

Consumer Protection and National Housing Policy: The Problem of New-Home Defects

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This article discusses the need for consumer protection against latent defects in new housing. After surveying state and private attempts to provide new-housing warranties, the author outlines the elements of effective warranty protection and demonstrates that its benefits are greater than its costs to home buyers and to the housing industry. Mr. Stanton then reviews past and present federal housing policies and shows that consumer protection has traditionally been subordinated to credit goals. He concludes by reviewing the increasing involvement of the Federal Trade Commission in meeting consumer housing protection needs.

INTRODUCTION

A HOME is the largest single purchase most consumers ever make. The average American household, whether it rents or owns a home, spends about thirty percent of its disposable income on housing.¹ In 1977, consumers purchased 820,000 newly constructed² and 3.6 million previously occupied homes.³ At an aver-

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1. According to the Bureau of Labor Statistics, housing expenditures currently account for a 29% share of the Consumer Price Index, by far the largest share of consumer expenditures. This figure includes the expense of mortgage interest but not outlays for related items such as fuel or home furnishings. The percentage must be used carefully since it reflects statistical assumptions necessary for computing the Consumer Price Index but not necessarily optimal for calculating actual disposable income. Interview with Mr. John Marcut, Bureau of Labor Statistics (Oct. 10, 1978).

2. U.S. DEP'T OF HOUSING AND URBAN DEV., TENTH ANNUAL REPORT ON THE NATIONAL HOUSING GOAL—1977 at 14 (1978). This figure does not include approximately

age cost of \$54,000 for a new home and \$47,900 for a used home that year, aggregate purchases totaled \$225 billion.⁴ Unfair and deceptive practices in housing construction and in the marketing of new homes thus potentially affect many consumers, adding unnecessary expense to the family housing budget and causing considerable discomfort as well. Many problems in the quality of a newly purchased home may manifest themselves only after the home has weathered several seasons. Since most home buyers lack the expertise to evaluate latent defects, they need some form of protection in making this substantial investment.

This need for consumer protection occurs in the context of long-standing federal involvement with housing, through such agencies as the Department of Housing and Urban Development (HUD), the Veterans Administration (VA), and the Farmers' Home Administration (FMHA). These agencies, however, are concerned primarily with housing production and especially with housing finance. Their concern for consumer protection is incidental to their goal of assuring a national market in home mortgages and to other housing credit activities.⁵ As a result, the Federal Trade Commission (FTC), in accordance with its mandate to police the marketplace against unfair and deceptive trade practices,⁶ is an especially important federal agency providing

500,000 single-family homes built by owners or custom-built by contractors on owners' land. *Id.* at 15.

3. *Id.* app. at D-10.

4. In addition, the expense of mortgage interest at, say, 10% over a 30-year mortgage costs the consumer over three times the mortgage value of his property. Finally, in 1977 consumers paid \$10 billion in brokerage commissions and approximately \$5 to \$10 billion in settlement costs. OFFICE OF POLICY PLANNING, FED. TRADE COMM'N, HOUSING POLICY REVIEW BRIEFING BOOK (1978) [hereinafter cited as FTC HOUSING POLICY REVIEW].

5. 42 U.S.C. §§ 3531-32, 3531 (1976) (establishing HUD "to encourage the maximum contributions that may be made by vigorous private home building and mortgage lending industries to housing, urban development, and the national economy . . ."); 38 *id.* §§ 1802-19 (extending mortgage credit to and providing housing for veterans); 42 *id.* § 1471 (authorizing the Secretary of Agriculture, through FMHA, to grant financial assistance to rural landowners in order to improve rural living conditions). See notes 66-84 *infra* and accompanying text.

6. Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1976), states in part:

Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful.

Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of

housing consumer protection.

This article looks at consumer protection issues as they relate to federal housing policy. Part I examines the need for specific consumer protections in the new-housing market. Part II surveys the activities of federal agencies as they relate to consumer protection. The article concludes with an overview of new-home defects and a prognosis for governmental reform and free market remedies through private warranty programs.

I. THE NEED FOR CONSUMER PROTECTION IN THE PURCHASE OF NEWLY CONSTRUCTED HOMES

About sixty-four percent of the nation's households own rather than rent their housing,⁷ and the home has become the primary middle class investment. It provides not only shelter but also a possible hedge against inflation and an opportunity to benefit from income tax subsidies.⁸ Yet, despite the great expense of a home, most buyers make the purchase without the ability to evaluate its structural soundness or the condition of the mechanical, electrical, and plumbing systems.⁹ These buyers need protection because the construction defects possible in a new home are considerable. For example, the Federal Trade Commission in its recent consent agreement with the nation's fifth largest home builder¹⁰ alleged that

in some houses, fire walls were improperly anchored, foundation walls were not covered with membrane waterproofing to prevent water seepage into habitable space, . . . siding was not properly anchored, roof sheeting did not meet with edges, . . . piping and bathroom fixtures were not properly installed, . . . walls were not properly supported by foundations, floor girders were not properly supported to prevent sagging floors, or foun-

the public, it shall issue and serve upon such person, partnership, or corporation a complaint

Id. § 45(a) (1), (b).

7. U.S. DEP'T OF HOUSING AND URBAN DEV., HUD STATISTICAL YEARBOOK, 1977 at 365 (1978).

8. See text accompanying note 84 *infra*.

9. Although precise figures are not yet available, it appears that few people avail themselves of professional inspection services before signing an agreement to purchase. A survey commissioned by the United States Department of Housing and Urban Development found that only about 5,000 professional inspections were performed for home buyers in 1977, including purchasers of both new and previously occupied homes. See U.S. DEP'T OF HOUSING AND URBAN DEV., 1 A STUDY OF HOME INSPECTION AND WARRANTY PROGRAMS 15-16 (1977).

10. Kaufman and Broad, Inc., 3 TRADE REG. REP. (CCH) ¶ 21,436 (1978).

dations contained cracks due to structural failures¹¹

Although no statistics are yet available, anecdotal evidence indicates that perhaps ten percent of new homes may have serious defects such as inadequate insulation or faulty plumbing.¹²

A. State Remedies for Home Buyers

Because of the perceived need to protect consumers from latent defects, most jurisdictions impose an implied warranty of habitability upon builders of new homes.¹³ Unfortunately, this implied warranty is difficult for many home buyers to assert. The builder may claim that the defects were within normal tolerances or caused by the owner's failure to properly maintain the property.¹⁴ The buyer has a heavy evidentiary burden since he must document the extent of damage from the defect and establish that the builder failed to construct a workmanlike product suitable for human habitation.¹⁵ The home buyer may have to hire a professional inspector as an expert witness, retain an attorney, and pursue the remedy through a long court battle.¹⁶ Finally, the builder may be judgment-proof by the time suit is brought.

The State of New Jersey has recently attempted to provide a

11. *Id.* In signing the consent agreement, Kaufman and Broad agreed to make restitution to the purchasers of certain defective homes and to offer warranties to all future purchasers of its homes, but it did not concede any violations of law. *Id.*

12. *See, e.g., Homeowners Outraged by New-House Defects and Delays on Repairs*, Wall St. J., Apr. 3, 1973, at 1, col. 3. While estimates of the incidence of new-home defects are still somewhat speculative, the HUD Office of Inspector General found that 24% of newly constructed homes in the § 235 subsidized housing program were defective. Over two-fifths of that number had "significant defects affecting safety, health, or liveability." *Housing Subsidies and Housing Policies, Hearings Before the Subcomm. on Priorities and Economy in Government of the Joint Economic Comm.*, 92d Cong., 2d Sess. 76 (1972). The FTC recently commissioned a survey of the incidence and severity of new-home defects.

13. The implied warranty of habitability imposes liability on the seller or lessor of real property for loss, injury, or damage caused by defects in the property. Annot., 25 A.L.R. 3d 383, 413-24 (1969). Several states statutorily require the warranty. *E.g.*, MD. REAL PROP. CODE ANN. § 10-203 (1974); MINN. STAT. ANN. § 327 A.02 (1978 Supp.). For an overview of the doctrine's development, see Bearman, *Caveat Emptor in Sales of Realty — Recent Assaults Upon the Rule*, 14 VAND. L. REV. 541 (1961); McNamara, *The Implied Warranty in New-Home Construction: Has the Doctrine of Caveat Emptor Been Abolished?*, 1 REAL EST. L.J. 43 (1972); Note, *Implied Warranty of Fitness for Habitation in Sale of Residential Dwellings*, 43 DEN. L.J. 379 (1966); Comment, *Extension of Implied Warranties to Developer-Vendors of Completed New Homes*, 11 URB. L. ANN. 257 (1976).

14. *See, e.g., Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968).

15. *Id.* at 555.

16. The expense of housing-defect litigation can also deter government agencies from lawsuits against builders of defective homes. *See* note 104 *infra* and accompanying text.

more effective remedy. It has enacted a statute¹⁷ which establishes a new-home warranty security fund "to provide moneys sufficient to pay claims by owners against builders participating in the fund for defects in new homes covered by the new home warranty."¹⁸ The statute expressly states that if a builder is unable or willfully refuses to correct construction defects, an amount sufficient to cure the problem shall be paid from the fund to the owner. The Commissioner of the New Jersey Department of Community Affairs may then proceed against the builder.¹⁹ The level of funds assessed against builders registered in the state is set by the Commissioner.²⁰ The Commissioner is also required to promulgate regulations providing for the processing of claims against builders.²¹ It remains to be seen whether other states will follow New Jersey in assuring the purchaser of a defective new home an effective remedy to implement the implied warranty of habitability.²²

B. *Private Remedies: Home Warranties*

One result of the growth of state-implied warranties of habitability and of increased congressional attention to the problem of defective new homes was the development of the Home Owners Warranty (HOW) Program by the National Association of Home Builders (NAHB).²³ The program has three main features: a

17. New Home Warranty and Builders' Registration Act, 46 N.J. STAT. ANN. §§ 3B-1 to 3B-12 (West 1977).

18. *Id.* § 3B-7(a).

19. *Id.* § 3B-7(c).

20. *Id.* § 3B-7(a).

21. *Id.* § 3B-3(a).

22. For a less effective model, see OR. REV. STAT. § 701 (1977), which provides that each builder must post a total bond of \$5,000 against which consumer claims may be assessed. *Id.* § 701.065. In addition, the builder must carry specified amounts of insurance against injury or damage. *Id.* § 701.105. See also S. 2919, 95th Cong., 2d Sess., 124 CONG. REC. 5519 (1978), introduced by Senator William Proxmire at the request of the Carter administration on April 13, 1978. The bill provided that condominium purchasers claiming defects could also proceed against subcontractors of the developer. *Id.* at 5337. Of course, this remedy assumed that the subcontractor would be solvent after the developer had gone out of business.

23. HOW is a wholly owned subsidiary of the NAHB. HOW officials sell the program as a means of forestalling otherwise probable government intervention in the national housing industry: "If industry self-regulation does not work, we can expect to vastly increase government regulation which wouldn't distinguish between good and bad builders." HOME OWNERS WARRANTY CORP., HOW APPLICATION BOOKLET 11, Item 16 (1978) [hereinafter cited as HOW APPLICATION BOOKLET]. Specifically, the industry was concerned with three pieces of proposed legislation: (1) an amendment proposed by Congresswoman Leonore Sullivan to the 1972 Housing Bill that would have extended the one-year FHA warranty to three years and required builders to post a \$1,000 construction bond on each house; (2) an April, 1973 bill introduced by Senator Charles Percy that called for a

package of explicit warranties, a mechanism to resolve disputes between the buyer and the builder, and backing by an independent insurance company. HOW provides for a one-year warranty against faulty workmanship or materials as defined by HOW; a two-year warranty against defects in wiring, piping, and ductwork in the home's electrical, plumbing, heating, and cooling systems; and a ten-year warranty against major structural defects in the load-bearing portion of the home.²⁴ HOW markets these warranties through the builder,²⁵ and the overall sales price of the home includes the costs paid by the builder.²⁶ The warranty makes the builder responsible for warranty defects in the first two years, while the HOW program, underwritten by an independent insurance company, insures the home buyer for the remaining eight years.²⁷ If the builder is insolvent or refuses to make good on valid claims in the first two years, the insurance company will reimburse the consumer.²⁸

HOW offers conciliation and arbitration procedures to resolve claim disputes between the initial or subsequent buyer and the

three-year warranty on new homes; and (3) a Truth-in-Lending bill introduced by Senator Philip Hart that would have required the seller of a new or previously occupied home to disclose to the buyer all known material defects and provided for punitive damages for all false statements or omissions of fact in that disclosure. *Truth-in-Housing Act, Hearings Before the Consumer Subcomm. of the Senate Comm. on Commerce*, 93d Cong., 1st Sess. 46 (1973) (statement of the National Association of Home Builders). In addition, the NAHB expressed concern about state and local government's intensified interest in consumer protection legislation. *Id.* at 49.

24. HOW APPLICATION BOOKLET, *supra* note 23, at 5-6. HOW defines the warranties' functional terms and standards.

25. *Id.* Local HOW councils set registration fees and propose local modifications to the first-year defect standards for approval by the parent corporation. The local council also determines whether to accept a builder on the basis of such predetermined criteria as the builder's track record and creditworthiness. Although the HOW program accepts non-NAHB builders, registration fees are significantly higher for them than for NAHB members. Nelson, *Why Builders Should Know HOW*, REAL EST. REV., Spring 1978, at 48 ("Depending upon the state, the non-NAHB-affiliated builder may have to pay up to four times more to enroll in HOW than the NAHB-affiliated builder."). The builder pays an initial registration fee ranging from \$100 to \$400 or more, as well as a one-time enrollment charge for each home to be covered by a HOW warranty. *Id.* The fee is currently \$2 per \$1,000 of the gross sales price of the warranted home with a minimum fee of \$50. The builder reenrolls in HOW each year for a renewal fee of \$25 to \$100 or more. The registration and renewal fee go primarily to the local HOW council for merchandising and other expenses, while one-half of the enrollment fee goes to HOW's insurer and one-quarter each to the national HOW corporation and the local HOW council. *Id.*

26. *Id.* A purchaser may refuse to accept HOW coverage. HOW APPLICATION BOOKLET, *supra* note 23, at 11, Item 23. In that case the builder still must pay a \$30 administrative fee, but not the entire \$2-per-\$1000 warranty amount.

27. HOW APPLICATION BOOKLET, *supra* note 23, at 5-6.

28. *Id.*

builder or insurance company.²⁹ A builder may be expelled from the HOW program for failure to comply with an arbitrator's decision.³⁰ The procedures are designed to conform to the fairness, impartiality, and speed required by the Magnuson-Moss Warranty Act of 1975.³¹

From a consumer point of view, HOW may resolve two of the major remedial problems of implied warranties for new-home defects by providing both a fast dispute resolution mechanism that binds the builder,³² and a pool of money to pay off claims against an insolvent or recalcitrant builder.³³ The third major consumer protection element — a fair set of standards for determining a defect — has not yet been fully satisfied by HOW. HOW officials concede that the standards were adopted from the builder's perspective and without input from consumer or other nonbuilder groups.³⁴ Thus, for example, HOW limits the ten-year warranty by defining a major structural defect as occurring only in the load-bearing portion of the house.³⁵ In doing so, however, HOW has traded higher standards for lower insurance premiums. This conservative approach can be expected until a longer actuarial record

29. *Id.* at 6-7.

30. Nelson, *supra* note 25, at 46, 49.

31. Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301-12 (1976). The Federal Trade Commission has published implementing regulations. 16 C.F.R. §§ 700-03 (1978). Although the Magnuson-Moss Warranty Act by its terms does not apply to real property, it does apply to consumer products intended to be attached to or installed in real property. 15 U.S.C. § 2301 (1976). For a discussion of the application of the Act to residential property, see Peters, *How the Magnuson-Moss Warranty Act Affects the Builder/Seller of New Housing*, 5 REAL EST. L.J. 338, 338-63 (1977).

32. HOW APPLICATION BOOKLET, *supra* note 23, at 6-7. However, a serious shortcoming may be that some HOW conciliators or arbitrators approve superficial repairs to correct the symptoms rather than origins of cracks, gaps, and other expensive home defects.

33. *Id.*

34. Meeting with NAHB and HOW officials in Washington, D.C. (October 23, 1978).

35. See note 24 *supra* and accompanying text. Elizabeth Hanford Dole, while she was a Commissioner of the FTC, signalled her agency's concern over these standards:

There are some questions concerning whether the standards for HOW claims adequately serve the homebuyer. For example, do the HOW approved standards for the first year provide sufficient consumer protection? Should the two year coverage of heating, plumbing, and electrical systems be limited to ductwork, pipes, and wiring or the ten year coverage of major construction defects be limited solely to loadbearing portions of the home? . . . [A]dding consumer representatives and other interested parties to the HOW Board of Directors and the local HOW councils would certainly help to assure that the program responsively serves as broad a market as possible and responds to a concern that a cross-section of interested parties is not involved in the policymaking process.

Address by Elizabeth Hanford Dole, then a Commissioner of the Federal Trade Commission, before the National Association of Home Builders Annual Convention in Las Vegas, Nev. (Jan. 21, 1979).

has been established for claims.³⁶ Moreover, the advent of serious competition from comparable warranty programs could result in higher quality standards as well as lower prices.

A major problem with HOW as a consumer protection remedy is that the large majority of builders do not offer such a program. While more than 14,000 builders now belong to HOW and almost eleven percent of the 1.5 million homes begun in fiscal year 1978 are covered by HOW warranties,³⁷ market penetration remains spotty. It depends largely upon the aggressiveness of the individual builder association in sponsoring HOW.³⁸ Nevertheless, HOW officials are optimistic that the program will continue to grow.

The New Jersey New Home Warranty and Builders' Registration Act³⁹ provides one means of extending coverage to all builders regardless of their consumer protection inclinations. Section 5 of that statute requires every builder engaged in the business of new-home construction to participate in either the state warranty security fund or an approved alternative home warranty program.⁴⁰ Ralph Nader's Housing Research Group has advocated extending this concept to all of the states by requiring that all builders of homes financed through federally related mortgages offer a new-home warranty.⁴¹ As is the case with HOW, the war-

36. The oldest HOW home is now only about five years old.

37. *Lots of Warranties but Spotty Coverage*, HOUSING, Sept. 1978, at 16.

38. The drawback is that under the HOW program subscribing to the warranty is the prerogative of the builder rather than the home buyer. The imperfection of the process can be seen in a recent survey showing that 79% of home buyers consider a warranty very important but only 22% of builders do. PROFESSIONAL BUILDER, Dec. 1977, at 71. Some of the largest builders choose not to participate either because they believe that the quality of their product is such that they do not need a warranty, or because they want to avoid increasing their product's cost or reducing their profit. *Lots of Warranties but Spotty Coverage*, HOUSING, Sept. 1978, at 16. The results may well be a reverse selection process, with the most consumer-minded builders joining HOW while the others — who cause much of the problem of unrepaired defects — do not. HOW APPLICATION BOOKLET, *supra* note 23, at 11. Moreover, HOW cannot afford to enroll builders known to have poor construction practices.

39. 46 N.J. STAT. ANN. §§ 3B-1 to 3B-12 (West 1977).

40. *Id.* § 3B-5.

41. *Future of FHA: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 95th Cong., 1st Sess. 385 (1977) (statement of Thomas H. Stanton, Director, Housing Research Group). The testimony pointed to the British method that requires that virtually all builders offer warranties. The result appears to be enhanced construction quality because builders excluded from the warranty program for excessive defects in their work product simply could not find financing. See, e.g., Note, *The Homeowner's Warranty, An Initial Analysis*, 28 STAN. L. REV. 357, 376-77, nn.99-104 and accompanying text (1976). The British program has been systematically upgrading its construction standards

ranty would be offered at the consumer's option; unlike HOW, it could not be withheld at the builder's option.⁴² A similar recommendation was recently made by a leading industry publication.⁴³

Such proposals deserve consideration, but only if they make economic sense. The question is whether imposition of a warranty requirement, as in the New Jersey statute, would save the home buying public more money than it would cost.

C. *The Utility of New-Home Warranties: Costs v. Benefits*

We live in an age that requires cost-benefit analyses to justify government intervention in the marketplace.⁴⁴ Optimal quality control will occur when the marginal cost of increased quality control equals the discounted value of future defect repairs. This section discusses the relative advantages to the consumer of new-home warranties and compares the market costs of builder and third party warranties.⁴⁵

New-home warranties have three potential major advantages: (1) spreading the risk of repairs over the home buying public, (2) enhancing initial construction quality, and (3) decreasing total

as it gains experience. See, e.g., National House-Building Council, 1977 Houses Compared With Early 1960's Houses: 57 Improvements in Minimum Standards (1978).

42. *Id.*

43. *Warranty Should Be Required of Builders*, PROFESSIONAL BUILDER, July 1979, at 1. According to the editor of *Professional Builder*, David E. Link,

a shortcoming of the HOW program is that it is available only to builder members of the NAHB. The Association's membership of some 46,000 represents between 30,000 and 45,000 building firms — less than a third of the 127,000 home building operations in the country.

True, the NAHB builders probably put up two-thirds of the housing and are, as a group the most professional and competent builders in the country. But even that membership has hardly stampeded to utilize the HOW warranty plan. Only one in three of the builder members offers the 10-year warranty. And in the five years that HOW has existed, less than 15 percent of the new houses sold have been covered by the warranty plan.

Clearly, it is time that NAHB insist that all of its builder members join the HOW program. Also, the HOW plan — or a form of it — should be made available to the 80,000 or so builders who are not members of NAHB.

44. See, e.g., *American Petroleum Inst. v. Occupational Safety and Health Adm'n*, 581 F.2d 493, 503 (5th Cir. 1978) ("Although the agency does not have to conduct an elaborate cost-benefit analysis, . . . it does have to determine whether the benefits expected from the standard bear a reasonable relationship to the costs imposed by the standard."); *Aqua Slide 'N' Dive Corp. v. Consumer Prod. Safety Comm'n*, 569 F.2d 831, 839 (5th Cir. 1978) (The Commission must look "not only at the nature and severity of the risk, but also at the potential the standard has for reducing the severity or frequency of the injury, and the effect the standard would have on the utility, cost, or availability of the product.").

45. Much of this discussion is based upon Brown, *Towards an Economic Theory of Liability*, 2 J. LEGAL STUD. 323 (1973). See generally FTC HOUSING POLICY REVIEW, *supra* note 4, at A-1 app.

housing costs. While many home buyers may not need a warranty since the builder would make good on valid claims without a warranty, some will need it badly because the builder is judgment-proof or recalcitrant in paying valid claims. Thus, the warranty serves a valuable function; it distributes the risk of defects among all home buyers and minimizes the chance of catastrophe for any single one.

Second, in the absence of any type of legal liability or warranty against defects in the new home, the builder has little incentive to prevent such defects. He will consider the cost of nonmandated building precautions unnecessary since the cost of any repairs will fall entirely on the consumer. The only market constraint (as distinguished from ethical considerations) on the builder's utter carelessness is the risk that the consumer will discover certain defects in the newly built home and purchase a better quality home from a competitor. This risk is minimal, however, if the consumer is unable to evaluate independently the quality of a home and the competitor is equally unable to prove the superior quality of his product.⁴⁶ Ideally a warranty program would give builders cost incentives to prevent defects.

But who should provide these warranties? Warranties provided by the builder impose the risk of paying for repairs on the builder rather than on the consumer. This situation is ideal since it forces the builder to weigh his costs of initial precautions against the cost of subsequent repairs. The builder's responsibility and the forces of competition will presumably effect an average quality which is both fair to the consumer and economically feasible for the builder.⁴⁷

The concept of builder-provided warranties has two problems. First, in this situation the consumer pays indirectly for all the builder's costs, including the cost of potential repairs. Second, the proposal is unrealistic since builders may lack the incentive and often the available funds to personally indemnify owners of defective new homes.⁴⁸

A more feasible alternative is third party warranties.⁴⁹ The

46. FTC HOUSING POLICY REVIEW, *supra* note 4, at A-3 app.

47. *Id.*

48. *Id.* See, e.g., Sichelman, *Housing Complaints to FTC Describe Buyers' Frustrations*, Washington Star, June 15, 1979, at D-1, col. 4; *Most Buyers Complain, Most Builders Respond*, BUILDER, Nov. 1, 1979, at 48 (24.6% of buyers surveyed said the builder "did not respond to their complaints at all").

49. The HOW program is developing an actuarial record that should allow private insurance companies to increase the availability of these warranties.

use of such warranties, which place the costs of repairs directly on the builder, will help to *approach* the ideal situation since the interests of the insurance company are closer to those of the consumer than to those of the builder. The insurance company, while indifferent to the costs of quality control, seeks to minimize payments for repairs.⁵⁰ The concept of third party warranties has one major problem: the insurance company generally cannot monitor quality in areas where the cost of such monitoring would be prohibitive.⁵¹ Consequently, builders will cut their own costs by taking fewer initial precautions in these areas, forcing insurance companies to set higher premiums based upon an expected lower average quality.

Despite the limitations on an insurance company's monitoring ability, there are several built-in monitoring devices which *may* help to increase quality and thereby lower premiums. First, common law rules imposing a minimum standard of care on the builder may spur him to ensure the habitability of the home that he constructs.⁵² Second, building codes may also help to produce a higher standard of builder workmanship.⁵³ These incentives will diminish, however, in proportion to the costs required of the consumer who seeks to enforce the law through litigation. Third, the builder risks damage to his reputation by constructing poorly built homes, though the deterrent effect of this risk may depend upon the size of the community.⁵⁴ Fourth, builders face expulsion from the warranty program if they do not maintain basic quality control in construction.⁵⁵ Where a warranty is mandatory, expulsion can mean a builder will have to cease building.⁵⁶ Lenders may also shy away from homes likely to have significant defects in

There are no plausible monopoly problems, no apparent economies of scale or indivisibilities, nor are there overwhelming barriers to entry. However, there are significant startup costs. The design of a totally new insurance policy for which there is no experience on which to base premiums is very risky business which, not surprisingly, insurance companies tend to shy away from.

FTC HOUSING POLICY REVIEW, *supra* note 4, at A-7 app.

50. *Id.* at A-4 app.

51. *Id.* at A-4 to A-6 app.

52. *Id.*

53. There are several problems associated with building codes: (1) they frequently do not reflect technological change, (2) they are often erratically enforced, and (3) their establishment and enforcement are too often politically influenced. *Id.* at A-6 app.

54. The citizens of a large community are typically less aware of the quality of a builder's work product than the citizens of a smaller community. *Id.* at A-5 app.

55. *See* Nelson, *supra* note 25, at 48.

56. *See* note 41 *supra*.

order to maximize the value of their security.⁵⁷ Finally, competition among builders may help to improve quality. This will occur, however, only when the consumer himself can discern the quality of his prospective purchase or can afford a professional evaluation.⁵⁸

While these constraints raise construction standards, they affect only the lowest quality builder. The most important factor in inducing improvement by other kinds of builders is co-insurance. For example, the HOW program requires the builder (if solvent) to pay all valid claims for repair on a home for the first two years after construction. An impartial arbitrator processes claims, and the builder's contract with HOW makes these decisions binding. The builder has the advantage of a fair, efficient process; the homeowner has avoided litigation. The market benefits because co-insurance provides direct cost incentives for the builder to upgrade quality control during construction.

In general, serious competition in the new-home warranty industry promises to bring lower prices for a given level of warranty coverage than does the nascent HOW program, although the magnitude of the average savings to home buyers under any type of warranty program has never been measured.⁵⁹ Recently, the Federal Trade Commission, with support from the Department of Housing and Urban Development, has commissioned a national survey of the incidence and severity of new-home defects, but the results will not be available for some months. Even without the availability of statistical evidence, there is good reason to believe the net benefit of a new-home warranty program will be significant.

Much of the present lack of quality control in residential construction can be traced to fluctuations in the housing and money markets. After a slump in construction, when mortgage money suddenly becomes available, builders must rush to staff up to take advantage of the temporary boom in the credit cycle. They are forced to hire unskilled labor and rely on on-the-job training. In the rush to benefit from the temporary flow of mortgage money,

57. Lenders will usually avoid only the lowest quality builder since only then is it likely that a defect will cause "damages so great as to destroy the owners' equity in the house." FTC HOUSING POLICY REVIEW, *supra* note 4, at A-5 app.

58. See text accompanying note 46 *supra*.

59. "Now that work has been done by the HOW program of NAHB, . . . competition [will likely] take the form that it does in most insurance lines — underwriting competition. Competitors will look for the best risks and undercut the premium presently charged; so-called 'cream-skimming.'" FTC HOUSING POLICY REVIEW, *supra* note 4, at A-7 app.

many builders have little on their minds besides the need for a high volume of production before the market turns.⁶⁰ After a year or two, just at the point when construction crews have become seasoned and capable, the credit cycle approaches a downturn. A decline in availability of mortgage money forces builders to discharge workers.

These cyclical fluctuations foster inadequate quality control.⁶¹ If the builder can externalize the cost of defects to consumers, he has no market incentive to maintain an adequate quality control program. To the extent that a mandatory new-home warranty program, public or private, will internalize the cost of defects, the program will be cost-effective.

II. CONSUMER PROTECTION AND NATIONAL HOUSING POLICY: THE ROLE OF FEDERAL AGENCIES

Despite a multibillion dollar housing program funded by the Department of Housing and Urban Development, the federal government has been relatively inactive in the area of housing consumer protection. This inertia ignores the importance of housing as a consumer purchase,⁶² the prevalence of housing defects as a

60. A recent HUD report concluded:

[T]he underlying instability in housing production has a pervasive effect on the basic technology, structure, and organization of the industry. The extreme cyclic instability that characterizes housing production raises the cost of all real and financial factors — land, labor, building materials, financing, and profit. In the short run, housing slumps lead to idle plant and construction equipment, to underutilized material manufacturing capacity, to homebuilder bankruptcies, and to unemployment of construction workers. But it is the long-run effects of the housing cycle that create the inefficiencies in homebuilding which are so costly to the American homebuyer. The constant need to adapt to wide fluctuations in production levels leads homebuilders and building material producers to use less efficient technology so that they can minimize their fixed costs in plant and equipment over a wide range of output levels. . . . Lumber prices and other building materials follow these cyclical ups and downs, and the industry invests less in job training to cut down on the cost of uncertain demand and labor turnover.

TASK FORCE ON HOUS. COSTS, U.S. DEP'T OF HOUS. AND URBAN DEV., FINAL REPORT OF THE HUD TASK FORCE ON HOUSING COSTS 55-56, 1978.

61. There is some evidence that fluctuations in the housing credit cycle also disrupt the ability of local communities to police housing quality through building code enforcement. A locality may have little need for a large inspection staff during periods of scarce mortgage money. But money may become available with little warning, and a rush of new development may swamp the community's ability to oversee construction. *See, e.g.*, DEP'T OF CONSUMER AFFAIRS AND DEP'T OF ENVIRONMENTAL MANAGEMENT, A STUDY OF NEW HOME CONSTRUCTION PROBLEMS IN FAIRFAX COUNTY (VIRGINIA) 4 (1979) (reporting a 59% increase in the number of homes under construction in that area between 1977 and 1978 alone).

62. *See* text accompanying notes 1-4 *supra*.

byproduct of cyclical fluctuations in the housing market,⁶³ and the cost-effectiveness of new-home warranties.⁶⁴ It also ignores the fact that a nationwide warranty program is now working in Britain.⁶⁵

A. *Historical Background*

An understanding of this federal passivity requires an historical perspective. Today's federal housing policy, at least as it relates to single family housing, grew out of the Great Depression. The collapse of bank credit, including mortgage credit, caused a virtual cessation of new construction. Production of homes in 1933 dropped to 93,000 units, less than one-tenth of those built in 1925.⁶⁶ Congress reacted to this calamity by designing a national housing policy that was intended to create a stable home mortgage market.⁶⁷ National housing policy was to be a federal mortgage credit policy.

In 1934, the Federal Housing Administration (FHA) was created⁶⁸ to appraise individual homes and to ensure that if a homeowner defaulted on mortgage payments, his debt would be paid by the federal government to the mortgage lender.⁶⁹ Through FHA and the various secondary market institutions, such as the Federal National Mortgage Association (FNMA)⁷⁰ and the Federal Home Loan Mortgage Corporation (FHLMC),⁷¹ the federal government fostered a thriving national mortgage market. The genius of the system was that it required no federal subsidy.

63. See text accompanying note 60 *supra*.

64. See text accompanying notes 44-61 *supra*.

65. See note 41 *supra*. See generally OFFICE OF INT'L AFFAIRS, U.S. DEP'T OF HOUS. AND URBAN DEV., AN INSURED BUILDING WARRANTY PLAN FOR HOME BUYERS (1974) (a proposal which describes and is patterned on the British warranty program). It was only partly in jest that a consumer protection attorney in the Massachusetts Attorney General's Office remarked: "Under the law in the United States you get more protection buying a toaster than in buying a home." *Raising the Roof: Buyers of New Homes Find Shoddiness, Flaws are Growing Problems*, Wall St. J., Sept. 28, 1978, at 1, col. 6.

66. U.S. DEP'T OF HOUS. AND URBAN DEV., HOUSING IN THE SEVENTIES, WORKING PAPERS I, NATIONAL HOUSING POLICY REVIEW 9 (1976).

67. This emphasis on housing as a credit problem explains why the congressional housing subcommittees are installed as subsidiaries of the House and Senate Banking Committees.

68. National Housing Act, ch. 847, 48 Stat. 1246 (1934) (codified at 12 U.S.C. § 1702 (1976)).

69. Exec. Order No. 7,280 (1934).

70. See National Housing Act, ch. 847, 48 Stat. 1246 (1934) (codified at 12 U.S.C. § 1716(b) (1976)).

71. See Federal Home Loan Mortgage Corporation Act of 1970, Pub. L. No. 91-351, 84 Stat. 451 (codified at 12 U.S.C. § 1452 (1976)).

Through a small surcharge on the mortgage rate, the FHA actually turned a profit for several decades.

Incidental to its primary mortgage credit functions, the FHA also provided some consumer protection. The FHA appraisal of the property, used to determine the size of the mortgage that the federal government would insure, was also used to screen out homes with especially serious defects that affected marketability of the property. Eventually, the FHA promulgated a set of Minimum Property Standards,⁷² which defined the minimum construction quality necessary for government mortgage insurance. Many builders, even if they did not use FHA financing, adopted the FHA standards for convenience. The term "FHA-approved," or, later, "FHA-VA-approved," became a symbol of quality to home buyers.

Impressed with the success of the FHA program, Congress authorized the Veterans Administration to begin a similar housing program after World War II to benefit returning soldiers.⁷³ The VA program provides a mortgage guaranty similar to the successful FHA model, with such minor variations as a provision requiring no down payment by the veteran home buyer.⁷⁴ Together, the FHA and the VA facilitated the dramatic burgeoning of the suburbs in the postwar years.

Congress attempted, in 1954 and again in 1964, to augment the consumer protection provided by these agencies. The Housing Act of 1954⁷⁵ authorized the Secretary of HUD to require the seller or builder of an FHA- or VA-approved home to warrant to the purchaser that the dwelling was built in substantial conformity with the plans and specifications approved by the FHA or VA.⁷⁶ The Housing Act of 1964⁷⁷ authorized the FHA to pay the owner of an FHA home any costs incurred in correcting "substantial defects" in the home if such payment is requested within four years of acquisition of the mortgage insurance.⁷⁸ FHA action under the

72. Minimum Property Standards, 24 C.F.R. §§ 200.925-.933 (1979).

73. Servicemen's Readjustment Act of 1944, ch. 268, §§ 500(a), 501, 58 Stat. 291 (repealed by Act of Sept. 2, 1958, Pub. L. No. 85-857, § 14(87), 72 Stat. 1273) (current version at 38 U.S.C. §§ 1801-04, 1810 (1976)).

74. 38 U.S.C. § 1805 (1976).

75. Ch. 649, 68 Stat. 590 (1954) (codified in scattered sections of 12, 18, 20, 31 U.S.C.).

76. Housing Act of 1954, ch. 649, § 801, 68 Stat. 642 (codified at 12 U.S.C. §§ 1701j-7 (1976)) (in the case of V.A. housing, codified at 38 U.S.C. § 1805 (1976)).

77. Pub. L. No. 88-560, 78 Stat. 769 (1964) (codified in scattered sections of 12, 15, 20, 38, 40, 42 U.S.C.).

78. Housing Act of 1964, § 121, 12 U.S.C. § 1735b(a) (1976).

1964 provision, known as section 518(a), has been reluctant at best.⁷⁹

As the veterans and increasingly affluent members of the middle class were successfully housed in the 1950's and 1960's, housing proponents — home builders, mortgage lenders, savings and loan institutions, labor unions, and political liberals — sought to expand homeownership to lower income groups through subsidized programs. Unfortunately, the FHA was administratively unprepared for the difficult tasks of appraising homes in lower income neighborhoods and protecting the government against fraud. When the dust finally settled in the FHA scandals, hundreds of people had been indicted, including some in high levels of the FHA bureaucracy. The majority of honest and competent FHA officials found themselves discredited and demoralized. Citing the scandals, the Nixon administration in 1973 ordered termination of the range of federally subsidized housing programs, primarily as a means of reducing federal expenditures.⁸⁰

Meanwhile, the FHA's success with unsubsidized housing programs encouraged competition from a nascent private mortgage insurance industry.⁸¹ The FHA experience over several decades provided an actuarial record on which private mortgage insurers could base their premium schedules. They skimmed, of course, the most lucrative parts of the market. Today, the FHA insures mortgages on only eight percent of single family homes bought during the year; the VA guarantees mortgages on only another eight percent. The remaining eighty-four percent of home mortgages insured in 1978 were privately insured or uninsured.⁸²

The swing from federal to private mortgage insurance has undercut support for federal housing programs. Home builders, lenders, and labor, the traditional and essential supporters of strong federal housing programs, have displayed less interest in these programs. While those groups have been losing interest in

79. See text accompanying notes 86-90 *infra*.

80. See, e.g., Statement of George Romney, former Secretary of HUD, reprinted in U.S. DEP'T OF HOUS. AND URBAN DEV., HUD NEWS (Jan. 8, 1973); U.S. DEP'T OF HOUS. AND URBAN DEV., HOUSING IN THE SEVENTIES, NATIONAL HOUSING POLICY REVIEW 83 (1974).

81. The Mortgage Guarantee Insurance Corporation (MGIC) was formed in 1957 and was quickly followed by over a dozen other firms.

82. The government had an even smaller share of the new-construction market: the FHA insured 4.5% and the VA guaranteed 7% of the mortgages on new homes bought in 1978. The remaining 88.5% were privately insured or uninsured. Telephone Interview with the Office of Policy Development and Research, Department of Housing and Urban Development, in Washington, D.C. (April 6, 1979).

HUD, local governments have successfully lobbied the department for economic development subsidies. Less than half of the eleven billion dollar budget of the Department of Housing and Urban Development now goes to private housing; most of the remainder is earmarked for community and urban development grants.⁸³ The HUD Assistant Secretary for Housing, who oversees the FHA and public housing programs, has already spoken of the possibility of extending FHA jurisdiction to insure mortgages on commercial and industrial properties. The constituency of the nation's housing department is, in short, changing. As the housing industry itself has turned to the private sector, HUD is becoming more responsive to economic development objectives, particularly those advanced by the nation's city and county governments.

The one federal housing program to survive this change is the system of income tax subsidies for homeownership. The deductions for home mortgage interest and property tax payments amount to a revenue loss of \$14.6 billion, or more than the combined funding of all HUD housing programs. Total homeownership tax subsidies amount to much more.⁸⁴ These subsidies are regressive: a deduction confers benefits directly proportional to the size of the home (or homes) the taxpayer owns and the homeowner's tax bracket. This distribution of benefit in favor of the well-to-do appears to have been one reason for the preservation of the tax subsidy from the fate of the declining direct housing subsidies. Upper income taxpayers have been strong supporters of the housing tax subsidy programs; by contrast, lower income housing consumers and their industry and liberal allies have proven themselves unable to secure congressional support for broad-based housing programs.

B. *Federal Consumer Protection and Housing*

It has been difficult to make consumer protection attractive to constituencies that otherwise support federal housing programs. Financial, labor, industry, and consumer interests have been able to agree on federal subsidies for housing. But lenders, workers, and the housing industry tend to lose interest once the housing is

83. SPECIAL ANALYSES: BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1980 at 198 (1979) [hereinafter cited as SPECIAL ANALYSES].

84. This figure does not include increases in homeowner tax benefits enacted by Congress in the Revenue Act of 1978, Pub. L. No. 95-600, §§ 404, 405, 92 Stat. 2763, or more important, the tax exemption on imputed income from homeownership. SPECIAL ANALYSES, *supra* note 83, at 186, 198.

funded and built. Then the only one interested in better protection is the consumer.

The problem is that the consumer's interest in protection is difficult to reconcile with those of HUD or the other constituent groups. A policy paper, prepared for then Housing Secretary James T. Lynn, explains that:

Normally, consumer protections involve some additional burdens on the lender, builder or the manager of the housing. Thus, builders have objected as to the existing requirement that they give the home purchaser a warranty against structural defects These and many other mortgage insurance requirements bear on whether a sponsor decides to use [FHA] mortgage insurance. That affects production. Therefore, any proposed legislation for additional consumer protection or other benefits [for FHA houses alone] must be weighed against its possible curtailment of the use of the program.⁸⁵

Thus, fearing that builders and lenders might desert the FHA program, HUD has cautiously limited new consumer protections for FHA home buyers. For example, in 1976, HUD created an Assistant Secretary for Consumer Affairs and Regulatory Functions. The office soon changed its name, however, to Neighborhoods, Voluntary Associations, and Consumer Protection. The change downgraded consumer issues in favor of neighborhood revitalization — a popular theme that can be pursued without having to confront the problems that increased consumer protection would pose for some lenders and builders upon whom HUD programs still depend.

HUD has not fully implemented the limited consumer protection provisions that are already law.⁸⁶ The Secretary of Housing and Urban Development is authorized, pursuant to section 518(a) of the National Housing Act, to reimburse purchasers who repair new FHA homes with structural defects.⁸⁷ HUD administration of that provision and the other builders' warranty provisions has

85. U.S. DEPT OF HOUS. AND URBAN DEV., HOUSING IN THE SEVENTIES, WORKING PAPERS I, NATIONAL HOUSING POLICY REVIEW 77 (1976). See U.S. DEPT OF HOUS. AND URBAN DEV., HOUSING IN THE SEVENTIES, NATIONAL HOUSING POLICY REVIEW 24 (1974).

86. 12 U.S.C. § 1735b(a)-(e)(1976). Indeed, it was FHA and VA reluctance to support consumer defect claims that led to the 1954 changes in the law. The Subcommittee on Housing of the House Committee on Banking and Finance "found that FHA and VA officials often provided little or no assistance in pressing claims against the builders, and that even when such claims were pressed, FHA or VA accepted the builder's statements that repairs had been made when as a matter of fact they had not." Bearman, *supra* note 13, at 551.

87. 12 U.S.C. § 1735b(a) (1976).

been criticized by the General Accounting Office and by legal services attorneys across the country.⁸⁸ The same protection is also available to lower income purchasers of used FHA homes with structural or other major defects.⁸⁹ HUD's administration of that program has not been without criticism.⁹⁰

In 1976 Congress instructed HUD to survey the incidence of defects in newly purchased used homes and to evaluate the possibility of establishing a federal inspection and warranty program to protect home buyers against defects.⁹¹ The study and report were to be submitted to Congress by March 1, 1977.⁹² Although HUD did complete the survey, the agency has not yet transmitted any policy recommendations to Congress.

In spite of their administrative difficulties, HUD officials at all levels have continued to express concern with consumer protection issues. Numerous HUD internal working papers, from the Office of Housing as well as from the Office of Neighborhoods, Voluntary Associations, and Consumer Protection, have deliberated the wisdom and feasibility of various home warranty programs.⁹³ Moreover, HUD has contributed half of the funding for

88. See, e.g., Letter from Henry Eschwege, Director of the Community and Economic Development Division, General Accounting Office, to Carla Hills, former Secretary of HUD, reprinted in *FUTURE OF FHA: HEARINGS BEFORE THE SEN. COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS*, 95th Cong., 1st Sess. 390 (1977); U.S. OFFICE OF THE COMPTROLLER GENERAL, REPORT OF THE U.S. COMPTROLLER GENERAL, CONSTRUCTION PROBLEMS WITH COUNTRY CLUB ESTATES, MERRIMACK, N.H. (Oct., 1976); ADMINISTRATION OF HUD'S SECTION 518(b) PROGRAM: HEARINGS BEFORE A SUBCOMM. OF THE HOUSE COMM. ON GOVERNMENT OPERATIONS, 95th Cong., 1st Sess. 56 (1977) (testimony on § 518(a) by Seymour J. Mansfield, Attorney for the Legal Assistance Foundation of Chicago).

89. National Housing Act § 518(b), 12 U.S.C. § 1785b(b) (1976). Congress passed this provision in response to consumer complaints about defects in the HUD lower income homeownership program. The HUD Office of Inspector General had found that 24% of newly constructed homes and 39% of the previously occupied newly purchased homes in the low income program were defective. See *Housing Subsidies and Housing Policies: Hearings Before the Subcomm. on Priorities and Economy in Government of the Joint Economic Comm.*, 92d Cong., 2d Sess. 76 (1972).

90. See, e.g., *Ferrell v. Harris*, No. 73-C-34 (N.D. Ill. Aug. 2, 1979) (HUD stipulation to reprocess claims under § 518(b)); UNITED STATES OFFICE OF THE COMPTROLLER GENERAL, REPORT OF THE UNITED STATES COMPTROLLER GENERAL, NEED FOR FAIRER TREATMENT OF HOMEOWNERS' CLAIMS FOR DEFECTS IN EXISTING INSURED HOMES (July 1977); *Finding Faults: Homeowners Raise Roof Over HUD Rejection of Most Repairs Claimed Under Federal Law*, *Wall St. J.*, July 2, 1976, at 28, col. 1.

91. Housing Authorization Act of 1976, Pub. L. No. 94-375, § 9, 90 Stat. 1072 (codified at 12 U.S.C. § 1735b(e) (1976)).

92. *Id.*

93. See, e.g., Memorandum from George Brown, Associate Deputy Assistant Secretary for Neighborhoods and Consumer Affairs, to Marilyn Melkonian, Deputy Assistant Secretary for Insured and Direct Loan Program (Feb. 1, 1978) (on file with the author);

the joint FTC-HUD survey of the incidence and severity of new-home defects. This continuing, if constrained, involvement with housing consumer protection issues may indicate a renewed HUD interest in creating a consumer constituency to support its housing and community development programs.

C. *The FTC and Housing*

The Federal Trade Commission has a mandate to protect consumers from unfair and deceptive practices and to protect the marketplace from unfair methods of competition.⁹⁴ Through that mandate the agency has been involved in many housing-related matters, including both individual cases and rulemaking.⁹⁵

The FTC became seriously involved in the new-housing problem only upon the passage in 1975 of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act.⁹⁶ That Act extended the agency's jurisdiction to matters affecting, not merely in, interstate commerce.⁹⁷ Housing-related issues have occupied considerable resources within the Commission, between forty and fifty attorney work years in 1978 alone, or six percent of total FTC attorney staff time.⁹⁸ On May 23, 1979, the Commission formally announced its new-home construction defects enforcement program within its Bureau of Consumer Protection.

Memorandum from George O. Hipps, Jr., Office of Underwriting Standards, to Sanford Witkowski, Acting Director, Office of Policy and Program Analysis and Development (Jan. 6, 1975) (on file with the author).

94. Federal Trade Commission Act § 5, 15 U.S.C. § 45 (1976). See note 6 *supra* and accompanying text.

95. Consumer protection cases include *Insilco Corp.*, 3 TRADE REG. REP. (CCH) ¶ 21,389 (1978) (consent order requiring sellers of pre-cut home packages to notify purchasers that assembly requires experienced construction help, and to process complaints according to specified procedures); *In re Society of the Plastics Indus., Inc.*, 84 F.T.C. 1253 (1974) (consent agreement requiring 25 manufacturers and trade associations to cease marketing foamed plastic insulation as nonburning or self-extinguishing, to notify past purchasers of fire hazards, and to spend \$5 million on research to minimize fire dangers).

Among regulatory activities affecting housing are the proposed Standards and Certification Rule, 43 Fed. Reg. 57,269 (1978) (setting procedural requirements for private developers including model code organizations whose standards are later incorporated into local building codes) and the proposed Mobile Home Rule, 40 Fed. Reg. 23,334 (1978) (setting performance standards for mobile home manufacturers and sellers offering written or implied warranties). The commission recently accepted a consent agreement with Kaufman and Broad, see notes 10-11 *supra* and accompanying text (alleging serious defects and requiring the builder to offer a HOW-type warranty to all future home buyers and to make restitution to some of the past purchasers of defective homes).

96. Pub. L. No. 93-637, 88 Stat. 2183 (codified in scattered sections of 15 U.S.C.).

97. *Id.* § 201(a) (amending 15 U.S.C. § 45 (1970)).

98. FTC HOUSING POLICY REVIEW, *supra* note 4, at 1.

In part as a result of publicity given the Kaufman and Broad matter, the FTC has received an increasing volume of consumer complaints about new homes. As mentioned above, the agency has responded (with support from HUD) by commissioning a survey of the incidence and severity of new-home defects. Initially, the survey will help provide a statistical basis for the volume of news stories, consumer complaints, and anecdotal evidence concerning the seriousness of the new-home defect problem. The survey may also prove valuable in informing the FTC and other law enforcement agencies about the most effective allocation of resources: for example, whether enforcement efforts should focus on larger or smaller builders or on selected demographic regions of the country.

In a major policy address, delivered to the 1979 annual convention of the National Association of Home Builders, Elizabeth Hanford Dole, then a Commissioner of the FTC, signalled the agency's increasing concern with the new-home defect problem:

You may think, as I do, that Americans are fed up with Big Government and want it to keep its cotton-pickin' hands out of private enterprise. That is true generally, but it is not true in every instance. There are many cases—and homebuilding is certainly one of them—where consumers are demanding more protection from the government, not less And it will not be denied over an issue so fundamental as decent housing. So I say to you today that as homebuilders, you have a choice: either you can each independently decide to make self-regulation work or you can brace yourself for full-scale, hard-hitting regulation from the government. It's that simple.

As homebuilders, you already have in your hands the instrument that you need. The HOW program, while imperfect, offers an excellent opportunity for homebuilders to be responsive to consumer concerns—and ultimately to bring great benefit to builders themselves⁹⁹

Commissioner Dole indicated that, in addition to possible direct action, the FTC might consider bolstering state enforcement practices:

The Commission has authorized its staff to investigate the incidence and severity of defects in new homes and the response of homebuilders to these problems, and to propose options to us in the near future. We may decide to bring increasing resources to bear against individuals and companies engaging in especially disreputable homebuilding practices, or these options may include increased support of state attorneys general in

99. Address, *supra* note 35.

prosecuting violators under the state "little FTC Acts."¹⁰⁰

This approach has some promise. The states have come far since Bearman's seminal 1961 law journal article¹⁰¹ and the early cases extending the warranty of fitness to real estate. The New Jersey law, supported by builders as well as consumers, may well be a model for legislation by other states that will extend warranty benefits and include a fair means of resolving disputes and independent insurance protection.¹⁰²

Another important step has been the law enforcement activity of state attorneys general, sometimes under "little FTC acts," to force builders of shoddy houses to offer warranty protection or provide other relief.¹⁰³ Federal support might help to encourage state attorneys general to become involved and might supplement the activities of those states that are concerned about policing housing defects but lack enforcement resources.¹⁰⁴ It remains to be seen whether the new interest by the federal government will result in the needed protection of home buyers, and how this protection will compare to that offered in those states unwilling to wait for potentially more comprehensive federal action.

100. *Id.*

101. *See* note 13 *supra*.

102. *See* text accompanying notes 17-22 *supra*. It will be up to the courts to assure that the New Jersey law is interpreted as a step forward in consumer protection. As was previously noted, the HOW standards for payment of defect claims are significantly narrower than might be obtained by an aggrieved home buyer suing in court under the relevant implied warranty law. This shortcoming in HOW is tolerable only because the alternative of suing for all damages exists even for consumers with HOW coverage. New Jersey builders will undoubtedly urge that that state's warranty law offers limited defect coverage. The state's courts should interpret the express warranty as a supplement to, rather than a substitute for, the state's judicially construed implied warranty. If builders can limit legal liability to a very narrow set of defect claims, the warranty statute would have the effect of reducing rather than increasing vigilance in construction quality. The overall cost of housing in New Jersey would increase correspondingly because builders would lose the incentive to take the small steps during construction that can save many more repair dollars later. *See* text accompanying notes 44-61 *supra*.

103. *See, e.g.,* Commonwealth v. Jim Walter Homes, Inc., No. 78-034 (Cir. Ct. Ky. April 11, 1978) (consent agreement requiring builder to provide restitution to past purchasers of defective homes, to institute improved quality control, and to provide warranty protection for future home buyers).

104. For example, the Massachusetts Attorney General's Office negotiated a consent agreement, which was unpopular with some purchasers of defective Kaufman and Broad homes, since it would have taken literally years to litigate a case. One can imagine that the Office would be especially concerned about the state's legal resources being tied up in such litigation. For coverage of the incident, see *Attorney Presents "Buy Back" Proposal*, The Daily News, Newburyport, Massachusetts, July 27, 1978, at 1; *Raising the Roof: Buyers of New Homes Find Shoddiness, Flaws Are Growing Problems*, *supra* note 65, at 1, col. 6.

III. CONCLUSION

The problem of new-home defects draws sporadic government attention, corresponding roughly to consumer complaints following the housing construction cycle.¹⁰⁵ The proposed federal home warranty legislation and hearings of the early 1970's followed the building boom that began in the late 1960's. The increased federal concern of the late 1970's followed the boom beginning in 1976. The earlier period of federal attention brought consumers the HOW program—the nation's first large scale new-home warranty effort. The more recent federal concern promises to extend such warranty coverage to more than a fortunate minority of home buyers and possibly to improve the quality of coverage as well.

The housing cycle has also had its impact on the state and local level. City and county building departments are staffed down after a few years of slow building. Suddenly the boom comes, and a locality is swamped with requests for building permits and inspections. Local governments face a dilemma: they don't want to turn away business that means local prosperity; yet, by the time they staff adequately to meet the sudden demand for building inspectors, the housing market will turn again, and they will not need the new staff.

The present consumer outcry has been loud enough to persuade the FTC to allocate resources for a formal enforcement program directed against especially bad actors in the residential construction industry. The paradox of national housing policy is that these developments are taking place outside traditional federal programs. The fear of private and public lawsuits, as well as the possibility of governmental regulation and the inevitable discovery that warranties can mean increased builder profits,¹⁰⁶ may trigger free market responses bringing warranty protection to the large majority of home buyers who want it.

105. See text accompanying note 60 *supra*.

106. A consumer survey indicated that 79% of the buyers of new homes rate a warranty as "very important" in the decision to buy, while only 22% of the builders surveyed thought that buyers considered warranties important. The magazine reporting the survey commented that, "Builders rate warranties much lower and may be missing a sales bet." PROFESSIONAL BUILDER, Dec. 1977, at 71. Another survey showed that 70% of the consumers would be willing to pay at least \$1,000 at the time of the purchase of a new home to reduce maintenance costs later. PROFESSIONAL BUILDER, Dec. 1978, at 85.