Economic & Planning Systems, Inc.
The Economics of Land Use

THE FINANCIAL IMPACTS OF CONSTRUCTION DEFECT LIABILITY ON HOUSING DEVELOPMENT IN CALIFORNIA

FINAL REPORT

Prepared for:
The Terner Center for Housing Innovation and the San Francisco Bay Area Planning and Urban Research Association (SPUR)

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1. Introduction and Summary of Findings

Introduction

This report explores how construction defect liability, and the associated risk of litigation and cost of insurance, affect condominium and townhome development in California. Economic & Planning Systems, Inc. (EPS) has conducted this study for the Terner Center for Housing Innovation and the San Francisco Bay Area Planning and Urban Research Association (SPUR) to support their on-going research on California's housing market. Numerous stakeholders active in California's housing market have reported that additional costs, risks and related burdens stemming from construction defect liability adversely affect the development of higher-density, for-sale housing.

This topic is highly relevant given California's severe housing crisis. A shortage of housing supply and growing costs have contributed to increased economic burdens on households, declining rates of homeownership, and other negative consequences (e.g., homelessness, out-migration, business relocation). Increasing the supply of condominiums and townhomes represents a key opportunity for creating homeownership opportunities accessible to middle-income households within the state's expensive urban markets. However, construction of condominiums has been falling in California for years, especially since the 2007-2008 financial crisis.[1] The Terner Center has explored the causes of this decline to identify potential changes that could lower housing costs and make homeownership more accessible.

The primary purpose of this study is to examine the economic impact of construction defect liability by quantifying the associated costs to developers of condominiums and townhomes. This report also includes context and background on the construction defect liability ecosystem in California, including the current process and incentives for bringing and resolving claims as well as the insurance structure and pricing needed to protect against such claims. Finally, this report includes several ideas for potential reform that emerged during our discussion with industry experts.

[1] See, for example, Alameldin, Muhammad & Karlinsky, Sarah. (2024). "Construction Defect Liability in California: How Reform Could Increase Affordable Homeownership Opportunities." Terner Center for Housing Innovation, UC Berkeley. Retrieved from: https://ternercenter. berkeley.edu/wp-content/uploads/2025/01/ConstructionDefectLiability01.08.25.pdf.

The information presented herein was gathered through conversations with over a dozen industry professionals including developers, insurance specialists, architects, and attorneys who represent developers and professional services (architecture and engineering) firms. EPS supplemented the 16 interviews completed with limited additional research from secondary sources, as needed.

EPS did not conduct primary data or statistical analysis or independently verify all claims or conclusions provided from these sources. Additionally, because commercial real estate insurance that covers construction defects is a relatively unregulated sector (unlike traditional homeowners' insurance), policy terms and conditions, including rates, can vary substantially over time and by location, and there is no central repository for data on these policies.

Summary of Findings

EPS's research has confirmed that construction defect liability contributes to higher development costs for typical condominium and townhome projects relative to rental projects. These higher costs are attributable to a variety of interrelated factors, including insurance premiums, deductibles, peer review quality assurance costs, escalated rates charged by architecture and engineering firms, as well as added complexity and uncertainty in the underwriting process.

While many of these factors are difficult to quantify in financial terms, EPS found that typical condominium and townhome projects spend about three to four times as much on commercial general liability insurance policies compared with typical rental apartment projects. These higher costs also come with significantly less insurance coverage: most developers of these projects buy around half as much coverage as would be typical for a similar rental project, and less than recommended amounts, because of the extraordinary cost to buy further coverage. Moreover, because lenders generally require developers to obtain construction defect insurance as a condition of a construction loan, with the entire premium paid in advance, it has a direct impact on development feasibility.

The higher cost for condominium and townhome insurance is directly linked to the risk of defect-related litigative action, which has become extremely common for these projects in California. While there is no official data available on the prevalence of claims and lawsuits, one insurance broker interviewed for this study estimated that 80 to 85 percent of (condo and townhome) insurance policies he had issued over the last 25 years had faced a construction defect claim.

Indeed, experts interviewed for this project consistently affirmed that insurance carriers expect most condominium and townhome developments in California to be sued for construction defects at some point during the 10-year window of liability (statute of repose), and they charge a premium for providing insurance that will protect a policyholder against such claims. As a standard, these carriers also require peer review quality assurance inspections, which add some additional project cost.

EPS also found that developers of condominium and townhome projects typically pay a markup for architecture and engineering (A&E) services. Firms providing these services typically pay a premium on their professional liability insurance policies, and they often pass these costs onto developers.

Overall, EPS estimates that condominium and townhome projects pay an insurance cost premium, above the amount for similar apartment buildings, that can range from just under two percent to nearly four and half percent (1.9% - 4.4%) of project "hard costs" due to the impact of construction defect liability. Using typical construction cost figures in the Los Angeles market, we conservatively estimated these costs at between $8,100 and $18,300 per unit, in 2024 dollars, as summarized in **Table 1** and detailed in **Table 3**.[2]

Table 1: Summary of Construction Defect Liability Cost Difference for Condominiums and Townhomes Compared to Rental Apartments

Cost Item	Estimates for Typical For-Sale Condominium in Los Angeles (in 2024 $s)	Difference as % of Hard Costs
Construction Hard Cost per Unit	$420,000	
Additional Costs for Townhome / Condo Projects per Unit[1]		
Liability Insurance Cost Difference	$4,200 to $6,720	1.0% to 1.6%
A&E Cost Markup	$295 to $1,181	0.8% to 2.0%
Peer Review Cost	$350 to $2,000	0.1% to 0.5%
Self-Insured Retention/Deductible	$177 to $1,181	0.0% to 0.0%
Total Additional Cost per Unit	**$8,100 to $18,300**	1.9% to 4.4%

[1]Represents the estimated cost difference per unit relative to a similar rental apartment project.

Source: Economic & Planning Systems estimates based on interviews with insurance brokers and other industry professionals.

[2] Note that these estimates reflect information collected prior to and during the devastating wildfires in Los Angeles County in early 2025. Thus, the estimates do not account for the impact of these fires on the California insurance market, if any, due to significant property damage, an increase in perceived risk, or other factors.

This cost increase relative to rental projects is driven by a difference of between 1.0 and 1.6 percent of building hard costs for commercial general liability insurance (a combination of primary and excess policies), an additional 0.8 to 2.0 percent of hard costs in the form higher rates for A&E services, between 0.1 and 0.5 percent of hard costs spent on peer review quality assurance, and up to 0.3 percent of hard costs held to cover self-insured retention costs.

While only a portion of this difference is due to insurance rates, the markup on insurance is significant: a condominium project might pay $6,720 to $8,400 per unit for commercial general/excess liability coverage (not including builders risk insurance) while a similar rental apartment project might pay just $1,700 to $2,650 per unit. This represents a premium of up to 500 percent.

While construction defect liability and related costs are certainly not the sole or even primary cause of relatively tepid condominium development in California, it is an important contributing factor among many others. On the margin, this additional cost can be the tipping point in the “go / no-go” decision of a particular investor, steering them towards a rental instead of for-sale project, or leading to a smaller or canceled project altogether. The costs of construction defect liability under current California regulations thus appears to be one contributor to the noted decline in condominium construction, potentially limiting the supply of entry-level, ownership housing in the state.

2. California Regulatory Context

Construction defect liability is a well-known issue within the home construction industry and its impacts on the development of for-sale condominiums and townhomes in California have been reported for decades. As early as the 1990s numerous reports emerged of the increasing numbers of homeowners and homeowner associations (HOAs) bringing lawsuits based on defect claims.[3] At that time, it was noted that such claims were contributing to the decline in condo construction relative to the 1970s and 1980s.

SB 800, also known as the Right to Repair Act and passed in 2002, was written to "specify the rights and requirements of a homeowner to bring [a legal] action for construction defects."[4] While many interviewees we spoke with believed there was also an intent to reform construction defect liability, the bill did little to limit liability for damages under common law and rather permitted homeowners to bring a claim even when no damages have occurred. It furthermore provided a "right to repair" for developers—a process for correcting or curing any construction defects and thereby avoid costly and unnecessary litigation—but that right is limited to specific circumstances and subject to specific requirements, including extensive noticing at time of sale.[5] [6]

Most of the experts interviewed for this study indicated that SB 800 has benefited builders of single-family homes but has had less impact on builders of condominium and townhome projects. In the years since its passage, there is little evidence that it has helped to prevent or resolve defect claims outside of the litigation process.

In California, there is a 10-year statute of repose for filing a construction defect claim. This puts a hard time limit on the ability of homeowners to get recourse against a developer for building defects. Homeowners and HOAs cannot file a lawsuit for construction defects more than 10 years after substantial completion of construction, regardless of whether a defect was or even could have been

[3] Howard, Bob. 1998. "Threat of Suits Curbs Condo Construction - Los Angeles Times." Los Angeles Times, October 6, 1998. Accessed January 2, 2025. https://www.latimes.com/archives/la-xpm-1998-oct-06-fi-29696-story.html.

[4] Allen Matkins. September 2013. "California Court of Appeal Opens the Door for Construction Defect Claims Outside of SB800." Accessed April 30, 2025. https://www.allenmatkins.com/real-ideas/california-court-of-appeal-opens-the-door-for-construction-defect-claims-outside-of-sb800.html.

[5] Ibid.

[6] Norton & Associates. "Statutes Of Limitations On Construction Defects In California" Accessed April 30, 2025. https://constructiondefect.com/statute-of-limitations-california/.

discovered in that period. California's 10-year term is on the higher side of the national average but on par with about 20 other states.[7]

While SB 800 has created a process and additional steps that claimants must follow, developers are not released from liability for any cures of construction defects that they make under this process. That is, the law allows a developer to be sued for the same defect or other defects, at a later date, even if they have made repairs to address the initial defects identified within the SB 800 process. The industry experts interviewed in this study consistently reported that the inability of developers to get a release of liability for repairs represents a significant deterrent to exercising the so-called "right to repair" clause of SB 800.

As an illustrative example, one insurance broker described SB 800 as a "sleeper" for an insurance professional—a procedure with little use to them because it only delays but does not derail litigation. He recommends his policy holders (i.e., developers) avoid trying to repair alleged construction defects under the SB 800 process because they are likely to face a lawsuit regardless. It is thus more efficient for them to wait for the claimant to initiate litigation, at which point their insurance policy kicks in and can help them defend and respond to the claim.

AB 2738, passed in 2008, made some additional reforms to construction defect liability, essentially putting strong limits on the ability of developers and general contractors to pass liability and cost onto subcontractors when facing construction defect liability claims. However, experts interviewed for this study suggested that such limits are not always reflected in contract agreements or actions taken in response to defect claims, especially given the wide range of organizational size and sophistication among actors within the development and construction world, some of who (especially subcontractors) are not well-versed on legal and technical aspects of insurance coverages and limitations nor associated legislative protections.

In recent years, among a flurry of legislative activity focused on the state's housing crisis, construction defect litigation has again emerged as a topic of interest among state legislators. Specifically, legislators have been trying to increase housing supply by removing regulatory barriers that have made home construction more costly and challenging. For example, State Senator Glazer (7th District) introduced an unsuccessful bill in 2024 (AB1470) that was intended to reduce the likelihood of litigation by creating a revised process for homeowners or HOAs to get construction defects repaired. An ongoing interest in legal reform is expected as policymakers seek to create more affordable housing options and expand homeownership opportunities for Californians.

[7] Rafii, Robert. 2024. "Construction Defect Laws by State." FindLaw. May 2, 2024. Accessed January 2, 2025. https://www.findlaw.com/realestate/construction-defects/construction-defect-laws-by-state.html.

3. Construction Defect Litigation and Insurance Trends

As noted in the previous chapter, while SB 800 was intended to reform construction defect liability, in practice it has had very limited success in curbing litigation risk and associated costs for condominium and townhome projects. Instead, developers continue to navigate a heterogenous and unpredictable ecosystem that includes litigation attorneys, homeowner association (HOA) boards, construction subcontractors, design consultants, insurance brokers and underwriters, among others. Given that lenders generally require construction defect insurance as a condition of construction loan approval, the issue is of critical importance to housing development in California.

Initiation and Resolution of Claims

The prevalence of construction defects and related legal claims is not well studied. A 2002 brief from the California Policy Research Center noted that "no available data sources report the amount of construction-defect litigation or insurance availability, the size of settlements, or changes in insurance costs and accessibility." This lack of data continues to be a challenge in fully understanding the related impacts on new housing development.

However, the developers, attorneys, and insurance experts interviewed as part of this study widely report that, within their industry, there is a prevailing expectation that a condominium or townhome project will face a construction defect claim of some kind during the 10-year window of liability (statute of repose). One California insurance broker specifically estimated that 80 to 85 percent of (condo and townhome) construction defect insurance policies they issued over the last 25 years have faced a construction defect claim.

> ***"I have written over 100 OCIP insurance policies [for condominium and townhome projects], and 80 to 85 percent have had claim activity."***
>
> ***– Insurance broker***

This high rate of claims in turn leads insurance carriers to price their policies assuming they will pay out the cost of settling such a claim at some point during the 10-year horizon. That said, developers with a strong track record of avoiding such claims may receive small concessions on their premiums.

While there is limited data on the number of overall claims, construction defects generally appear to be more common in new condominiums than in other types of projects. A 2017 study from the Community Associations Institute found that, nationally, 57 percent of defects reported by homeowners and community associations were in new condominiums, while around 18 percent were in townhomes, and less than 10 percent were in single-family homes.[8] Given that condominium developments are less common than other types of housing development, this seems to indicate a very high rate of construction defects being identified in condominium projects.

According to interviewees, most construction defect claims in California are initiated by defect litigation attorneys who specialize in helping clients investigate and find potential construction defects rather than due to homeowners identifying construction defects on their own before initiating a claim.

Such law firms typically work on a contingency fee model, so there is no cost to homeowners or HOAs for initiating a claim. However, the firms are ultimately well compensated, typically taking up to 33 percent of any final settlement amount plus direct costs for expert fees, according to several sources interviewed for this study. This means that homeowners only receive around two-thirds of any settlement proceeds. Nationally, associations report that only about half of claims result in damages sufficient to cover the costs of rebuilding, replacing, or repairing the identified defects.[9]

According to some of our interviews, the broad definition of construction defects and the legislative rules around defect liability make it relatively easy for a claim to be made on almost any building, regardless of the quality of the building or merits of the builder. Indeed, a typical construction defect claim on a larger (100+ unit building) could include 50 to 100 defects.

While detailed data on the type and severity of construction defects brought in claims in California is not available, many interviewees expressed that a large proportion could be categorized as minor or cosmetic (stucco cracking, pain chipping) rather than meaningful construction defects (issues with foundation, plumbing, roof, etc.).[10] However, current California law leaves developers relatively open to liability claims and litigation for both cosmetic and meaningful construction defect claims.

[8] Community Associations Institute. February 2017. "Construction Deficiency Survey Report." Accessed April 30, 2025. https://www.caionline.org/getmedia/729365af-6bc6-4572-a578-d5c8583d4aa1/CAI-Construction-Deficiency-Survey-Report-2017.pdf

[9] Ibid.

[10] One attorney we spoke with estimated that fewer than 15 percent of claims have substantial and meaningful construction defects.

While SB 800 limited the statute of repose for certain types of defects to less than 10 years (e.g., a 5 year time limit to file a claim for plumbing, electrical or HVAC claims), these limits effectively apply only for defects where no resulting damage has yet occurred. Claimants still have other legal routes available under common law, such as suing for damages caused by latent defects or negligent construction.[11]

Role of Homeowner Associations (HOAs)

While construction defect liability applies to all residential projects, the existence of a homeowner's association or a condo owners association (HOA or COA) can play a role in the likelihood of a defect claim. While all condominiums must belong to an HOA/COA, only about two-thirds of single-family homes are part of an HOA according to national data.[12] As the body responsible for managing major decisions for a residential complex, HOAs are typically initiate and investigate a building defect claim on behalf of many homeowners.

From the perspective of defect litigation attorneys, HOAs make much easier clients than a group of unaffiliated single-family homeowners. An HOA can typically engage an attorney and initiate a construction defect investigation and claim process with a simple majority vote of the board. In fact, SB326 (2019) prohibited HOAs in California from requiring a member vote to initiate construction-defect litigation under most circumstances.

Defect litigation firms often successfully persuade HOA board members by explaining that they could be held personally liable if they failed to investigate or make a claim against the developer for a potential construction defect.[13] Because these litigation firms also often work on a contingency basis, there may be no upfront cost to the HOA. HOA Boards—comprised of voluntary, unpaid members unlikely to have expertise in either commercial liability law or residential construction—have a natural tendency to defer to litigation attorneys on the topic of defect concerns.

[11] Allen Matkins. September 2013. "California Court of Appeal Opens the Door for Construction Defect Claims Outside of SB800." Accessed April 30, 2025. https://www.allenmatkins.com/real-ideas/california-court-of-appeal-opens-the-door-for-construction-defect-claims-outside-of-sb800.html

[12] Sola, Ana Teresa. December 2024. "Here's what the rise of homeowners associations means for buyers." Accessed April 30, 2025. https://www.nbclosangeles.com/news/business/money-report/heres-what-the-rise-of-homeowners-associations-means-for-buyers/3572438/?utm_source=chatgpt.com.

[13] An HOA board member's concern over personal liability stems from Civil Code § 5800. Limitation of Officer and Director Liability.

Once an HOA board engages with a litigation firm, the firm will typically bring in experienced property inspectors and a structural engineer who can perform "destructive testing," which involves demolishing a small portion of a building to reveal the condition of materials under the surface. Because inspection / investigation costs can often be recouped in a settlement down the road, some industry experts explained that these law firms are incentivized to go on "fishing expeditions" to find all potential construction defects, however minor.

Interviewees described the defect litigation industry as highly sophisticated and methodical in their approach to find potential claimants. Many of these firms comb publicly available HOA registries and track formation and project completion dates to be able to strategically approach HOAs prior to the end of the 10-year mark.[14]

One developer interviewed had built a large condominium building in 2003 and continued to hold a position within the HOA board due to his ownership of a ground floor retail suite. He maintained a good relationship with owners and believed this would allow him to address any building challenges directly and thereby avoid defect litigation. Without his knowledge, a litigation firm approached other members of the HOA individually and convinced them to initiate a construction defect investigation and claim process.

Some firms are even more aggressive: one developer explained that he has recently seen a construction defect litigation claim initiated in the first year after construction, even though the property was still under the developer's one-year warranty. This may follow a trend among litigation firms of reaching out to HOAs sooner to beat competitors to the punch. Other litigation firms have reportedly implemented a business strategy of reaching out to as many HOAs as possible, rapidly initiating a claim, and settling for a relatively low amount to more quickly move onto the next client, even if it may not be in the best interests of their homeowner clients.

[14] An HOA is required to file their Articles of Incorporation with the California Secretary of State. This process legalizes the HOA and creates a public record of its existence.

Claim Resolution

While construction defect claims and lawsuits have become fairly ubiquitous for condominium and townhome projects in California, most are settled out of court. The Community Associations Institute's 2017 survey revealed that 44 percent of associations resolved their claims through direct negotiation, 14 percent through pre-litigation settlement, and 32 percent through a court judgement.[15] Although this is national data, interviewees confirmed that most California claims are settled out of court. One interviewed attorney estimated that 90 to 95 percent of lawsuits they had seen brought against builders resulted in a negotiated settlement. This attorney also noted that trial cases usually only occur for big, serious structural issues and / or those that involve crossclaims against subcontractors. That said, the threat of an actual trial, and the costs and risks that come with it, is an important bargaining chip in the settlement process.

In general, the size of settlements may not be correlated with the type or degree of building defects. One attorney reported settlements ranging in size from $3,000 to $15,000 per unit, with the amounts primarily based on the strategy of the defect litigation firm rather than the identified defects. Other factors that seem to more frequently impact the total settlement amount include: the reputation of the plaintiff firm, the wealth of the neighborhood, or the sophistication of the homeowner group involved. We also heard that lawyers target the settlement to the size of the insurance coverage—which is revealed to them during the discovery process—to obtain the maximum possible amount. For such attorneys, gathering a laundry list of potential defects upfront is crucial to their strategy.

As apparent in some of these examples, the current, litigation-driven system—while ostensibly built around consumer protection—seems to present several potential negative impacts on consumers:

- Construction defect liability has made it harder to build condominiums and townhomes – meaning fewer consumers have access to the homes and homeownership they desire.
- Litigation firms that encourage homeowners to bring claims and enter into settlement agreements too early during the statute of repose can limit the ability to bring claims later should additional defects become apparent.
- Litigation firm strategy may be driving settlement amounts rather than actual presence of construction defects, meaning those who need money to address defects are not getting it.

[15] Community Associations Institute. February 2017. "Construction Deficiency Survey Report." Accessed April 30, 2025. https://www.caionline.org/getmedia/729365af-6bc6-4572-a578-d5c8583d4aa1/CAI-Construction-Deficiency-Survey-Report-2017.pdf.

- Claims or litigation initiated by HOAs without knowledge or input of all homeowners can lead to unexpected and negative impacts on individual homeowners; many are unable to refinance or sell their home during litigation and forced to disclose construction defects to future buyers.
- Contingency fee model and settlement agreements may be driven by litigation firm business goals more than homeowner needs. Among other factors, this can contribute to settlement amounts being insufficient to cover the cost of repairing construction defects identified. The strong financial incentives under the litigation-based system has led to instances of high-profile abuse among litigation and HOA property management firms and professionals.

While interviewees were concerned about these negative impacts, several recognized that the current construction defect liability system helps safeguard consumers against developers who cut costs at the expense of quality. Most interviewees also stressed that any regulatory reform will need to balance the legitimate need to protect homeowners against shoddy construction.

While the net impact on consumers may be somewhat unclear, the robust defect litigation industry seems to be a major factor in why California sees relatively high risk and insurance costs associated with condominium and townhome projects.

Many other states are reportedly less litigious on this issue, though the nuances of the regulatory and political environment vary significantly by state. Some insurance brokers explained that they do see similar challenges in a handful of other states such as Arizona, Texas, Florida, Nevada, South Carolina, and Colorado. It was clear from interviews that California has a reputation as one of the most litigious around construction defects, and some also speculated that more states could become like California if / as the litigious culture spreads.

Insurance Coverage and Cost Drivers

The structure and market dynamics in the residential insurance market are fundamental to the health of the residential sector overall. For residential construction, obtaining adequate insurance is a critical step in the development process because without it a developer cannot obtain a construction loan.

Types of Construction Insurance

Condominium and townhome projects don't pay higher insurance costs on all types of insurance. Prices for builder's risk insurance policies, for example, are reportedly comparable between condo and rental apartment projects. Prices on excess commercial general liability (CGL) insurance, on the other hand, are the most impacted by construction defect liability and litigation concerns.

Aside from cost, the main difference in insurance between rental projects and condominium/townhome projects is the use of what are known as wrap policies. Wrap policies essentially cover the developer, contractor, and all subcontractors under a single commercial general liability policy. A wrap policy can be set up as either an owner-controlled insurance policy (OCIP) or a contractor-controlled insurance policy (CCIP). OCIPs are more common among larger and more sophisticated developers, while CCIPs tend to be used on smaller projects.

The **key types of insurance** residential developers purchase prior to construction (as generally required by lenders) include:

Builders risk coverage: This type of policy, also known as "course of construction" insurance, generally covers the owner from losses related to the building or site while it is under construction. For example, if the building catches fire prior to completion or is subject to vandalism, this insurance can help the developer recover their resulting losses.

Commercial general liability (CGL): This type of insurance policy, which serves as the "primary" liability policy for a project, provides coverage for premises liability, product liability, and completed operations. Sometimes referred to as a "2-2-2" policy, the limits are very commonly set at $2 million for each of these three coverage types (for small- to medium-sized projects). Among the various CGL coverages, product liability would provide for claims of construction defect under applicable state law. Premises liability would cover personal injury claims that occur while the builder is on-site completing work on the building, while completed operations would cover personal injury claims any time thereafter.

Commercial excess liability: This type of policy extends the CGL coverage by providing additional liability coverage for claims that exceed the limits under the primary policy. Developers purchase this type of policy in varying amounts beyond the primary policy to create a "tower" of insurance coverage that meets the recommended minimum coverage of 30-40 percent of hard costs, a threshold often sought by lenders. Typical increments of excess coverage are $1 million or more, with each subsequent amount priced lower than the last, reflecting the lower likelihood of a claim large enough to require a payout.

Wrap policies have become the norm for all condominium and townhome projects in California; insurance carriers largely stopped issuing any other types of policies for such projects starting in the late 1990s. This was in part driven by the fact that insurance companies started creating condominium and townhome exclusions on commercial general liability policies for subcontractor businesses in California, itself driven by construction defect claim risk. This resulted in developers having to use a wrap policy to get sufficient CGL coverage because there are no subcontractors whose own business CGL policies will cover their work on condominium / townhomes projects.

These changes were a direct result of the increasing frequency and size of construction defect claims on for-sale housing projects. Multifamily rental projects, on the other hand, are still typically built under a "project-specific" insurance policy. Unlike a wrap policy, this type of insurance does not cover the general contractor and subcontractors, whose liability falls under the CGL policy of each of their respective business entities.

The higher insurance cost is not primarily related to the use of wrap policy, however, but rather directly related to the construction defect liability and litigation risk for the condominium and townhome projects. Some rental project developers choose to use a wrap policy to streamline the insurance process and ensure comprehensive coverage for all parties. The insurance brokers we spoke with noted these policies are still priced much lower for rental projects.

Construction Defect Liability Cost Drivers

In addition to the risk of litigation, a variety of factors affect the total cost of addressing construction defect liability and related insurance costs, creating additional uncertainty and complexity for townhome and condominium developers relative to rental developers. The key factors are further described below.

Global Reinsurance Market Dynamics

Liability coverage for condominium and townhome projects is considered a type of high-risk insurance policy, and the insurance carriers who offer it are uniformly "non-admitted" insurers within the state of California. This means, unlike with many homeowner insurance providers, they are less subject to regulatory controls such as rate increases or other consumer protections and there are no guarantees on their coverage if they go out of business. This higher risk insurance is harder to obtain in the market, provided by a much smaller pool of carriers, and at prices that are highly susceptible to adverse market conditions in California and globally.

Insurance carriers that issue expensive and high-risk excess liability policies for real estate projects rely heavily on reinsurance markets traded out of London.[16] To manage their own exposure, carriers purchase reinsurance coverage or transfer portions of their policies to reinsurance firms, which specialize in insuring insurance companies and spreading risk across international markets.

A series of major insurance payouts due to large disaster events in recent years has led the insurance industry into a "hard" market, which is characterized by reduced capital availability, less competition, higher premiums, stricter underwriting, and more restrictive policy terms. Reinsurance companies, having absorbed significant losses, are more cautious in deploying capital for new policies and therefore less competitive in pricing. Real estate insurance carriers' own insurance costs are thus higher, leading them to be more conservative on pricing to manage the risk of doing business. This is evident through increases in insurance pricing not only for developers but for homeowners and purchases of many types of insurance.

Insurance market conditions tend to impact all types of insurance, meaning costs should increase similarly for both rental projects and condominium or townhome projects. However, increases in insurance market pricing will tend to hurt condominium and townhome developments more because their cost of insurance is already higher and represents a greater portion of project costs. Thus, any fluctuation is more impactful on the overall development budget.

Increases in insurance market pricing will tend to hurt condominium and townhome developments more because their cost of insurance is already higher and represents a greater portion of project costs.

It is also important to note that this study was conducted just prior to and during the devastating wildfires in Los Angeles County in early 2025. Thus, the estimated premium costs do not account for the impact of these fires on the California insurance market, if any, due to significant property damage, the increase in perceived fire risk, or other factors.

[16] Reinsurance in general is widely traded around the world (notable markets exist in Bermuda, Zurich, New York, and Singapore). However, the market for very large excess liability (umbrella) policies ($10M + and layered towers) like those needed for condo development are dominated by Lloyd's of London and their syndicates.

Cost of Third-Party Peer Review for Insurance Carrier

Insurance carriers for condominium and townhome CGL policies also typically require a third-party peer review to ensure quality assurance of workmanship during construction. This is a type of assurance needed to be able to sell the policies on the reinsurance market. Reinsurers want to see such peer reviews to assuage their concerns about risk and make this a requirement to take on such policies from the insurance carrier.

The cost of basic peer review can be estimated around $350 per door, according to one insurance broker, but the price can be much higher. One large townhome developer we spoke with said that they use multiple layers of quality assurance inspection at several points during the construction process (beyond what is required by their carrier) because the structure of their owner-controlled wrap insurance policy does not provide sufficient incentives for subcontractors to do their own quality assurance. EPS estimated this cost to be as high as $2,000 per door based on past research conducted on condominium development costs.

Self-Insured Retention

Under a wrap policy, the equivalent to a deductible is known as a self-insured retention (SIR), which a developer must be able to fund before they can access their insurance coverage. According to one insurance broker, a typical required SIR amount starts at $25,000 to $50,000 for smaller projects and can be as high as $250,000 on very large projects with budgets over $100 million.

Deductibles on project-specific policies for rental apartment projects are usually much cheaper, starting around $5,000 to $15,000 for smaller projects. Unlike with a deductible, a developer cannot initiate an insurance claim until they have spent their SIR, though the SIR amount spent does not count against insurance coverage limits like a deductible. The SIR essentially acts like an additional policy underneath the primary policy, funded by the developer. Selecting a higher SIR does allow developers to save some money on insurance cost, but for smaller and medium-sized developers, most insurers will insist on an SIR below $100,000 because they doubt the ability of the developer to fund a greater amount. EPS used this $100,000 amount as an upper end estimate for the example shown later in **Table 3**.

Maintaining the ability to fund these larger SIR amounts for the 10-year liability period adds an additional layer of financing and accounting complexity for condominium and townhome developers otherwise seeking to close out a project and pay back investors upon completion of a building.

Architecture & Engineering Professional Services Coverage

Architecture and engineering (A&E) consultants are not typically covered by wrap policies, and some insurance carriers refuse to have them named as additional insured on such a policy. Even when included as an insured party, the CGL coverage of a wrap policy provides no protection against errors and omissions, which is the primary liability that these professionals face on building projects. Attorneys and insurance brokers we spoke with indicated that many clients have misunderstandings about the various types of coverage, which may lead to more cautious behavior in dealing with projects.

In addition to some carriers refusing to include A&E firms, interviewees reported that some A&E firms will not work on projects if they are not covered within a wrap. This is one factor in why an A&E firm might refuse to take on condominium and townhome projects, as we heard from interviewees.

The other factor is that working on these projects can affect the professional liability insurance costs of A&E firms. While insurance companies vary in their practice and pricing can depend on many factors, professional liability carriers typically charge a higher price on insurance for A&E firms that work on condominium and townhome projects. For example, one industry professional indicated that insurance companies typically set a threshold for A&E firms of condominium and townhome projects making up no more than 10 to 15 percent of their work. Beyond those amounts, the firm would face increased premiums or a loss of coverage, though it may depend on track record, project characteristics, or which developer is involved. Some carriers may even charge a higher rate if a firm does any condo/townhome work at all.

Due to these risks and costs, many smaller A&E firms refuse to work on any for-sale project larger than a single-family home. Thus, medium and large firms are typically the only ones that take on condominium and townhome projects, and they often charge a markup or may refuse the work if they are busy. One architect reported charging a 50 percent premium on his rates for work on a condominium or townhome project, as a rule. This interviewee also noted that the majority of developers that hire him for these projects ultimately build their project as something other than condominium or townhome (e.g., they build the project as rental housing because of more favorable economics, even though they may still obtain condominium maps to facilitate future conversion). EPS assumed a slightly more conservative assumption of up to a 25 percent markup on overall architecture and engineering fees for the example shown later in **Table 3**.

Subcontractor Coverage

Wrap policies typically cover all commercial general liability and risk for subcontractors, which means that their insurance costs are not typically affected by working on these projects. We did not find clear data that developers pay a markup for subcontractor services for such projects, but some industry experts suggested that rates are higher because some subcontractors still refuse to work on condominium and townhome projects. This is in part explained by the fact that, like many actors within the development and construction industry, subcontractors are often not well-versed in the legal and technical aspects of insurance coverage and limitations, leading to potentially cautious behavior.

One homebuilder attorney reported that such behavior can limit the pool of available subcontractors to hire, driving up subcontractor rates for developers. When it does occur, it may be because some developers try to pressure subcontractors to fund a portion of the SIR costs, which may be more common among larger and more sophisticated homebuilders. AB 2738 largely protects subcontractors from such costs and unreasonable liability, but one insurance broker noted that many subcontractors are not fully aware of these protections.

One drawback of subcontractor inclusion under wrap policies that can affect costs is a lack of accountability. Without their own insurance policy and premium costs directly impacted, subcontractors are somewhat less incentivized to complete high-quality work. Many developers implement additional quality assurance reviews throughout the project to counteract this challenge, at an additional cost.

4. Construction Insurance Costs and Impacts on Housing Development

Greater construction defect litigation risk leads to higher costs for commercial general liability (CGL) insurance for developers of condominiums and townhome projects compared with similar rental projects. The overall CGL costs for condo projects (including excess coverage) can be more than three to four times as much as similar rental projects. Additionally, most developers purchase less total coverage (as a percentage of project costs) for condominium and townhome projects because of the high price, and/or because it is difficult to find a provider for additional coverage.

Higher construction defect liability costs for condominiums relative to rental apartments is one of several factors that has led to the concentration of condo development projects in more exclusive urban locations, such as high-rise towers in San Francisco or high-end, boutique projects in Santa Monica and Beverly Hills. The higher profit margins on these projects make it easier for them to bear the excessive costs of insurance—which also tend to make up a smaller portion of such projects' sizeable budgets. Meanwhile, smaller and more moderately priced projects may be more strongly impacted by insurance cost premiums. One architect reported that the costs and challenges are so great that most condominium projects that his firm is hired for are later redesigned as rentals.

The case of townhomes is somewhat different, and California has seen a significant wave of townhome construction in recent years. Although construction defects may be less common in townhomes than in condominium buildings, we heard consistently that townhome project insurance pricing is generally comparable to condominium projects. The reason for the proliferation of townhome projects is thus more likely explained by other economic factors, such lower per-square-foot costs of construction, simpler building codes (compared with multifamily or condo construction), the ability to phase construction and / or build smaller projects, as well as a continued strong for-sale market in California. Thus, while the cost impacts of construction defect liability are significant and impactful, they are not always decisive in project economics.

Commercial General Liability Pricing

As noted, condo and rental developers face different insurance options and pricing due to differences in construction defect litigation risk. While apples-to-apples comparisons can be difficult because these policies often have different coverages, limits, and other features, CGL insurance policies are typically priced

per $1,000 of project hard costs (with some minor variation in how hard costs are determined by each lender).

Table 2 provides case studies of CGL insurance premiums relative to construction costs for a Sacramento area apartment project and a Bay Area condominium project. The pricing is based on recent quotes (i.e., late 2024) provided by an insurance broker. As shown, the price for a *primary* CGL policy for a rental project was $4 per $1,000 of hard cost. A similar condominium project would be priced around $11 per $1,000 of hard cost, which is almost three times as expensive.

The difference in pricing for *excess* liability coverage is even more dramatic. Though these represent successive levels within the "tower" of insurance and are relatively less expensive than the primary policy, the pricing differential increases because the size and frequency of claims means that those excess liability policies for condominiums are much more likely to pay out against defect claims.

Table 2: Rental Apartment and Condominium Insurance Pricing Examples

	Policy	Coverage Amount	Price	Cost
Sacramento Area Rental Apartment Project		*Total Hard Cost (HC) Construction Budget:*		*$12,000,000*
Insurance Tower	$2 million primary CGL Policy[1]	$2,000,000	$4.00 per $1,000 of HC	$48,000
Insurance Tower	First excess CGL coverage policy	$1,000,000	$1.00 per $1,000 of HC	$12,000
Insurance Tower	Second excess CGL coverage policy	$1,000,000	$0.50 per $1,000 of HC	$6,000
Insurance Tower	Third excess CGL coverage policy	$1,000,000	$0.25 per $1,000 of HC	$3,000
Insurance Tower	Fourth excess CGL coverage policy	$1,000,000	$0.13 per $1,000 of HC	$1,500
Insurance Tower	Fifth excess CGL coverage policy	$1,000,000	$0.06 per $1,000 of HC	$750
Total Insurance Purchased		$7,000,000		$71,250
			Average Cost per $1,000 of Hard Cost:	**$5.94**
Bay Area Condominium Project		*Total Hard Cost (HC) Construction Budget:*		*$20,000,000*
Insurance Tower	$2 million primary CGL Policy	$2,000,000	$11.00 per $1,000 of HC	$220,000
Insurance Tower	First excess CGL coverage policy	$3,000,000	$9.00 per $1,000 of HC	$180,000
Total Insurance Purchased		$5,000,000		$400,000
			Average Cost per $1,000 of Hard Cost:	**$20.00**

[1] Policy pricing reflects a project-specific policy, which is different from the wrap policy that is typical for a condominium and townhomes project. Under a project-specific policy, contractors and subcontractors are responsible for the cost of their own insurance coverage, which they sometimes pass on to developers in the form of higher bid pricing. However, townhome and condominium developers may often pay the same or higher bid prices because some subcontractors choose not to work on such projects (largely due to liability-releated complexities), leading to a smaller and less competitive pool of available subcontractors for townhome and condominium projects.

Source: Economic & Planning Systems estimates based on interviews with insurance brokers and other industry professionals.

For rental projects, where defect litigation claims are rare, excess liability coverage is usually relatively cheap. In the Sacramento case study, the developer purchased $5 million in excess coverage for a cumulative cost of $1.94 per $1,000 in hard cost: the first million policy was priced at $1 per $1,000 of hard cost, and each additional million-dollar policy was half the price, down to a price of 6.25 cents per $1,000 of hard cost for the last million dollars in coverage.

The example condominium project developer paid $9 per $1,000 of hard cost for $3 million in excess coverage—meaning they paid more than 4.5 times as much as the example rental project ($9 vs $1.94) for 40 percent less coverage ($3 million vs $5 million). An additional challenge that condominium developers face is negotiating with third parties about the amount of required insurance. As in this example, many condominium developers buy less than the recommended coverage of 30-40 percent of hard cost, but not all lenders or general contractors are willing to partner on a project with lower insurance coverage.

One insurance broker interviewed noted that a condominium developer client began looking for a new general contractor after finding out how much it would cost to meet the insurance coverage requirements insisted upon by their first general contractor.

While coverage for condominium and townhome projects is invariably higher than rental projects, several factors can help individual developers or builders achieve more favorable coverage rates. These include:

- **Builder experience and track record**: a builder with a history of successful projects and a lower-than-average rate of construction defect claims will be able to negotiate lower insurance pricing.
- **Project location**: some insurance companies view certain (primarily coastal) counties as more litigious, costly to build, and with judges / juries less sympathetic to developers.
- **Product type**: each insurance company may have specific building criteria that result in higher insurance rates. For example, stacked condominiums will have a higher rate than side-by-side townhomes, a five-story building may have higher rates than a four-story building, and a building with a pool may have higher rates than one without.

Impact on Development Economics

As described above, the primary direct cost impacts of construction defect liability come in the form of higher insurance premiums, increased fees for architecture and engineering services, and self-insured retention payments (in the event of a claim). Although difficult to quantify, developers incur additional indirect costs as well, including additional risk and uncertainty, overhead and administration, and potential project delay.[17]

[17] For example, we heard examples of complexity in finalizing insurance amounts for condominium projects as a result of developers having to negotiate acceptable coverage amounts with lenders and contractors, requiring multiple quotes, bids, etc. to come to a reasonable deal. We also heard that many condominium projects are more likely to pivot to another project type due to various economic considerations.

Given that these costs are more pronounced for townhome and condominium projects relative to either single-family or rental projects, the combined effect creates a competitive disadvantage in the development of this product type, likely resulting in a lower level of investment and fewer overall units being built.

The best way to illustrate the cost impact of construction defect liability is by comparing projects that could be built as either rental apartments or condominiums. Multi-story, multifamily buildings represent the most common type of construction that is often built as either condo or rental (new townhomes are not typically delivered as a rental product). Accordingly, **Table 3** provides an example of the additional construction defect liability (CDL) related costs that may be incurred for a generic multifamily project with a $25 million construction hard cost budget in an urbanized area of California. The estimates are based on information provided by developers and insurance brokers interviewed for this study. While the example reflects a condo project, the findings can be considered generally representative of townhome project cost impacts as well, based on feedback from interviewed professionals.

As shown, there is a clear increase in insurance and architecture and engineering costs for a condominium project relative to a rental apartment project. The analysis calculates an estimated additional cost of $8,100 to $18,300 per unit based on construction costs typical for the Los Angeles area. This amount equates to about 1.9 to 4.4 percent (1.9% to 4.4%) of project construction hard costs. The per unit increase in costs for a typical condominium would likely be greater in market such as the San Francisco Bay Area where construction costs are higher and lower in a region such as Fresno or Bakersfield.

Although **Table 3** shows identical projects for illustrative purposes, comparing rental and condo projects side-by-side is challenging because these product types target different market or consumer segments are rarely designed the same. For example, developers tend to design condominiums to have larger units, more parking, and higher-end finishes (cabinets, countertops, appliances, sinks, faucets, showerheads, etc.) that are more expensive than those used in apartments. As a result, a typical condominium project of the same budget would cost more per unit and include fewer units, which also means the insurance- and CDL-related costs per unit would be slightly higher. Thus, the estimated per unit differences provided in **Table 3** are somewhat conservative.

Table 3: Illustrative CDL-Related Cost Difference for Condominium versus Rental Project

	Rental Apartment (Rental Project)	For-Sale Condominium (Condo Project)	Per Unit Difference[1]	Percent of Hard Costs
Cost Assumptions				
Building Type	Midrise (3 to 5 stories) Wood Podium			
Building Location	Los Angeles			
Construction Hard Cost	$25,000,000	$25,000,000		
Per Unit Hard Cost[2]	$420,000	$420,000		
Unit Count	60	60		
Insurance Coverage[3]				
Recommended *(% of Hard Cost)*	30 - 40%	30 - 40%		
Typical (% of Hard Cost)	40%	20%		
Coverage Amount	$10,000,000	$5,000,000		
Insurance Pricing[4]				
Low *(Per $1,000 Hard Cost)*	$4.00	$16.00		
High *(Per $1,000 Hard Cost)*	$6.00	$20.00		
Total Insurance Cost				
Low	$100,000	$400,000		
High	$150,000	$500,000		
Per Unit Insurance Cost				
Minimum Difference (High Rental vs Low Condo)	$2,520	$6,720	$4,200	1.0%
Maximum Difference (Low Rental vs High Condo)	$1,680	$8,400	$6,720	1.6%
Architecture & Engineering (A&E) Cost Markup[5]				
Base Services Cost per Unit (8% of Hard Cost)	*$33,600*	*$33,600*		
Low Markup *(10% increase)*	$0	$3,360	$3,360	0.8%
High Markup *(25% increase)*	$0	$8,400	$8,400	2.0%
Peer Review Quality Assurance Cost[6]				
Low Cost per Unit	$0	$350	$350	0.1%
High Cost per Unit	$0	$2,000	$2,000	0.5%
Self Insured Retention / Deductible Cost[7]				
Low Nominal Cost	$10,000	$25,000		
High Nominal Cost	$0	$100,000		
Low (Discounted) Cost per Unit	$0	$295		
High (Discounted) Cost per Unit	$118	$1,181		
Minimum Difference (High Base vs Low Condo)	$118	$295	$177	0.0%
Maximum Difference (Low Base vs High Condo)	$0	$1,181	$1,181	0.3%
Total Insurance- and CDL-Related Cost per Unit *(rounded)*				
Minimum Difference (High Rental vs Low Condo)	$2,650	$10,750	**$8,100**	**1.9%**
Maximum Difference (Low Rental vs High Condo)	$1,700	$20,000	**$18,300**	**4.4%**

[1]Per unit differences are shown to indicate the lower and upper bounds (e.g., minimum and maximum) of potential cost difference between a rental and condominium project. The minimum difference is the low (lower end range) estimate of condo project costs minus the high (upper end range) estimate of rental project costs, while the maximum difference is the high estimate of condo project costs minus the low estimate of rental project costs.

[2]Construction hard costs are reflective of a typical apartment building and for illustrative purposes only. Typically, condominium projects costs per unit are significantly higher than rental projects, reflecting larger floorplans and higher-end finishes common in for-sale projects. Per unit cost is estimated using data from Rider Levett Bucknall Construction Cost Indicator for multifamily projects.

[3]Insurance coverage amounts can vary significantly for a given project. Lenders typically expect at least 30-40 percent. Condominium projects typically purchase less than recommended amounts because greater amounts are very expensive or not offered by some carriers. Rental projects sometimes purchase more than recommended because additional excess policies on a rental project are very cheap. Very large projects also often negotiate and purchase lower coverage amounts.

[4]The insurance prices listed are averages for an entire tower of insurance, reflecting a composite of the primary policy and any excess insurance policies purchased. The low end scenario reflects the smallest difference between projects--optimistic pricing for the condominium project and pessimistic pricing for the rental project. The high end scenario reflects the opposite in order to show an upper end estimate of cost difference between the two projects.

[5]Assumes a 10 to 25 percent premium on the cost of A&E services for a condominium project. A&E firms face higher professional liability insurance premiums for such projects and often pass these costs onto developers.

[6]Most insurance companies require that policyholders complete third-party peer review inspections on any condominium projects due to the high-cost and high-risk nature of the policies, and some developers perform additional quality assurance inspections due to the structure of wrap insurance policies, which are required for condominiums but less commonly used on rental projects.

[7]Wrap insurance policies for townhome and condominium projects typically have higher self-insured retention (SIR) minimums compared with the deductible for a self-insured policy. The high end scenario reflects a rental project for which no claim is ever made ($0 deductible owed) versus the expensive end of the SIR cost range of $100,000. Discounted per unit costs are estimated assuming they must be paid 8 years after the purchase of the policy and can earn 4.5 percent interest.

Source: Economic & Planning Systems

An even clearer case study in cost comparison comes from the example of a recent condominium conversion project. This San Francisco Bay Area project is described below and shows how the price of insurance alone cost over $12,000 more per unit for a condominium project policy than for a similar policy on the same building when being developed as a rental project.

Insurance Pricing Case Study: Bay Area Condo Conversion

A five-story, wood-frame-over-podium building was recently built in the East Bay as rental apartments. The total hard cost to construct the building was around $195 million, and the developer purchased insurance coverage of $42 million, at a price of $1.9 million.

The project, less than two years old, is now being converted to condominiums with minimal changes to the building design—the renovation cost is around $800,000. The previous insurance policy is not valid for condominiums, so the owner is purchasing $20 million in insurance coverage at a price of $6 million.

As a condo project with roughly the same replacement cost, the owner is getting less than half the coverage and paying almost three times as much. ***The extra cost of insurance works out to almost $12,450 per unit****, adjusted for inflation.*

According to the insurance broker, there was no appetite in the insurance market to offer more than $25 million in total coverage for this project, though $5 million of additional coverage could have been purchased for around $1 million.

5. Ideas for Reform

The real estate, legal, and insurance professionals interviewed for this study presented a variety of perspectives on the issues and causes of California's current construction defect litigation environment, as well as several concepts for reform. Key themes from these interviews are summarized below followed by both specific and more general ideas for legislative action. This information is provided as additional context on the perspectives of those interviewed and is not intended to serve as a basis for recommendations. Moreover, EPS has not conducted independent research on the merits or potential benefits of these perspectives or proposals.

Most of the interviewees agreed that the current regulatory environment governing construction defect liability has not been completely effective at either reducing claims or protecting consumers. There was broad agreement that the system creates unnecessary obstacles for developers, yet several also recognized that it functions to safeguard consumers from those developers who cut costs at the expense of quality. While most agreed that legislative reform is needed, some emphasized the need to balance any changes to the current system against the legitimate need to protect homeowners against shoddy construction.

In terms of the causes of the current dysfunction in California's construction defect ecosystem, many pointed to the profit motive among litigation attorneys as a prime culprit. Specifically, the desire for large settlements drives litigation firms to seek out problems even if none exists rather than focus on cases where homeowners really need help. At the same time, because HOAs often lack the sophistication to address these construction issues, litigation attorneys can easily sway them to take legal actions that may not always be entirely in their members' best interests.

Other re-occurring themes include the need for better standards for what constitutes a defect, a system that better responds to serious building issues, and appropriate accountability with contractors and architects (which is not solved by the wrap insurance policies). Several suggested that, ultimately, some sort of state agency or system for certification, claim handling, or warranty management may be needed.

Potentials for Reform

Several potential ideas for reforming California's existing system and reducing the costs of construction defect liability are outlined below.

Suggested HOA Rule Changes

- Consider reforming SB326 to make initiation of a defect claim require a vote of all HOA members, rather than a simple vote of the HOA board members only. This would align the process with the decision to approve a major capital expenditure, which typically requires either a simple majority vote or a supermajority vote of all homeowners, depending on the CC&Rs.
- Require that homeowners be notified about the potential risk and downsides of initiating a defect claim prior to initiating such a claim. This would parallel Nevada law (NRS 116.31088) that requires both a full member vote and that certain written information be provided to all homeowners about impacts of a lawsuit before it is filed.
- Ensure that HOAs address long-term maintenance needs and hold sufficient (higher) reserve thresholds to do so. This requirement is driven by the reality that building issues are often more related to poor maintenance and upkeep than actual defects in construction.

Suggested Claim Rule Changes

- Revise the law to allow for repairs made under the SB 800 process to be exempt from future litigation after review and approval by a third party.
- Revise rules at the California Department of Real Estate around how fees are recovered to potentially disallow or cap the collection of litigation fees spent on the costs of defect investigation. Litigation attorneys working on a contingency basis also typically take a percentage of settlement. New rules could also specify that the percentage is on the settlement amount net of any charges for defect investigation. This change could discourage unreasonable or excessive investigation by litigation attorneys looking for any possible defects to justify a claim.

Reduction in Statute of Repose

- Reduce the statute of repose to five years or less to provide a smaller window for claims of construction defect. One argument for shortening the statute of repose is that 10 years is typically too late to do anything meaningful about building deficiencies, whether trying to prevent them from happening again or penalizing any of the parties involved. By that time, undiscovered construction defects, like insufficient waterproofing, are likely to have worsened, compounding the original defect.
- That said, others recognized that this change would likely be politically difficult. Moreover, even if the period were shortened by a few years, many of the same challenges would still exist, and could result in the unintended outcome of insurance policy carriers charging more due to more claims coming due in an earlier year after construction.

Warranty System

- Adopt a warranty system like those in the Canadian provinces of British Columbia, Alberta, Ontario, as well as the state of New Jersey. A warranty system could involve professional certification or credentialing for developers that participate in the system. These systems may be able to better resolve issues and ensure that the legal focus is on valid and meaningful defects. They may also have the potential to better align cost and risk by taking the plaintiff attorney's business strategy out of the equation.
- A more comprehensive system warranty system could also facilitate the collection of data on common defects to potentially inform future process changes.