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Courtroom battles over building defects leave condo market reeling

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Seattle Times business reporters

Drive through Belltown, the Issaquah Highlands or south Snohomish County, and new condominium developments abound.

But amid this apparently booming market, builders are turning away from condo development.

The problems began about five years ago, when condo owners around Puget Sound began experiencing water damage to buildings — damage that sometimes costs as much to fix as the project cost to build. Frustrated homeowners associations, aided by aggressive lawyers, began to sue developers over construction problems.

Some builders say newer building codes and materials are to blame, but others admit a role in bad construction. Regardless, the number of costly lawsuits has risen, and as a result, the price of insurance for condo builders has skyrocketed, and some banks no longer finance condo development. Despite demand for condos, many developers say they've moved on to other projects.

"We don't have to build condos," said Todd R. Bennett, chairman of Bellevue-based Bennett Cos. "We're going to start building single-family homes."

Within a few years, the lack of condo development could reduce entry-level housing options and push more buyers into the suburbs, making traffic worse. Affordable-housing options could decrease dramatically.

"Litigation is one of the reasons there are (fewer) condos being built, and that flies in the face of the Growth Management Act to increase density," said Jim Hebert, president of Hebert Research in Bellevue. "That raises a real question about the success of public policy."

The Condo Alliance — a coalition of builders, affordable-housing activists and area politicians — wants state lawmakers to help developers by limiting what builders could be sued for and what they would pay for condo damage. During this year's legislative session, several bills were proposed, but only minor ones passed.

The problem is not unique to Washington. Several other states have faced the same issue, and some have passed laws to limit the amount developers pay for damage or to require homeowners groups to work with builders before they sue. That is not good news for builders or buyers. Few condos will be built until developers can afford to build them.

"If this was solved tomorrow, it would take three to four years to bring

Condo legislation

Builders groups and others proposed several bills during this year's legislative session, but only one — a minor one — passed. The groups plan to push some of the same bills during next year's legislative session.

Law passed

the market back," said Sam Anderson, executive officer for the Master Builders Association of King and Snohomish Counties.

New condos continue to come on the market, but developers say their retreat from building them has just begun. Permit applications for multifamily projects, which include condos and apartments, are steadily declining.

Around Puget Sound, the number of permits has fallen from 53 percent of housing permits in 1998 to 37 percent in 2002. In the same period statewide, multifamily permits fell from 37 percent of housing to 25 percent. While no condo-specific data were available, builders say condo trouble is driving the decline.

Condo prices have begun to rise and would climb sharply if no solution is found.

Tough for developers

In 1997, Washington builders could buy insurance from 25 companies, but now they have two choices, said Shelli Lucus-Kennedy, a broker with McDonald Insurance Group in Kirkland who advises the Master Builders.

While rates have gone up — in some cases 10-fold; in others, even more — what policies cover has shrunk. That means developers are paying more for less coverage and are financially more vulnerable to litigation than they used to be.

In addition, developers are spending money to hire special inspectors to baby-sit condo construction and help forestall lawsuits. They either pass the extra costs on to buyers by charging more for condos or build only high-end projects with wider profit margins.

"I can only build in communities where we can achieve higher prices," said Karen Anderson-Bittenbender, principal of Seattle-based developer Intracorp. "You don't see us in Snohomish County looking for things because we don't think we can achieve (prices to cover) what it will cost."

One builder, Bellevue-based Seco Development, changed a planned condo community in Kirkland to Chelsea Apartments.

"Our insurance company said they would drop us if we built (condos)," Seco President Michael Christ said.

For nonprofit builders, the problem is more acute because they can't easily raise prices.

Seattle-based Homesight, which develops and sells homes for \$160,000 to \$210,000, now pays \$9,000 a unit for insurance instead of the few hundred dollars it had been paying, Executive Director Dorothy Lengyel said. For now, the organization eats the cost, but difficulty securing insurance is slowing projects, she said.

Window woes

For owners, condo problems can be costly even when homeowners associations win in court.

When Mike Albert, 34, learned that the Seattle Heights homeowners association planned to sue the building developer, he willingly paid an extra \$200 in monthly homeowners' dues to cover legal fees. He

Washington's contractor-protection law: Promoted by the Building Industry Association of Washington, the bill took effect in late July. It considers factors such as homeowners' maintenance efforts in assessing builder responsibility and reduces the time window within which owners can sue builders from 12 to six years.

Legislation proposed

Washington's condo bill: This bill, promoted by the Master Builders, encourages out-of-court arbitration (instead of litigation) to settle owner-builder disputes and clarifies builder responsibilities.

Omnibus tort-reform bill: This bill aims to clarify when professionals in multiple industries — including the medical field and builders/developers — can be sued. The condo bill is seen by some as a single-industry offshoot.

Insurance-market bill: Promoted by the Office of the Insurance Commissioner, the bill would create a "joint underwriting association" among insurers to maintain a minimum number of available condo and builder liability policies. Critics of the bill say that wider policy availability can't remedy unaffordably high policy rates.

even sold that condo to buy a more expensive unit on a higher floor.

But three years later, when the association didn't win enough money to cover the balcony and window repairs named in the suit, owners had to pay the difference. Albert's share: \$30,000.

Meanwhile, the view he paid \$450,000 for has been partly obscured for months.

"I have a really great view, but right now it's stuck behind plastic," Albert said. "There's a little bit of resentment."

Some condo owners are selling — or trying to — before litigation starts.

Rafael Flores spent \$15,000 on attorney fees and lost \$19,000 in rental income on the Queen Anne condo he eventually sold. He's trying to sell the other condo he owns in Belltown.

"The market is soft now for condominiums, but I know litigation is coming," Flores said. "I can almost guarantee that by the summer of 2004, the lawyers will be there."

Lawyers get involved

By law, homeowners associations have six years to sue over problems that would make a home unsafe to occupy and four years to sue over building-quality issues, such as windows that leak, said David Merchant of Barker Martin & Merchant. The Seattle firm has handled more than 40 cases for homeowners associations.

In the 1990s, California went through litigation, insurance increases and development declines, and condo production in that state fell dramatically, from 18,691 units built in 1994 to 2,945 in 1999. The number of insurers backing condominium projects fell dramatically — from 30 in 1991 to two this year.

Some of the lawyers who succeeded in California now represent homeowners groups in Washington state.

"They ran out of homes to sue in California, so they had to go somewhere else," said Timothy Coyle, senior vice president and head of governmental affairs at the California Building Industry Association.

Last spring, when the Kelsey Lane homeowners association in Bellevue learned that decks on some units had dry rot, the group hired a contractor, who found wood-eating ants below the decks.

"We realized we had a major problem," said Carol Lee, then president of the association.

In late July, Lee said, the association found out it had one week until the developer dissolved the corporation that built the project. The group hired lawyers and sued immediately.

The developer, Polygon, declined to discuss the lawsuit, which a judge dismissed earlier this year. Lawyers for Kelsey Lane's homeowners association filed an appeal on Oct. 24. One lawyer in the case said damage will exceed \$2 million and that Polygon has made no offers to repair buildings.

When homeowners groups hire lawyers so early, critics say, problems that might have been handled between associations and developers go straight to court. That adds legal costs on top of repair costs, drives up insurance prices and frustrates builders.

If homeowners groups talked more with builders and less with lawyers, developers say, problems could be resolved for less money.

"Lawyers have the right to go out and get business," said Anderson, the Master Builders executive. "(But) the predatory marketing stuff causes us heartburn — the 'we-don't-know-if-anything-is-wrong-with-your-

building-but-we'll-help-you-get-it-torn-apart-and-rebuilt' (approach)."

Finding a solution

The Condo Alliance — composed of area politicians, Master Builders, developers and others — has met regularly since June to discuss plans for the next legislative session, when it intends to continue pushing "the condo bill," which would clarify developers' warranty responsibilities.

Members also plan to keep talking to the insurance industry. The state Insurance Commissioner's Office plans to monitor the market and may reintroduce a bill to create a "joint underwriting association" that maintains a minimum number of insurance policies to give developers more choices.

State underwriting assistance won't reduce prices, and brokers say it could make other kinds of insurance more expensive. But industry advocates say it's a strong first step.

"It would do nothing for price, but it would help availability," broker Lucas-Kennedy said.

Vincent DePillis, a lawyer who drafts documents for developers, says the state needs to adopt stricter building codes, require condo builders to pass special inspections, and offer buyers individual insurance policies that provide more coverage than a typical homeowners' association policy. The extra measures would impact condo prices, DePillis said, but not as much as costly insurance policies now do.

Real-estate agents, developers and lawyers have different ideas about how the condo crisis will affect housing choices.

Some say developers and real-estate investment groups will buy apartment buildings and turn them into condos to try to sidestep construction-liability issues. Others say lots for single-family homes will shrink to remain affordable and to appeal to would-be condo buyers.

Some experts believe buyers will seek out town homes or "zero-lot-line" homes, which are built on land that buyers own, instead of condominiums, whose land falls under different legal regulations. Luxury condos, they say, will proliferate, and prices will rise significantly for existing condos and single-family homes.

In the meantime, those involved in the condo market will protect their interests: Developers will exit the condo market or build high-end projects. Insurers will keep increasing the cost of builders' policies. Condo buyers will pay more. Sellers will do what they can to get out of buildings in litigation. Real-estate agents either will avoid condos or seek discounts on units in litigation. Lawyers will sue developers.

Some condo owners hope developers have to change how they build.

"If (builders are) slowed down, that's fine with me," Lee said. "They need to build better."

No one seems to think the problem will be solved quickly — especially not the developers who've stopped building condos.

Sundquist Homes President Larry Sundquist says his Lynnwood-based company has been sued four times in the past few years. The company's insurer paid \$1.65 million to settle claims from two lawsuits. Sundquist says it probably would have cost about \$500,000 to fix the problems addressed in the suits.

"I have an in-house attorney, and he used to do land-use work," Sundquist said. "Now he works exclusively on (condo) litigation. I look back over the past five to six years, and I wish I hadn't built any (condo projects)."

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