



## **2021 CLM Construction Conference**

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### **Champagne Wishes: Navigating the Pitfalls of High-End Home Litigation**

In the last two years, the construction defect industry has seen an influx of high-end home litigation throughout the nation. Our panel will focus on this current trend in the Southwest (CA, AZ, and TX). Today we will discuss the unique issues that make high-end home litigation different than other cases and techniques to employ to control the costs to defend these claims and set reserves.

But first, this panel will take a look at how COVID-19 and the current status of the economy has affected the construction industry in general, including the cost to build high end home in the Southwest.

#### **I. COVID IMPACT ON THE CONSTRUCTION INDUSTRY**

COVID has significantly impacted the construction industry including owners, developers, general contractors, subcontractors, vendors, and insurance professionals.

##### **a. What is the cost to build a home per square foot?**

###### **i. Arizona**

In 2020 (pre-covid and lumber shortage) a moderate custom home is around \$120. A high-end home is \$200 sq foot. In 2021 (after covid) a moderate custom home is around \$250. A high-end home is \$325 sq foot.

###### **ii. California**

In So Cal in 2020 (pre-covid and lumber shortage) a moderate custom home is around \$150. A high-end home is \$250 sq foot. 2021 (after covid) a moderate custom home is around \$250. A high-end home is \$400 sq foot.

In Nor Cal 2020 (pre-covid and lumber shortage) a moderate custom home is around \$175. A high-end home is \$300 sq foot. In 2021 (after covid) a moderate custom home is around \$350. A high-end home is \$575 sq foot.

### **iii. Texas**

In 2020 (pre-covid and lumber shortage) a moderate custom home is around \$110. A high-end home is \$150 sq foot. In 2021 (after covid) a moderate custom home is around \$225. A high-end home is \$325 sq foot.

Cost to remodel an existing home is usually 10-25% higher as dealing with existing conditions. For example, in So Cal, a remodel is \$600 per foot.

#### **b. Why is the Cost to Build a home so high?**

##### **i. Lumber Shortage**

According to National Association of Home Builders, prices for lumber are up nearly 80% since April 2020. Lumber mills were shut down due to COVID. This created uncertainty which disrupted the perception of demand (people thought it would be low). So lumber production slowed. Then, there was a "DIY surge" where homeowners flocked to big box stores and purchased lumber for their projects. Took a huge chunk of inventory. Since restaurants were limited to outdoor seating, they also purchased lumber to build outdoor seating. Lumber mills cannot just come back, it can take weeks. Increase in demand, but limited supply – means high prices. Building again and the housing market is booming.

##### **ii. Concrete Shortage**

A plant in NorCal burned and thus the supply is short. COVID has slowed the chain of materials from China and India. China closed a cement production plant (cement is the glue-like substance used in concrete) and 1/3 of all materials that we use to build in US, come from china. 500 cement and concrete plants in northern Mexico suspended production due to an ongoing shortage of natural gas.

##### **iii. Steel Shortage**

According to the Concrete Foundation Association, the shortage of steel form ties is threatening to create a temporary shutdown in construction. While they are manufactured domestically, to meet rising demand and address cost, a significant volume of supply has transitioned to imported ties from China. The concerns are contractors taking short-cuts like opting to use fewer ties in the forms, while others might try alternative tie systems that are not tested nor designed for the loads.

##### **iv. Labor Shortage**

The demand is high, higher wages. Specialty trades in particular demand very high wages. You will get people who will do the work for less money, who are less skilled. While design professionals have continuing education, trades do not.

##### **v. Why is this important?**

This is important because higher lumber prices have added more than \$16,000 to the price of the average newly built home, according to the National Association of Home Builders. Some estimate the added cost is even more than that. You will have homes being built by individuals who do not have the skills nor training to perform certain tasks which increases the number of claims. Less skilled/trained/experienced contractors are less likely to have contracts or insurance. Hard to transfer the risk.

## **II. UNIQUE ISSUES FOR HIGH-END SINGLE FAMILY CONSTRUCTION DEFECT CLAIMS**

What makes a home high end is the size and finishes – the type of flooring, tile, cabinets, fixtures, etc.

### **a. Current Trends in Southwest**

In Arizona & Texas, they are seeing an influx of people moving in from out of state. There is land available, so most people are interested in new high-end home constructed instead of a remodel. [Interesting – a contractor does not need a license to build in TX, so it is not regulated. One of the largest growing areas in Texas is around Austin; prices are rapidly climbing; lots of corporations moving to Texas.]

In California, there is not a lot of land to build on, so remodel construction is the wave of construction. A lot of baby boomers are passing their homes to their kids, who in turn gut/remodel the homes.

### **b. Original Construction Issues with High End Homes**

In California, new residential construction defect litigation that is sold after January 1, 2003, is governed by Civil Code Section 986, or commonly known as SB 800. SB 800 only applies to new construction and to builders/developers (those in the business of building and selling to the public). Essentially, SB 800 establishes functionality standards of how a home and its components should function.

Arizona has a similar pre-litigation repair process known as the Purchaser Dwelling Act which requires a residential dwelling purchaser to give notice to the “seller” of defects. The PDA requires that the seller forward this notice to all construction professionals that are responsible, and they have the same rights to inspect, test and repair.

The problem with SB 800 & PDA, is that it has very strict timeline of events that if not met, forfeit the builders right to repair. When a builder has 30 plus subcontractors that worked on building this new home, it is extremely difficult to track them down and provide notice within 14 days of the inspection and right to repair. It is even more difficulty if dealing with a pro per homeowner.

Another issue is that a developer/subcontractor rarely wants to perform repairs. Finding repair contractor willing to perform repairs and take on the risk/warranty the repair work, is hard. It can be very expensive. Moreover, it resets the clock for the statute of limitations wherein the homeowner now has additional years to make claims regarding the repairs.

New Mexico has a lot of land, so we are seeing larger home builders moving into these areas to develop.

#### c. Remodel Construction

Recently, the construction defect industry has seen a surge in claims involving remodel construction for high end homes.

##### **i. Advantages & Pitfalls**

Pre-Litigation is beneficial as the parties can control the timing of events and work on early resolution. Parties can agree and/or stipulate to a tolling agreement and/or a timeline of events for inspections, production of cost of repair and/or mediation.

Pitfall is that no "strong arm" to serve subpoenas or discovery. Hard to get subcontractor participation if no litigation.

Hard to get 1542 waiver for settlement.

##### **ii. Who performed the work?**

As defense counsel, I am seeing a lot of cases where the general contractor either self-performed most of the work or does not have the documentation to show who performed the work. In some cases, the GC refuses to participate and/or aid in determining who performed the work.

##### **iii. Failure to obtain valid subcontracts.**

As defense counsel, I often run into situations where the client did not consult an attorney and drafted a contract himself or printed it from the internet. Or just did not bother with contracts whatsoever (I run into this a lot in AZ where they are still on the handshake).

### **III. COVERAGE ISSUES HIGH VALUE SINGLE FAMILY HOMES**

As coverage counsel I have seen an increase over the last few years in the number of claims being brought by insureds who were involved in new construction of, or significant renovation of large expensive single-family homes. These claims present coverage issues that while similar to the more traditional homeowner association type claims prevalent in the past, also present unique and in some cases more complex coverage issues.

a. Who is the insured

Correctly identify and compare names between the insured listed on the policy and the insured who did the work.

**i. Developing entity**

1. LLC
2. Joint Venture
3. Sole proprietors
4. Contractors
5. Contracts with owner
6. Contracts with design professionals
7. Contracts with general contractors/subs
8. Subcontractor

b. Type of Policy

Understanding the type of policy (CGL/E&O) and how various issues like limits and the timing of notice of claim is important to the proper handling of the claim.

**i. Occurrence Based**

1. CGL
2. Limits – Single/Aggregate
3. SIR's v. Deductibles
4. Additional Insured

**ii. Claims Made**

1. E&O
2. Notice of Loss issues
3. Design Professionals
4. Additional Insureds

**iii. WRAP**

1. OCIP/CCIP

c. Specific Claims

As coverage counsel I have seen certain claims brought by homeowners appear more frequently in high-end home claims.

**i. Disgorgement**

**ii. Licensing issues**

1. Failure to cooperate

**iii. Payment**

1. Completion Bond/liens

**iv. Intentional Conduct**

1. Right to Independent Counsel

**v. Mold**

1. Other exclusions

**vi. Affirmative Relief Claims**

**vii. Restatement of Law Liability Insurance (RLLI)**

d. Risk Transfer

In order to successfully manage claims arising from high-end single-family homes, both insurance carriers and construction insureds need to be familiar with and utilize best practices when it comes to Risk Transfer.

**i. Contractual Indemnity**

**ii. Cross-complaints**

**iii. Right to Repair Claims**

1. No suit
2. Suing subcontractor

**iv. Additional Insured Issues**

**v. Actions for Negligence**

e. Claim Handling

**i. Reserve issues**

**ii. Separate Claims Handlers**

**iii. Sharing counsel/experts**

**iv. Authorizing Declaratory Relief Actions**

1. Judicial Stay on construction claim