity to cure construction defects before a lawsuit could be filed; legislation creating "affirmative defenses," meaning developers could argue certain facts to mitigate or avoid liability; Condo Act amendments creating an insurance program patterned on a program adopted in British Columbia that added a heightened standard of proof for defect claims; new requirements for inspection of building enclosures; and an alternative dispute resolution (ADR) procedure and others.

Despite these changes, several challenges remain. For example, in the ADR procedure adopted in 2005, mediation and arbitration are non-binding. This means if homeowners don't like the arbitrator's decision they don't have to accept it, and they can still take the developer to court.



Also, the warranty insurance program authorized in 2004 is not mandatory, and under the law, insurance companies may still seek payment from developers, so risk and uncertainty are still issues for builders.

Most importantly, the legislative changes have not been enough to encourage more development of affordable condos, particularly in cities like Auburn, Maple Valley, Shoreline, Everett and Tacoma where land costs are less than downtown Seattle.

SOLUTIONS

Several potential condominium reform measures have been proposed in recent years.

In 2016, the Runstad Center for Real Estate Studies released a report, “Incentivizing Condominium Development in Washington State: A Market and Legal Analysis,” suggesting specific ways policymakers could lower the perceived risk and uncertainty imposed by the Washington Condominium Act. Ideas include clarifying the nature of a construction defect; incentivizing repairs rather than money damages as a remedy; making arbitration mandatory and binding; and others. The report has spurred conversation around these and other potential solutions.

In 2018, Representative Tana Senn introduced legislation, HB 2831, that would restrict the board of directors of a condominium association from participating in litigation without approval from a majority of unit owners. The idea was based on legislation adopted by Colorado in 2017. HB 2831 would have also required that the builder be given the opportunity to address the association before litigation is initiated.

MBAKS supports lowering regulatory barriers associated with building affordable condos and has made this a top legislative priority. Despite previous efforts to update the Washington Condominium Act and improve the climate for condominium construction in Washington state (outlined above), additional changes are needed to create more certainty for developers and insurers and remove disincentives to building affordable condominium projects while maintaining consumer protections.

Specifically, MBAKS supports:

- Better defining what constitutes a construction defect to reduce litigation without diminishing consumer protections.
- Providing safe harbor for members of Homeowner Association boards of directors when declining to file construction defect litigation against a builder.
- Revising the substance of warranties regarding building defects.
- Requiring builders to be provided with notice of defect and a timely opportunity for consultation prior to initiating condominium construction defect litigation.

The time has come to address concerns about excessive litigation risk and encourage construction of affordable condominiums without diminishing consumer protections.

Enacting condominium liability reform would create more supply by decreasing risk and uncertainty for developers and removing barriers to constructing this affordable housing type. Increased supply makes housing more attainable for everyone and provides alternative homeownership options for consumers.