CASE STUDY

Multifamily Construction Defect Reform in Minnesota

SUMMARY

As policymakers examine barriers to the construction of needed housing, they are increasingly looking at how existing laws are impacting the production of needed housing. One of these topics is multifamily construction defect laws and the impact on the production of "for-ownership" housing vs. "for-rent" housing.

In 2017, the state of Minnesota overhauled its construction defect law with bipartisan support from its state Legislature. After the passage of the bill, Minnesota saw increases in multifamily production statewide and in Minneapolis-St. Paul MSA that far exceeded national averages and the increases observed are some of the highest in the nation:

- Comparing 2014 to 2018, Minnesota saw the 4th highest increase in multifamily units, up 92% the highest of any mid- to high-volume state.
- Comparing 2014 to 2018, Minneapolis-St. Paul saw the 3rd largest multifamily construction increase for MSAs with a population of 2.5 million or more, up 94.10% with the increase driven by projects with five or more units (up 95.18%).

From a 30,000-foot level, given the timing of the increase and law change, anecdotally and a quick look at the data indicates this law change led to an increase in multifamily projects. Examination of a limited data set on for-ownership production and interviews with townhome builders tells a different story.

- For multifamily projects, greater than five units, for-ownership production decreased in 2018 and became almost non-existent, despite the surge in multifamily construction.
- For townhomes, production increased, but that share of "for-ownership" and "for-rent" did not change in a meaningful way.

Interviews with townhome developers clarified the discrepancy. The law, they said, did not go far enough in. The demand for townhomes, builders say, was from the affordability pressures in the Minneapolis-St. Paul area, with townhomes being the only new-home product largely available to buyers for less than $400,000, according to one builder.

Given the length of Minnesota's construction defect warranty period and the phased approach for homeowner's association maintenance requirements, the full effects of this law may not be seen until 2027 or 2029. Until then, the lesson from Minnesota appears to be that leaving too much on the table minimizes the impact of the legislation, keeping barriers to needed, for-ownership housing in place.

TOPLINES

Initial permit data suggested that reforming multifamily construction defect laws had led to an increase in multifamily housing production in Minnesota.

Data for the Minneapolis-St. Paul area showed a minor change in the share of "for-ownership" townhomes and a significant decrease in the development of "for-ownership" condominiums.

Interviews with builders and developers of projects subject to multifamily construction defect litigation say the reforms in Minnesota did not go far enough in changing the legal environment.

While more time may need to pass before the 2017 law change can be fully evaluated, states examining similar reforms should seek as comprehensive of a legislative solution as possible.

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BACKGROUND

In 2017, the Minnesota Legislature reformed its construction defect laws for multifamily for-ownership housing to encourage more multifamily development in growing areas. This change was connected to Minnesota's statutory home warranty requirement. Under Minnesota law, new housing units are required by law to include a one-year, two-year, and 10-year warranty for any issues caused by the failure to comply with the State Building Code:

- *For One Year:* The home must be free of defects caused by faulty workmanship or materials.
- *For Two Years:* the home must be free of defects caused by faulty installation of heating, cooling, electrical, or plumbing systems.
- *For 10 Years:* The home must be free of "major construction defects."

The effective date is the date the housing unit is transferred from the homebuilder to the homeowner (the closing date). These warranties are connected to the home and remain in place even if the home is sold.

Developers cited the litigation environment as a reason to not proceed with more condominium and townhome projects, despite the low inventory and high demand for new housing. Minnesota's home warranty requirement, they contended, was being abused by homeowners' associations (HOAs) and construction defect attorneys.

According to media reports, builders and developers felt these lawsuits were frivolous and meritless:

> *"Builders feel that spurred frivolous and unjustified lawsuits by associations that didn't properly maintain common spaces."* (Moylan)

Developers stated they would forgo for-ownership multifamily projects if the risk of litigation was too high:

> *"But because of the liability issue, condos and townhomes represent a much smaller share of new housing units. Two years ago [2015], 3% of new multifamily units were condos and townhomes, down from 23% in 2007."* (Johnson)

For projects that were built, deveoplers stated that housing prices included an additionalcharge of up to several thousands of dollars charged to cover the risk of future litigation.

Additional identified issues included:

- Owners of units in multifamily properties in Minnesota were unable to sell their units due to construction defect litigation; some owners were unaware of the litigation as their HOA entered into the litigation through board action.
- Builders and developers highlighted a "cottage industry" of lawyers assisting HOA management firms in pursuing claims against builders.
- Builders and developers classifying HOA litigation as "minor or meritless construction defect complaints" with attorney's fees and damages to costly "making the condominium development project not worth the risk." (Rowell)
- Lack of maintenance and upkeep of common property by the HOA, sometimes leading to litigation.

SCAN TO VIEW THE ENACTED BILL LANGUAGE

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IMPACT ON HOUSING: PERMIT DATA

According to data from the Unites States Census Building Permit Survey, multifamily construction in Minnesota and the Twin Cities did increase following the passage of the bill.

External factors have also impacted construction and development trends over the past decade in Minnesota and elsewhere; there is evidence that the construction defect law passed in 2017 has had a direct and positive impact on the amount of new multifamily buildings.

Over the 10-year period, 2013-2022, single-family attached and multifamily construction increased:

- from 34.42% nationally to 37.97%;
- from 35.32% in Minnesota to 57.01%;
- from 40.20% in the Twin Cities to 63.34%.

Prior to 2018, the share of three- and four-unit projects and multifamily projects with five or more units in both Minnesota as a whole and in the Twin Cities was much closer to the national average than after the reforms passed in 2015.

FIGURE 1 - MULTIFAMILY SHARE OF NEW CONSTRUCTION

	UNITED STATES	MINNESOTA	TWIN CITIES
2013	35.81%	35.32%	40.20%
2014	37.70%	36.44%	41.09%
2015	39.71%	43.73%	41.47%
2016	36.22%	43.14%	43.81%
2017	34.55%	37.82%	40.99%
2018	33.96%	46.36%	50.04%
2019	36.08%	57.01%	56.89%
2020	31.50%	46.63%	53.87%
2021	33.96%	49.31%	54.88%
2022	39.28%	57.01%	63.34%

United States Census Bureau, Building Permit Survey

Looking at the five-year period of 2014-2018, Minnesota had one of the largest increases in multifamily production in the nation, with a 92% increase in multifamily units. In 2018, Minnesota had the 10th highest number of units in that nation, up from 20th in 2014. The national average of increase in multifamily units from 2014-2018 was 15%.

FIGURE 2 - FIVE-YEAR CHANGE IN MULTIFAMILY UNITS BY STATE

1.	Hawaii	137.86%
2.	Rhode Island	129.49%
3.	Maine	96.03%
4.	Minnesota	92.02%
5.	Kentucky	74.70%

United States Census Bureau, Building Permit Survey

For a 10-year period, 2013-2022 multifamily units in Minnesota increased 198.24%, the seventh highest overall and the third highest of the mid- to high-production states. The national average for multifamily units increasing was 83.69%.

FIGURE 3 - TEN-YEAR CHANGE IN MULTIFAMILY UNITS BY STATE

1.	Idaho	300.3%
2.	Rhode Island	285.34%
3.	Nevada	353.99%
4.	Arizona	248.20%
5.	Maine	247.80%
6.	Utah	221.11%
7.	Minnesota	198.24%

United States Census Bureau, Building Permit Survey

For a five-year period, 2014-2018 multifamily units in the Twin Cities increased 94.10%, the third highest of the nation's 25 largest MSAs, all of which have a population of 2.5 million or more. This increase was driven primarily by projects with five or more units, up 95.18%, also the third largest increase from this group. The number of units for three- to four-unit projects was up 35.29%.

For a nine-year period, 2014-2022 multifamily units in the Twin Cities increased 233.96%, the second highest of the nation's 25 largest MSAs, all of which have a population of 2.5 million or more. This increase was driven primarily by projects with five or more units, up 235.91%, also the second largest increase from this group. The number of units for three- to four-unit projects was up 128.24%.

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IMPACT ON HOUSING: OWNERSHIP VS. RENT

New housing permits are generally not tracked in Minnesota as "for-ownership" or "for-rent." However, the Metropolitan Council, a regional planning entity, does track projects as "for-rent," "for-ownership," and "coops." This data set includes the seven-county metropolitan area (Anoka County, Carver County Dakota County, Hennepin County, Ramsey County, Scott County, and Washington County) and is collected through a variety of sources including county parcel data at the annual level.

In the seven-county metropolitan area, data from the Metropolitan Council confirms the increase in both townhome and multifamily production. This data set, however, shows:

- The share of "for-rent" and "for-ownership" townhomes increased modestly. For-ownership represented 85.85% of all townhomes from 2013-2016, 97.83% in 2017, and 87.40% from 2018-2021.
- The share of "for-ownership" multifamily projects fell, with for-rent projects representing 95.20% of all multifamily from 2013-2016, 92.09% in 2017, and 97.89% from 2018-2021. Note: Some multifamily projects were listed as "coops:. Only the "for-ownership" figure has been used.

FIGURE 4 - OWNERSHIP SHARE OF HOUSING PRODUCITON (SEVEN COUNTY METRO AREA)

	TOWNHOME	MULTIFAMILY 5+
2013	**87.91%** (596 of 678 Units)	**6.47%** (483 of 6769 Units)
2014	**91.53%** (627 of 685 Units)	**1.64%** (92 of 5,626 Units)
2015	**89.53%** (495 of 554 Units)	**2.23%** (172 of 7,726 Units)
2016	**76.63%** (600 of 783 Units)	**1.94%** (159 of 8,205 Units)
2017	**97.83%** (948 of 969 Units)	**4.05%** (382 of 9,427 Units)
2018	**87.32%** (1,047 of 1,199 Units)	**0.00%** (0 of 10,655 Units)
2019	**76.37%** (937 of 1,227 Units)	**0.00%** (0 of 13,316 Units)
2020	**96.69%** (989 of 1,020 Units)	**0.28%** (36 of 12,994 Units)
2021	**89.63%** (1,555 of 1,735 Units)	**0.00%** (0 of 13,711 Units)

Source: Metropolitan Council

Interviews with developers of CIC projects provided context on the data. In conversations with the researcher, builders and developers reported that the legal environmental for multi-family, for-ownership construction has yet to change substantially and they approach these projects as not ***if*** they will get sued, but ***when***.

INTERVIEW EXCEPTS:

"I cannot say that we changed our strategy on townhome developments due to the bill as much as we have due to pressing market conditions and the cost of both land and housing."

"[Attached housing is] the only housing type that you can deliver sub $400,000… To be honest, I don't think the changes to the law helped much – or at least they didn't go far enough. You will get sued regardless of what the law says."

"We certainly did not seek out additional opportunities as a result of it. "

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CONCLUSION

Minnesota's 10-year warranty window and the delay of maintenance plan requirements until 2019 may mean it will be years until the litigation window closes for projects built prior to the new law going into effect. Once that window closes, the complete impact of the law can then be fully studied and evaluated.

With the data available on the share of for-rent and for-ownership multifamily and townhome projects in the Minneapolis-St. Paul area, the reforms seem to have had no meaningful impact on the production of townhomes. For projects of five or more units, only 36 of the 49,607 multifamily units built since 2018 were reported as "for-ownership," suggesting the risk of litigation is too great and developers choose to instead focus on "for-rent."

States looking to reform multifamily construction defect can learn from Minnesota's efforts and do not give too many concessions and to seek reforms that close reform the litigation window for both already-built strictures and structures yet to be built.

NOTES

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