Market Update

Signs of life for condo projects slowly emerging

Eighteen months have passed since former Gov. John Hickenlooper signed House Bill 1279. That legislation, passed in the wake of a surge of construction defect lawsuits against developers, contractors and architects, was supposed to set off a tidal wave of new condominium construction – particularly in the entry-level market. More specifically, the legislation was intended to realign the risks associated with building condos in an effort to entice developers, lenders and insurers to re-enter the market. So, what has happened?

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It's no secret that new condo construction hasn't taken off as predicted. That said, there are signs that the tide is starting to turn.

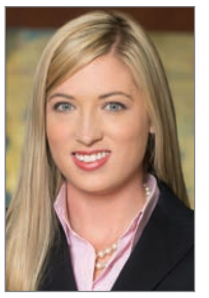
The market continues to see a trickle of small- and medium-size projects, particularly in neighborhoods experiencing rapid change such as the Lower Highlands. Listing prices can vary widely – between $300,000 and more than $900,000 – sometimes within the same project.

At the other end of the unit-count spectrum, developers have announced plans to move forward with at least two very large condominium projects in downtown Denver. Amacon, a Canadian developer with significant experience in high-rise condominium projects, announced the redevelopment of the Shelby's Bar & Grill site on 18th Street in downtown Denver. The project will reportedly be nearly 40 stories tall and contain over 450 units. Similarly, Ubuntu Partners Real Estate announced plans for a 19-story, 342-unit project in Arapahoe Square that will include retail and an 8,000-square-foot private club.

The relative absence of condo projects doesn't mean, however, that developers aren't still betting on – and investing big in – residential projects.

Not yet comfortable with the economic and legal risks of condo projects, many developers are continuing to proceed with a product that they perceive both to be in demand and less risky, namely multifamily apartment projects. The data is somewhat staggering, particularly in comparison to the figures for for-sale projects.

Since 2014, over 40,000 new apartment units have been added to markets in the Denver metro area, according to a recent CoStar study. Approximately 25,000 of those units came on line in 2017 and 2018. Although permit applications during 2019 suggest that new unit growth peaked during 2017, according to an analysis by Apartment Insights, there are an additional 50,000 units either under construction or in the pipeline. Needless to say, these figures dwarf the numbers of new condominium units being built or planned.



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There appear to be at least four reasons for this.

First, continued growth in the population of the Denver metro area has allowed developers to opt out of taking the risks associated with condominiums. Indeed, the widely publicized influx of millennials and other newcomers to Colorado has continued to fuel the seemingly bottomless demand for apartment units.

Second, recent studies have documented shifts in attitudes about homeownership among the millennial generation – particularly among millennials who enter the workforce with significant student loan debt. A 2018 Urban Institute study found that the rate of homeownership for millennials between the ages of 25 and 34 was approximately 8 percentage points lower than the rate for Gen Xers and baby boomers when they were the same age. The National Apartment Association has documented a similar trend among members of the baby boomer generation who want the mobility of renting and don't want to be responsible for keeping up a yard and maintaining a home. In response to this, many for-rent multifamily developers, such as Nex-Metro Communities, are attempting to appeal to the growing population of renters by choice – and harness the multigenerational appetite for for-rent product that "feels like home."

Third, construction and insurance costs in Colorado remain high, and it can be difficult to make entry-level condominium projects pencil. This is especially true given the more exacting design and construction standards that architects, developers and contractors often feel they must meet on condominium projects to mitigate their own potential liability.

Finally, the legal risks associated with developing condominium projects remain very real. Many developers have adopted a now-standard playbook that includes the use of Owner-Controlled Insurance Programs (aka "wraps"), peer review of project design and construction, and provisions in condominium declarations that enhance the ability of developers and contractors to head off disputes with unit purchasers and homeowner associations before they ripen into lawsuits. Despite this, the risk of facing a lawsuit for up to eight years after a project's completion remains too great for many developers.

In the meantime, there appears to be relatively little statewide political will to make further efforts to reduce the legal risks associated with for-sale condominium developments. Most observers think it's unlikely that the Legislature will attempt to tackle further reforms, which means that the legal landscape is unlikely to change for the foreseeable future. ▲