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MEMORANDUM

April 17, 2015

TO: Interested Persons
FROM: Matt Kiszka, Research Analyst, 303-866-6275
SUBJECT: Construction Defect Laws and Issues

Summary

This memorandum provides information on Colorado's construction defect laws and the various issues surrounding construction defects in Colorado. It summarizes the current construction defect laws in the state, provides a summary of a recent Denver Regional Council of Governments study of the Denver housing market, and gives a comparative view of the civil laws of Arizona, California, Nevada, and Texas as points of reference.

Colorado Construction Defects Legislative History

In Colorado, the following bills have made significant additions and changes to construction defect law, dating back to 2001:

House Bill 01-1166 created the Construction Defect Action Reform Act (CDARA).¹ The act distinguishes construction defect lawsuits related to real property from common lawsuits, such as negligence. The act requires claimants to create a list of property defects that must be filed with the court and served on the defendant within 60 days of commencing action. It allows a homeowners' association (HOA) to file a defect action for five or more units that are part of the association, and requires it to notify unit occupants of the action.²

House Bill 03-1161 made amendments and additions to CDARA, and was dubbed "CDARA II." Many provisions of the bill were introduced in response to numerous class-action lawsuits that had seen large damages awarded to claimants, which construction industry professionals argued were above and beyond reasonable amounts. It initiated a "notice of claim"

¹Section 13-20-801, *et seq.*, C.R.S.

²Section 38-33.3-303.5, C.R.S.

process, requiring residential owners to notify the construction professional no later than 75 days before filing an action, provide them with a list of alleged defects, and allow them the opportunity to inspect the defects and to tender an offer to fix them. Damages were limited to \$250,000 in any action brought against a construction professional. The bill also defined the terms "actual damages" and "construction professional," and expanded the act's scope to commercial construction.

House Bill 07-1338 voided the waiver of certain statutory rights and remedies by residential property owners in their transactions with construction professionals. Specifically, the bill prohibits clauses in contracts between home buyers and construction professionals from expressly waiving any of the rights contained in either CDARA or the Colorado Consumer Protection Act. However, these rights may be waived if a homeowner settles with a construction professional after the claim for a defect accrues.

House Bill 10-1394 was enacted following a number of contradictory Colorado Court of Appeals rulings surrounding what constitutes an "occurrence" in a construction defect claim. The bill states that insurance companies must broadly interpret their duty to defend the insured under a commercial general liability policy in cases involving construction defect complaints. The act applies only to insurance policies that were in existence at the time or issued on or after the effective date of the legislation, and guides the pending and future actions of insurers in interpreting liability policies issued to construction professionals.

In *Hoang v. Monterra Homes* (2005), the Colorado Court of Appeals held that faulty workmanship constitutes an "occurrence," triggering an insurance company's duty to defend the insured in a construction defect claim.³ However, in *General Security Indemnity Company of Arizona v. Mountain States Mutual Casualty Company* (2009), a different panel of the Court of Appeals held that faulty workmanship does not constitute an "occurrence," and therefore construction defect claims against the insured do not need to be defended by an insurance company under a commercial general policy.⁴

For the purposes of guiding pending and future actions in interpreting liability insurance policies issued to construction professionals, HB 10-1394 clarifies the state's policy as follows:

- in interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage is an accident unless the property damage is intended and expected by the insured;
- upon a finding of ambiguity in an insurance policy, a court may consider a construction professional's objective, reasonable expectations in the interpretation of an insurance policy issued to a construction professional;
- if an insurance policy provision that appears to grant or restore coverage conflicts with an insurance policy provision that appears to exclude or limit coverage, the court shall construe the insurance policy to favor coverage if reasonably and objectively possible;

³*Hoang v. Monterra Homes LLC*, 129 P.3d 1028 (Colo. App. 2005).

⁴*General Security Company of Arizona v. Mountain States Mutual Casualty Company*, 205 P.3d 529 (Colo. App. 2009).

- if an insurer disclaims or limits coverage under a liability insurance policy issued to a construction professional, the insurer shall bear the burden of providing a preponderance of the evidence that the policy bars or limits coverage for legal liability and any exception to the limitation, exclusion, or condition if the policy does not restore coverage under the policy; and
- an insurer's duty to defend a construction professional or other insured under a liability insurance policy shall be triggered by a potentially covered liability.

Since 2010, a variety of bills have been introduced by the General Assembly to amend or address construction defect laws in Colorado, but have not been adopted. These bills have attempted to change the law to:

- establish legal procedures and limitations related to construction defect claims to make construction professionals involved in transit-oriented development (TOD) immune from claims surrounding noise, odors, light, and other environmental conditions related to TOD;
- provide insurance premium rebates for developers creating multi-family, owner-occupied affordable housing;
- require the Division of Housing within the Department of Local Affairs to collect and study data on the effects of various factors on new owner-occupied affordable housing in Colorado; and
- require HOAs involved in a construction defect claim to use mediation or third-party arbitration, and to send advance notice to all unit owners, before a lawsuit can be filed in disputes involving construction defects.

Denver Metro Area Housing Diversity Study

In October 2013, the Denver Regional Council of Governments (DRCOG) published its comprehensive [Denver Metro Area Housing Diversity Study](#), which sought to identify factors influencing attached-housing construction trends in the Denver metro area. The study highlighted housing diversity within Denver, Denver housing market trends and conditions, and factors affecting housing construction in Denver.

Housing diversity within Denver. The study noted that, much like the rest of the country, housing construction in the Denver region nearly came to a halt during the recession of 2009, and at the time of the study was significantly below pre-recession levels. DRCOG said that while certain types of housing, such as single family homes and apartment buildings, had seen some recovery toward pre-recession levels, this was not true across the industry. The study showed that in 2013 the construction of for-sale housing had experienced the least rebound, and accounted for only 2 percent of all active construction in downtown Denver.⁵ According to DRCOG, out of a total of 8,545 housing units under construction in downtown Denver at the time of the study, only 193 units were for-sale product. The study also noted that there were no for-sale unit permits issued for downtown Denver in 2012 and in 2013 by the time of publication.

⁵Downtown Denver Partnership, DRCOG.

More recent data obtained by Legislative Council Staff from the city and county of Denver suggests that the issuance of new construction permits has been steadily rising since 2011. Table 1 shows the new construction permit history of the city and county of Denver from 2005 through 2014. Table 2 shows this permit history by the number of units the permits represent.

**Table 1
City and County of Denver Residential Construction Permit History
2005 to 2014**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Single-Family Detached	1,875	1,691	1,191	801	366	535	622	843	825	1,023
Single-Family Attached*	N/A	N/A	N/A	N/A	117	92	71	200	444	668
Two-Family Dwelling	186	257	203	169	82	134	148	169	243	277
Apartments and Condominiums	157	70	81	50	9	13	32	109	96	57
Total	2,218	2,018	1,475	1,020	574	774	873	1,321	1,608	2,025
Percent change over prior year	N/A	-9%	-27%	-31%	-44%	35%	13%	51%	22%	26%

Source: City and County of Denver.

*Single-family attached permit data was combined with single-family detached permit data until 2009. Single-family attached data contains townhomes of up to three units. Larger townhome developments are included with apartment and condominium permit data.

**Table 2
City and County of Denver Residential Construction Permit History, Total Units
2005 to 2014**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Single-Family Detached	1,875	1,691	1,191	801	366	535	622	843	825	1,023
Single-Family Attached*	N/A	N/A	N/A	N/A	117	92	71	202	444	671
Two-Family Dwelling	186	257	204	169	83	134	148	170	246	284
Apartments and Condominiums	1,250	1,691	2,407	2,545	336	645	1,912	4,578	4,683	4,127
Total	3,311	3,639	3,802	3,515	902	1,406	2,753	5,793	6,198	6,105
Percent change over prior year	N/A	10%	4%	-8%	-74%	56%	96%	110%	7%	-2%

Source: City and County of Denver.

*Single-family attached permit data was combined with single-family detached permit data until 2009. Single-family attached data contains townhomes of up to three units. Larger townhome developments are included with apartment and condominium permit data.

The data appears to suggest that the issuance of total new construction permits in Denver is now approaching pre-recession levels. The total number of units represented by these permits is in fact outpacing pre-recession levels, and is primarily made up of apartment and condominium product. It is worth noting that the data for apartments and condominiums does not illustrate the breakdown between for-sale and rental product, so it is difficult to determine the current mix of this type of construction.

Additional costs of condominium construction in Denver. In its market study, DRCOG estimated that because of additional costs related to construction defects, developers need to pay approximately \$15,000 more per unit for a condominium project than an apartment building, reducing the profitability of such projects and making more affordable condominiums less viable for developers. DRCOG adds that in industry interviews many national builders said they were no longer pursuing condominium projects in Colorado because of the increased costs and heightened risk of litigation.

Conclusions of the DRCOG market study. DRCOG identified lending, foreclosures, economic and market factors, changing demographics, and construction defects litigation as factors that have impacted the housing market in the greater Denver area. The report's authors noted an increase in the availability of construction financing, a reduction in the number of foreclosures, and an overall improvement in the housing market from positive employment growth and declining unemployment as factors that have created construction growth within the Denver area since the recession. Conversely, wage compression and demographic trends have increased the demand for more affordable housing, while construction of attached multi-family product has moved towards apartment buildings and high-end condominiums, meaning that this demand is not being met.

DRCOG's conclusions suggest that the most significant impact on the construction of for-sale attached products has come from costs related to construction defects litigation. It notes that most developers believe that the probability of being sued for a construction defect in Colorado is near 100 percent for projects involving an HOA. DRCOG also states that construction insurance costs have grown significantly since the passage of HB 10-1394 as multiple carriers have left the state, although insurance company concerns over their ability to offer policies in the Colorado contractor liability market appear to stem back further than the enactment of the bill.

Department of Regulatory Agencies Insurance Industry Survey. For a Department of Regulatory Agencies (DORA) [publication](#) from September 2005, the department's Division of Insurance conducted a series of industry surveys to create a comprehensive list of licensed insurers who were active in the marketplace and providing general liability policies to construction professionals. The list is brief, and provides information for only three companies willing to insure general contractor business; five companies who would cover subcontractor business; and six companies offering general liability policies to cover artisan and trade contractor businesses. In the publication, the department speaks of a number of problems faced in compiling the list, such as companies that would not grant permission to be listed or insurers that were already in the process of discontinuing general liability policies for construction professionals, but it states that it did attempt to make the list as comprehensive as possible. Thus, it appears that marketplace insurance issues were commonplace years before the enactment of HB 10-1394, and commercial general liability insurance options for construction professionals have been limited for a significant time period. The division has not updated the publication since 2005.

According to a representative from DORA, several insurance companies discontinued commercial general liability coverage due to HB 10-1394, although there is no official record of this.

DORA does not track the actual number of insurance companies that have chosen not to offer coverage as a result of the bill, and there is no statutory requirement for insurance providers to report discontinuance of coverage or reasons for discontinuance, making it very difficult to quantify the effects of the bill. A representative of the Division of Insurance reviewed the history of rate filings since June 2010 and did not find any filings indicating any insurance company left Colorado because of the bill.

Comparative View of State-by-State Laws

Table 4 provides a summary of current laws that address residential construction defect issues in the states of Arizona, California, Colorado, Nevada, and Texas. Information on the laws of each state is provided, specifically addressing the statute of repose (the law that provides a time period after which a right to action expires); pre-litigation requirements for claimants wishing to file an action; the opportunity to remedy that is available to a contractor; any limitation on damages that may be recovered from a construction defect action; the definition of a "construction defect" within that state; and any other relevant law or noteworthy information.

**Table 4
Summary of State Laws Addressing Residential Construction Defects**

State	Statute of Repose	Pre-litigation Requirements	Opportunity to Remedy	Limitation on Damages	Definition of "Construction Defect"	Additional Statutory Provisions	Notes/Relevant Info
Arizona ⁶	Action cannot be brought more than eight years after substantial completion. If a defect is discovered in the eighth year, the homeowner can file an action in the ninth year. ⁷	<p>Before filing a dwelling action, the purchaser must deliver notice to the seller specifying the basis of the dwelling action. Seller has the right to inspect dwelling, and purchaser must allow inspection within ten days of seller's request.</p> <p>A purchaser may not file a dwelling action until the seller has completed all intended repairs and replacements of the alleged construction defects.</p> <p>If the seller does not comply with right to remedy requirements, the purchaser may commence a dwelling action.</p> <p>Purchaser cannot reject seller's offer to repair or replace the alleged construction defects, but may request that the repair or replacement be performed by a different construction professional.</p>	<p>Within 60 days of the purchaser's notice of action, the seller must provide a response. The response may include the seller's notice of intent to repair or replace any alleged construction defects, to have the alleged construction defects repaired or replaced at the seller's expense, or to provide monetary compensation to the purchaser.</p> <p>The purchaser may accept or reject an offer of monetary compensation or other consideration, other than repair or replacement and, if rejected, may proceed with a dwelling action on completion of any repairs or replacements the seller intends to make or provide.</p> <p>The seller must make reasonable efforts to begin repairs or replacements within 35 days after the seller's notice of intent to repair or replace was sent.</p>	Purchaser cannot recover attorney and expert fees in a construction defect dwelling action against a seller.	<p>A material deficiency in the design, construction, manufacture, repair, alteration, remodeling, or landscaping of a dwelling that is the result of one of the following:</p> <p>(a) a violation of construction codes applicable to the construction of the dwelling;</p> <p>(b) the use of defective materials, products, components or equipment in the design, construction, manufacture, repair, alteration, remodeling, or landscaping of the dwelling; or</p> <p>(c) the failure to adhere to generally accepted workmanship standards in the community.</p>	<p>Indemnity clauses against liability for defective construction in a contract between a purchaser and a seller are against the public policy of the state and are deemed void.</p> <p>An HOA may file a dwelling action against a seller after it has provided full disclosure in writing to all of its members and held a meeting of its members and board of directors, and as long as it satisfies the additional pre-litigation requirements. The association's board of directors must also authorize the filing of the action.⁸</p>	Arizona's construction defect laws were substantially revised in 2015 to define a construction defect, prevent a purchaser or seller from recovering attorney and expert fees in a construction defect lawsuit, and to further establish the seller's right to repair defects before a homeowner can file a lawsuit.

⁶ Ariz. Rev. Stat. § 12-1361, *et seq.*

⁷ Ariz. Rev. Stat. § 12-552.

⁸ Ariz. Rev. Stat. § 33-2002.

**Table 4
Summary of State Laws Addressing Residential Construction Defects (Cont.)**

State	Statute of Repose	Pre-litigation Requirements	Opportunity to Remedy	Limitation on Damages	Definition of "Construction Defect"	Additional Statutory Provisions	Notes/Relevant Info
California ⁹	Action may be brought for up to ten years, depending upon the specific component or function of the home that the plaintiff is bringing action on against the builder, and when the suit is filed.	Homeowner must notify builder that building standards have been violated and that a claim is being filed. Builder has 14 days to acknowledge the claim. After acknowledgment, builder can perform an inspection within 14 days. If a second inspection is deemed necessary, builder must request this within 3 days of initial inspection, and then complete second inspection within 40 days.	Builder can make a cash offer or an offer to repair the violation within 30 days of initial or second inspection. Homeowner has the right to request up to three additional contractors that could do the work. Builder must also provide an offer to mediate the dispute, if the homeowner so desires.	Limited to the reasonable value and cost of repairs, relocation and storage costs, lost business income if home was principal place of business, and investigation costs for each violation.	None, but clearly defined "building standards" are provided that must be met.	HOAs are treated as a "purchaser" under this law. Certain conditions can lead to the builder being excused from any obligation or liability, such as an "unforeseen act of nature," or a homeowner not following the builder's or manufacturer's recommendations.	
Colorado ¹⁰	Six years, with a two-year extension if defect is discovered in fifth or sixth year after substantial completion. ¹¹ The action must be commenced within two years after a defect is discovered. ¹²	"Notice of claim" process, whereby the residential homeowner must notify the construction professional at least 75 days before filing an action. The homeowner must allow the construction professional the opportunity to conduct an inspection of alleged defects, which is to be completed within 30 days of notice.	If a builder wishes to remedy, the builder must deliver an offer of payment to cover defects or agree to remedy, within 30 days of inspection.	A claimant may not recover more than actual damages, unless there is a violation of the Colorado Consumer Protection Act, or if the construction professional does not substantially comply with the Notice of Claim process. A claimant may then receive treble damages. Damages are limited to \$250,000 in any action against a construction professional.	None.	An HOA may file a defect action for five or more units that are part of the association, and must notify unit occupants of the action.	See legislative history section in memo above.

⁹Cal. Civil Code § Division 2, Pt. 2, Title 7.

¹⁰Section 13-20-801, *et seq.*, C.R.S.

¹¹Section 13-80-104, C.R.S.

¹²Section 13-80-102, C.R.S.

**Table 4 (Cont.)
Summary of State Laws Addressing Residential Construction Defects**

State	Statute of Repose	Pre-litigation Requirements	Opportunity to Remedy	Limitation on Damages	Definition of "Construction Defect"	Additional Statutory Provisions	Notes/Relevant Info
Nevada ¹³	Action must be brought within six years from date of substantial completion. This can be tolled from the time notice of the claim is given, up to one year.	Claimant must provide contractor with a notice of defect before filing an action, which states in specific detail the nature and location of defects within the residence. Claimants must allow contractors to inspect alleged defects. The claimant must be present during the contractor's inspection and must identify the exact location of each alleged construction defect.	<p>Claimant must allow the contractor a reasonable opportunity to repair the construction defect or cause the defect to be repaired if the contractor makes an election to repair within 90 days of the construction defect notice. These repairs must be completed within 105 days. If the repairs are for a notice received from five or more owners or from an HOA, they must be completed within 150 days.</p> <p>If the contractor has elected not to repair the constructional defect, the claimant may bring a cause of action for the construction defect.</p>	If a contractor does not elect to repair or have a construction defect repaired, a claimant can recover the reasonable cost of repair, loss of use, interest, and expert costs. This is limited to construction defects actually proven by the claimant, not merely alleged. Attorney fees are not recoverable damages.	<p>A defect in the design, construction, manufacture, repair or landscaping of a new residence, of an alteration of or addition to an existing residence, or of an appurtenance and includes, without limitation, the design, construction, manufacture, repair, or landscaping of a new residence, of an alteration of or addition to an existing residence, or of an appurtenance:</p> <ul style="list-style-type: none"> • which presents an unreasonable risk of injury to a person or property; or • which is not completed in a good and workmanlike manner and proximately causes physical damage to the residence, an appurtenance or the real property to which the residence or appurtenance is affixed. 	<p>If construction defects create an imminent threat to the health or safety of the property's inhabitants, then the responsible party must cure the defect in a reasonable time. If the repair is not cured in a reasonable time, the owner may have the defect independently fixed and can recover costs for the repairs from the responsible party.</p> <p>An HOA may only bring a claim on the common elements of a building.</p>	<p>The Center for Business and Economic Research at the University of Nevada, Las Vegas, produced a study in 2013 entitled "The Nevada Housing Market: Prospects for Recovery." The publication identifies how protections intended for homeowners that were built into Chapter 40 of the Nevada Revised Statutes by Senate Bill 241 in 2003 had the adverse effect of dramatically increasing the number of lawsuits brought against contractors by too loosely defining the term "construction defect."</p> <p>Nevada's construction defect laws were substantially revised in 2015 to limit what constitutes a construction defect, shorten the statute of repose, eliminate recovery of attorney fees in lawsuits, change pre-litigation notice procedures and the claims a homeowner may bring suit against, limit indemnity, and restrict an HOA to bringing a claim on only the common elements of a building.</p>

¹³ Nev. Rev. Stat. § 40.615, *et seq.*

**Table 4 (Cont.)
Summary of State Laws Addressing Residential Construction Defects**

State	Statute of Repose	Pre-litigation Requirements	Opportunity to Remedy	Limitation on Damages	Definition of "Construction Defect"	Additional Statutory Provisions	Notes/Relevant Info
Texas ¹⁴	Ten years after substantial completion of improvement. If a claim is brought during the tenth year, the period is extended for two years from the date of the claim. ¹⁵	<p>Claimants must give notice 60 days prior to filing an action. They must provide, at the request of the contractor, any evidence that shows alleged defects and the extent of the repairs needed. Claimants must provide the contractor with an opportunity to inspect in the first 35 days following notice of receipt.</p> <p>If a claimant files suit seeking damages in excess of \$7,500, the claimant or contractor may file a motion to compel mediation of the dispute. The motion must be filed not later than the 90 days after the suit is filed.</p>	Contractors can make a written offer to repair or have defects repaired by a third party. If claimant rejects the offer, he or she must outline why in reasonable detail, after which the contractor has the chance to make a counter-offer.	<p>Should a claimant reject a reasonable offer from the contractor, or not allow the contractor a reasonable opportunity to inspect or repair the alleged defect pursuant to an accepted offer of settlement, there are limitations on the amount that a claimant may recover. These limitations are based upon the fair market value of the contractor's last offer of settlement, or, if the contractor made an offer to purchase the residence from the claimant, the amount that was offered for this purchase.</p> <p>There are limits on the amount that a claimant may recover, based upon the economic damages caused by a construction defect, such as: the reasonable cost of repairs; replacement or repair of any damaged goods in the residence; engineering and consulting fees; cost of temporary housing during repairs; reduction in current market value after the construction defect is repaired if the construction defect is a structural failure; and attorney's fees.</p> <p>If a contractor does not repair defects as part of an accepted offer, there are no limitations on recoverable economic damages.</p>	A matter concerning the design, construction, or repair of a new residence, of an alteration of or repair or addition to an existing residence, or of an appurtenance to a residence, on which a person has a complaint against a contractor. The term may include any physical damage to the residence, any appurtenance, or the real property on which the residence and appurtenance are affixed proximately caused by a construction defect.	An HOA has the power to bring a claim on behalf of itself or two or more unit owners. ¹⁶	<p>In 2003, the state enacted legislation creating the Texas Residential Construction Commission Act (TRCCA), which governed residential construction defect claims for single family homes. The TRCCA created the Texas Residential Construction Commission (TRCC) and the State Sponsored Inspection and Dispute Resolution Process, which were designed to oversee construction of single family residential properties, review construction defects, and offer a neutral analysis of construction defect claims.</p> <p>The TRCC went under sunset review in the 2009 legislative session, and was not renewed. It became a defunct state agency in 2010.</p>

Source: Legislative Council Staff.

¹⁴Tex. Prop. Code Ann. § 27.001-004.

¹⁵Tex. Civ. Prac & Rem. Code § 16.009.

¹⁶Tex. Prop. Code Ann. § 82.102(a)(4).