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Rethinking Residential Private Government in the US: Recent Trends in Practices and Policy

Evan McKenzie

Abstract This chapter assesses the current state of national and state public policy regarding the operation of residential private governments in the United States. From the early 1960s to the mid-1990s, the emphasis was on promoting more condominium and homeowner association run developments. The mid-1990s saw a new emphasis on state regulation to protect consumers. But when the housing market crashed in 2007 governments and financial institutions sought to protect themselves from the risk that condominium and homeowner associations would become insolvent. Left unanswered is how homeowners are to be protected against those risks.

1 Introduction

This chapter assesses the current state of national and state public policy regarding the operation of residential private governments in the United States. From the early 1960s to the mid-1990s, the focus of public policy was on promotion of this form of housing, and during that time association-run developments went from being vir- tually nonexistent to becoming the predominant form of new housing construction. Then, from the mid-1990s to the housing market crash in 2008, the focus shifted to increasing regulation of the internal processes of associations. This appeared nec- essary because conflicts between associations and their members became com- monplace and drew the attention of the news media. However, since the crash of the housing market in 2007−2008, policy makers became increasingly concerned about the financial strength of many associations. They began to adopt policies that address the risks posed by the fiscal fragility of associations, and this chapter focuses on that current concern.

Common interest developments (CIDs) with residential private governments have predominated in the new housing construction market across the United States

E. McKenzie (✉)
Political Science Department, University of Illinois at Chicago, Chicago, USA e-mail: mckenzie@uic.edu

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Table 1 Community association data, US, 1970–2014

US community associations, housing units, and number of residents							
Year	CIDs	Housing units (millions)	Residents (millions)	Housing units US, total	Population US, total	CID % of housing units (%)	CID % of US population (%)
1970	10,000	0.7	2.1	68.7	203.2	1.0	1.0
1980	36,000	3.6	9.6	88.4	226.5	4.1	4.2
1990	130,000	11.6	29.6	102.3	248.7	11.3	11.9
2000	222,500	17.8	45.2	115.9	286.2	15.4	15.8
2010	309,600	24.8	62	131.7	309.3	18.8	20.0
2014	333,600	26.7	66.7	133.8	318.9	20.0	20.9

Source CAI (2014); US Census (1993, 2004, 2012)

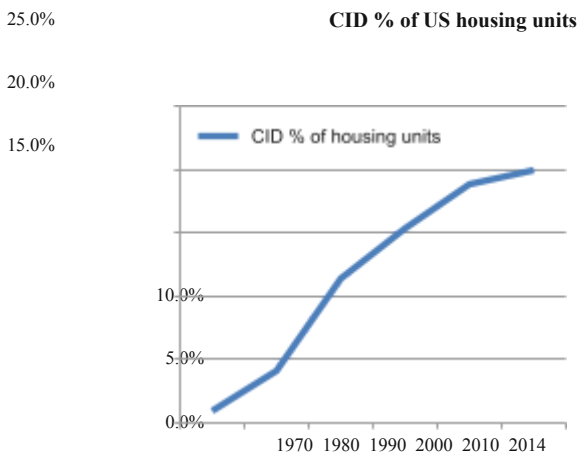


Fig. 1 CIDs as a percent of US housing units, 1970–2014. *Source* Community Associations Institute (2014); US Census (1993, 2004, 2012)

since the 1980s (Table 1; Fig. 1). These projects consist almost entirely of planned developments of single family homes in homeowners' associations, and condominium projects, many of them converted from apartment buildings, with housing cooperatives forming a small share of the total of CID housing in the United States. The CID share of the housing market varies from state to state (Table 2).

This revolution in the housing market is actually best viewed as a form of local government privatization that is the result of economic incentives impacting real estate developers and local governments. Developers find CID housing profitable, and local governments benefit from a tax windfall in that they receive full property tax payments from CID owners but do not have to provide them the same level of services and infrastructure as other residents. (McKenzie 1998).

A great deal of thought and planning has gone into the physical design of these private communities, but for many years little effort went into determining the best way to govern them, or how their private governments should be integrated into the overall system of public local governance. Since the mid-1990s a number of states

State	Number of CIDs	CID population 2014 (millions)	State population 2010 (millions)	Percent CID population (%)
Florida	47,100	7.9	18.8	42.0
Massachusetts	12,000	2	6.5	30.8
Colorado	9100	1.5	5	30.0
Washington	10,200	1.7	6.7	25.4
North Carolina	13,600	2.3	9.5	24.2
South Carolina	6700	1.1	4.6	23.9
Illinois	18,250	3	12.8	23.4
Arizona	9250	1.5	6.4	23.4
Minnesota	7500	1.2	5.3	22.6
Connecticut	4750	0.8	3.6	22.2
Utah	3300	0.6	2.8	21.4
California	43,300	7.2	37.3	19.3
Maryland	6550	1.1	5.8	19.0
Nevada	3200	0.5	2.7	18.5
Georgia	10,200	1.7	9.7	17.5
Virginia	8400	1.4	8	17.5
Oregon	3700	0.6	3.8	15.8
Missouri	5300	0.9	6	15.0
Michigan	8200	1.4	9.9	14.1
Wisconsin	5100	0.8	5.7	14.0
Texas	19,400	3.2	25.1	12.7
New Jersey	6600	1.1	8.8	12.5
Tennessee	3700	0.8	6.4	12.5
Indiana	4700	0.8	6.5	12.3
Ohio	8300	1.4	11.5	12.2
New York	13,400	2.2	19.3	11.4
Pennsylvania	6000	1.1	12.7	8.7

Table 2 US states ranked by percent CID population US

States−CIDs and population

Source Community Associations Institute (2014), US Census (2012)

have begun to change that, and today there is an emerging model of CID regulation in the United States (McKenzie 2011).

However, the crash of the housing market in 2007−2008 precipitated the insolvency and financial collapse of condominium and homeowner associations. This highlighted the previously-unrecognized fragility of CID housing, which is ultimately based entirely on the resources of the owners. In some states, policy makers began to address the question of what to do when a residential private government collapses. Federal agencies involved in lending, and banks themselves, enacted a number of policy changes to protect themselves against these risks. Local

governments began to create special districts with taxing power, in case associations failed to perform their functions. Most recently legislative battles have erupted over whether associations should have "super lien" priority over first mortgages when trying to collect delinquent association assessments from an owner in fore- closure. The increased concerns about association finances highlight the extent to which the rapid spread of common interest housing has outpaced the public policy process, is now trying to catch up.

2 Structure and Functions of US Residential Private Governments

The nomenclature for this housing sector is diverse to say the least, with various people using term such as "gated communities" to describe places that lack either gates or any sense of community. I prefer the term "common interest develop- ments" (CIDs) to describe the housing developments, and the term "residential private governments" as a catch-all phrase for the institutions that run them. I coined the *portmanteau* word "privatopia" to refer to this housing sector as a whole, because it embodies a utopian belief that living in a neighborhood with privatized local government functions, including privatized corporate governance, is the route to a far better life than what is enjoyed by the rest of us.

Within the universe of American CIDs, there are three different institutional arrangements, all of which share some characteristics in common. The shared characteristics are:

(a) Some form of common ownership of real property, called "common areas" or "common elements," which is combined with an individual interest owned or occupied exclusively by one person or family unit.
(b) Private governing documents that derive their power from the deed and that are interpreted under the laws of contract. These usually include deed restrictions (so-called "CC&Rs," for "covenants, conditions, and restric- tions"); articles of incorporation; association bylaws; and perhaps special sets of rules for architectural modifications, pets, pools, parking, and so forth.
(c) Automatic membership in an association that is viewed by the law as voluntary.
(d) A residential private government that has the power to regulate land use and behavior, collect and spend revenues, and act on behalf of all owners as a legal entity. This is typically a not-for-profit corporate board of directors.

There are three different forms of ownership that can be built on this set of common characteristics. Planned developments of single-family homes with *homeowners' associations* comprise an estimated 51−55 % of the nation's CIDs. *Condominiums* make up about 42−45 % of the total. *Housing cooperatives* are the least common, representing only about 3−4 % of total CIDs (CAI 2014), and most

of those are in a few large cities, such as New York City and Chicago. In many metro areas, cities began to require that all new housing construction must be in CIDs, in order for local governments to receive a tax windfall, with more property taxes and fewer services to provide (Siegel 2006).

In a homeowner association-run development, the association owns the common areas, which are typically streets, recreation areas, drainage ponds, golf courses, utility systems, and other infrastructure and amenities. Residents own the physical structure in which they reside, generally including a yard in front and back.

Condominium ownership is quite different, and it is nearly always used in attached or multi-family owner-occupied structures, including converted apartment buildings. The entire physical structure of the property, including buildings and land, is owned in a tenancy in common arrangement by all unit owners, each of whom has a percentage share of the property. That percentage usually corresponds to their percentage voting interest in the association. The condominium association does not own any real property, but manages all of it, meaning that everything outside of the inner painted or finished surface of the walls and floors is association-run. The individual interest is a legal fiction consisting of the "airspace" inside the unit and the painted or finished surfaces of the walls and floors, but not even including the walls themselves.

In a housing cooperative, people buy a share of stock in the cooperative and acquire with it a proprietary lease that entitles them to occupy the unit as long as they own the share of stock in the cooperative. Cooperators are in essence their own landlord. The cooperative, which is usually incorporated, owns all the property so that everything is common area, and the individual real property interest is simply the lease.

All these forms of CID housing require owners to operate a residential private government, and this is where many of the problems have arisen that have led to legislative action. During planning, construction, and the first few years of a project's life, the association board of directors is controlled by representatives of the real estate developer, who, as unit sales progress, is required eventually to turn over control of the board to directors elected by the unit owners. During the period of developer control, problems can occur, such as underfunding of the project's reserves funds, sweetheart deals and kickbacks involving property management firms and other contractors that are affiliated with the developer, defective construction of units or common areas, developer insolvency, denying unit owners access to association financial and administrative records, and fraudulent sales practices. There are laws in place in all states that are intended to protect the unit owners during the period of developer control, but if developers choose to ignore those laws the only remedy is private litigation by affected owners. This path is expensive and often ultimately fruitless in the case of financial issues, because the developer often files for bankruptcy protection.

After turnover, all the directors, or at least a majority, are elected by unit owners. The owners, through their corporate board of directors, henceforth will make all the decisions about finances, property maintenance, adoption and enforcement of rules

and regulations, running meetings and holding elections, legal action, and maintaining and enhancing their property values.

These are important collective decisions that affect people's lives in their homes and the neighborhoods where they spend most of their time. People can become angry, even violent, over decisions made by their HOA board. Every owner can be subjected to enormous financial liability because of board decisions. Yet, there are no qualifications for being a board member, other than being a unit owner, there are few reasonably-priced educational opportunities for new board members, and these volunteer boards operate virtually free of governmental oversight. As with developer mismanagement, the only remedy in most states is private civil litigation, in which the owner must fund his or her own case while also paying a share of the association's legal expenses.

The entire institution of common interest housing rests on the resources of individual owners—their money, judgment, loyalty, commitment, organizational expertise, and social skills. There is virtually no institutional support for them, except for the professionals they are able to hire to advise them and to carry out delegated tasks. Public local governments are supported in many ways by private and public institutions, but residential private governments are not (Table 3). Many associations, especially large ones, hire property management firms. These property managers are subject to a wide range of requirements such that in some states they must be licensed and satisfy certain educational requirements, while in others they need no license at all and are not held to any professional or educational standards

Table 3 Institutional support for CIDs and municipalities

Institutional support	CIDs	Municipalities
Financial support	General and special assessments, recreation fees—insurance proceeds in some situations	Taxes, fees, bonds, intergovernmental transfers and grants in aid
Bankruptcy	Extremely risky—owners ultimately responsible for paying debts of corporation	Chapter 9 of Bankruptcy code allows restructuring of debt
Training for community leaders	None required; expensive	Offered by national league of cities and other organizations
Professional support	Largely unregulated vendors organized through Community Associations Institute	Public Administration profession; academic journals; national and state level organizations
Government oversight	Minimal—judicial review in private litigation	Substantial
Media and public scrutiny of internal activities	Minimal—limited to colorful controversies–flags, pets, religious symbols, etc.	Substantial
Public availability of data on activities and finances	Almost nonexistent	Freedom of Information Act; sunshine laws; public availability of voluminous data

(IREM 2013). Association boards often find themselves in need of legal advice, and there are attorneys who specialize in what is called "community association law." These attorneys, property managers, and other vendors are organized in trade associations, the most important of which is the Community Associations Institute (CAI), which has its national headquarters in Virginia and many state chapters around the country. CAI offers training for its members and functions as an interest group that has substantial influence on legislation and court decisions (McKenzie 1994).

The vast bulk of law relevant to CIDs emanates from state legislatures and state courts. These laws regulate the internal procedures of CIDs, including assessments, elections, document amendments, insurance, reserves, access to association records, and myriad other matters. Some rules are found in the state not-for-profit corporation act and others are located in special statutes that cover CID housing in particular.

But the most important rules are in each development's governing documents. Developers and their attorneys draft these documents in a form of private law-making that has great significance for all owners long after the developer has sold out and moved on. The association is typically incorporated, which requires Articles of Incorporation. Every owner's deed is encumbered with a Declaration of Covenants, Conditions, and Restrictions (or similar appellation) that may be as much as one hundred pages or more in length. All the deed restrictions bind all owners from the moment of purchase, and they are usually only subject to amendment by vote of a super-majority of all owners, with 2/3 being the most common provision. In practice this is extremely difficult to accomplish. In addition, there will be a set of association bylaws that detail how the association will operate, and there may be special sets of rules for parking, use of recreational facilities, architectural modifications, and so forth.

The complexity of association governing documents, and the degree to which they intrude on areas of life that many people think should be matters of individual choice—such as what color to paint the house, whether to plant bushes, or whether to park one's car in the driveway—that an enormous body of state court case law has grown up, in which judges have interpreted the meaning of covenants, set rules for what is enforceable or not, and balanced the rights of individuals against those of the association, in the light of public policy considerations.

In most states, association decisions are reviewed in light of either the business judgment rule or the rule of reasonableness. The business judgment rule provides that judges will review the way a decision was made, and if it appears to have been made in an informed and good faith manner, with no self-dealing by association directors, they will not inquire further into the merits or wisdom of the decision. This is in essence a rule of judicial deference to the association's board of directors. The rule of reasonableness, by contrast, requires the judge to consider both sides of the decision and make a ruling on the merits (Hyatt and French 1998).

But judicial decisions are retrospective for the most part, resolving past disputes and establishing principles for the future that are open to further dispute over their proper interpretations. And, despite the recent spate of regulatory measures, the

public policy umbrella for common interest housing remains questionably sparse. This is especially true where the financial condition of associations is concerned.

3 Recent Crises in Residential Private Governance, and Public Policy Responses

There is an unstated assumption underlying this massive privatization of local government functions, which is that somehow the unit owners will be willing and able to perform in perpetuity all the duties necessary to maintain the properties. They will pay their assessments, set aside sufficient reserve funds to be ready for future repairs, volunteer to serve as directors and officers, vote and participate in private governments, and when trusted with responsibilities they will educate themselves and do a responsible job. A number of recent events have called these assumptions into question and raised concerns about the financial and organizational viability of CID private governments.

For this reason, trends in public policy since the housing crash have moved in new directions, albeit in a piecemeal, incremental, and self-protective fashion that reflects concern for local governments and financial institutions should private governments fail.

From 1970 to the mid-1990s, policies were promotional in nature, intended to make it easier for developers and local governments to bring more CID housing into the market. By the mid-1990s, the policy focus shifted in a number of states to a more regulatory emphasis. Nevada, Florida, California, and several other states enacted laws that specifically addressed how associations should handle their internal affairs, such as running meetings, maintaining records, disclosing financial data to existing owners and prospective buyers, making decisions about owner proposals for architectural modifications, amending their governing documents, and collecting assessments including the ultimate weapon of foreclosing on the delinquent owner (McKenzie 2011).

But then the housing market collapsed in 2007, followed in 2008 by the banking crisis, a recession, and high levels of unemployment. Developers were unable to sell their new housing units, so they filed for bankruptcy and left CID projects unfinished and partially occupied. Condominium and homeowners' associations either were never set up or were left too underfunded and understaffed to function. Many existing CIDs across the nation saw their main revenue stream, monthly owner assessment payments, dry up. Many unit owners lost their jobs and could no longer make mortgage or assessment payments. Others had "subprime" mortgages that were designed to change from interest only payments to interest plus principal payments after a few years, a tool that made sense when housing prices were going up and houses were easy to sell, or at least to refinance. When the housing market

stalled, these owners could not sell at a profit as they had planned, and could not refinance, and instead they were forced to watch their mortgage payments increase on schedule. Suddenly they were living far above their means. Instead of being investor-owners, about to cash in on their home and move on, they were underwater and insolvent, and unable to sell or to pay their mortgage, their property taxes, or their homeowner association. Banks foreclosed, or owners simply abandoned their homes and walked away. Banks, forced to deal with unprecedented levels of "REO" (real estate owned) inventory, were unable to process and resell their stock of foreclosed homes in a dead housing market, so they left units vacant for long periods of time and did not pay assessments on the properties, even though the law required it. This forced associations to decide whether to spend their dwindling income on hiring attorneys to sue major banks, a process that can take years of expensive civil litigation.

Losing a substantial part of the assessment stream quickly becomes disastrous for associations, especially small ones, because the burden of paying for the association's common operating expenses and reserves falls on fewer people. Assessments must be increased to compensate for the units from which no income is being received. This in turn increases the likelihood that some of the remaining owners will be unable to handle the increased assessments, and so it goes—a spiral of greater burdens falling on fewer people, with more and more of them giving up on the effort. The result in many neighborhoods was a large number of empty houses or condominium units and a defunct HOA.

These events found their way into the press and came to the attention of policy makers. State and local governments were concerned about what would happen if associations failed to do what was expected of them. An institution that had been treated as if it could be counted upon to last forever was suddenly exposed, and it became clear to many observers that governments and lending institutions needed to protect themselves against the possibility that associations would become insolvent or simply cease operating.

Yet, this eventuality had in fact been foreshadowed earlier. The institutional weaknesses of CID private governments—financial fragility, untrained directors and officers, and an owner culture of non-participation—became apparent before the housing crash, in the wake of natural disasters and in shocking examples of mismanagement, fraud, and embezzlement.

4 Crumbling Condos and California Earthquakes

Many condominiums and homeowner association-run developments have had to deal with the need to perform major repairs to common areas and units. Often these problems are due to defects in the original construction of the project. In other situations, it is simply a matter of building components such as decks, roofs, and

streets wearing out over time. And occasionally the need for repairs stems from a major natural disaster.

At 4:31 A.M. local time, on Monday, January 17, 1994, the San Fernando Valley area of southern California was struck with an earthquake measured at 6.7 on the Richter scale. The earthquake was centered 32 km west-northwest of Los Angeles near the city of Northridge, a densely populated area with many condominium buildings. 57 people died and 5,000 were injured, and the structural damage was enormous, with 112,000 buildings being damaged, many of them collapsing entirely, and 20,000 people rendered homeless. The total property damage was estimated at $20 billion, making the Northridge earthquake the most expensive earthquake in US history up to that time, and the second costliest natural disaster, exceeded only by Hurricane Katrina (Martinez 2014).

Many condominium buildings suffered damage that ranged from minor to catastrophic. Volunteer boards of directors were forced to deal with insurance companies and contractors in order to finance and carry out complex and expensive repairs. The legal aftermath of the Northridge earthquake played out in the California courts for several years. Ultimately, a great deal was revealed about the competence of residential private governments, and about the ultimate liability of owners for the costs of major repairs and for the debts of their associations in general.

Three cases in particular are instructive, all of which involved developments that are in or near Los Angeles, California. These cases involved the Le Parc complex in Ventura County, California, just north of Los Angeles; the Oak Park Calabasas project, also north of Los Angeles; and the Los Angeles Kingsbury Court condominium.

The Le Parc homeowners association board of directors became embroiled in litigation with ZM Contracting, a firm the board had retained to perform extensive repairs on the project. ZM claimed that the association had broken their agreement, interfered in ZM's relationship with subcontractors, and committed trade libel. Arbitrators awarded ZM $7.4 million in damages, which the association's insurance company said was not covered under their policy.

The association's board of directors refused to assess the owners to pay the judgment, and the members refused to vote to pay it. Instead, the association filed for bankruptcy. But the bankruptcy court refused to confirm a bankruptcy plan. The state trial court appointed a receiver who took control of the associations' affairs and diverted all the association's assessment revenues to pay the judgment creditor, ZM. This meant that the 264 residents of the project suddenly had no money in the association account to pay their operating expenses.

The utilities were cut off, the county health department closed the pool, and owners lost their homes in foreclosure because they could not pay a special assessment. The association set up a web page and begged for contributions. Fortunately an attorney who had extensive experience dealing with insolvent CIDs, James Lingl, brokered a $5 million dollar settlement that involved the insurance

company, the association, and ZM, with the insurer agreeing to pay the money out over a ten-year period (Peinemann 2000).[1]

Attorney Lingl then approached the California legislature with a proposal to prevent this from happening again in other uninsured judgments against associations. The legislature passed a bill [AB 1859, amending California Civil Code Sect. 1366(b)(1)] that shields a portion of association revenue from a judgment creditor and a receiver, so that an association's utility bills can be paid, with the remainder going to pay the judgment.

The Oak Park Calabasas Condominium Association also become involved in a dispute with a construction contractor. The project suffered serious damage in the 1994 Northridge earthquake, and retained ECC Construction to do the repairs, using money from a settlement with the association's property insurance company, State Farm Insurance, but the association and the contractor ended up in litigation. A six-month jury trial ensued in 2002 that resulted in a $7.1 million verdict against the association for breach of contract and fraud, including punitive damages.[2]

The association filed for bankruptcy protection, but once again the court refused to confirm a bankruptcy plan, finding that the association actually had assets to pay the judgment: the power to levy a special assessment on the owners and force them to pay or lose their homes in foreclosure.[3]

The net result, as in Le Parc, is that the owners are responsible for paying the judgment that was rendered against the association due to mistakes made by the board of directors. If they, or the board, vote not to specially assess themselves, the court will appoint a receiver who will do that.

[1]In an interview with Mr. Lingl, he explained that Farmers Insurance company paid the negotiated settlement as a business decision, not because they agreed that the loss was covered by their policy. Defamation is an intentional tort and not typically covered by a liability policy and the same is true for breach of contract. However, the highly publicized plight of the Le Parc owners, who were without water or electricity, reflected badly on the insurer and on the CID housing sector, which was and is a lucrative source of insurance premiums because all associations are required to carry insurance. Farmers' business decision reflected a cost-benefit analysis in which ending the publicity about the situation weighed heavily. See also Le Parc Simi Valley Le Parc H.O.A. v. ZM Corp, Ventura County Super.Ct. Case No. CIV 159037 (1995–2000); Bankruptcy case—Central District of California Case No. SV 97-20190; AB 1859 Assembly Analysis, April 26, 2000.

[2]ECC v. Oak Park Calabasas Condominium Association, 118 Cal. App. 4th 1031 (2004).

[3]The association filed for a Chapter 11 reorganization, but the court refused to approve a reorganization plan because the creditor would not have done as well under the reorganization as under a Chapter 7 liquidation of the association's assets. The "best interests of the creditor rule" requires that the creditor must receive as much under the reorganization plan as it would have received in a liquidation. Under a liquidation, the court would have ordered the association to impose a special assessment on the members to pay the entire judgment, and held them in contempt of court if they did not comply. Although the owners were not directly liable to the contractor and could not be sued as individuals [ECC v. Ganson, 82 Cal. App. 4th 572 (2004)], they were indirectly responsible for paying the judgment against the association. See also "Memorandum of Opinion on Confirmation of Debtor's Plan," *In re Oak Park Calabasas Condominium Association*, US Bankruptcy Court, Central District of California, 302 BR 665; 2004 Bankr LEXIS 1636 (2003).

The association then proceeded to lose yet another lawsuit, when it sued State Farm Insurance under the directors' and officers' coverage, seeking to force State Farm to pay the judgment as if it were a liability of the association's board of directors. They lost this claim, with the appellate court saying that there was no coverage for breaching a contract, and also that the association was seeking unjust enrichment. They had already been paid for the property damage by State Farm, but chose not to pay the contractor, and lost that lawsuit. They could not now go back and seek more money from State Farm.[4]

The Los Angeles Kingsbury Court condominium project was also damaged in the Northridge earthquake. The association hired a private insurance adjuster, O'Toole, to help them deal with their insurance company over the proper dollar amount for repairs to their project. The Association agreed to pay the adjuster 10 % of the proceeds paid by its insurer. They received $1.4 million from the insurance company, but then refused to pay the adjuster his 10 %. O'Toole sued the association for breach of contract and won. The trial court ordered the association to impose a special emergency assessment to pay the judgment, but the association refused. The court then appointed a receiver to carry out the court's order.[5] Kingsbury Court appealed and lost. This approach was approved by the appellate court, and may be considered binding authority for similar cases in California.[6]

These cases and others illustrate certain uncomfortable facts about the potential liabilities associated with owning a CID unit, and they are facts that very few members of the public understand:

- **Owners are responsible for paying to maintain and repair their common areas. Insurance coverage pays for certain types of damage to the association's property, and ther liability insurance covers them against slip and fall accidents and other sudden and accidental loss. However, there is generally no coverage for the cost of maintaining or replacing major building components that have simply worn out over time, such as roofs, streets, and swimming pools.**
- **Owners are also liable for other debts of the association resulting from acts of its board of directors, such as intentional torts or breaches of contract, and these are not covered by liability insurance.**
- **Special assessments for emergency losses, such as uninsured damages or lawsuit judgments, can be in the tens of thousands of dollars per owner.**
- **Attempting to bankrupt the association to protect the owners against having to pay these judgments will not work. One bankruptcy law scholar has characterized these efforts as a "death spiral" (Pinkerton 2009).**

[4]Oak Park Calabasas Condominium Association v. State Farm, 137 Cal. App. 4th 557 (2006). [5]O'Toole v. Los Angeles Kingsbury Court Owners Association, Superior Court of Los Angeles County, No. LC050749, Richard B. Wolfe, Judge (1995–2000).

[6]O'Toole v. Los Angeles Kingsbury Court Owners Association, 126 Cal. App. 4th 549 (2005).

- **If owners do not pay court judgments, judges will appoint receivers who will make them do it, and they will take over the associations' monthly assessment stream and impose special assessments to do that.**
- **Owners who fail to pay their share of any such judgment will lose their homes in foreclosure.**

Even for associations whose directors display more wisdom than those at Le Park, Oak Park Calabasas, Kingsbury Court, and the other places where horrendous decisions have exposed owners to draconian liabilities, there is the enemy known as time, and that can lead to the same outcome. Many associations are under-reserved because director-owners control their own assessment levels and decide not to set aside enough for future repairs that are both costly and inevitable. Their calculus is simple: why should I pay to build a roof in ten years, when I will have sold my unit and moved on and the roof will benefit somebody else?

An attorney and author who has studied this situation systematically has concluded that many CIDs are a fiscal time bomb and that reform is needed to prevent widespread CID insolvencies in the years to come. Nearly all the CID units in the United States were built during the last thirty years, and their main components will wear out at a fairly predictable rate. When the bill comes due for repair or replacement of major building components that have worn out, there will be little if anything in reserve, there will be no insurance coverage at all, there will be no responsible party to sue, a loan will be difficult if not impossible to obtain, and the owners will have no choice but to assess themselves tens of thousands of dollars to pay for it (Berding 2005).

It can be argued that somehow "the market" will solve this problem, on the assumption that fully informed buyers will not purchase homes in under-reserved developments or places in need of major repairs. This argument fails to consider the difficulties involved in buyers becoming fully informed. The condition of major components of a multi-unit building may not be visible or otherwise discoverable to ordinary scrutiny. Unless the board has hired an expert to perform a reserve study that estimates the time frame and cost of repair of major building components, there may be no association records that reflect the condition of the common areas. Prospective purchasers have no right of access to association financial information until after they have signed a contract to buy a unit, which ordinarily requires placing a cash deposit. Thus they are committed to the purchase before they are able to learn all the facts, and their ability to back out of the sale is determined by the language of the sale contract.

5 The Las Vegas HOA Takeover Ring

Earthquakes and construction defects highlighted the financial fragility of many associations, and illuminated the risks to which owners are exposed if their boards of directors make serious mistakes. Recently in Las Vegas, Nevada, a federal

prosecution of a massive HOA fraud ring showed how easy it can be for criminals to take over HOA residential private governments and use them to commit multi-million-dollar fraud.

There have been many cases of embezzlement and fraud where association officers, managers, or other employees have been convicted in cases involving tens or hundreds of thousands of dollars. The most dramatic example to date occurred in Las Vegas between 2003 and 2009, and it became the subject of what has been described as "the largest case of public corruption federal authorities have ever brought in Southern Nevada" (German 2015b). A ring of white-collar criminals, led by a construction contractor, took over eleven homeowners' associations by fraudulent means and used their powers as HOA directors to bilk insurance companies out of $10 million. *Las Vegas Review-Journal* reporter Jeff German has covered the case extensively. The allegations are summarized in a press release from the Federal Bureau of Investigation, following a jury trial in which three of the numerous defendants were convicted:

> According to the evidence presented at trial, from approximately August 2003 through February 2009, the defendants engaged in a complex scheme to direct construction defect litigation and construction repairs at more than 10 condominium complexes in the Las Vegas area to a law firm operated by a co-conspirator and a construction company, Silver Lining Construction, owned by Leon Benzer. In order to accomplish the scheme, the defendants and their co-conspirators identified HOAs for condominium complexes that had potential construction issues that could result in construction defect litigation and require repair. They then sought to take controlling interests on the identified HOAs' boards by purchasing units in the condominium complexes and running for election to the boards… To ensure that conspirators won the HOA elections, the defendants employed deceitful tactics, such as submitting fake and forged ballots, and hiring complicit attorneys to run the elections as "special election masters," who presided over the elections and supervised the counting of ballots.
>
> The evidence demonstrated that, once elected, the conspiring board members, including Ruvolo and Ball, met with Benzer and other co-conspirators in order to manipulate the selection of property managers, contractors, general counsel and construction defect attorneys to represent the HOAs. Gregory, an attorney licensed in Nevada, agreed to become the general counsel for two HOAs and to take direction from Benzer… Over the course of the scheme, more than $7 million in construction contracts were awarded to Benzer's company from a single HOA. Several million dollars in legal fees were also directed to another co-conspirator… On Jan. 23, 2015, Benzer pleaded guilty to one count of conspiracy to commit mail and wire fraud, fourteen counts of wire fraud, two counts of mail fraud, and two counts of tax evasion. He is awaiting sentencing (FBI 2015).

The fraud ring was raided and broken up by the FBI and local Las Vegas police in 2008 while the fraudsters were on the verge of expanding their scheme to many other associations. Almost 100 conspirators were identified, and to date 42 people have been convicted. The US Attorney's office lists eleven HOAs that were either taken over or were in the process of being taken over. It is claimed in sentencing documents that the actual losses were $10 million, representing money that was fraudulently obtained from insurance companies, but the intended losses, if all had gone as planned would have been $60 million. The conspirators included high-profile attorneys, several police officers, and a prominent Republican Party

figure (German 2015b). Two of the attorneys committed suicide before being charged, and a retired police officer and one of the other defendants also took their own lives (Murphy 2012). Steve Wark, the former chair of the Nevada Republican Party, pled guilty and was sentenced to 366 days in federal prison (German 2015a). Benzer was sentenced to 15.5 years in prison (German 2015c).

This prosecution is significant for several reasons. First, it illuminated how easy it can be for a committed group to take control of a CID private government. In many, if not most, associations, the majority of owners pay little attention to association activities or finances. A culture of non-participation exists, with people not voting in elections, not volunteering for board or committee positions, and generally behaving as if they lived in an apartment building where the landlord is responsible for everything.

Industry professionals have expressed concerns over this problem and have tried to find ways to create a more vibrant sense of community in associations and thus engender norms of participation and voluntarism (Overton 1999). However, this remains a challenge. Association directors and officers are not financially compensated for their work. Yet, if they are to do the job well they must devote a great deal of time and energy to educating themselves about the law and corporate procedures, learning about their association's social and economic condition, attending meetings, hearing people's complaints, and making often-difficult collective decisions about matters that may affect hundreds of people. Some people do all this, and well, but others do not. And in many associations, especially small ones, association leadership elections draw little interest and few volunteers. Consequently it can be relatively easy for a committed group of like-minded people to take over an association board of directors and make decisions that favor themselves or their associates. It is entirely possible that this can go on without most owners knowing it. Once in control, boards can obstruct member access to records and prevent anybody from penetrating the scheme.

Second, the Las Vegas takeover ring is a highly-publicized example of HOA-related fraud, which is a significant problem that is rarely prosecuted unless there are substantial monetary losses and an easily provable case.[7] Even so, there have been many other cases across the nation in which people used their positions as directors, officers, managers, or other related jobs, to bilk HOAs or those who deal with them. There are opportunities for people to embezzle money from HOA reserve or operating accounts, engage in sweetheart deals with contractors in

[7]In this case, the prosecution only came about because another local construction defect attorney believed he lost a chance to work with an association due to the activities of this ring. He and his law firm did their own investigation and turned the evidence over to the US Department of Justice. The case was handled by a special public corruption task force from Washington, DC, instead of the local US Attorney's office in Las Vegas. The local US Attorney's office withdrew from the case when a criminal investigation was started into whether inside information on the investigation was being leaked to one of the attorneys who was under suspicion (German 2013).

exchange for kickbacks, impose bogus fees on owners and prospective buyers, and (as in Las Vegas) make fraudulent insurance claims.[8]

Third, many of the Las Vegas HOA swindlers were established, well-known professionals who had been making their livings for many years serving HOAs. They had the necessary knowledge, the contacts, and the credibility to make this scheme work. This raises a question concerning whether there is adequate supervision and regulation of the lawyers, managers, and contractors who work for HOAs. If a scheme this enormous and brazen could go on for six years, in a state that has one of the most developed systems of HOA regulation, it suggests that industry self-regulation is insufficient, and there is a need for greater governmental oversight. It also suggests that the CID housing sector needs some institutional support other than profit-motivated professionals.

6 Condo Fraud, Chicago Style

As of yet there is no new legislation in Nevada or elsewhere aimed at addressing the problems highlighted by the Las Vegas HOA takeover ring. However, another massive condominium-related fraud in the state of Illinois did lead to enactment of a law that can be used to reorganize failed condominium projects. From about 2000 to 2007, the Chicago housing market was booming, and nearly all the new housing was in HOAs and condominium projects. Around the Chicago downtown area, north, west, and south, a ring of redevelopment sprouted, as former industrial buildings were carved up into trendy loft condominiums, and old apartment buildings were converted into condominiums. In such a hot market, banks and mortgage companies were eager to make loans, even based on questionable documentation, because they could sell the notes overnight on the secondary market, where they were securitized and sold as residential mortgage backed securities. Investors in the United States and other nations were eager to purchase units, sight unseen, acting on the advice of realtors and appraisers, in the hope of renting them out and holding onto them while the market value increased, waiting for the proper time to sell and reap a profit.

Enterprising but unscrupulous individuals saw the opportunity to set up fraud rings and take advantage of easy credit and absentee investors. Several of these groups, including slumlord apartment building owners, dishonest appraisers, employees of mortgage companies, and straw purchasers, did the paperwork necessary to convert hundreds of apartment buildings into condominium projects and obtained approval from the City of Chicago. They prepared beautiful advertising materials full of photos depicting marble countertops, hardwood floors, new appliances, and all the *accoutrements* of trendy urban condos and listed the units for

[8]I have reported on some of these numerous cases over the years in my weblog, *The Privatopia Papers*, at http://privatopia.blogspot.com, which can be searched for the fraud-related posts.

sale. Unfortunately, the photos were of not of the properties that were being converted, which were in fact the same slums they had been for decades, and were still full of low-income tenants. But crooked appraisers would certify the value of the units, and straw purchasers were paid to fill out loan applications supported by fake documentation. Lending institutions, sometimes by virtue of misconduct of their own employees as well, would cut checks to purchase the fictitious condo units, and the building owner would pocket hundreds of thousands of dollars for each unit, paying off the straw purchaser who would promptly disappears. In other situations, absentee investors bought these units without ever seeing them, only to later dis- cover that their investment was worthless. Hundreds of millions of dollars went directly from banks into the pockets of criminals.

The US Attorney for the Northern District of Illinois prosecuted a number of these rings. In a press release concerning one of these many prosecutions, the US Attorney explained as follows:

> Seven defendants, including two real estate investors and three licensed loan originators, were indicted today for allegedly participating in a scheme to fraudulently obtain more than 20 residential mortgage loans totaling approximately $8.5 million from various lenders. The indictment alleges that the mortgages were obtained to finance the purchase of properties primarily in and around Englewood and West Englewood in Chicago by buyers who were fraudulently qualified for loans while the defendants allegedly profited. As a result, various lenders and their successors incurred losses because the mortgages were not fully recovered through subsequent sale or foreclosure… Since 2008, more than 200 defendants have been charged in Federal Court in Chicago and Rockford with engaging in various mortgage fraud schemes involving more than 1,000 properties and approximately $300 million in potential losses, signifying the high priority that federal law enforcement officials give mortgage fraud in an effort to deter others from engaging in crimes relating to residential and commercial real estate. (US Department of Justice 2012) [emphasis added]

These prosecutions were, of course, necessary to restore confidence in the Chicago condominium market, but they did not solve a residual problem that befell the City of Chicago, the low-income tenants who lived in the crumbling buildings, and anybody living in the neighborhood of one of these fake condominium con- versions. That problem was simple: if the condominium conversion was fake, then there was certainly no association running the building, and since the former building owner had taken his ill-gotten gains and disappeared, or been arrested, there was nobody responsible for maintaining the building. Utility bills were not being paid, so water, electric, and gas service was disconnected. Tenants were patching into the electric lines of neighboring buildings and draping extension cords across gangways. Hazard abounded, including roof leaks, vermin infestation, and fire hazards from indoor burning of wood for heat. Banks did not bother to foreclose on the loans because the buildings were valueless and constituted nothing but a liability. There was perhaps no better illustration of what can happen when a condominium or homeowner association fails to function.

This crisis produced a unique response from the City of Chicago, the Illinois state legislature, and Community Investment Corporation (CIC), a not-for-profit lending institution led by affordable housing expert Jack Markowski, the former Housing Commissioner of the City of Chicago. CIC had a loan pool of some $400 million

derived from 31 lenders and other institutions, and it had long been actively involved in helping building owners obtain loans and expertise to rehabilitate existing structures and improve the quality of affordable housing. They worked closely with the Chicago city attorney's office, known as the Corporation Counsel, because problem buildings were cited for code violations and prosecuted in the Cook County Housing Court, which would in many situations refer the owner to CIC for assistance with a plan of action. This initiative is called the Troubled Buildings Initiative (Roeder 2010).

But as more and more of the fraudulent condo conversions began to come to light, the City Attorney and CIC realized that the normal approach for troubled apartment buildings would not work. There was no building owner to cite or deal with, and the condominium association did not even exist except on paper. Ownership of the units was spread across a bewildering array of absentee investor owners and mortgagees, because mortgages were being sold and resold constantly and even the lending institutions themselves were being purchased or going out of business.

CIC and the City of Chicago persuaded the Illinois State Legislature to pass the Illinois Distressed Condominium Property Act, which allows the city to go to Housing Court and ask the court to appoint CIC (or another organization) as a receiver who can go about the arduous task of locating all the property interests in the building and buying them for a fraction of their original loan value. Once title is unified, all the liens can be extinguished and the building is then de-converted, or turned back into an apartment building. The condominium is dissolved by court order, a new building owner is located, and loans are structured to put the property back in operating condition as an apartment building. The statute prescribes the conditions for appointing a receiver, and it is evident from this list that conditions in these buildings were dire indeed:

Sec. 14.5. Distressed condominium property.

(a) As used in this Section:

(1) "Distressed condominium property" means a parcel containing condo- minium units which are operated in a manner or have conditions which may constitute a danger, blight, or nuisance to the surrounding com- munity or to the general public, including but not limited to 2 or more of the following conditions:

(A) 50 % or more of the condominium units are not occupied by per- sons with a legal right to reside in the units;
(B) the building has serious violations of any applicable local building code or zoning ordinance;
(C) 60 % or more of the condominium units are in foreclosure or are units against which a judgment of foreclosure was entered within the last 18 months;
(D) there has been a recording of more condominium units on the parcel than physically exist;

(E) any of the essential utilities to the parcel or to 40 % or more of the condominium units is either terminated or threatened with termi- nation; or
(F) there is a delinquency on the property taxes for at least 60 % of the condominium units.[9]

CIC estimates that there are at least 250 buildings that may satisfy the criteria, scattered all over the city (Podmolik 2012). This program, which appears to be unique to the city of Chicago, is effective as a pragmatic solution to a serious problem.

It must be noted, though, that condominium ownership is at the root of the problem. Condominium units are sold in individual transactions to different buyers using different lenders, with no overall coordination. Once sold, each unit's mortgage can be resold many times, the owner can take out second mortgages, and eventually the ownership of the building is dispersed in ways that only an expert can track. With ownership goes control of the condominium association, and as can be seen from this saga, when the condominium association ceases to function enormous problems are created for local government, building residents, and the entire neighborhood.

Even where there was no fraud involved, the problem of "busted" condominium projects and HOA-run subdivisions has become such a problem that bar associations are offering courses to attorneys in how to deal with them. One of the leading authorities on workouts for such projects is Chicago attorney Brian Meltzer, who, in one of his instructional documents, describes typical problems situations that, he contends, often can only be solved only by starting with condemnation of the building and public acquisition through eminent domain.

> Building A is a new construction or gut rehab condominium building consisting of 30 units, 20 of which were sold to buyers who financed their purchase with high LTV [loan to value] mortgage loans and 10 of which were not sold and are now owned by a bank, the developer or a successor developer/investor. All of the sold units are "under water" and many of them are delinquent on mortgage payments, assessment payments and real estate tax payments and are in various stages of foreclosure. The unsold units are currently worth far less than the sale prices paid for the sold units and less than the replacement cost of the units… There is no unit loan financing or refinancing available for an owner/occupant and there is no readily available financing for an investor who desires to purchase units in either Building for use as rental units, further adding to the depressed value and lack of marketability of the units…Unless something is done to deal with these distressed properties, they will dete- riorate and become a slum or worse (Meltzer 2012).

The solution of condemnation and public acquisition has in fact been adopted in a number of cases, including condominium developments that disintegrated into gang-ridden slums full of abandoned units (Berding 2005). However, it is con- ceivable that earlier public intervention, in the form of monitoring and oversight and regulation, could forestall such drastic and expensive action.

[9]Illinois Distressed Condominium Property Act (765 ILCS 605/14.5).

7 New Agency Policies in the Mortgage Industry

There are few federal statutes that regulate the governance of CIDs, but federal agencies involved in promoting homeownership and mortgage lending have adopted a number of significant policies.

Until recently, federal housing policy was focused on promoting the sale of new homes and increasing the homeownership rate. From the early 1960s to the present, the Federal Housing Administration has promoted the spread of CID housing, including drafting and disseminating model documents. Condominium housing was brought to the United States in 1961 when the FHA decided to ensure condo- minium mortgages, and required all states to enact condominium property acts that would allow for creation of these interests, that were unknown in the United States previously. The federal government also inaugurated a New Communities Program in the 1970s, providing financial guarantees for a number of large "New Town" CID developments with populations in the tens of thousands. Most of them were not financially successful and the program was terminated (McKenzie1994).

More recently, the Hope VI program, a $5 billion initiative that has begun in 1992 and pursued aggressively by the Clinton administration, provided for demolishing old public housing projects and replacing them with a combination of subsidized-rent apartments and condominiums. Although unpopular with the Bush administration, by 2004 the program had demolished or scheduled for redevelopment over 80,000 public housing units (Popkin et al. 2004).

However, following the crash of the housing market in 2007−2008, the federal policy focus shifted from promoting CID housing, and homeownership in general, to protecting the federal government from further losses. These policies emanated from the federal quasi-public agencies known as "GSEs" or "government sponsored enterprises," such as the Federal National Mortgage Association, or "Fannie Mae." They require standardized CID document provisions, and rate units and projects to determine if they qualify to have mortgages on those units sold in the secondary market, thus freeing up the original lender's liquidity to make more loans.

After the crash of the housing market, Fannie Mae reduced its exposure to risk of failed associations by stating that it would no longer purchase mortgages on homes in CIDs unless the association met certain requirements. In December 2008, the agency announced its concerns and imposed a new set of rules, including a requirement that "established condominium projects consisting of attached units have an owner-occupancy ratio of at least 51 % at the time the loan is originated (purchase or refinance) if the mortgage loan being delivered is secured by an investment property" (Federal National Mortgage Association 2008).

In order to address the new environment of risk in Florida, where the housing market collapse was severe, Fannie Mae inaugurated a special approval process for Florida condominiums to protect itself against risk. Fannie Mae announced, "Many established Florida condominium projects that initially met Fannie Mae's eligibility requirements may no longer be eligible, potentially limiting access to mortgage financing. Reasons why these projects may not currently meet Fannie Mae's project

eligibility standards include significantly weakened homeowners' association (HOA) budgets—association fees are not being paid by delinquent homeowners; unpaid common expenses including pest control, property insurance, water, pool service, and garbage collection; or increased vacancies and REOs, exacerbated by the length of time it takes to complete the foreclosure process".

Fannie Mae imposed new requirements nationwide that have been modified and can be expected to change. However, they convey a sense of how concerned Fannie Mae became about association solvency:

- No more than 15 % of a condo project's units can be more than 60 days delinquent on HOA dues.
- Fidelity insurance is required for condos with 20 or more units, ensuring that homeowner association funds are protected. No more than 10 % of a project can be owned by a single entity.
- No more than 20 % of a project can consist of non-residential space, meaning that mixed residential-commercial developments are disfavored.
- No more than 10 % of the units can be owned by the same entity, meaning that projects owned by investors who are buying up the units in a distressed property are not viewed as good risks.
- The association must have at least 10 % of its budgeted income designated for replacement reserves and adequate funds budgeted for the insurance deductible (Federal National Mortgage Association 2015).

The Federal Housing Administration also imposed a new set of requirement for issuing mortgage insurance:

- No more than 25 % of the property's total floor area in a project can be used for commercial purposes.
- No more than 10 % of the units may be owned by one investor.
- No more than 15 % of the total units can be in arrears (more than 30 days past due) of their condominium association fee payments.
- At least 50 % of the units of a project must be owner-occupied or sold to owners who intend to occupy the units (Federal Housing Association 2009).

While these provisions are salutary from the standpoint of the agencies that are charged with safeguarding public funds and protecting lending institutions, the owners of units in buildings that fail to meet the standards are placed in a difficult position. Prospective buyers of their units will be unable to qualify for a conventional loan—one that can be insured and sold on the secondary market—and this restricts the pool of purchasers for the most part to cash buyers. Public policies as of this writing do not protect the unit owners from the economic consequences of market forces that have been rippling through the US for many years. This must be seen as one of the perils of collective ownership of real property in the form of condominiums.

8 Lien Priority

When unit owners in CID projects become unable or unwilling to pay their debts, and their unit must be sold in foreclosure in order to pay those debts, conflicts arise concerning the order in which lien holders should be repaid. For example, there may be a first mortgage, a second mortgage, a lien for unpaid CID association assessments, and a property tax lien from the county. The law of lien priority is a matter of state law, but the US housing market is truly national in scope and the lenders and other institutions involved desire consistency. In the United States there are organizations that promote uniformity in state laws. The most influential of these is the Uniform Law Commission. They have promulgated a series of recommended codes on many subjects, including the law of common interest housing. Two of these proposed laws, which have been adopted by many states, directly address lien priority, and they reflect a concern for the financial wellbeing of CIDs. In most cases, once the first mortgage is foreclosed on, there is little or nothing left for any other lien holder. If there is, it will have already been paid out to satisfy a tax lien or a second mortgage. The condominium associations or HOA would end up receiving nothing.

Consequently, the ULC in its proposed state laws has tried to protect the financial health of associations by awarding them a "super-lien" that takes prece- dence over other liens, including the first mortgage, to the extent of six months of unpaid assessments. This was first placed in the Uniform Condominium Property Act of 1980 (UCA), and then in the Uniform Common Interest Ownership Act of 1982 (UCIOA). Presently, 21 states and the District of Columbia give some form of lien priority to the CID claim for unpaid assessments, nearly all of the using the six month standard. Eight UCIOA states do it, as do five UCA states and nine other states using their own version of super-lien protection (Lewis 2013).

However, lending institutions are understandably unhappy about this situation. Most notably, Fannie Mae has been active in challenging these super-lien provisions in court, and private banks with federally insured loans have also taken up the cause. The claim is that these state laws impermissibly extinguish a property interest of the United States government, and there are other legal issues as well. The validity of CID super-priority liens is currently before several state and federal courts. Notably, in 2014, the federal Court of Appeals for the District of Columbia ruled that the super-priority lien extinguished the first mortgage.[10] The shock waves from this and several other cases continues to reverberate through state and federal courts, and it is likely that one or more other federal appellate courts will render decisions on the matter. These cases pit banks against CIDs in competition for what can be salvaged from the wreckage when homeowners become insolvent. The stakes for the nation's CIDs are substantial.

[10]Chase Plaza Condominium Association v. J. P. Morgan Chase 98 A 3d 166 (2014).

8.1 Concluding Thoughts

The residential private governments that govern US CIDs are not islands of private local self-determination. They are inextricably, unalterably embedded at the inter- section of two complex institutional networks—the housing market and government. The ebbs and flows of the housing market and the public and private agencies that participate in it directly impact the finances and fortunes of CIDs. The planning, taxing, spending, regulatory, and constitutive policies of public governments, especially at the state and local level, are of great importance to CID private governments and all unit owners.

Yet, if we examine the relevant post-housing crash policies, it appears that there is still a reluctance among policy makers to recognize the degree to which CID private governments have become not just guardians of neighborhood property values, but guarantors of the value of residential mortgage backed securities, and at the same time an increasingly important part of the intergovernmental system. Despite the mounting evidence that CID private governments are overly reliant on owner resources and lacking in institutional support, policy makers have favored self-protective steps to insulate public institutions from the risk of loss, rather than bolstering the private governments that pose that risk.

Such policies are an improvement over the reckless promotion and unregulated privatization that marked the rise of residential private government. At least we appear to have discarded the cavalier assumption that no institutional support or regulation are necessary. **But what is missing, still, is a proactive and forward looking approach**. It is worth considering what such an approach might look like, because some of the moving parts are emerging in a few states.

First, it should be recognized that condominiums are the most fragile type of CID, because attached housing typically includes building-wide systems for electricity, water, gas, forced air, garages, elevators, roofs, and other features that are complex and expensive to repair. All owners are linked financially to each other and are obligated to maintain, repair, and replace these systems. Many if not most of them do not understand the nature and possible extent of these obligations, and the degree to which they are pledging their own resources to those ends. And the risks go up substantially when the condominium is a converted apartment building. These structures are often old and suffering from deteriorating infrastructure systems at the moment the new units are sold to the public. When condominium housing is made affordable for people of low to moderate means, the owners may have insufficient savings to contribute to a special assessment, and little or no home equity to borrow against. Any forward-looking policy must take these facts into account.

Second, there is, in general, insufficient institutional support for all forms of CIDs in the United States. The resource base of this institution is inadequate for the long term and in many cases, for the short term. Owners as a group cannot be counted upon to adequately fund CIDs beyond their monthly operating expenses. The notion that they will happily tax themselves today to build a roof for other

owners in ten years is fanciful. State laws should include minimum reserve requirements, regular reserve studies, and annual public disclosure of those studies and the actual reserves on account, for every CID. In the absence of such requirements we should expect that many associations will experience eventual financial crisis even if nothing goes wrong—no earthquake, mismanagement, fraud, or recession—simply because inadequate reserve are available to pay for inevitable failure of major building components.

Third, information on the operation of CIDs should no longer be regarded as private. States should be mandating not just disclosure of information on reserves, but comprehensive annual registration and data gathering on officers and directors, finances, disputes, and other basic information. If CIDs are going to carry out what would otherwise be local government functions, they should perform those functions to public standards, and that can only be determined if we have more transparency.

Fourth, there should be state-level oversight commissions for this type of housing, including managing an ombudsman or other low cost dispute resolution system, educating owners and directors on their responsibilities and rights, and undertaking studies on a state's stock of CID housing. This is already being done for cities, counties, school districts, and special districts.

Fifth, there need to be state laws, as there are in several states, that create clear and specific expectations for CID private governments concerning their internal operations. There should be an owners' "bill of rights" that states clearly what parts of their lives are off limits to association rules and regulations. This would reduce the conflict over flags, religious symbols, political signs, and other expressive conduct that wastes everybody's resources on litigation. Directors and officers, and owners generally, should be able to understand how to run meetings, handle records, prepare budgets, resolve disputes, rule on requests for architectural changes and exceptions to rules, collect assessments, and plan for the future.

Finally, state governments should re-introduce diversity into the new housing market by prohibiting municipalities from requiring CIDs in all new residential construction.

If the foregoing steps were taken, market forces and objective researchers would supplement public policies and improve CID housing. The public generally would be able to make informed decisions about where to shop for a home, instead of having to wait until they are bound by a contract. Academic and government researchers could perform studies that would enlighten all concerned, instead of the current situation, in which nearly all the data available are coming from self-interested professionals and trade associations. There is nothing improper about professionals advancing their interests in the press and through the policy process, but there is an enormous public interest in having a full understanding of what is going on in this privatized realm, and that will never come from private professionals who are making their living solving problems that could be prevented by more enlightened public policies.

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