



Confronting Condominium Risk | Design Professional

**RISK MANAGEMENT INFORMATION
FROM THE DESIGN PROFESSIONAL GROUP OF
XL INSURANCE**

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XL Insurance
2959 Monterey-Salinas Highway
Monterey, California 93940-6439
800.227.4284
831.649.5522
www.xldp.com

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Introduction

The condo market is back, and the risks for design professionals are greater than ever. Managing those risks takes a cool head, a steady hand and a combination of loss prevention approaches.

Bolstered by high demand and low mortgage rates, the condo market is nearing a staggering million units per year in the United States. Condos made up 30 percent of new multifamily starts in 2004, a record-high percentage.ⁱ And for the first time, the price midpoint for condos in the final quarter of 2003 topped that of detached single-family homes.^{ii iii}

Condominiums are attractive to diverse segments of the population. A recent survey shows that more than 42 percent of all condos are purchased by people over 50, mostly empty-nest baby boomers.^{iv} They're attracted to the ease of condo ownership and are also seeking more upscale units.

If ever there was a
perfect liability storm,
the condo market is it.

At the same time, younger first-time buyers also are drawn to condos by lifestyle considerations and the lower cost of more modest condo units. They see condominiums as the entry point into the housing market.

It's true that condos have a lot going for them. They can provide solutions to traffic and commute problems, as well as the shortage of developable or affordable land in some areas. And they can answer the demand for affordable housing and the concerns from no-growth advocates.

But condominiums also come with real problems. While the boom may be good news for developers and real estate agents, it also means increased risks for design firms. In the rush to cash in on the burgeoning market, many architects and engineers seem to have forgotten the litigation worries that left the sector atrophied in the 1990s.

This paper will take a fresh look at the risks associated with condominium projects and suggest some ways you might help manage those risks.

Are Condominium Projects Really High-Risk?

Yes. Condos are the riskiest of all project types for architects and engineers.

While less than one percent of the fees generated by the design professional policyholders of XL Insurance come from condo projects, nearly eight percent of claims dollars paid arise from them. (It is worth noting that most—or perhaps all—of the concerns about designing condominiums also apply to co-ops.)

It's scary stuff, and it gets worse. Insurance companies sometimes examine claims statistics through the lens of an exposure base. For a design project, the exposure base is determined by making a comparison of the design fees associated with and the claims that arise from a particular project type. The result is a ratio that reflects the exposure base. To an insurer, a ratio of 1.0 represents an average project, in which the ratio of percentage of fees to percentage of claims dollars is equal. For condos, the ratio of claim dollars to fees is a staggering 12.0. That means, for every dollar of fees earned on condos, \$12 gets paid in claims. To put it another way, if you earn \$100,000 in fees from condo design work, you could be charged the same premium as another design professional who earns \$1.2 million in fees from less risky project types such as retail projects.

While condominium developments may appear to be just the kind of projects that can help your firm's bottom line, they're fraught with risks.

What Is It About Condo Projects That Makes Them So Risky?

If ever there was a perfect liability storm, the condo market is it. A number of factors converge to create an ideal climate for a lawsuit. First, duplicative construction and design means that a single construction defect or design error in a multi-unit project can be reproduced many times, resulting in huge damages. A \$2,000 construction error repeated in each of 500 units adds up to a mighty big claim.

Lawsuits are generally brought by the homeowners' association board (HOA) either against the developer, who brings in the contractor and designer by cross-complaints, or against all the parties directly.

According to attorney David Ericksen, of Severson & Werson in San Francisco, from the HOA's perspective each method has its own merits. "By suing only the developer, the HOA can assert all theories, including strict products liability and warranty, and avoid the burden of proving claims against the other parties. By suing all of the parties, the HOA creates the greatest pressure and accelerates the process. By suing everyone, the HOA also preserves claims which might become time barred and avoids the risks posed by an insolvent or dissolved developer." In either case, these lawsuits quickly involve many parties; indeed, large projects may have dozens of subcontractors who will be drawn into the dispute by the general contractor.

The design team is almost inevitably drawn into the suit. And when a claim is filed, the contractor and developers are sometimes nowhere to be found. Contractors can bankrupt their organizations and disappear; developers frequently set up separate corporations for developing single projects and later dissolve them. The only (or most vulnerable) deep pockets remaining to face the lawyers and the condominium association are usually those of the design team.

Condo claims are not a new phenomenon. Construction defect litigation was so prevalent in the late 1990s that it was held partly responsible for the near demise of the condominium market. While other factors certainly came into play, the resulting settlements and judgments rendered much of condo construction unprofitable. In many cases, builders could not obtain financing, and insurance premiums for builders and subcontractors skyrocketed. Indeed, the

WHAT IS A CONDOMINIUM?

A condominium is a relatively new form of property ownership, born of various state condominium laws in the 1960s and popularized during the 1970s and 1980s. A condo buyer takes ownership of a single unit, typically in a multi-unit building, and the owners of the individual units jointly own the building exterior and common areas.^v

This is a purely statutory form of joint property ownership, which means that all rights and duties of a condominium are delineated in either statutes or are created in contracts between the parties. Virtually all states require that a developer file a Declaration of Condominium (sometimes known as the Covenants, Conditions and Restrictions or CC&Rs) or similar document, which outlines many of the rights and obligations of each party, including those of the developer, the owners and the condominium or homeowners' association (HOA). Unit owners automatically become members of the HOA and generally will pay an "assessment" (a regular fee, often monthly, that is used for upkeep of the common areas and other services and amenities). Additional details of ownership, privileges and responsibilities of the unit owner and the association of unit owners are generally described in the Condominium Bylaws.



increases became so high in a few states—California, for example—that some builders and insurers withdrew from those states, and others slowed the pace of condominium building.

Today, while the condo market is rebounding in most regions, some builders, insurers and lenders are still gun-shy. A recent survey of southern California home-builders^{vii} found that of the 42 percent who said they do not plan to build condominiums, 79 percent cited litigation concerns and high insurance costs as reasons for not entering the market. Fifty percent said they were unable to obtain the necessary insurance at any cost.

Who's to blame for all those lawsuits? Each player in the condo game blames the others, but the truth is that nearly everyone has at least some culpability. Let's look at some of the factors:

THE DEVELOPERS

Condominium developers are often highly leveraged financially and may care more about speed and cutting costs than the quality of their projects. The result is often poor construction and increased defects. This sort of developer rarely gives the design team the opportunity to provide construction phase services; construction observation may be “on call” at the developer's discretion or eliminated altogether to save money.

As mentioned earlier, some condo developers are one-time paper “shells” set up for a single project, which means the shell has no ties to the community and no long-term relationship with the contractor and the design team. Some developers act as their own contractors, thus relegating the design professionals to the status of “outsiders.”

THE CONTRACTORS

Construction defects are increasingly problematic in residential construction. A recent year-long study by the Consumer Union^{viii} found that 15 percent of new homes built each year have substantial construc-

WHAT ABOUT TIMESHARES?

There is some anecdotal evidence that suggests that designing for the time share^{vi} market may be less risky than condominium or co-op projects. The thinking is that owners don't have the emotional or financial investment in a time share as they do in a residential condo. It makes sense: individual ownership interests are highly diluted. In a 100-unit timeshare complex, for example, each unit may have as many as 50 owners (one for every week of the year, say, less one week for restoration and maintenance). That's 5100 owners in the complex. It would be difficult communicating with all of them, let alone getting them to agree to initiate litigation. However, bear in mind that because timeshares are a relatively new phenomenon in North America, it isn't known whether the lower claims figures are due to their “newness” or the fact that they are indeed a safer type of project to design.

tion defects. Other reports have similar—and even worse—findings, indicating the new home defect ratio is even higher in some areas where home buyers were surveyed.^{ix} While a survey by J. D. Powers^x of 21 metropolitan markets, found an eight percent increase in consumer satisfaction nationwide, it also says there is an average of 1,372 construction problems per 100 homes.

These defects, according to the Consumer Union study, arise from an array of causes, including shoddy, assembly line-like production; builders are completing homes in 90 to 120 days, down significantly from a decade ago. In addition, shortages of skilled tradespeople sometimes contribute to the problem of substandard construction. To lower costs, builders often substitute new, less-expensive materials. Many of these may not work well with other components or may not last as long as traditional ones. And some new materials simply don't perform as promised.^{xi} Finally, there are inadequate building codes in some areas, the lack of uniformity in others and the lack of enforcement of what codes and regulations do exist.

All these factors can add up to one big liability headache. A good example is the “leaky condo crisis” in British Columbia. During the 1980s and 1990s, a boom in condominium construction, coupled with building code changes and poor workmanship, combined to create numerous ways for rainwater to enter a building without any means of escape. At least 300 buildings in BC alone suffered from building envelope failure, which cost on average \$1 million each to repair.

THE DESIGN TEAM

The Design Professional group of XL Insurance recently polled a group of claims managers, attorneys, design professionals and developers. The question: Where do architects and engineers go wrong on condominium projects?

STEALTH CONDOS

A few developers, aware that many architects and engineers are steering clear of condominium projects, are changing their tactics, by building “stealth condos.” It works like this: the developer retains the design team to design an apartment complex. During construction or shortly thereafter, the A/E learns that the complex is being converted to condominiums. There's little he or she can do. If the A/E is still performing services, in theory he or she can argue that there's been a cardinal change to the scope of the contract, and can threaten to terminate services. But in reality, the condo owner probably doesn't care. Because the A/E's contract with the developer did not anticipate the increased risk and liability, and because the A/E has no contractual arrangement with the future condo buyers to whom he or she now owes a duty of care, the attendant liability multiplies a hundred-fold.

The consensus was that too few design firms are able to resist the siren's call of condo project fees in the first place—many turn a blind eye to the risks. They aren't selective enough about the client or the project, and they sometimes ignore the facts that the clients are inadequately funded, that the contractor is selected on a low-bid basis and that quality and risk management are not priorities. Some design firms sign contracts with inadequate protections and agree to provide little or no construction phase services.

Geographical factors come into play, too. A design that works for a Phoenix condo project won't stand up to the wind-driven rains, proximity to the ocean and the salt environment of the Outer Banks. A CEO of an A/E firm based on the East Coast has seen it all. "A firm that's used to designing 20-story condos in Atlanta that tries to pick up the same design solutions and move them to Virginia Beach or Ocean City is in for a rude awakening. You can't believe the outcomes until you've seen them," he added. "But by then it's too late."

Once involved in the project, some A/Es compound the problem by paying inadequate attention to their own communication and documentation practices and their approach to checking and coordination.

THE BUYERS

Maybe marketing is to blame. Condo buyers believe the advertisements, promotional materials and marketing tactics that promise much more than their dollars can realistically buy. Many are first-time homebuyers or older people with limited resources or perhaps less sophisticated consumers. They may have never owned a unit in a shared multi-family community before or never have been part of a homeowner association that must bear the responsibility for upkeep and maintenance.

Conversely, affluent "empty nesters" or those buying a second home may have unrealistic expectations of the construction quality of higher-end units. For example, in one condo development in a Western city, the units as designed were intended to sell for \$170,000. But by the time construction was completed, the real estate market was so robust that the condos sold for more than \$300,000. There was nothing

MOLD AND CONDOS

The specter of a mold claim is enough to give anyone pause, and condominiums provide perfect breeding grounds for such a lawsuit. While thus far design firms have largely side-stepped the mold-claim juggernaut, the risk is still very much alive.^{xii}

wrong with the design, but buyers complained that the HVAC system was too noisy. The problem, of course, was that the buyers of \$300,000 condos expected a quieter HVAC system than the buyers of a \$170,000 unit, and a lawsuit followed.

THE HOMEOWNER ASSOCIATIONS

The homeowner associations (*see The Buyers, page 6*) are famously reluctant to set dues high enough to cover the upkeep required for the utilities, roofs, common areas and building exteriors. The result is poor maintenance, deferred maintenance or no maintenance at all.

The HOAs also have unrealistic expectations with respect to the condition of structures or common property (such as the pool, streets, sidewalks, hardscape, clubhouse or recreational facilities) when the ownership of the property is transferred to the HOA. In some cases, this unrealistic expectation is exacerbated by the fact that ownership of this common property may be transferred several years after the first purchasers occupied their homes. During this time, little maintenance may have been undertaken at all. Thus, when common property is transferred, it's sometimes in need of expensive "catch-up" maintenance that the HOA never anticipated and now must fund.

Who will pay? All too often, someone else. Unfortunately, HOAs provide ready vehicles for class action suits. Enter the lawyers.

THE CONTINGENCY FEE PLAINTIFF LAWYERS

The scenario goes like this: Aggressive law firm meets with the HOA board and raises the disturbing prospect of a "failure of a board's fiduciary duty" to the HOA and the potential for personal liability if they do not act. The result: the HOA board decides to take its own aggressive, proactive stance to protect and preserve the rights of the homeowners and the board members themselves.

The board hires the law firm who—while usually working on contingency—asks the HOA for an advance on expenses for the litigation. The firm in turn hires "experts" who then "inspect" the condominium property to find any alleged design or construction defects or code violations, which form the basis for damages in a subsequent lawsuit.

Can I Manage These Risks?

It won't be easy. Outside of refusing condominium work altogether—which often is the most prudent decision of all—there are no simple measures to address the high risks involved. There are, however, several tactics you can employ to help minimize those risks. Your goal is to try to anticipate problems and devise a multifaceted strategy to control your exposure to claims.

The good news is that if you do condo work, you may be in a better position than you realize to improve your liability exposure. For all the very sound reasons just listed, not everyone is providing these services, and many developers—regardless of what they say—are having trouble finding design professionals to take on their projects. What this means is that you can go into the contract negotiation from a position of strength and demand protections you might not ordinarily get. But it takes nerves of steel. According to one attorney, “Many A/Es tend to be facilitators and non-confrontational. But if they do condo work, they really need a backbone.”

Your choice of client and project may be the single most important factor in a successful and trouble-free venture.

PROFESSIONAL LIABILITY INSURANCE

The frequency of claims against condominium designers was (and is) so high that, for a time, almost no professional liability insurer would cover architects or engineers who designed condominiums.

Today, professional liability insurance companies remain concerned about the exposure presented by condominium design and construction. They look very carefully at their insureds who do condo work and want some assurance that the insureds successfully manage their risk. Some insurers impose a cap of a certain percentage of condominium work; others underwrite condo work separately. Certainly, if you are doing a lot of condominium work, expect your rates to reflect the increased risk, perhaps for several years in the future. When deciding whether to take on condominium projects, you'll need to weigh increased premiums against any profit you expect to make. (One A/E firm refuses condo projects unless the developer is willing to pay an additional \$70,000 – \$100,000 to cover the future cost of professional liability coverage; the charge actually shows up as a separate line item in the A/E's proposal.) Remember, too, that in the event of a claim, you'll have to pay not only the deductible (which may increase) but the significant “soft” costs associated with the claim.

Before you accept any condominium project, it's important to become aware of your insurer's approach to condos. At the very least, have a frank talk with your professional liability agent or broker.

PROJECT AND CLIENT SELECTION

Your choice of client and project may be the single most important factor in a successful and trouble-free venture. Try to select clients who are sufficiently financed, who have experience in condominium projects, who have ties to the community, who will be around for many years after completion of the project, and who care about quality. You want a client who is as concerned as you are about the high-risk nature of condominiums. Talk to the client about partnering, project peer reviews and constructability reviews. Ask them about their previous projects and litigation history. Get a list of references from past designers, and contact them. Avoid projects involving developers who have a history of dissatisfied clients or "cut-rate" approaches to construction.

Learn as much as you can about the project. How large is it? (Anecdotal evidence suggests that smaller projects are less risky.) Are there any unusual requirements? Is the project controversial or is there opposition to the project? Does the site present any unique challenges? Is the fee worth the risk? Find out how the developer plans to market the project. Will the advertising be realistic? Will your name be used?

The Declaration of Condominium presents an opportunity to build in risk management and loss prevention solutions.

Find out about the contractor. What is the selection process? If the client has already chosen a contractor, talk to the contractor about his or her condo experience. Consider making your involvement with the project contingent on your acceptance of the contractor.

Think, too, about your own firm's experience in condominium work. (Design firms who are very experienced in condo work, who are aware of the pitfalls and who institute steel-plated risk management measures may have fewer claims.) Do you have enough qualified staff for high-density residential projects? Just as important, consider whether your firm is knowledgeable about the project locale. Make sure your subconsultants are qualified, too, and carry adequate professional liability insurance.

CONDOMINIUM LEGAL STRUCTURE

The Declaration of Condominium presents an opportunity to build in risk management and loss prevention solutions—assuming you are involved early enough in the project to have some say in the drafting of the document. Granted, this may be difficult. The Declaration is filed very early in the development process and the risk management language should be contained in this original filing. (Altering the initial version of the filed Declaration may be difficult.) Still, it's worth a try. Here are several concepts you might discuss with your client and attorney and consider for inclusion in the Declaration. (It's important to note that the applicability and enforceability of these provisions will vary from jurisdiction to jurisdiction.)

- Require a super majority (75 percent) of the voting HOA *members*, not just the HOA board, to initiate a lawsuit. Such a provision would force the board to involve all HOA members in the decision, and may produce negotiations and other alternative dispute resolution (ADR) methods to resolve legitimate problems. Without this provision, all that's generally required for a HOA to initiate a lawsuit is a majority of the board of directors. The board votes to initiate a lawsuit and retains a law firm. The board then can vote for a special assessment of the HOA members to support the litigation (generally allowed under the HOA Bylaws) and each HOA member receives an "invoice" for the special assessment—which they are obligated to pay.
- Require mediation of a dispute prior to arbitration or litigation. This might discourage lawsuits and also present a forum to address legitimate issues raised by the HOA. Mediation can lead to the resolution of many conflicts quickly and inexpensively.
- A waiver of a jury trial might make a plaintiff's attorney think twice about pursuing a lawsuit in which an impartial judge—and not a jury largely made up of homeowners—would render the verdict and decide the damages.
- Include a provision that would limit the liability of the design team to a certain amount. The scope and amount of this clause would vary by project.
- Require an independent expert prior to litigation/ADR; all parties could agree to the hiring of an independent expert to review the project. You could require that the design professional be reimbursed for the cost of an independent expert if that independent expert determines the design professional is not at fault. Alternatively, consider requiring the developer to handle the expenses of all issues as warranty work, and limit the design role to review and provide design assistance where necessary.

- Clearly spell out the maintenance responsibilities of the HOA, including reasonable requirements for funding a maintenance program, and limit the design team's liability if the maintenance is not performed. Make sure that realistic time lines are set and reasonable requirements for funding a maintenance program are established. One successful condo developer provides a comprehensive maintenance manual with detailed information from manufacturers along with a detailed maintenance schedule for numerous items. They spend time meeting with the HOA explaining the maintenance manual and schedule in great detail, and also get written acknowledgement from the HOA that the developer has explained the manual.
- Require an annual inspection by the developer, contractor, design professional and a member of the HOA for a certain number of years to identify areas in need of maintenance.
- Establish multiple HOAs. If a condominium development contains multiple buildings, then the development could be broken down into separate entities with separate HOAs. This might be helpful for three reasons: First, each building is unique and will be slightly different from the other buildings. Accordingly, there may be different design/construction issues in each building. Second, by dividing the development into several HOAs, you dilute the number of individuals that will need to contribute to a lawsuit, making each HOA member have to pay more to subsidize potential litigation. Finally, different buildings might have different "personalities," and one may be easier to deal with than another.
- Require settlement agreements. These are agreements between the developer, the contractor and the HOA that requires the HOA to hire a qualified engineer to inspect the condo for design defects, construction defects and code violations when the property is transferred to the HOA. Alternatively, if the HOA is unwilling to hire a qualified engineer, the developer might agree to reimburse the HOA for the cost. Once the inspection is complete and a "2nd punch list" is provided, the parties negotiate each item and arrive at an acceptable solution for each issue. Once this process is complete, the parties execute releases. (One developer has successfully utilized Settlement Agreements on several projects. They provide the HOA with a list of several engineers, and the HOA makes a choice. The developer says it is money well spent; the Settlement Agreement is the outcome of the process and minimizes future claims.)
- Consider giving the contractor or contractors the unfettered right to correct the conditions for a certain amount of time. (*See also Legislative Protection, on page 15.*)

YOUR SCOPE OF SERVICES

Insist on providing full construction observation and administration to observe the progress and quality of the work and to determine, in general, if it is proceeding in accordance with the contract documents. This will also give you the opportunity to spot any potential trouble spots and to work with the contractor to take corrective actions in a timely and cost-efficient manner.

Some firms incorporate two separate scope of service clauses into their contract with the developer: one for the actual design and construction observation, and another addressing the long-term maintenance of the project. The developer then must initial a rejection of the maintenance scope. Although this would not protect your firm from the HOA, it might provide some measure of defense against claims from the developer.

Another option is the development of a maintenance manual as part of your scope, which would provide written recommendations for the required minimum maintenance of the project. Talk to your attorney about this. While this may carry some additional liability, many design firms feel the benefits far outweigh any risks. (See suggested contract language in **Exhibit 3**.)

YOUR CONTRACT

The process of contract formation should include a candid discussion of the project risks. Your goal is to negotiate a fair agreement that properly addresses the allocation of risks associated with condominium projects. It won't be easy. Some condo developers are notoriously inflexible when it comes to contract negotiation. They often hire the toughest attorneys who write onerous, one-sided contracts. As the partner of one experienced design firm pointed out, "The lure of huge profits in the condominium market may draw the attention of some A/Es, but condo developers are typically very tough negotiators, so we usually have lean budgets with which to work. Trying to 'make it up on volume' usually leads firms further down an unprofitable path." Still, try to stand tough; as mentioned earlier, you might have more bargaining power than you realize.

You and your attorney will need to address a number of issues. Be certain your contract contains most—if not all—the must-have contract clauses listed in **Exhibit 1**.

Most importantly, try to get a strong indemnity that requires your client to protect you from third-party claims. Have your attorney help you draw up the broadest, most enforceable language possible, perhaps including a waiver. As a starting point, consider the language in **Exhibit 2**.

As mentioned earlier, consider development of a *maintenance manual* as part of your scope of basic services. The idea is that all professional consultants on the project would develop, as part of their scope of services, written recommendations for the required minimum maintenance of their particular component of the project, such as the decking, plumbing, lighting, HVAC, roofing, sidewalks and so on. These recommendations would then be compiled into a maintenance manual for the project. In your contract, your client would agree to write into the Declaration or the Bylaws a requirement that the recommended maintenance be the responsibility of the HOA. An example of a clause to accomplish this is shown in **Exhibit 3**. Talk with your attorney about including a clause in the maintenance manual or in the contract that states that inspection, maintenance and repair are the owner's sole responsibility and that the design team shall not be responsible for any damages arising out of the owner's failures to perform these duties. (Attorney David Ericksen uses such language to cut off mold-type damage claims.)

A *limitation of liability* is another important provision. In most cases, the developer has a significant profit potential from a condominium project. It is only right, then, that they be willing to take on a significant risk. Demand that your liability on the project be limited to some reasonable level, such as the fee you earn on the project. And, as mentioned earlier, you might want to require that a limitation of liability provision in favor of the design team be included in the Declaration.

You and your attorney should also discuss the possibility that your services could be *terminated prior to providing construction administration*. Your contract should provide for that eventuality with appropriate protections such as limitations of responsibility as well as a waiver and indemnity for interpretations by others or issues which could have been solved had you provided construction phase services.

Finally, consider requiring that the client maintain a *contingency fund* set aside to handle unanticipated expenses. You'll want to maintain ownership of your plans and specification so that the developer

IF YOUR PROJECT COULD BE CONVERTED: STEALTH CONDOS

There is limited protection available if you are designing a project that could conceivably be converted to a condominium in the future—an apartment or townhouse complex, for example. Still, before accepting any such project, talk to your attorney about including a provision that would provide that your client (presumably the original developer) offer you some protection. **Exhibit 4** offers sample language that should help flush out those unscrupulous clients that intend to convert to condos but have concealed that fact, and gives you some leverage for proposed conversions prior to or during construction of the project.

doesn't take your design and replicate it at other project sites. You'll also want the right to terminate your services should your client fail to live up to financial or contractual agreements; consider having your client indemnify you in the event you must terminate for cause.

PLANS AND SPECIFICATIONS

The construction documents should be as complete, fully coordinated, consistent, easy to follow and error-free as possible. Design with an eye to future maintenance issues, too. For example, as one expert points out, "Multiple roof lines and valleys can be visually appealing, but the designer needs to remember water and leaf collection problems."

In addition, consider including the maintenance requirements for various portions of the structure in the project specifications. Note that the requirements are not all-inclusive and that maintenance is an owner responsibility.

Another suggestion came from a principal in a large engineering firm specializing in residential projects. While admitting it was easier said than done, she pointed out that "the design budget to prepare plans and specifications should reflect the inherent risks of condominium projects by increasing the allowance for Quality Control/Quality Assurance."

COMMUNICATION AND DOCUMENTATION

A look at XL Insurance clients and their projects reveals that successful, claims-free condominium projects have two factors in common:

- 1) an experienced, well-financed team of design professionals, developer and contractor, and
- 2) "over-communication" among the team.

Hold "change order prevention" and "owner-design professional-contractor" meetings frequently—perhaps biweekly—during design and construction. One firm that instituted these meetings on condo projects hasn't had a single condo project claim in 30 years.

Scrupulously document all meetings and conversations pertinent to the project. In particular, note any recommendations you make that are not followed by the developer or contractor. Watch, too, for any substitution requests and document any objections you have.

POST-OCCUPANCY

Consider meeting with the homeowners' association shortly after occupancy to discuss the importance of maintenance for the development and to provide a proposal for conducting it. If not already required in the Declaration of Condominium, propose an annual inspection by the developer, contractor, design professional and a member of the HOA for a certain number of years. You'll want to discuss the length of time with your attorney and insurance agent.

LEGISLATIVE PROTECTION

State legislatures have attempted to encourage processes other than litigation to resolve construction-defects disputes, particularly for builders of attached or condominium projects. New laws, variously known as "right to repair," "right to cure" and "notice and opportunity to repair," require builders to be given a chance to fix defects before homeowners can sue. Nearly 20 states have passed such laws in the last two years, and legislation is pending in others. Some of these set statutory limitations of varying lengths of time for bringing litigation for design and construction defects, and many require ADR prior to litigation.

What's the Bottom Line?

At first glance, while condominiums may appear to be just the kind of projects that can help your firm's profitability, they're fraught with risks that can easily wipe out any profit. Work with your professional liability insurance agent or broker and attorney to carefully weigh the risks and rewards and, if you choose to proceed, to develop a comprehensive risk management strategy. But even with the most carefully chosen preventive steps and the most protective contract terms, condominium projects still represent a high-risk undertaking.

The bottom line is that condominium project design is so risky that if you can't obtain adequate protection and institute many of the appropriate loss prevention measures described above, you should consider declining the project.

The future of your firm is at stake.

Exhibits

In this section, you'll find a list of important clauses for condo projects, as well as some sample language for your consideration. For the clauses listed in **Exhibit 1**, you may want to visit *The XL Insurance Contract Guide for Design Professionals* for more information.

**This section is provided for information only and does not constitute legal advice.
For legal advice, seek the services of a competent attorney.**

EXHIBIT 1

Important Contract Clauses for Condominium Projects

- Construction Observation
- Contingency Fund
- Corporate Protection
- Defects in Service
- Design Without Construction Administration
- Dispute Avoidance and Resolution
- Excluded Services
- Hazardous Materials
- Indemnities
- Interpretation
- Jobsite Safety
- Limitation of Liability
- Opinions (Estimates) of Probable Construction Costs
- Ownership of Instruments of Service
- Severability and Survival
- Standard of Care
- Statutes of Repose and Limitation
- Termination
- Third-Party Beneficiaries
- Unauthorized Changes to Plans



EXHIBIT 2**Indemnification**

The Client acknowledges the risks to the Consultant inherent in condominium projects and the disparity between the Consultant's fee and the Consultant's potential liability for problems or alleged problems with such condominium projects. Therefore the client agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Consultant, its officers, directors, employees and subconsultants (collectively, Consultant) against all damages, liabilities or costs, including reasonable attorneys' fees and defense costs, arising out of or in any way connected with the services performed under this Agreement, except for the Consultant's sole negligence or willful misconduct.

Waiver

In consideration of the substantial risks to the Consultant in rendering professional services in connection with this Project, the Client agrees to make no claim and hereby waives, to the fullest extent permitted by law, any claim or cause of action of any nature against the Consultant, its officers, directors, employees and subconsultants (collectively Consultant), which may arise out of or in connection with this Project or the performance, by any of the parties above named, of the services under this Agreement.

EXHIBIT 3**Maintenance Manual**

The Client agrees that the Bylaws of the Homeowners' Association established for this Project will require that the Association will perform at a minimum, as recommended in the Maintenance Manual, all routine maintenance, maintenance inspections and any other necessary repairs and maintenance called for as a result of these maintenance inspections. The Bylaws shall also contain an appropriate waiver and indemnity in favor of the Client, the Consultant and his or her subconsultants, and the Contractor if the maintenance recommendations contained in the Maintenance Manual are not performed.

EXHIBIT 4**Condominium Conversion**

The Consultant's services and construction documents are intended solely for the design and construction of residential rental units under the ownership and control of a single, integrated owner. In the event the project is changed to any other purpose or use, including, but not limited to, subdivision into individual units for sale, the Consultant shall have no responsibility for the project and each and every right, license and/or ownership interest of the Client in the construction documents shall be void. The Client shall be expressly prohibited from making any further use of the construction documents for any purpose, including, but not limited to, the conversion for another purpose. This provision shall survive termination of this Agreement.

Endnotes

- i New Live-Work-Play Condos Spark Urban Renewal, *National Association of Homebuilders press release January 18, 2005.*
- ii *National Association of Realtors (NAR), 2004.*
- iii *Note that in tracking the condo market, the NAR includes the co-operative.*
- iv *National Association of Realtors (NAR).*
- v *Condominiums differ from the co-operative, which is a form of ownership that predates condos by many years and is found in large urban areas such as New York City and Chicago. Co-op buyers acquire a fractional share of ownership in the building and grounds, entitling them to live in one of the units. In general, a co-op owner gets the right to occupy an apartment or unit by means of a proprietary lease with the cooperative corporation.*
- vi *The term vacation time share in general refers to a group of people sharing the cost of a vacation home, be it traditional deeded timeshare ownership, fractional ownership, private residence clubs, points clubs, and more.*
- vii *Southern California Homebuilder Survey, Deloitte & Touche LLP, April 2004.*
- viii *Housewrecked, Consumer Reports January 2004.*
- ix *Construction Quality Varies Widely, The Arizona Republic, Nov. 20, 2001; Nightmare Dream Home, St. Petersburg Times, March 12, 2000; Building Homes: Building Problems, Orlando Sentinel, Oct. 31, 2003 – Nov. 11, 2003.*
- x *J.D. Powers' 2003 New Home Builder Study.*
- xi *For example, plastic polybutylene pipe has been the subject of product-defect lawsuits because of leaks. Consumer Reports January 2004.*
- xii *For more information about managing the risks of mold claims, see the XL Insurance design professional group's Coping with the Mold Crisis, available at www.xldp.com/plep/Moldpaper.pdf, or from your professional liability agent or broker.*

