

ASSEMBLY THIRD READING

AB 1406 (Ward, et al.)

As Amended January 5, 2026

Majority vote

SUMMARY

Increases the permissible amount of liquidated damages that may be imposed on a buyer who breaches a contract for the purchase of a newly constructed condominium from three to ten percent of the purchase price.

Major Provisions

- 1) Provides that, for the initial sale of a newly constructed attached condominium unit, as defined, that involves the sale of an attached residential condominium unit located within a structure of ten or more residential condominium units, the amount actually paid to the seller pursuant to the liquidated damages provision cannot exceed ten percent of the purchase price of the residential unit in the transaction.
- 2) Requires a seller to refund any retained liquidated damages in excess of ten percent of the purchase price unless the buyer can demonstrate the amount is unreasonable as liquidated damages, as specified.

COMMENTS

There is little question that finding an affordable home is growing increasingly difficult for many Californians. A 2022 report by the state Department of Housing and Community Development noted that the state needs to produce approximately 2.5 million housing units over the next eight years, with roughly one million of those units being set aside for lower income households, in order to meet the anticipated demand for housing over the same time period. (Dept. of Housing and Community Development, *California Statewide Housing Plan: A Home for Every Californian* (Mar. 2022) available at:

<https://storymaps.arcgis.com/stories/94729ab1648d43b1811c1698a748c136>.) However, as a result of persistently high interest rates in recent years, many housing developers are now noting that obtaining adequate financing to construct new homes is becoming increasingly difficult. This is especially true for condominium development which, unlike single family homes projects that can be built in phases, must obtaining funding for the entire project upfront.

The author and proponents of this measure note that one of the main obstacles to obtaining funding for condominium development is the fact that the developer must demonstrate sufficient and legitimate interest from buyers. One means of demonstrating such interest is to obtain security deposits from would-be buyers to indicate that the eventual sale of the condominium units will be sufficient to repay construction loans. The proponents of this measure note that the existing security deposit limits are no longer sufficient to satisfy many lenders. Thus this bill would increase the amount of a deposit a developer may retain if a buyer backs out of a purchase agreement from three to ten percent of the purchase price.

The Subdivided Lands Act guides the purchase of newly constructed properties in California.

Broadly speaking, there are two primary types of homes available for purchase in California: single-family homes and multifamily developments. Although new developments of both types of homes are typically governed by a homeowner association, single family homes are

standalone units that developers can build in phases to meet financing needs and projected sales. Conversely, multifamily housing developments including condominiums, townhomes, stock cooperatives, limited-equity housing cooperatives, and other similar types of dwellings are frequently joined together in one physical structure. Given the unitary structure, these developments must be built at the same time, regardless of sales demand. These types of dwellings are typically considered a subdivision, which California law defines as improved or unimproved land that is divided or proposed to be divided for sale, lease, or financing into five or more lots or parcels. (Business and Professions Code Section 11000, 11004.5.) Seeking to protect would-be purchasers of subdivided interests from fraud, deceit, or misrepresentation, the Subdivided Lands Act adopts an extensive series of consumer protections. Most notably, the Act requires a developer seeking to sell subdivided properties to obtain a subdivision public report from the Department of Real Estate prior to offering any property for sale. The Department's public report includes information and disclosures regarding the subdivision and the developer's commitments regarding facilities and improvements for the subdivision. A developer of the subdivision must meet certain requirements and provide documentation of sufficient financial arrangements for the completion of the improvements and facilities that will be included in the subdivision.

Additional protections for buyers can be found in both the Civil Code and the Subdivided Lands Act's requirements that many downpayments or deposits provided by a buyer in advance of a final purchase of a newly constructed property must remain in an escrow account managed by a neutral third party. The role of the escrow account is to ensure that the buyer has a stake in completing the purchase while simultaneously protecting the deposit should the developer be unable to complete a project. Under the existing law, unless the developer follows existing procedures and obtains permission from the Department of Real Estate, the escrow money cannot be utilized to fund construction of the project. Nonetheless, the existence of the escrow money is a critical component of loan applications utilized by developers to borrow the funds necessary to finance the development.

California maintains one of the lowest permissible liquidated damage levels in the nation when buyers breach property sale agreements. Under existing law (Civil Code Section 1675), California law caps the amount of liquidated damages a property seller may recoup from a defaulting buyer at three percent of the purchase price. The author and proponents of this bill note that this is significantly less than many other states, including other large, urbanized states like New York or Washington. For example, a combination of case law and statutory provisions in the State of New York, of which condominiums make up a comparatively large share of the housing stock, maintains a ten percent cap on liquidated damages for breaching buyers. (NY-RPP Chap. 50, Art. 9-b *et seq.*) Despite the statutory provisions, however, New York state case law prohibits the developer from recovering the full ten percent if the liquidated damages are sought to punish buyers and not reimburse sellers (*Atlantis Management Group II LLC v. Nabe* (2023) N.Y. Slip Op. 02737). Notably, California case law has established a similar prohibition on punitive liquidated damages provisions in real estate contracts. (*Myers Building Industries, Ltd. v. Interface Technology, Inc.* (1993) 13 Cal.App.4th 949.)

This bill would increase the liquidated damage caps for downpayments on new condominiums only. Seeking to align California law with the laws of other large states, this bill would increase the liquidated damage cap imposed on buyers breaching property sale contracts for the purchase of *new* condominiums from three percent of the purchase price to ten percent of the purchase price. The bill maintains the existing law's requirement that the money be held in escrow and

similarly maintains the law's general prohibition on the use of such funds to finance construction and other related costs. Additionally, as proposed to be amended, this bill does not impact any single family home sales, for new or existing properties, and this bill does not apply to the sale of *existing* condominiums. This bill only raises the liquidated damages cap on new construction condominiums in order to provide developers and their lenders sufficient financial assurances in the event a buyer breaches a sales contract.

Although the opposition raises valid concerns, the scope of this bill is limited and market forces may negate many of the potential impacts. This bill, as currently in print and as proposed to be amended, is vociferously opposed by a coalition of stakeholders in the property sales industry. Writing jointly in opposition, the California Association of Realtors and the California Land Title Association argue the bill, "will expose homebuyers to extraordinary financial risk while serving to dismantle strong consumer safeguards enacted specifically to protect California homebuyers." They also argue the bill does, "nothing to address the home affordability crisis and in fact likely put the dream of homeownership more at risk as buyers could lose so much money in one transaction they could be forced out of the market for years."

The opposition is certainly correct in noting that the bill does expose a larger percentage of a downpayment to loss should a buyer breach a sales contract. However, it should be noted that, as proposed to be amended, this bill only make such an adjustment to a relatively small portion of California's housing market. Indeed, based on current trends, by limiting this bill to *new* condominiums only, the measure impacts a part of the housing market typically found in large urban areas and purchased by affluent professionals. While this does not wholly relieve the risk that such an individual may lose a sizable security deposit, these buyers tend to be relatively sophisticated, capable of weighing the risk, and are more likely to be able to retain any professional services necessary to vindicate their rights. Additionally, the damage provisions are only triggered if the buyer *defaults* or otherwise violates their contractual obligations.

Furthermore, the bill does not require a liquidated damage level of ten percent but simply permits such damages. Indeed, although existing law sets a three percent cap on liquidated damages, many real estate contracts presently do not impose the maximum level of damages. Moreover, should, as the opposition also contends, market forces prevent many Californians from being able to afford a ten percent downpayment, condominium developers will have no choice but to apply lower liquidated damages in actual sales agreements if the developer actually wants to generate a market for the units. Nothing in the bill overrides the terms of a contract and nothing permits a developer to seek higher liquidated damages than originally agreed to in the sales contract. For example, if market conditions drive a developer to impose a five percent damage amount in contract, nothing in this bill authorizes the developer to subsequently seek additional damages should the seller breach the agreement. A final safeguard, as noted above, can be found in the case law interpreting Civil Code Section 1671 which prevents punitive liquidated damages provisions. (*Myers Building Industries, Ltd. v. Interface Technology, Inc., supra.*) While the opposition is correct that invoking these provisions of law is likely to require the employment of legal counsel and the potential for litigation, beyond raising the permissible level of non-punitive liquidated damages, nothing in this bill changes the existing statutory or common law protections for potential condominium buyers.

This bill remains a work in progress. The original version of this measure was substantially broader than the current version of the bill. Indeed, that version of the bill contained provisions that significantly undermined existing consumer protections, most notably the elimination of the

escrow provisions that prevented a developer from accessing a buyer's downpayment to pay for construction costs. The author and the Judiciary Committee agreed to significantly narrow the bill to only include the increased liquidated damages provisions and to restore all other existing consumer protections. Unfortunately, as discussed above, these significant amendments did not ameliorate the opposition's concerns. Nonetheless, the author is committing to ongoing engagement with all stakeholders to achieve their mutual goal of spurring much needed housing development while protecting everyday Californians. The Judiciary Committee will continue to monitor these discussions, and as always, reserves the right to recall the bill for additional consideration should existing consumer protections not be maintained. Nonetheless, the bill appears to strike an appropriate balance between spurring new housing construction and protecting the hard-earned savings of prospective California homeowners.

According to the Author

As California embraces pro-housing and environmentally responsible policy, the share of multifamily housing in the state continues to grow. However, only a small fraction of this housing is available for purchase. Between 2011 and 2021, an estimated 3 percent of newly built housing in California consisted of multifamily condominiums. AB 1406 would align California with best practices from states such as New York, Colorado, and Nevada, by raising the liquidated damages cap in current statute from 3% to 10%. This change would unlock financing for condo projects and increase the supply of more affordable, for sale housing.

Arguments in Support

This bill is supported by a coalition of developers and affordable housing advocates under the umbrella of the California Home Building Alliance. A coalition letter from organizations that include the California Building Industry Association, the California Coalition for Affordable Housing, the San Francisco Bay Area Planning & Urban Research Association, and the Abundant Housing LA argue in support of the bill:

Condominiums have proven to be an effective path to affordable, entry-level homeownership for first-time buyers. California lags when compared to other states, like Hawaii and Washington, who produce condominiums at roughly ten times the annual rate in California. We have seen that this limited production significantly restricts pathways to homeownership especially in dense urban areas where land is scarce, and costs of single-family homes put them financially out of reach for most Californians. Additionally, despite significant growth in multifamily housing, very little of this new housing is available for ownership.

One major barrier we have identified is that in California, there is a de facto three percent earnest money deposit cap, requiring any funds over three percent to be fully refunded to the buyer if they decide to terminate the deal. AB 1406 would incentivize condominium development by increasing the existing liquidated damages cap from 3% of the sale price to 10%, aligning California with other states such as New York, Colorado, and Nevada that have a higher cap. This change would reduce lender risk, unlock financing for condo projects, and increase the supply of more affordable, entry level for-sale housing.

Arguments in Opposition

As noted a coalition of property sales professionals including the California Association of Realtors oppose this measure. In opposition the coalition jointly argues:

California's liquidated-damages framework for owner-occupant buyers exists to protect homebuyers from disproportionate financial loss. In *Guthman v. Moss*, 150 Cal. App. 3d 502 (1984), the Second District Court of Appeal held that "...the purpose of enacting section 1675 et seq. was to protect buyers who fail to complete the purchase of real property and not sellers." The proposed language in AB 1406 (Ward) would turn that purpose on its head by forcing buyers to forfeit unreasonable sums that bear little relationship to any actual harm.

At today's statewide median home price of approximately \$887,000, a 10-percent liquidated-damages provision would allow a seller to retain nearly \$89,000 from a defaulting buyer, an amount that in most transactions bears no reasonable relationship to foreseeable damages. Liquidated damages are intended to substitute for proof of actual damages by setting a reasonable, good-faith estimate of what a seller is likely to lose if a buyer defaults, not to create a windfall untethered to real economic harm, but this proposal does just that.

FISCAL COMMENTS

None

VOTES

ASM JUDICIARY: 7-3-2

YES: Kalra, Bauer-Kahan, Bryan, Connolly, Harabedian, Papan, Stefani

NO: Dixon, Macedo, Sanchez

ABS, ABST OR NV: Pacheco, Zbur

UPDATED

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