

# COLORADO CONSTRUCTION MONITOR

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An Update from Sherman & Howard's Construction Industry Practice Group

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SHERMAN & HOWARD L.L.C.

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ESTABLISHED EXCELLENCE

WINTER 2015 / 2016



# SHERMAN & HOWARD CONSTRUCTION INDEX WINTER 2015 / 2016

# 119.1



## SHERMAN & HOWARD L.L.C.

Construction activity in Denver (and throughout Colorado) remains remarkably high. Sherman & Howard's Construction Index rose to 119.15 for the quarter, which establishes a new record high for the Index. The previous high was 118.53 set in March 2007, immediately prior to the onset of the last recession.

The Index pushed higher in winter 2015 despite flat employment growth over the summer, a condition blamed on serious labor shortages in about half of U.S. markets and confirmed locally. Industry data shows that 86 percent of contractors nationwide had difficulty filling key positions during that period, and experts speculate that the \$1.1 trillion of construction spending documented in September 2015 would have been even higher had the market not been constrained by labor shortages. While some softening appears to be developing in the construction market nationwide, growth is likely to continue in Colorado through 2016 absent the development of unforeseen negative market factors.

### GROUNDBREAKINGS

Colorado State University  
football stadium

**\$220**  
million

Denver Water campus  
redevelopment

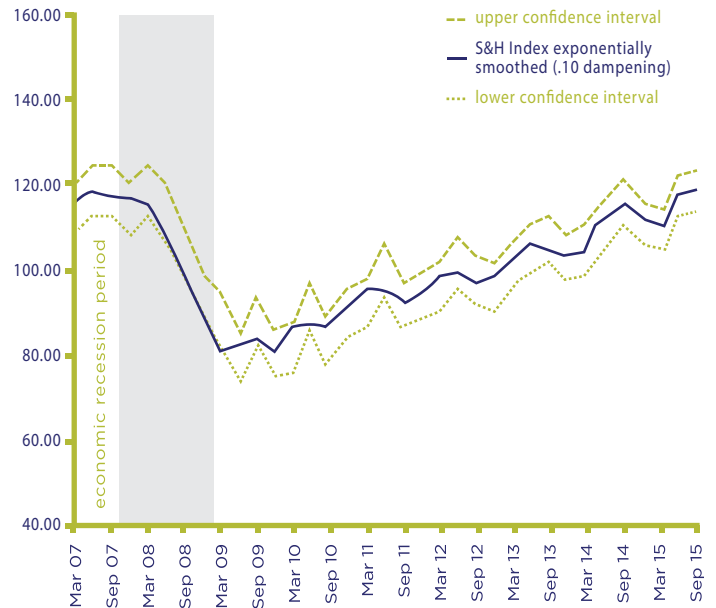
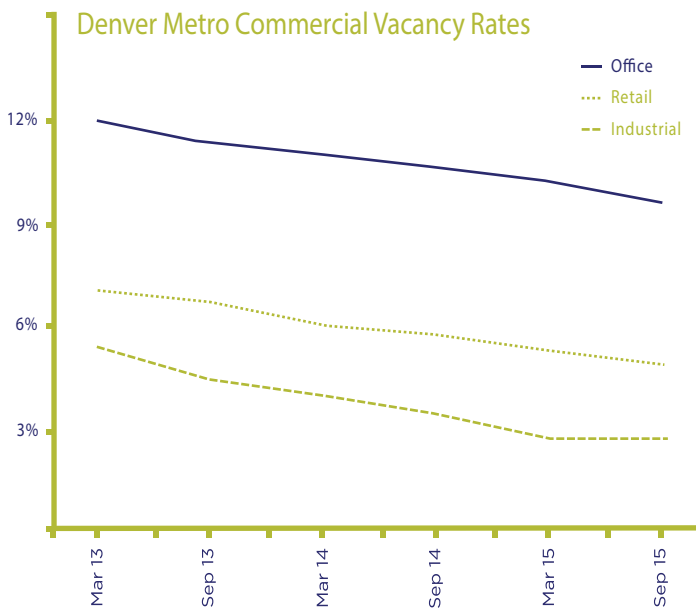
**\$195**  
million

Ballot Measure 2C - Redevelop  
National Western Complex

**\$800**  
million

Ballot Measure 1A - Greenlights  
development around DIA

**1500**  
acre project



The Sherman & Howard Construction Brief & Index is a statistical indicator of construction-related activity in Colorado and the surrounding intermountain region that provides a three to six month indication of the growth or decline in the industry and its relative health. The Index is determined by several factors considered on a local, regional and nationwide basis, the data for which are collected at least quarterly, including unemployment rates, new permits issued, vacancy and under construction rates, as well as the cost of funds and the competitive condition of the local marketplace. The quarterly Index scores are reported against a baseline of 100, with scores above 100 indicating an increase in related activity and scores below 100 indicating a decline.

Although Sherman & Howard makes efforts to forecast accurately using the most current information, the factors and trends tracked by the Construction Brief & Index are based on a mathematical regression model that is imperfect and does not measure every possible factor of influence. Nevertheless, we trust the Index we report and accompanying Brief we issue will serve as a valuable tool for evaluating construction and development opportunities in the Denver area and in the broader Colorado construction market, and for making informed business decisions. Some of the factors used to calculate the Index may be periodically adjusted by various reporting agencies. We regularly monitor those factors and adjust the Index accordingly.

## ABOUT THE FIRM

For additional questions please contact  
Blane Harvey or David Frommel at 303.297.2900

Sherman & Howard L.L.C. is a super-regional firm with a national practice. While the firm serves a broad range of clients, including individuals, privately held businesses, multi-national corporations and government entities, our Construction Industry Practice Group is one of the largest, if not the largest, dedicated construction law practice in the Rocky Mountain region and features lawyers who focus exclusively on construction. Our attorneys include former architects, engineers, contractors and government attorneys, as well as experienced arbitrators and mediators of construction disputes.

Find more information at [www.shermanhoward.com](http://www.shermanhoward.com)

## Market Update

Construction activity in Denver and throughout Colorado remains remarkably high, with Sherman & Howard's Construction Index rising to 119.15 for the quarter ending September 30, 2015. That level establishes a new record high for the Index, eclipsing the previous high of 118.53 set in March 2007, immediately prior to the onset of the last recession.

The Index pushed higher during the latter half of 2015 despite flat employment growth over the summer. Nationwide, labor shortages were thought to be the source of receding construction employment in about half of all major markets during July and August, a factor confirmed locally through anecdotal evidence. According to the Associated General Contractors of America, 86 percent of contractors nationwide experienced difficulty filling key positions during key summer construction months. Experts have speculated that the \$1.1 trillion of construction spending documented in September 2015 was constrained by labor shortages. While some softening appears to be developing in the nationwide construction market, growth is likely to continue in Colorado through 2016 absent the development of unforeseen negative market factors.

### Groundbreakings and Announcements:

Denver recently passed two major ballot measures that should significantly impact local construction spending for years to come. Ballot measure 1A opens the doors to additional development near Denver International Airport, and measure 2C secured over \$800 million in funding for the redevelopment of the National Western Complex in north Denver. Both areas will benefit from new commuter/light rail corridors scheduled to come online during 2016, which will help drive continued construction activity.

- In July, CDOT short-listed four teams to propose on the \$1.8 billion redevelopment of I-70 through northeast Denver, including a team anchored by Colorado's own Flatiron Constructors, Inc. and CH2M Engineers.
- CSU football stadium: \$220 million
- Denver Water Campus Redevelopment: \$195 million

### Winter 2015/2016 Construction Market Update:

Strong economic growth in Denver continues to set the national pace for construction activity. The Denver Metropolitan area was second only to the greater Phoenix area in construction job growth during September. Nationwide, the construction industry leads job growth, and Engineering News Record predicts an additional 10,000 construction sector jobs will be added to the economy in 2016. But despite Denver's market strength, job growth across Colorado is predicted to slow, with 2.6% growth projected for 2016, compared to 2.8% in 2015 and 3.3% in 2014. Unemployment of only 3.7% state-wide masks the significant numbers of jobs being shed in the mining and energy sectors as a result of low oil and gas prices. Many of those workers are migrating to other sectors, including construction. Low unemployment in Colorado means contractors will continue to experience skilled labor shortages, a situation which can be remedied only with immigration, time and aggressive job training initiatives.

While labor shortages have anecdotally contributed to rising project costs in Denver and beyond, those increases are now being offset, in part, by the declining prices of iron, steel, non-ferrous wiring and other energy-intensive construction materials. Engineering News Record attributes downward price trends to a stronger dollar, weak global demand for building materials, and a significant supply glut. Over the latter half of 2015, the market has only seen a slight increase in a few materials prices, including asphalt, concrete, and lumber.

New building permit activity remains strong across Colorado, with more than 2,700 permits issued during the third quarter of 2015. Nearly 900 of those permits were issued for buildings containing five or more units, a metric which has remained elevated above historic levels for the past 14 quarters, indicative of the ongoing multifamily housing boom. The multifamily vacancy rate, a bellwether of economic strength in Colorado, has fluctuated between 4.5% and 5% since the economic recovery began in earnest during 2011. By comparison, it peaked at 9% during the last Recession and in excess of 12% during the "Dot Com" recession. The multifamily vacancy rate during the third quarter of 2015 rang in at 5%, a slight increase over previous quarters which experts have attributed to a significant number of new apartment units that were delivered during the quarter. Despite the increase in supply, apartment rents in Colorado increased 11% year-over-year for the quarter.

Available industrial, office and retail space are difficult to find in the Denver metro area. On both a gross and a percentage basis, available space is at a record low, providing a significant driver for additional development across all building sectors. Vacancy rates reflect the space shortages throughout the market, with industrial and retail vacancy at historic lows of 2.8% and 3.1% respectively. In addition, vacant office space has been below 10% for the past year. The market has eagerly absorbed the new space made available during the past three years along with the vast majority of vacant space which existed going into the economic recovery. Yet despite low vacancy rates in each of these sectors, the amount of new space under development has remained relatively static during 2015, suggesting a cautious pace for new project development.

Even though interest rates are low and infrastructure needs are great, many agencies have held off on issuing new debt. We anticipate infrastructure growth should begin to see an uptick and continue as tax revenues rebound into 2016. As a result, potential impacts on contracting volume would occur primarily with state agencies, which are estimated to make up around one in four of the state and local projects. Another key source of increased funding of infrastructure will most likely come from Colorado Senate Bill 09-228. Under that 2009 law, transfers from the general fund to highway projects in the amount of \$200M begin to kick in this year and will continue to do so for the next four fiscal years. Unfortunately, the state's growth may be a limiting factor to this much needed funding. Senate Bill 09-228 limits the General Fund transfers in relation to TABOR refunds. If the amount of the TABOR refund is between 1.0 percent and 3.0 percent of General Fund revenues for the state fiscal year, the S.B. 09-228 transfer is reduced by half in that year. If TABOR refunds exceed 3.0 percent, the S.B. 09-228 transfer is eliminated. Simply put, if TABOR refunds increase, S.B. 09-228 transfers will decrease.

**Conclusion:**

The construction market in Denver and Colorado remains strong despite growing headwinds on a national and global level. Although major indices of construction activity such as the ENR quarterly confidence index are pulling back from recent highs, low vacancy rates in Denver and Colorado, coupled with new transit lines that are expected during 2016 should continue to drive development across all construction sectors through 2016. While growth may slow, it is expected to continue its performance above the national level.

## Court of Appeals Ruling Favors Arbitration of Construction Defect Claim

By John Mill, Rebecca Fischer and Katie Varholak

### FOREWARD - DAVID FROMMELL:

Years of construction defect legislation stalemate in Colorado's General Assembly has depressed the state's condominium construction market. In a significant May 2015 ruling, the Colorado Court of Appeals upheld the right of developers and contractors to enforce arbitration clauses contained in HOA declaration documents. Will the courts uphold other private (contractual) restrictions on construction defect lawsuits before the General Assembly takes meaningful action? Time will tell.

Finally—there is some good news for developers and general contractors regarding condominium construction defect claims. In a decision issued May 7, 2015, the Colorado Court of Appeals held that construction defect claims by a homeowners' association must be decided in arbitration—not litigation—where the condominium declaration (i) requires arbitration of construction defect claims, and (ii) requires the developer's consent to amend the arbitration provision, but consent is not obtained. The decision, *Vallagio at Inverness Residential Condominium Ass'n, Inc. v. Metropolitan Homes, Inc., et al.*, No. 2015COA65 (Colo. Ct. App. May, 7, 2015), will give developers and contractors greater confidence that if the declaration is properly drafted, any construction defect claims will be decided in arbitration instead of litigation.

### Facts of the Case:

The Vallagio project ("the Project") is located near the Inverness Hotel in Arapahoe County. Metro Inverness, LLC was the Project's developer and drafted the declaration for the Project. The declaration included a mandatory arbitration provision that required any construction defect claims be decided in arbitration. The declaration also provided that the arbitration provision could not be amended without the written consent of the developer/ declarant. The developer recorded the declaration and began selling condominium units in 2007.

In 2013, the members of the HOA voted to amend the declaration by deleting the arbitration provision. The developer did not consent to this amendment.

The HOA then filed a lawsuit against the developer, general contractor and others alleging various construction defects and demanded a jury trial. The developer and other defendants moved to compel arbitration and require the claims be decided in arbitration. They argued the amendment deleting the arbitration provision was void because the developer had not consented to it. The HOA opposed the motion to compel arbitration. The district court ruled for the HOA and held the consent provision violated the Colorado Common Interest Ownership Act ("CCIOA"), C.R.S. § 38-33.3-101 et seq. The developer and other defendants immediately appealed pursuant to the Colorado Uniform Arbitration Act, C.R.S. § 13-22-228(1)(a).

### Court of Appeals Decision:

The Court of Appeals held that the declaration's consent provision was not ambiguous and the Project's unit owners were required to obtain the developer's consent before amending the declaration to remove the arbitration provision. The Court of Appeals also ruled that the consent provision did not violate CCIOA and was enforceable. Therefore, the Court of Appeals reversed the district court and held that the HOA's claims against the developer/declarant must be decided in arbitration. The Court of Appeals noted that CCIOA endorses the use of alternative dispute resolution and expressly allows declarations to require binding arbitration.

The Court of Appeals remanded the case back to the district court to determine if the arbitration provision may also be enforced by the general contractor. The general contractor was not a party to the declaration, and the declaration did not require the contractor's consent to amend the arbitration provision. The Vallagio declaration required arbitration of claims against the developer "and any contractor against whom such Construction Defect Claim is targeted." Decision at 23. The Court of Appeals held that the record before it was unclear on whether the general contractor was an intended third-party beneficiary of the arbitration provision. That determination will be made by the district court based on the language of the declaration and the surrounding circumstances. Given the declaration's reference to claims against the contractor, we predict that the district court will rule that the general contractor may enforce the arbitration provision.

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**Impact of the Decision:**

The decision is good news for developers of already-completed condominium projects where the declaration contains arbitration and consent provisions. The decision's impact on general contractors that have built condominium projects will depend on the declaration's specific language and other facts. The Court of Appeals decision also provides a clear roadmap for developers regarding how to draft declarations for future multi-family residential projects to ensure that any potential construction defect claims by a homeowners' association must be decided by arbitration instead of by jury trial.

The decision's impact on the insurance industry remains to be seen. It is possible insurers will view the decision favorably to the extent they believe it will reduce the overall cost of construction defect claims. If so, the decision may induce insurers to expand construction coverage operations in Colorado. However, the reaction of the insurance industry to the decision is not yet clear.

The HOA could ask the Colorado Supreme Court to review the Court of Appeals decision. However, the Court of Appeals decision is well-reasoned, and we expect it will remain the law in Colorado.

Sherman & Howard's construction, real estate and insurance attorneys are experienced in drafting declarations, enforcing arbitration provisions, helping clients avoid and resolve construction defect claims, and assisting clients with insurance coverage issues. We recommend that developers and general contractors considering new for-sale multi-family residential projects consult with experienced counsel to ensure that declarations are carefully drafted to provide maximum protection from construction defect claims and proper insurance coverage is obtained. In addition to arbitration and consent provisions, declarations can include other provisions that reduce the risk of construction defect claims and/or make them easier to resolve. While efforts to pass state legislation to address construction defect claims have failed in the last three legislative sessions, the Court of Appeals decision in Vallagio is great news for developers and contractors and may encourage new condominium construction projects in Colorado.

## Denver City Council Advances Construction Defect Ordinance

By Jared E. Berg, John W. Mill and William R. Reed

### FOREWARD - DAVID FROMMELL:

In the absence of progress in the General Assembly, a growing number of local governments are enacting their own construction defect reform ordinances in the hope of promoting condominium construction. The City and County of Denver recently joined those ranks, a move which may motivate state lawmakers to take action during the next session. Yet despite the multitude of new ordinances, few new condominium projects are underway. Whether local ordinances will survive the inevitable legal challenges from HOA groups remains to be seen.

The Denver City Council on November 16, 2015 unanimously approved the first reading of a construction defect action reform ordinance designed to spur condominium development in Denver. Like Lakewood and other metro-area municipalities that have passed similar ordinances, Denver is concerned about the chilling effect construction defect lawsuits have had on condo development and believes this ordinance will provide developers with necessary protection from such suits.

The City Council voted after over two hours of debate and public comment both in favor of and against the ordinance. The ordinance elicited strong support from community leaders, construction trade organizations, and business leaders and strong opposition from some homeowners and community associations. Denver Mayor Michael Hancock introduced the ordinance.

The ordinance provides that a failure to substantially comply with the building code cannot support any type of defect claim unless the violation causes actual damage to property, loss of use of property, bodily injury, death, a risk of bodily injury or death or a threat to life, health or safety. The ordinance prohibits any strict liability or negligence per se claims based on a violation of the building code. The ordinance also provides that to the extent the building code specifically regulates any particular element, feature, component or other detail of construction, if the work complies with the building code, then it shall not be considered defective.

The ordinance requires that before an HOA asserts a construction defect claim the HOA must provide certain information about the claim to all HOA members and obtain the consent of a majority of HOA members. The ordinance also provides that if a condominium declaration requires arbitration of defect claims the HOA cannot modify or eliminate that provision without the developer's consent, provided the declaration contains certain specific language.

The final reading of the ordinance is scheduled for November 23, 2015. The Council will take further public comment, consider amendments, and hold its final vote at that time.

Sherman & Howard represents owners, developers, general contractors and others in construction defect actions and advises clients on ways to reduce and manage the risk of construction defect claims. Our construction and insurance attorneys are actively following state and local construction defect action reform efforts and frequently speak to clients, construction industry organizations and others about construction defect issues.

Attorneys

About Sherman & Howard

Sherman & Howard L.L.C. is a super-regional firm with a national practice. While the firm serves a broad range of clients, including public and privately-held businesses, multi-national corporations, government entities and individuals, our Construction Industry Practice Group is one of the largest, if not the largest, dedicated construction law practice in the Rocky Mountain region and features lawyers who focus exclusively on construction. Our attorneys include former architects, engineers, contractors and government attorneys, as well as experienced arbitrators and mediators of construction disputes.

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