Client Alert

September 1st Marks New Era for Developers and Lenders in the Colorado Residential Condominium Market

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Over the past several years (and during the last residential real estate boom), certain Colorado laws have proven to favor the position of condominium boards over that of developers in disputes over construction defects. As a result many residential developers have not participated in the condominium market during this time. As of September 1, 2017, however, the balance of power is shifting and lenders and developers should take notice of the new, more favorable environment.

Elsewhere in the U.S., condominium construction in most real estate markets has comprised approximately 15-20% of all new residential construction. In Colorado that number has been closer to 3%, and most of that is expensive "specialty" projects. As a result, there is virtually no inventory of newly-constructed condominiums for first-time homeowners, as developers have avoided building such units and lenders have avoided lending on them due to the increased exposure regarding potential disputes with homeowners and HOAs.

Artificially restricting one product line out of the residential market has not been good for that market. As a result, a number of cities and other interested parties have attempted to address this problem through the Colorado legislature. In 2017, a potential solution was finally created by the passage of House Bill 17-1279, which will go into effect on September 1, 2017. In addition, the Colorado Supreme Court, in the recent decision of Vallagio v. Metropolitan Homes, sided with developers in connection with the use of arbitration to determine potential damages in the event of a construction defect. Both of these recent events are likely to have significant, positive impact on bringing the residential condominium market in Colorado back to the forefront.

Prior to the recent changes, the Colorado Common Interest Ownership Act (CCIOA) permitted a simple majority of a condominium homeowners' association's (HOA's) executive board to approve of filing a construction defect action.

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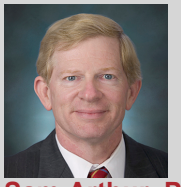

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Further, CCIOA did not explicitly permit developers to meet with individual unit owners to try to resolve potential claims prior to a suit being filed. The recently-passed House Bill 17-1279 amends CCIOA and imposes more requirements on HOAs considering construction defect class actions.

First, HOAs must deliver written notice of an anticipated lawsuit to any construction professional that might face liability. Second, a majority of unit owners – not merely a majority of an HOA's executive board – must vote in favor of litigation before an HOA may file suit. HOAs must hold a meeting at which unit owners can discuss the possibility of a claim.
The construction professionals implicated in such claim must be notified of the meeting. More importantly, they must be permitted to attend, address the unit owners, and offer to remedy the alleged defect. Finally, unit owners must receive more detailed information about potential costs and risks associated with the litigation, including their responsibility to contribute to the legal fees incurred and the potential adverse impact the litigation may have on their ability to sell or obtain loans on their units. Although HB 17-1279 tolls the statute of limitations while unit owners consider and vote on a construction defect action, the tolling period may not exceed ninety days.

In addition to HB 17-1279's safeguards, the Colorado Supreme Court recently affirmed a developer's right to include a permanent "developer consent to amend" clause in a condominium project's Declaration. In Vallagio v. Metropolitan Homes, a condominium HOA challenged the validity of a developer's declaration provision that mandated the use of binding arbitration to settle construction defect disputes, and precluded amendment of the provision without the developer's consent.

Construction defects allegedly arose, and the unit owners unilaterally voted to remove the declaration's arbitration provision. When the HOA subsequently sued the developer, the developer argued that the "consent to amend" clause invalidated the unit owners' vote and barred the suit. The Colorado Supreme Court agreed with the developer, finding that CCIOA's plain text – which permits amending a declaration "only by an affirmative vote of a majority of unit owners," where the percentage required to amend may not exceed 67% – does not prohibit supplemental amendment requirements unrelated to the vote percentage. As such, the "consent to amend" clause did not violate CCIOA's amendment provision.

The Court also found that the "consent to amend" clause did not impermissibly restrict the HOA's power to "deal with" the developer, because the power to amend a declaration lies with unit owners, not the HOA. In addition, the Court found that a mandatory binding arbitration provision does not violate a consumer's right to sue guaranteed by the Colorado Consumer Protection Act (CCPA) because the CCPA does not have a non-waiver clause regarding a consumer's right to a

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"civil action." The Court explicitly did not address whether CCIOA allows a declaration "to prescribe certain dispute resolution procedures," like mandatory binding arbitration.

It did, however, refer approvingly to CCIOA's preference for alternative dispute resolution and its provision that declarations may specify when binding arbitration shall resolve disputes.

The protections afforded by HB 17-1279 and Vallagio v. Metropolitan Homes, along with various municipal ordinances with similar safeguards, should reduce the risk to condominium developers and lenders. Ideally, these barriers to filing large construction defect claims should reduce insurance premiums and make condominium projects less risky for lenders. With the appropriate insurance in place for the projects, lenders should feel more comfortable making construction and permanent loans for condominium developments in Colorado..