

MULTIFAMILY PROPERTIES

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Mitigate Litigation Risks for Condo Development

It's no secret that there is pent-up demand for condominiums in Colorado – and developers are starting to venture back into the market. There has been some legislative reform, but uncertainty is still the norm. Multifamily housing construction has been booming across Colorado's Front Range, but for-sale condominium construction is at near all-time lows, largely due to a legal framework that makes it easy for homeowner associations to bring expensive construction defect suits against developers and their contractors. This situation persists despite over five years of efforts by the Colorado Legislature as well as metro area municipalities and housing advocates to modify those aspects of Colorado's legal framework that discourage the construction of for-sale multifamily housing.

With the 2017 legislative session nearing an end, however, the Colorado General Assembly appears poised to pass at least one bill that may make condominium projects more attractive to developers. The leading bill, HB 1279, would require HOAs to go through stricter processes and follow tougher voting requirements before bringing construction defect claims against developers, contractors and designers.

Colorado courts also have struggled to balance the competing interests, and the Colorado Supreme Court has agreed to review a Court of Appeals decision involving the ability of developers to require arbitration of disputes in an HOA's governing documents. Developers and contractors are natural (and sometimes easy) targets for HOA boards, who all too often view a construction defect lawsuit as a no-lose proposition.



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Once filed, construction defect lawsuits can last years, and the costs of defending them can be staggering – and, in the meantime, unit owners are frequently unable to sell their units. The current state of uncertainty means that developers must find their own tools to mitigate the risks associated with condo projects.

However, the risks can be mitigated. The following are a few things developers can do to reduce the likelihood of finding themselves on the wrong end of a construction defect lawsuit.

- **Design peer review.** Successful developers are investing in having the architectural and engineering drawings for their project reviewed by a second (or third) set of eyes. This process, often called peer review, gives an independent architect or engineer the chance to review the plans for errors as well as point out any room for improvement.

- **Construction inspections.** Another technique that is increasing in popularity is to rigorously inspect the contractor's work and create extensive photographic and video documentation of the construction techniques used. A developer might, for instance, photograph the waterproofing elements of every window and door before they are finished and covered up. These photos could be critical evidence in a defect lawsuit down the road.

- **Keeping the buyers happy.** On the assumption that a happy buyer is less likely to be litigious, developers also are



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focusing on ways to keep their buyers satisfied with their purchase. Options can include maintenance funds, aggressive warranty and repair programs, and financial incentives for buyers and HOAs not to sue the developer.

Keep in mind that, in addition to constituting modern best practices, many of these same strategies will be required by the insurance carriers underwriting the project.

OCIPs are Key

Speaking of insurance, perhaps the most important component of any defect mitigation strategy is the use of an owner-controlled insurance program, sometimes called a "wrap."

Traditionally, developers have relied on the general contractor and the dozens of project subcontractors to purchase their own liability insurance. The result can be a maze of insurance policies with varying limits, coverages and exclusions. Worse, when there is a claim, each carrier is incentivized to point the finger at other parties. Under an OCIP, by contrast, the developer buys a single package of liability insurance policies that provides coverage to all of the parties that enroll and perform work on the project. An OCIP can provide significant advantages to developers, including:

- **Control.** With an OCIP, the developer gains control over what is included in



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the insurance program for the project and how much insurance is available to respond to claims.

- **Longevity.** If structured correctly, an OCIP should provide coverage for the entire eight-year statute of repose, so developers don't have to worry about

whether their contractor and his subs will have insurance after the project is complete.

- **Cost savings.** Rather than paying for insurance costs that are imbedded in contractors' and subcontractors' bids, by purchasing a single policy, developers can potentially negotiate less expensive coverage and higher limits.

Not all OCIPs are created equal, however, and it is critical to understand what is and is not included in a particular program. Common coverage exclusions can weaken the coverage provided by an OCIP. It's important to work with a skilled risk management team that can help you shape the right OCIP for your project. Getting started early is critical, and the sooner you can assemble your risk management team, the better.

There may not be a silver bullet for avoiding litigation on condominium projects, but developers who work to mitigate risks – and maximize insurance coverage – can be successful even in the current environment. Look for the second part of this series about mitigating condo development risks in the next issue of Multifamily Properties Quarterly.▲