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OREGON'S CONSTRUCTION DEFECT LIABILITY LAWS: A BARRIER TO HOMEOWNERSHIP?

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Oregon is an outlier in terms of the share of multifamily housing units that are owner occupied. Strong construction defect protections are likely playing a role

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ABOUT COMMON SENSE INSTITUTE

Common Sense Institute is a non-partisan research organization dedicated to the protection and promotion of Oregon's economy. CSI is at the forefront of important discussions concerning the future of free enterprise and aims to have an impact on the issues that matter most to Oregonians. CSI's mission is to examine the fiscal impacts of policies, initiatives, and proposed laws so that Oregonians are educated and informed on issues impacting their lives. CSI employs rigorous research techniques and dynamic modeling to evaluate the potential impact of these measures on the Oregon economy and individual opportunity.

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INTRODUCTION

Oregon is grappling with a significant housing shortage, intensified by a chronic undersupply that has pushed home prices beyond the reach of many residents. This crisis undermines homeownership, a crucial pathway to accumulating personal and generational wealth, particularly for first-time buyers and middle-income households.

Among the viable solutions to this issue, condominiums and townhouses stand out as accessible options. However, despite their potential to ease the housing crunch, production of these units in Oregon has not kept pace with demand. The peak of **condominium production** in 2006 saw 4,199 units built, but this figure has plummeted to an average of just **309 units annually** since then.

The state needs over **550,000 new housing** units to accommodate projected population growth over the next two decades, with a current shortfall of **65,819 units** already straining existing resources¹. This shortage is particularly acute in the condominium market, which could otherwise provide more affordable homeownership opportunities.

Restrictive Construction Defect Liability (CDL) laws exacerbate this problem by creating significant barriers for developers. These laws not only increase construction costs but also discourage the development of units for sale, leading developers to prefer building rental units due to shorter liability periods.

Examining legal reforms in other states that have successfully balanced homeowner protections with development incentives offers crucial lessons for Oregon policymakers. This report delves into the specific challenges posed by Oregon's CDL laws, comparing them with regulations in other states, assessing their impact on housing development, and proposing avenues for essential legal reforms. By revisiting these laws, Oregon can take significant steps toward revitalizing its housing market, ensuring it meets the needs of its residents, and supports economic stability for future generations.

¹ Oregon Housing Needs Analysis, Oregon Department of Land Conservation and Development

KEY FINDINGS

- **Oregon is experiencing a severe housing shortage.** The state needs **65,819 units** immediately to satisfy the current population's demands. Additionally, to accommodate expected growth, 554,691 new housing units will be necessary over the next 20 years.
- **Condo production in Oregon has dropped significantly.** Between 2006 and 2023, annual condominium development fell by 92%, with only 309 units built per year on average, down from a peak of 4,199 units in 2006.
- **Condos are more affordable entry points to the housing.** The median sale price of a condominium in Oregon was \$341,000 in 2023, 38% lower than the \$552,460 price of a single-family home.
- **Condo prices have increased substantially.** Condominium prices have risen 24% in Oregon over the past five years, contributing to affordability challenges for prospective buyers.
- **Oregon faces significant challenges with owner-occupancy rates.** The proportion of owner-occupied multifamily units in the state is less than half the national average.
- **Housing is more expensive in Oregon than the national average.** The median price for properties in buildings with five or more units is \$380,000—approximately 8.5% higher than the national median of \$350,000 according to the American Community Survey of 2022.
- Oregon arguably has the most restrictive Construction Defect Liability (CDL) protections in the country, with long timeframes for making claims after the construction or conversion of housing units.
- Policymakers across the country are working on CDL reforms to increase access to homeownership. Many of these options are available for Oregon to consider.
- To address the demand for affordable condominiums in Oregon, strategic legal reforms are necessary to balance the protection of homeowners and the interests of developers. Our proposed policy adjustments do not necessitate the complete overhaul of existing laws but suggest targeted, incremental reforms. These reforms should include streamlining the statute of repose to encourage more development, instituting a Statewide Construction Quality Standard to guarantee construction quality, and establishing tiered timeframes for construction defect claims to differentiate between major and minor issues effectively.

WHAT ARE CONSTRUCTION DEFECT LIABILITY LAWS?

CDL laws hold parties involved in the construction of a building —such as contractors, developers, or builders— liable for any defects that occur during or after the construction process. These laws, by providing an implied warranty, are designed to protect property owners by ensuring accountability for construction flaws, including poor workmanship, the use of substandard materials, or failure to adhere to building codes.

OPERATIONAL FRAMEWORK OF CDL LAWS IN OREGON

Oregon arguably has the most restrictive CDL protections in the country, with long timeframes for making claims after the construction or conversion of housing units (ORS Chapter 12). Upon issuance of a Certificate of Occupancy (COO) for new developments in Oregon, the enforcement periods for the statute of limitations and the statute of repose commence. These periods are crucial, defining the timeframe within which stakeholders can initiate legal actions concerning construction defects.

Oregon's CDL laws impose a 10-year statute of repose and a 6-year statute of limitations for construction defect claims.

Statute of Repose: This **10-year period** begins with the substantial completion of the construction project. It sets a final deadline by which any claims related to construction defects must be filed. After 10 years, property owners can no longer file claims, even if the defect is discovered afterward. The statute of repose provides certainty by capping the total timeframe in which claims can be brought, regardless of when the defect becomes apparent.

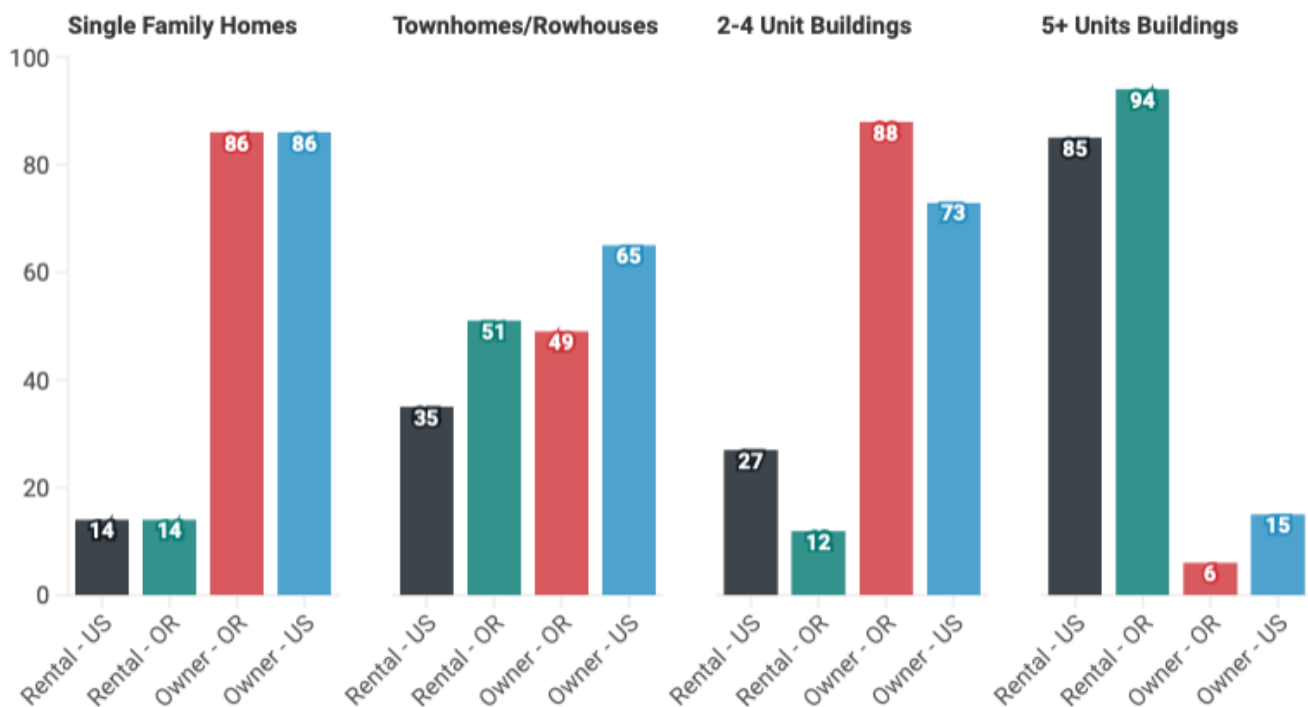
Statute of Limitations: The statute of limitations in Oregon provides property owners with up to 6 years to file a lawsuit after a defect is discovered, or reasonably should have been discovered. However, this 6-year period is subject to the 10-year statute of repose, which sets a hard deadline for filing claims. No claims can be made after 10 years from the substantial completion of the construction, regardless of when the defect was discovered.

2-Year Discovery Rule (Negligence Claims): For negligence claims (e.g., faulty construction that causes damage), Oregon law applies a **2-year discovery rule**. This means property owners have **2 years** to file a lawsuit after discovering a defect or when they reasonably should have discovered it. However, like other claims, the discovery rule is subject to the 10-year statute of repose.

These timeframes are designed to balance protecting homeowners and ensuring some degree of certainty for developers and contractors. However, it can be argued that the long duration of the statute of repose increases legal risks for developers, contributing to higher insurance costs, more costly units and, potentially, reducing the supply of condominium units for potential buyers. Oregon is an outlier relative to other states with the share of local multifamily units that are owner occupied less than half that of the national average.

Ownership and Rental Rates by Building Size

■ Owner - US
 ■ Owner - OR
 ■ Rental - US
 ■ Rental - OR



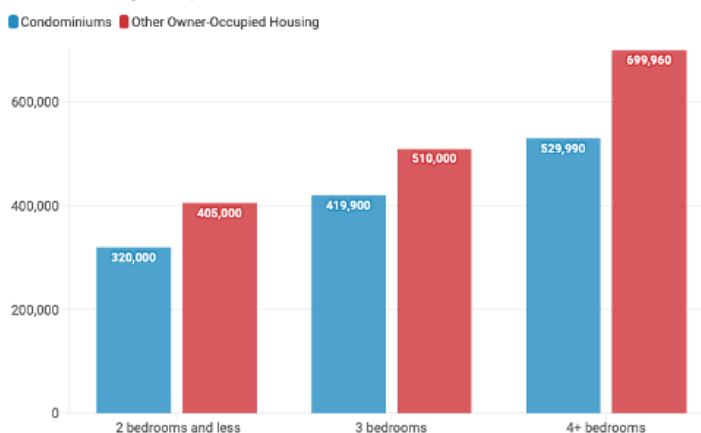
Types of Legal Claims

- Contract Claims:** These arise from failures to adhere to the agreed construction standards and specifications. Owners must initiate these claims within six years of the COO, guided by the discovery rule which may extend this period if defects are found towards the end of the six years.
- Negligence Claims:** These claims address construction works that result in damage or harm due to negligence and must be filed within two years of discovery, but always within the overarching ten-year repose period. This distinction underscores the heightened proof requirements for negligence compared to contract claims.

CONDOMINIUM DEVELOPMENT IN OREGON

Condominiums often represent an initial entry into the housing market due to their lower prices compared to residential units. In 2023, the median sale price for single-family residential units in the Portland Metro area was approximately \$552,460, substantially higher than the median price for condominiums, which was \$341,000. This notable price difference underscores condominiums as a more accessible option for many homebuyers.

Median sale prices, Portland Metro Area for 2023



Source: Regional Multiple Listing Service (RMLS)

Housing Units Built, Portland METRO, 2000-2023



Source: Multifamily Housing Inventory

The development of new condominiums has declined significantly since the 2008 financial crisis. Figure 1 illustrates the total construction of residential and condo units from 2000 to 2023, highlighting that condominium production peaked in 2006 with 4,199 units. Since then, the annual production rate has averaged around 309 units. CDL protections are not the only factor that has discouraged condominium production over the past decade. Pricing has also played a role.

In particular, apartment rents increased sharply after the housing bust and remained high due to low vacancy rates for years afterward. However, in recent years, apartments have become much more affordable relative to ownership due to higher vacancy and mortgage rates. This relative affordability has yet to be reflected in an increase in condominium supply, suggesting factors other than price such as CDL restrictions are likely holding back production.

Condominium affordability has deteriorated over time, despite their lower cost relative to other types of owner-occupied housing.

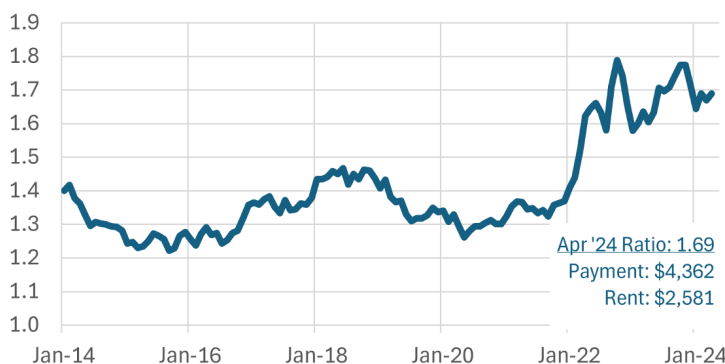
According to RMLS data, the **median sale price** for condominiums was \$275,000 five years ago, compared to \$341,000 in 2023. This significant increase highlights a general trend in rising property prices, making condos, alongside other types of owner-occupied housing, less attainable for average earners. Despite this increase, in 2023, the median price of a condo unit is still 38% lower compared to other types of owner-occupied residential units, positioning condos as a more accessible entry point into the housing market.

However, it's important to note that in Oregon, **properties within buildings that house five or more units** are more expensive than the national average.

The most recent Census data estimates put the median purchase price of such properties at **\$380,000 in Oregon**, relative to **\$350,000** nationwide. This category includes condominiums but isn't limited to them, encompassing various types of multifamily units. CDL protections are likely to contribute to higher sales prices not only through elevated insurance costs but also through increased borrowing costs for developers and the incentive to use higher quality building materials such as concrete and steel.

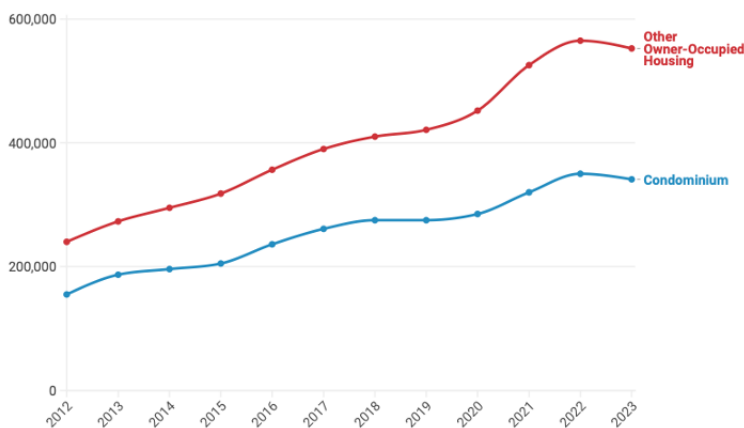
Portland Metro Price to Rent Ratio

Ratio of monthly mortgage payment for RMLS median sale price to monthly Zillow single family rent



Mortgage payment assumes 5% down, includes principal, interest, property taxes, insurance, & routine maintenance | Latest Data: April 2024 | Source: RMLS, Zillow, Oregon Office of Economic Analysis

Median Prices of Units Sold in Portland Metropolitan Area Over Time



Source: Regional Multiple Listing Service (RMLS)



RACIAL DISPARITIES IN HOMEOWNERSHIP

Racial disparities in homeownership remain one of the most significant contributors to the racial wealth gap in the United States. Black and Hispanic households continue to experience significantly lower homeownership rates compared to their white counterparts. Zillow data shows that on national level Black households have a homeownership rate nearly 30 percentage points lower than white households, while the National Association of Hispanic Real Estate Professionals (NAHREP) reports that Hispanic homeownership reached approximately 50% in 2021. These disparities are especially pronounced in suburban areas, where the gap tends to be wider than in urban environments. In Oregon, the overall homeownership rate, according to the 2019 Census, is 65.5%. However, for people of color, this rate drops to 46.9%. While Asian households have homeownership rates nearly on par with white households, Black, Hispanic, and Native American households face significantly lower rates. Specifically, the homeownership rate is just 33.9% for Black households, 42% for Hispanic households, and 48.5% for Native American households, highlighting a substantial disparity.²

Homeownership is a key driver of wealth accumulation and intergenerational wealth transfer, making these disparities a central issue in the broader racial wealth divide. While the pandemic led to a slight narrowing of the homeownership gap for Black and Hispanic households, the overall disparity remains significant, perpetuating inequities in wealth building across racial lines.

The Role of Condo Development

Condo development could play a vital role in addressing these disparities by providing more affordable and accessible homeownership options, particularly in areas where single-family homes are unaffordable. Condominiums, often priced lower than traditional homes, offer a more attainable entry point for first-time buyers. Expanding condo availability, particularly in suburban areas where the homeownership gap is wider, could enable more Black and Hispanic households to build equity, thereby helping to reduce the racial wealth gap over time.

² Joint Center for Housing Studies of Harvard University tabulations from US Census Bureau, 2019 American Community Survey 5-Year Estimates.

LESSONS FROM OTHER STATES

When evaluating potential changes to Oregon's CDL laws, it's helpful to examine how other states have structured their laws, particularly regarding shorter statutes of repose and streamlined dispute resolution processes.

Statute of Repose:

In contrast to Oregon's 10-year statute of repose, several western states have adopted shorter repose periods:

- Colorado, Washington, and Nevada have set their statutes of repose at 6 years. This shorter timeframe helps reduce the long-term liability risks faced by developers, fostering more condo development by lowering barriers to new projects.

Dispute Resolution Mechanisms:

Many states have also introduced or proposed pre-litigation processes to resolve disputes more efficiently:

- Washington proposed House Bill 2475, which aims to **require mediation before any construction defect lawsuits can be filed**. This would encourage early resolution and reduce court cases.
- Colorado's House Bill 1279 implemented a system where homeowner associations must get a **majority vote** before initiating legal action. It also mandates mediation or arbitration for defect claims, reducing the number of costly and time-consuming lawsuits.
- Nevada, through Assembly Bill 125, introduced **a warranty process that gives builders the opportunity to fix any identified defects before homeowners are allowed to file lawsuits**. This process effectively reduces litigation and encourages developers to take remedial action without fear of immediate legal repercussions.

HOA Consent for Litigation:

- Colorado's reforms also **require informed consent from the majority of HOA members before defect-related lawsuits can proceed**. This measure ensures that litigation is only pursued when it has broad community backing, preventing unnecessary or frivolous lawsuits that could deter developers from undertaking new projects.

POTENTIAL POLICY CONSIDERATIONS FOR OREGON

Oregon's housing challenges can potentially be mitigated through a variety of policy adjustments. A key area of focus is the statute of repose for construction defects. Recent legislative discussions, such as **House Bill 3432** in 2019, have explored shortening this timeframe, suggesting ongoing efforts to refine the legal framework for construction defects.

House Bill 3432 proposed **reducing the statute of repose for construction defects from 10 years to 6 years**, aligning Oregon with other western states like Colorado and Nevada, which already have shorter repose periods. This change would limit the timeframe during which developers can be sued for construction defects, reducing the long-term liability risks for builders and developers. The logic behind this reduction is that the extended liability period can make developers hesitant to undertake new condominium projects, particularly in urban areas where housing shortages are most acute.

In addition to shortening the statute of repose, **House Bill 3432** introduced other provisions aimed at addressing construction defect disputes in a more streamlined and balanced way. Key elements included:

- **Requiring HOA Approval for Litigation:** The bill has similar provisions from Colorado's House Bill 1279, which mandates that homeowner associations (HOAs) secure a majority vote before initiating any construction defect lawsuits. This would help ensure that litigation is pursued only when it has broad community support, helping to prevent unnecessary lawsuits that could deter developers from future projects.
- **Pre-Litigation Notice and Cure Period:** The bill also aimed to introduce a more structured pre-litigation process, similar to the **Calderon Process** in California, where homeowners must provide contractors with written notice of the alleged defect. The contractor would then have a set period to inspect the defect and offer a solution or cure before the homeowner can proceed with litigation. This provision seeks to resolve issues more quickly and reduce the burden on the courts.

Although **House Bill 3432** has not yet passed, it represents a significant effort to modernize Oregon's approach to construction defect liability. By reducing the statute of repose and implementing structured pre-litigation procedures, Oregon could address some of the unintended consequences of its current CDL laws, such as the reluctance of developers to build condominiums, which are critical to solving the state's housing crisis.

Consideration: Reducing the Statute of Repose

Reducing the current 10-year statute of repose to 6 years may align Oregon with other states that have implemented similar changes. House Bill 3432 previously proposed reducing the period for legal claims in both multi-unit buildings and single-family dwellings. Additionally, the bill also introduced provisions requiring homeowner associations to secure majority approval before initiating legal actions, fostering more community-driven decision-making.

A shorter statute of repose period could lead to several potential outcomes:

- **Enhanced Housing Development:** Shorter liability periods may incentivize developers to undertake more housing projects, including condominiums, by lowering long-term risks. This could potentially increase housing supply in areas where development has been constrained due to legal uncertainties.
- **Lower Litigation Risks and Cost-Effective Construction Options:** Shortening the timeframe for construction defect claims can reduce both litigation risks and long-term liability for developers. With reduced legal uncertainties, developers could potentially benefit from lower insurance premiums and overall project costs. This could create incentives for the adoption of more cost-effective construction methods, such as **Type 2 construction**, which uses non-combustible but less fire-resistant materials. These materials tend to be more affordable than those used in Type 1 construction, potentially enabling developers to undertake more economically viable projects. As a result, this approach may support the development of a broader range of housing types, contributing to increased affordability and housing supply in Oregon.

Consideration: Statewide Construction Quality Standard for Oregon

Introducing a **Statewide Construction Quality Standard** could offer a framework to incentivize developers while ensuring higher construction quality. Such a standard could serve as a “safe harbour” for developers who adhere to specific, predefined building practices. By meeting these standards, developers may gain legal protections against certain types of construction defect claims, potentially reducing the risks associated with condominium development and encouraging more housing projects across the state.

A statewide standard could complement existing building codes by promoting adherence to established safety and construction quality regulations. This approach would necessarily involve **collaboration with key stakeholders**—such as the *construction industry, builders' associations, consumer advocacy groups, and legal experts*—in creating these standards. It could operate as a statewide code, with the flexibility for local governments to adopt provisions that meet their specific needs.

Potential impacts of a statewide standard could include:

- **Reduced Legal Risks for Developers:** Developers who comply with these standards may experience lower litigation risks, potentially making projects more financially viable.
- **Increased Homebuyer Confidence:** Homebuyers might benefit from knowing their homes are constructed to a high standard, potentially leading to higher satisfaction and fewer defect claims.

This standard should be developed in close collaboration with key stakeholders, including the **Building Codes Division**, to ensure it meets industry needs and incorporates the input of all relevant parties.

Consideration: Tiered Timeframes for Construction Defect Claims

Construction defect claims can encompass both structural issues and non-structural problems, such as cosmetic defects. These may include minor issues like bubbling paint, nail pops in drywall, or improper paint application. By distinguishing between cosmetic defects and more serious structural flaws, Oregon could explore the implementation of tiered timeframes. This approach would provide shorter periods for addressing cosmetic defects, while keeping the longer timeframes in effect for more significant structural issues.

Potential outcomes of such a system could include:

- **Enhanced Fairness:** Differentiating between cosmetic and structural defects may help ensure that claims are resolved in proportion to the severity of the issue, potentially reducing the burden of prolonged liability for minor problems.
- **Streamlined Legal Proceedings:** Shorter timelines for addressing non-critical, cosmetic defects could expedite resolutions, while more time could be allocated for structural problems that may take longer to surface.
- **Reduced Developer Liability for Minor Issues:** Developers might benefit from limited liability for cosmetic defects, allowing them to focus resources on ensuring the safety and integrity of more critical construction aspects.

This approach would recognize the importance of addressing both cosmetic and structural defects, while aiming to create a legal framework that is fair and efficient. By balancing these timelines effectively, the system could protect homeowners while reducing the potential for prolonged liability for developers regarding minor issues.



BOTTOM LINE

For most Oregonians, the most likely avenue for wealth generation is through homeownership. Relatively few households own profitable businesses or have large stock portfolios to rely upon. With the housing shortage having prevented many Oregonians from entering the market, wealth losses will be felt for years to come.

Policymakers must do all that they can to promote affordable entry into homeownership. Reforming Oregon's Construction Defect Liability protections represents one promising part of the solution. The supply of owner-occupied multifamily housing units is much lower in Oregon relative to other states, and there is little doubt that CDL protections are playing a role. Not only do CDL protections deter lenders and developers from building condominiums or converting apartment units, they also lead to higher prices that shut out potential buyers. As Oregon enters the upcoming legislative session, many options are available to policymakers to help resuscitate the market.

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