
Appropriations Committee

E2SSB 5258

Brief Description: Increasing the supply and affordability of condominium units and townhouses as an option for homeownership.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Shewmake, Gildon, Billig, Lias, Lovick, Nguyen, Nobles, Randall and Wellman).

Brief Summary of Engrossed Second Substitute Bill

- Makes the statutory qualified warranty program available to developers of condominiums subject to the Washington Uniform Common Interest Ownership Act rather than the Washington Condominium Act.
- Requires a claimant in a construction defect action commenced after the effective date of the bill to follow additional requirements before an action against a construction professional may be filed.
- Provides that in a construction defect dispute involving a multiunit residential building, a complaint must have been filed and served before a declarant, association, or party unit owner may make an offer of judgment.
- Requires only earnest money deposits, rather than any deposit, to be placed in escrow.
- Removes provisions limiting the deposit made in connect with purchasing a unit to 5 percent of the purchase price and instead applies the 5 percent limit to the amount of deposit funds that can be used for construction costs.
- Modifies local government planning related to the construction of condominiums.
- Exempts certain sales of condominium units and townhouses from the

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real estate excise tax.

- Creates the Down Payment Assistance Account and specifies that moneys in the account may only be used for payment towards down payment assistance loans offered by the Washington State Housing Finance Commission (Commission) for persons purchasing a condominium or townhouse.
- Requires, beginning in fiscal year 2025, the Legislature to appropriate from the State General Fund to the Down Payment Assistance Account an amount equal to the real estate excise tax revenue collected on sales of condominiums or townhouses to persons accessing down payment assistance loans offered by the Commission during the previous calendar year.

Hearing Date: 4/18/23

Staff: Jessica Van Horne (786-7288).

Background:

State Law Governing Condominiums.

A condominium consists of real property that has individually owned units and also has commonly held elements in which all the individual unit owners have an undivided common interest.

Two main statutes that govern the creation, construction, management, and termination of condominiums are the Washington Uniform Common Interest Ownership Act (WUCIOA) and the Washington Condominium Act (WCA). The WUCIOA took effect on July 1, 2018, and is applicable to residential common interest communities (CIC) created after that date. A CIC includes condominiums, cooperatives, leasehold CICs, miscellaneous communities, and plat communities. A CIC created prior to July 1, 2018, may choose to opt in to the WUCIOA. The WCA controls the creation, construction, management, and termination of condominiums created after July 1, 1990, but before the effective date of the WUCIOA.

Under both the WUCIOA and the WCA, a condominium is created by the recording of a "declaration," and the person creating a condominium is referred to as the "declarant." A condominium may be created by the construction of a new condominium building, or by the conversion of an existing building, such as an existing apartment building.

Qualified Warranties for Condominiums.

Both the WCA and the WUCIOA authorize the use of express warranties and create non-waivable implied warranties regarding the quality of materials and construction in a

condominium. The implied statutory warranties provide that the condominium unit and the common areas are suitable for the ordinary uses of real estate of its type and that any improvements made or contracted for by the declarant or the dealer will be: free from defective materials; constructed in accordance with sound engineering and construction standards; and constructed in a workmanlike manner. The WCA additionally requires the condominium unit and the common areas to be constructed in compliance with all laws then applicable to such improvements. All of a declarant's or dealer's implied warranties of quality transfer to the purchaser upon any conveyance of the condominium unit.

In 2004 a qualified warranty program was created by the Legislature as an alternative to the implied warranty provisions of the WCA. A qualified warranty is an insurance policy that meets certain requirements and includes coverage for repair of physical damage caused by the defects covered by the qualified warranty. A defect is defined as any aspect of a condominium unit or common element which constitutes a breach of the implied warranties set forth in the WCA.

A qualified warranty must provide minimum coverage periods for:

- defects in labor and materials (12-15 months);
- defects in electrical systems, mechanical systems, doors, and windows (24 months);
- defects in the building envelope (5 years); and
- defects in the structure (10 years).

The qualified warranty statute outlines what terms, exclusions, and limitations may be included in a qualified warranty and how claims are to be administered.

Construction Defect Claims.

Before a lawsuit can be filed alleging a defect in the construction or substantial remodel of a residence, a claimant, a homeowner or an association of homeowners, must serve a written notice of claim on the construction professional alleged to be responsible for the defect. The written notice of claim must be served at least 45 days before a suit is filed and must describe the claim in reasonable detail sufficient to determine the general nature of the defect.

Additionally, for construction defect actions brought by a board of directors of a condominium or homeowners' association, the board of directors must substantially comply with a requirement to mail or deliver written notice of the commencement or anticipated commencement of the action to each homeowner.

Within 21 days of receiving the notice, the construction professional must serve a written response on the claimant by registered mail or personal service. In the response, the construction professional must do one of the following:

- propose to inspect the alleged defect and then, based on the inspection, either offer to remedy the defect, compromise by payment, or dispute the claim;
- offer to compromise and settle the claim by monetary payment without inspection, including possibly buying the residence back from the homeowner; or
- dispute the claim.

If the construction professional fails to respond, or disputes the claim, or the claimant rejects an offer of inspection or settlement, then the claimant may bring an action against the construction professional for the construction defect claim described in the notice of claim.

Any action commenced by a claimant prior to compliance with the statutory requirements must be dismissed without prejudice and may not be recommenced until the claimant has complied with the statutory requirements.

Construction Defect Actions Involving Multiunit Residential Buildings.

Certain rights and obligations are specified by statute with respect to construction defect actions concerning multiunit residential buildings, including condominiums, and apply to actions that allege breach of an implied or express warranty under the WCA or that seek relief that could be awarded for such breach, regardless of the legal theory pled. The statute provides a right to arbitrate and to collect attorney fees and costs under certain circumstances, and it also imposes an obligation on parties to meet and confer, and to prepare a joint case schedule.

Additionally, the parties must engage in mediation, which must commence within seven months of the later of the filing or service of the complaint, unless the parties agree otherwise with respect to timing. Completion of the mandatory mediation occurs upon written notice of termination by any party.

On or before the sixtieth day following completion of the mediation, the declarant, association, or party unit owner may serve on an adverse party an offer of judgment, which must specify the amount of damages, not including costs or fees, that the declarant, association, or party unit owner is offering to pay or receive. Any offer not accepted within 21 days of the service of that offer is deemed rejected and withdrawn. Offers of judgment are not admissible in court or arbitration, except in a proceeding to determine costs and fees or in a proceeding to determine the declarant's ability to pay.

Earnest Money Deposits and Enforcement of Earnest Money Forfeiture Provisions.

Many contracts for the purchase and sale of real estate use an earnest money forfeiture provision in which one party, typically the purchaser, agrees to deposit a sum of money. A party forfeits the deposit by breaching the contract, allowing the other party to keep the money. Courts treat these arrangements as a form of liquidated damages, which are the specific amounts of damages that parties to a contract agree to pay as damages if they breach the agreement.

Under common law, a liquidated damages clause is enforceable if it does not constitute a penalty and is not otherwise unlawful. In determining whether the amount of liquidated damages constitutes a penalty, courts consider whether the amount of liquidated damages is a reasonable forecast of just compensation for the harm caused by the breach and whether the harm caused by the breach is impossible or very difficult to ascertain.

State law guarantees enforcement of an earnest money forfeiture provision regardless of the

seller's actual damages if:

- the agreement designates a payment as an earnest money deposit;
- forfeiture of the deposit is the seller's exclusive remedy; and
- the amount of earnest money to be forfeited does not exceed 5 percent of the purchase price.

An earnest money forfeiture provision that does not satisfy these requirements is interpreted and enforced under the common law liquidated damages requirements.

For the purposes of these provisions, state law defines "earnest money deposit" to mean any deposit or payment of a part of the purchase price for the property, made in the form of cash, check, promissory note, or other things of value for the purpose of binding the purchaser to the agreement and identified in the agreement as an earnest money deposit, and does not include other deposits or payments made by the purchaser.

Deposits for Purchase of a Unit under the WUCIOA.

Under the WUCIOA, any deposit made in connection with the right to purchase a unit from the declarant or dealer of a common interest community under the WUCIOA must be placed in escrow until delivered to the declarant at closing or because of the purchaser's default under the purchase contract, refunded to the purchaser, or delivered to a court in connect with certain legal actions. The amount of the deposit may not exceed 5 percent of the purchase price.

A declarant may withdraw escrow funds when construction of improvements has begun if:

- the purchase agreement provides that deposit funds may be used for construction; and
- the declarant obtains and maintains a surety bond in favor of the purchaser in an amount adequate to cover the amount of the deposit to be withdrawn.

The declarant may not withdraw more than the face amount of the bond.

Down Payment Assistance Programs.

The Washington State Housing Finance Commission (Commission) is a public body created by the Legislature to make housing financing available at affordable rates throughout the state by acting as a financial conduit. Among other programs, the Commission offers affordable home loans and down payment assistance programs. The Commission's down payment assistance programs assist low-income and first-time home buyers in qualifying for a mortgage by lending them funds for the required down payment. These down payment assistance loans are low- or no-interest loans that do not need to be paid back until either the primary mortgage is paid or the home is sold.

State Real Estate Excise Tax.

The state imposes a graduated real estate excise tax on the sale of property that is not timberland or agricultural land. The portion of the selling price up to \$525,000 is taxed at 1.1 percent; the portion that is more than \$525,000 but less than or equal to \$1,525,000 is taxed at 1.28 percent; the portion that is more than \$1,525,000 but less than \$3,025,000 is taxed at 2.75 percent; and

any portion of the selling price over \$3,025,000 is taxed at 3 percent.

The Department of Revenue (DOR) is required to adjust the first price threshold every four years by the lesser of the growth in the Consumer Price Index for shelter or 5 percent, rounded to the nearest thousand dollars. The first update to the price thresholds occurred on January 1, 2023; it resulted in an increase of 5 percent to the first price threshold, which translated to an increase of \$25,000 at each threshold. Timberland and agricultural land is taxed at a flat rate of 1.28 percent.

Until June 30, 2023, the revenue from the state real estate excise tax is deposited as follows: 1.7 percent into the Public Works Assistance Account, which is used to make loans and grants to local governments for public works projects; 1.4 percent into the City-County Assistance Account, which provides funding to local governments based on their size and how their sales and property tax revenue compare to the statewide average; 79.4 percent to the State General Fund; and 17.5 percent into the Education Legacy Trust Account, which is used to support education. After July 1, 2023, the portion going to the Public Works Assistance Account increases to 5.2 percent, while the amount going to the Education Legacy Trust Account decreases to 14 percent.

The tax imposed is due at the time of sale, and is subject to monthly interest if paid more than a month after the sale. The tax is a lien on the property, and its payment is the responsibility of the seller. The Department of Revenue may foreclose on the property if the tax remains unpaid.

Real Estate Excise Tax Exemptions.

Some transfers of property are exempted from being considered a sale. Because these transfers are not considered sales, they are not subject to real estate excise taxation. These exemptions include, among other things, property transfers made by gift or through inheritance, transfers made pursuant to a dissolution of marriage, or the transfer of a mortgage interest in property. Certain property sales or transfers related to low-income housing are also exempt from being considered, and thus taxed as, sales. These exemptions cover low-income housing developments that qualify for federal low-income housing tax credits or for tax credits from the Commission. The exemptions also include sales of self-help housing to households that have an income of less than 80 percent of the median income, adjusted for house size, of the county in which the dwelling is located.

Also exempted are sales or transfers to certain entities that use the property for low-income housing, as long as certain conditions are satisfied. First, the property must qualify for a property tax exemption related to certain properties owned by a qualified entity. A qualified entity is a nonprofit organization that provides low-income rental housing or develops properties for sale to low-income households; a housing authority; a public corporation; or the United States, Washington, a county, or a municipal corporation. Second, the property must actually be used as housing within one to five years by a household that has an income of less than 80 percent of the median income, adjusted for house size, of the county in which the dwelling is located, with the time frame dependent on whether the organization is operating existing

housing, renovated housing, or constructing new housing on the site. If this deadline is missed, then the organization must pay the tax that would have been due at the time of the transfer, plus interest.

Multifamily Property Tax Exemption.

The Multifamily Property Tax Exemption, also referred to as the multi-unit urban housing property tax exemption, exempts the value of real property associated with the construction, conversion, or rehabilitation of qualified, multi-unit residential structures located in residential targeted areas contained within an urban center. The tax exemption applies only to the value of the construction, conversion, or rehabilitation projects, and does not exempt the value of the underlying property or other improvements on the property. To qualify for an exemption, the housing project must be located within a residential targeted areas designated by a qualifying county or city.

Tax Preferences.

State law provides for a range of tax preferences that confer reduced tax liability upon a designated class of taxpayer, including exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference, unless the legislation contains an explicit exemption from those requirements.

Impact Fees.

Local governments that plan under the Growth Management Act may impose impact fees on development activity to finance public facilities to serve new growth and development. For example, if a new residential development would require increased school facilities for the residents, then an impact fee could be assessed to pay for the new facilities. The ordinance establishing impact fees must include a schedule of impact fees for each type of development activity.

Approval of Short Plats and Short Subdivisions.

City, town, and county legislative authorities shall adopt regulations and procedures for the approval of short plats and short subdivisions.

Summary of Bill:

Qualified Warranties for Condominiums.

Key terms, such as "condominium" and "association," in state law regarding qualified warranties for condominiums are redefined by reference to the same terms in the WUCIOA instead of the WCA, with the effect that the qualified warranty program is made available to developers of condominiums subject to the WUCIOA rather than the WCA.

Construction Defect Claims.

A claimant in a construction defect action commenced after the effective date of the bill must follow additional requirements before an action against a construction professional may be filed.

If the claimant in a construction defect action is a condominium association created after the effective date of the bill, the written notice of claim must additionally include a written report from a construction defect professional, defined as an architect, builder, builder vendor, contractor, subcontractor, engineer, inspector, or other person with verifiable training and experience related to the defects or conditions identified in the written report included with a notice of claim.

The written report must include a description of the defect, the construction defect professional's qualifications, the manner and type of inspection that served as the basis for the report, and the general location of the defect. Prior to the service of the summons and complaint on any defendant in a construction defect action, the association must provide a copy of the construction defect professional's report to each unit owner upon request.

Within 14 days after service of the notice of claim, a construction professional may serve a written response demanding a meeting with the claimant and the claimant's expert to confer regarding the report and its contents. The meeting must take place within 14 days of service of the construction professional's demand or at a later date mutually agreed to by the parties.

Within 14 days of the meeting, or within 21 days after service of the claim in the absence of a demand for such a meeting, whichever is later, the construction professional must serve on the claimant the written response currently required by law. Prior to the service of the summons and complaint on any defendant in a construction defect action, the association must provide a summary of the construction professional's written response to the claimant's written notice of claim.

If the claimant is an association, the association may incur expenses to prepare and serve a notice of claim and any related reports notwithstanding any contrary provisions in the association's governing documents.

Construction Defect Actions Involving Multiunit Residential Buildings.

In a construction defect dispute involving a multiunit residential building, a complaint must have been filed and served before a declarant, association, or party unit owner may make an offer of judgment within the 60-day timeline currently specified in the law.

Deposits for Purchase of a Unit under the WUCIOA.

Only earnest money deposit, as defined in state law related to enforcement of earnest money forfeiture provisions, are required to be placed in escrow.

Provisions limiting the deposit made in connection with purchasing a unit to 5 percent of the purchase price are removed. Instead, the 5 percent limit applies to the amount of deposit funds that can be used for construction costs.

Down Payment Assistance Programs.

The non-appropriated Down Payment Assistance Account (Account) is created. Expenditures from the Account may be used by the Commission for payment towards a person's down payment assistance loan offered by the Commission that was used to purchase a condominium or townhouse.

Beginning in fiscal year 2025, the Legislature must appropriate from the State General Fund to the Account an amount equal to the total amount of real estate excise tax collected on sales of condominiums or townhouses to persons using down payment assistance programs offered by the Commission during the prior calendar year, as determined by the DOR. Beginning on or before March 1, 2024, and each March 1 thereafter, the Commission must provide data on each qualifying sale of a condominium or townhouse that occurred during the prior calendar year to the Department of Revenue.

The Account and related requirements to appropriate from the State General Fund to the Account expire January 1, 2034.

Real Estate Excise Tax.

Sales of condominiums and townhouses that are constructed in buildings qualifying for the multifamily property tax exemption, and that meet the definition of permanently affordable housing at the time of the sale, are exempted from the real estate excise tax. The real estate excise tax exemption expires January 1, 2034. The bill provides an exemption from requirements to include a Tax Preference Performance Statement.

Impact Fees.

Impact fee schedules shall reflect the proportionate impact of new housing units, including multifamily and condominium units, based on the square footage and number of bedrooms, or trips generated, in the housing unit, to produce a proportionally lower impact fee for smaller housing units. Any changes to the impact fee schedule take effect six months after the next periodic comprehensive plan update adopted by a city or county.

Approval of Short Plats and Short Subdivisions.

All cities, towns, and counties shall include procedures for unit lot subdivisions allowing for division of a parent lot into separately owned unit lots in their short plat regulations.

Miscellaneous Provisions.

Several technical and clarifying revisions are made in the statutes governing various common interest communities, including the following revisions:

- The definition of "homeowners' association" under the Homeowners Associations Act is revised to exclude an association created under the WUCIOA.
- Inaccurate subsection references are corrected in the WUCIOA provisions related to development rights.
- Inaccurate use of "condominium" is corrected to "common interest community" in the

WUCIOA provisions related to public offering statements.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains multiple effective dates. Please see the bill.