Legislative Memo

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Proposed state-mandated warranty would increase costs to homebuyers

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At a time when housing is becoming increasing unaffordable for many Washington families, one legislative proposal would raise insurance premiums of homebuilders, make it more harder for small contractors to stay in business, and increase costs for people trying to buy a home.

A new way to sue

Engrossed Substitute Senate Bill 5550 would increase home costs by creating a new way to sue homebuilders and contractors. The bill would mandate, "as a matter of law," that all new homes carry a state-imposed warranty that creates liability for builders for up to 10 years. Under the bill, substantial remodels of existing homes would be included in the definition of "new homes."

The price of new and substantially remodeled homes affects sale prices across the real estate market, so a mandated warranty would have the effect of artificially pushing up the price of all housing in Washington.

Under ESSB 5550, the warranty would be involuntarily mandated by the state, even if that works against the wishes of the homebuyer. Under the bill, homebuyers may not choose to have no warranty, a different warranty or to voluntarily establish their own guarantee terms with the builder. The state-mandated warranty remains in effect if the home is later sold to a new owner, even if the provision is imposed against the wishes of the new owner.

By greatly expanding the legal grounds for bringing a lawsuit against homebuilders, the bill would result in more litigation. As in health care, creating new ways to sue drives up costs for customers and suppliers, because all parties in a transaction must be prepared in case the friendly agreement they started with turns into a contentious lawsuit later.

The threat of more litigation would mean higher liability insurance premiums for architects, engineers, builders, general contractors and subcontractors. Higher premiums in turn drive up costs for these professionals and make it harder to operate a successful business in our state. Small and minority-owned businesses would be especially hard hit by the legislation.

Increasing the burden of regulation

ESSB 5550 mandates that contractors provide a variety of warranties to homeowners. As mentioned, these warranties would be carried over to subsequent buyers.

Defective materials and workmanship would be under warranty for two years, and systems such as electrical and plumbing for three years. Damage due to water penetration would be under warranty for five years, and structural defects would be under warranty for ten years.

Any legal action to enforce these warranties would have to be taken within six years of when the defect is discovered, or should have been discovered with due diligence. This statute of limitations would be tolled if the homeowner provides the builder with a reasonable description of the defect. The tolling would continue until the builder fixed the defect or notified the homeowner of the builder's unwillingness to begin or complete the repair.

If passed, this bill would make it more difficult and costly to become a contractor in Washington, thus restricting the supply of contractors, reducing competition and raising the price of new and remodeled homes.

Low complaint rate for contactors

Research of consumer complaints against homebuilders finds that the vast majority of customers are generally satisfied with the quality of the work done by building contractors.

The number of complaints on record with the state Attorney General's office is small in comparison to the number of contractors registered with the Department of Labor and Industries. The complaint rate, the number of complaints per registered contractor, was 1.46% in 2006. A 1.46% complaint rate means that, on average, 0.0146 complaints are filed against each contractor, or 1 complaint for every 68 contractors. In 2005, the complaint rate was 1.59%, and in 2004 it was 1.56%. These figures are summarized below.

Annual customer complaints against
contractors as a percentage of registered contractors

2006 – 1.46%
2005 – 1.59%
2004 – 1.56%

The number of complaints filed with the Better Business Bureau yields a similar rate for 2006, 1.49%. Some of the complaints to the Better Business Bureau probably overlap with those filed with the Attorney General's office.

The complaint rate has declined slightly in the last reported years, and the overall proportion of bad builders in the industry is small compared to the number of registered building contractors. Based on data from annual complaint filings, about 98.5% of building contractor customers are either satisfied with the price and quality of the service they received, or were able to resolve minor disagreements without resorting to the formal process.

Complaint rates for other industries

Compared to builders, providers in other industries are not much better, and some are worse, in satisfying the expectations of their customers. Contractors rank sixth in the number of consumer complaints made to the Attorney General's office. Communications, retail sales, collections, auto sales and electronic shopping have higher consumer complaint rates. Communications services, for example, have an annual complaint rate that is twice that of home contractors. Of all industries, builders account for just 4.46% of total complaints, a ranking has been relatively stable over the last half decade.

In contrast, the legal profession has a far higher consumer complaint rate. The Washington State Bar Association reports that the complaint rate against attorneys in 2005 was 7.51%, or about 470% greater than the number of complaints filed against contractors that year.

If the goal of the proposed policy change is consumer protection, it would make more sense for the legislature to enact new regulations and warranty requirements on auto dealers or law firms before it considers new restrictions on the building industry.

Consumer options for resolving disputes

Under the existing system, home buyers already have options for consumer protection. They can be careful in selecting a contractor in order to avoid problems in the first place, educating themselves, checking references and organizations like the Better Business Bureau, or using a company with a good reputation.

Consumers can also file a complaint with the Attorney General or the Department of Labor and Industries, or they can sue if the contractor refuses to fix a serious defect. In addition, builders are required by law to have insurance that pays customers if the company fails to fulfill the terms of its contracts. Establishing a new way to sue, as this bill does, would create an incentive for lawyers to take disputes to court in search of large money awards, before pursuing more effective and less expensive alternatives.

Conclusion

By creating a new mandate, ESSB 5550 would greatly restrict the freedom of people voluntarily to make contracting agreements that serve their interests and particular circumstances. Essentially, the bill would substitute the judgment of policymakers in Olympia for that of ordinary citizens. In an effort to police about 1.5% of contractors who are accused of doing poor work, the customers of the other 98.5% of contractors would be forced to pay higher prices.

Builders should be free to offer and homeowners should be free to accept any warranty, whatever its duration or caveats, or no warranty at all. Market forces should determine what sorts of warranties become commonplace and widely accepted. A state-mandated warranty would likely cause many builders to withdraw the voluntary customer guarantees that they offer now.

Similarly, it is unnecessary for the government to set universal standards. Many industries form their own standards. In others, different brands compete and offer the consumer a degree of confidence in the quality of the product, such as in the automobile industry. Buyers and sellers working voluntarily in the market can produce standards that suit their needs, without a one-size-fits-all regulation being imposed by lawmakers.

Taken together this expensive new regulation would increase costs for all construction businesses, but they would fall especially hard on small and minority-owned businesses. Large, established businesses often have the resources to meet new financial requirements. Small and minority-owned businesses tend to operate on a smaller profit margin and may not be able to meet the costs of the new regulations.

The result of the policy proposed in this bill would be to drive economically vulnerable businesses out of the home construction market and make it harder to people in Washington to buy a home.

About the Author

Paul Guppy is a graduate in Liberal Arts of Seattle University and holds a Master of Arts degree in American government and public policy from Claremont Graduate University, and a Master of Science degree in political science from the London School of Economics. He completed higher education programs at The Sorbonne, Paris and at Gonzaga University in Florence, Italy. He served for 12 years in Washington D.C., most of that time as a Legislative Director and Chief of Staff in the United States Congress, before joining Washington Policy Center in 1998 as Vice President for Research. He is the author of previous Policy Center studies on civil rights, labor policy, property taxes, insurance regulation and health care reform.

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