

Private Covenants, Public Laws,  
and the Financial Future of Residential Private Governments

by

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## Abstract

Common interest housing developments (CIDs) are the predominant form of new residential housing construction in most major metropolitan areas in the US. Condominiums proliferate in large central cities and the inner suburban ring, while the outer ring and the exurbs are replete with subdivisions of single-family homes run by homeowner associations. These private organizations, numbering nearly 350,000 nationwide, perform many of the functions of local government for an estimated 70 million Americans, making CIDs perhaps the most dramatic unplanned privatization program ever witnessed. It has been argued that the rapid spread of CID housing since the early 1960s is evidence of market sovereignty in operations. Home-buyers, it is said, are “voting with their feet” and choosing private over public local government in a process much like the public choice theories advocated by Charles Tiebout and James Buchanan. Industry-sponsored surveys show that most CID unit owners appear to be contented enough with their association and its activities. For those reasons, believers in market sovereignty insist that only the most minimal regulation of private government activity is needed, or even justified. Standard state regulation covers the major internal processes of condominiums and HOAs, such as assessment collection, elections, and architectural review. However, there is almost no meaningful governmental oversight of the financial health of associations. This reflects the widespread belief that no such regulation is necessary. In this article I argue that the foregoing picture, is fundamentally flawed. In reality, the entire institution of common interest housing rests on the resources of the owners, and there are good reasons to believe that these resources are too often inadequate. By “resources” I mean not just the money that is needed to maintain the properties, but also the organizational abilities, the knowledge, the wisdom and judgment, and the loyalty to the community that this form of housing requires of the people who run them. As I show, there are many examples of large-scale failure of CID government, including financial fraud and embezzlement, disastrous decisions, underfunding of necessary reserves, and hostile takeovers. Moreover, the aging of the entire CID housing stock means that financial challenges are becoming a structural feature of this housing sector. When associations fail, the consequences harm all the owners, and often extend to entire neighborhoods or even cities. I argue that increased state oversight and regulation of CID finances should be instituted to prevent more widespread problems, which are increasingly likely as these properties age and major building components require costly repair and replacement, but the funds to make those repairs are not available.

## Introduction

Common interest housing developments (CIDs) are the predominant form of new residential housing construction in most major metropolitan areas in the US. Condominiums proliferate in large central cities and the inner suburban ring, while the outer ring and the exurbs

are replete with subdivisions of single-family homes run by homeowner associations. These private organizations, numbering nearly 350,000 nationwide, perform many of the functions of local government for an estimated 70 million Americans, making CIDs perhaps the most dramatic unplanned privatization program ever witnessed.<sup>1</sup> In many metro areas, local governments require that all new housing construction must be in CIDs, so that they can receive a windfall in the form increased tax revenues from new construction with fewer services to provide.<sup>2</sup> Recent research shows that homes in CIDs cost 4%, or \$13,500, more than comparable non-CID homes, and that they appear to be viewed by homebuyers as a “valuable substitute for local government.”<sup>3</sup>

It has been argued that the rapid spread of CID housing since the early 1960s is evidence of market sovereignty in operations. Home-buyers, it is said, are “voting with their feet” and choosing private over public local government in a process much like the public choice theories advocated by Charles Tiebout and James Buchanan.<sup>4</sup> Industry-sponsored surveys show that most CID unit owners appear to be contented enough with their association and its activities.<sup>5</sup> For those reasons, believers in market sovereignty insist that only the most minimal regulation of private government activity is needed, or even justified. This is a quasi-utopian belief, and I coined the word “privatopia” to refer to the CID housing sector as a whole, because it seems to

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<sup>1</sup> Community Associations Institute, *National and State Statistical Review for 2017*.  
<https://foundation.caionline.org/wp-content/uploads/2018/06/2017StatsReview.pdf>

<sup>2</sup> Steven Siegel, “The public role in establishing private residential communities: Towards a new formulation of local government land use policies that eliminate the legal requirements to privatize new communities in the United States.” *Urban Lawyer* 38 (4): 859-948, 2006.

<sup>3</sup> Wyatt Clarke and Matthew Freedman, “The rise and effects of homeowners associations,” *Journal of Urban Economics*,” 112 (2019) 1-15.

<sup>4</sup> See, for example, Fred E. Foldvary, 1994. *Public Goods and Private Communities: The Market Provision of Social Services*. Northhampton, VA: Elgar.

<sup>5</sup> The Community Associations Institute is the leading trade association for providers of services to CIDs. They sponsor surveys that show most CID unit owners are satisfied with their associations.  
[https://www.caionline.org/PressReleases/Statistical%20Information/HOMEsweetHOA\\_2018.pdf](https://www.caionline.org/PressReleases/Statistical%20Information/HOMEsweetHOA_2018.pdf)

represent a utopian belief that living in a neighborhood with unregulated and privatized local government functions is the route to a far better life than what is offered by municipalities.<sup>6</sup>

The belief that minimal oversight of CIDs is sufficient tends to predominate in the public policy network, where regulation is limited for the most part to the kinds of state laws that are typical for not-for-profit corporations. Standard state regulation covers the major internal processes of condominiums and HOAs, such as assessment collection, elections, and architectural review.

However, there is almost no meaningful governmental oversight of the financial health of associations. This reflects the widespread belief that no such regulation is necessary. In this article I argue that the foregoing picture, which is largely the product of industry public relations departments, is fundamentally flawed. In reality, the entire institution of common interest housing rests on the resources of the owners, and there are good reasons to believe that these resources are too often inadequate. By “resources” I mean not just the money that is needed to maintain the properties, but also the organizational abilities, the knowledge, the wisdom and judgment, and the loyalty to the community that this form of housing requires of the people who run them.

As I show, there are many examples of large-scale failure of CID government, including financial fraud and embezzlement, disastrous decisions, underfunding of necessary reserves, and hostile takeovers. It is undeniable that most associations do not experience such troubles, and function reasonably well most of the time. But I argue that the evidence of association failure is more than sufficient to warrant increased attention. Moreover, the aging of the entire CID housing stock means that financial challenges are becoming a structural feature of this housing

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<sup>6</sup> Evan McKenzie, *Privatopia: Homeowner Associations and the Rise of Residential Private Government*. New Haven: Yale University Press, 1994.

sector. When associations fail, the consequences harm all the owners, and often extend to entire neighborhoods or even cities. I argue that increased state oversight and regulation of CID finances should be instituted to prevent more widespread problems, which are increasingly likely as these properties age and major building components require costly repair and replacement, but the funds to make those repairs are not available.

### What is common interest housing?

I use the term “common interest developments,” or CIDs, and “residential private governments” in this paper to describe three different types of common ownership housing arrangements that share certain characteristics, which are:

1. A dual form of property ownership in which there is some form of common ownership of real property, called “common areas” or “common elements,” that is combined with an individual interest owned or occupied exclusively by one person or family unit.
2. Private governing documents that typically include deed restrictions (so-called “CC&Rs,” for “covenants, conditions, and restrictions”); articles of incorporation; association bylaws; and often special sets of rules for architectural modifications, pets, pools, parking, and so forth.
3. Automatic membership in an association that is viewed by the law as voluntary, but that is actually a mandatory-membership organization, nearly always a not-for-profit corporation, that owners “join” by purchasing their unit.

4. 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 corporation board of directors.

In the US, three different forms of CID ownership are built on this set of common characteristics. Planned developments of single-family homes with homeowners' associations (HOAs) comprise an estimated 54-60% of the nation's CIDs. These are creatures of common law that have existed in the US since the mid-19th century. These associations own the common elements, and the individual property interest typically consists of a detached single-family home with a yard. Condominiums make up about 38-42% of the total. This form of ownership is a creature of statute that did not exist in the US until the early 1960s, when state condominium property acts made this possible. Housing cooperatives are the least common, representing only about 2-4% of total CIDs, and most of those are in a few large cities, such as New York City and Chicago.<sup>7</sup>

There were fewer than 500 CIDs in the US in 1964, when the first attempt was made to count them. Today there are almost 350,000 associations housing nearly 70 million people. This fast-moving revolution in the organization of Americans' neighborhoods happened largely because developers found common ownership arrangements highly profitable, in that they facilitate increasing density and thus reducing land costs. Small lots, or units stacked vertically, allow them to put more people on less land. And local governments are attracted to the tax

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<sup>7</sup> Data are from Community Associations Institute, *National and State Statistical Review for 2017*. <https://foundation.caionline.org/wp-content/uploads/2018/06/2017StatsReview.pdf>. For analysis of the common law versus statutory origins of HOAs and condominiums, see Wayne S. Hyatt, "Condominium and Homeowner Associations: Formation and Development." 24 *Emory Law Journal* 977.

windfalls afforded by having homeowners paying full property tax bills, even though they are paying privately through association dues for their own infrastructure, such as streets, parks, and water features, and for association-delivered services such as garbage collection and street cleaning. The property tax revolt of the late 1970s and the rising cost of land fueled the rapid spread of common interest developments.<sup>8</sup> Similar dynamics in other nations, and the availability of the documents and legal structure needed to create the main existing forms of CID housing, have spread condominiums and HOAs to nations on every continent.<sup>9</sup>

### The inadequacy of state oversight

The massive spread of CID housing from a niche market to the predominant form of new home ownership happened in only a few decades. It occurred without any level of government anticipating it, much less planning or preparing for it. Consequently, the legal environment within which associations operate has always been in the position of trying to catch up with events.

While it is always the case that condominiums are more tightly regulated than HOAs, beyond that there is considerable variation from state to state. In some states, condominiums and HOAs are under the same regulatory scheme, such as in California, where they are regulated under the Davis-Stirling Common Interest Development Act.<sup>10</sup> In other states, such as Illinois, they are addressed differently by a Condominium Property Act, and a separate Common Interest

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<sup>8</sup> For a quantitative analysis of the relative roles played by land costs and local government financial conditions in the spread of CIDs, see Evan McKenzie, "Homeowner Associations and California Politics: An Exploratory Analysis," *Urban Affairs Review*, 34:1, September 1998, 52-75.

<sup>9</sup> See Sarah Blandy et al. eds., *Multi-Owned Housing: Law, Power and Practice*, Ashgate 2010; Rowland Atkinson and Sarah Blandy, eds., *Gated Communities*, Routledge 2006; Georg Glasze, et al. (eds), *Private Cities: Global and local perspectives*, Routledge 2006.

<sup>10</sup> California Civil Code Sections 4000-6150.

Community Associations Act for HOAs.<sup>11</sup> Some states have detailed sets of special statutes governing the internal procedures of CIDs, while others leave the state law governing not-for-profit corporations, or corporations generally, to do most of the work.

State regulation is focused largely on facilitating and regulating the creation of subdivisions and lots and the creation of associations to govern them, and on prescribing the minimum contents of association operating documents, primarily the declaration of deed restrictions and the corporate bylaws. Internal association procedures are subject to regulation in most states. During the mid-1990s, Nevada, Florida, California, and several other states enacted detailed statutes that addressed how CID private governments 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. However, a review of state laws governing CIDs shows that state regulations have less to say about the finances of associations, and I argue that this particular deficiency of state oversight is a serious problem.<sup>12</sup>

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. The developer is required eventually to turn over control of a board to directors elected by the unit owners, and from turnover on all directors are elected by unit owners from among their members. The owners, through their corporate board of directors, henceforth will make all the decisions about

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<sup>11</sup> The Illinois Condominium Property Act is found in the Illinois Compiled Statutes at 765 ILCS 605/1-35. The Illinois Common Interest Community Associations Act is located at 765 ILCS 160/1-90.

<sup>12</sup> The variations in approaches to state regulation are discussed in Chapter 5 of Evan McKenzie, *Beyond Privatopia: Rethinking Residential Private Government*. Urban Institute Press, 2011.



finances and property maintenance. These are important decisions that affect the lives and the property values of every owner, and that impact the surrounding neighborhood.

As I explain below, every owner can be subjected to enormous financial liability because of board decisions. Yet, there are no minimum qualifications for being a board member, other than being a unit owner. Education and training are expensive, and direct governmental oversight is practically nonexistent. When owners wish to challenge board decisions, in most states the only remedy 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 huge responsibilities that CID housing places on untrained, largely unsupported volunteer directors and officers exemplifies the larger problem, which is that the institution of common interest housing relies almost entirely on the resources of individual owners. It is not just that the owners' financial resources are in most cases the only regular source of revenue for the association. Beyond that, CID housing depends heavily on the judgment, loyalty, commitment, organizational expertise, and social skills of the directors and officers, and indeed of all owners. The unstated assumption underlying this massive privatization of local government functions 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 always have the money and the willingness to pay their assessments; they will vote and participate in association meetings; they will volunteer to serve as directors and officers; they will tax themselves today to set aside sufficient reserve funds for repairs years ahead; and when trusted with association responsibilities they will educate themselves and do a responsible job.

This foundational assumption that the owners will keep these associations operating in perpetuity certainly deserves more scrutiny than it has received to date. As will be shown, there is a substantial gap between what is expected of association directors and officers and what most

of them can actually deliver. Considering the complex nature of the quasi-governmental tasks they perform, it is striking that associations have so little institutional support. Public local governments are sustained in many ways by private and public institutions, but residential private governments are reliant on their own resources, insurance claims, and bank loans. Cities and counties can file for bankruptcy and retain control of their resources, but as will be discussed in detail below, bankruptcy is a risky proposition for a CID.<sup>13</sup>

Recent events have called these assumptions into question and raised concerns about the financial and organizational viability of CID private governments. The housing crash of 2007 and the recession that followed caused financial distress for associations because millions of unit owners who were underwater on their mortgages or in foreclosure stopped paying assessments or simply abandoned their homes and walked away from their mortgages. Banks found themselves in possession of an unprecedented number of foreclosed housing units that they were unable to resell easily in a dead housing market. The bank response to this situation was often to stop paying association assessments on the properties. Associations then were forced to decide whether to engage in expensive civil litigation to force banks to pay, or to reconcile themselves to the lost revenues as a business decision

When unit owners stop paying assessments, the burden of paying for the association's common operating expenses and reserves falls on fewer units, whose owners must pay more to compensate for the non-paying units. This increased financial burden starts a downward spiral that can lead to an HOA or condo development becoming a ghost town with vacant units and a non-functioning association.

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<sup>13</sup> For a full explanation of the perils of bankrupting condominium associations, see Trevor G. Pinkerton, 2009. "Escaping the death spiral of dues and debt: Bankruptcy and condominium association debtors." 26 *Emory Bankr. Dev. J.* 125

These events found their way into the press and came to the attention of policy makers.<sup>14</sup> The weaknesses of an institution that had been treated as if it could be counted upon to last forever were suddenly exposed, and it became clear that governments and lending institutions needed to protect themselves against the possibility that associations would become insolvent or simply cease operating. Problems such as financial fragility, untrained directors and officers, and an owner culture of non-participation were exposed after natural disasters and in shocking examples of mismanagement, fraud, and embezzlement.

### California: Crumbling Condos

Many condominiums and homeowner association-run developments face the necessity of performing major repairs to common areas and units. Often it is simply a matter of building components such as decks, roofs, and streets wearing out over time, which usually means that the association must use reserve funds, special assessments, and bank loans to cover the cost of repairs. But in other situations, the problems are due to defects in the original construction of the project by the developer, and occasionally the need for repairs stems from a major natural disaster. In either of these scenarios, repair funds may be obtained through the association's insurance coverage or through litigation against potentially responsible parties. These are complex and difficult challenges for volunteer CID directors and officers, and courts in

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<sup>14</sup> The plight that many associations found themselves in following the housing crash was documented in the news media. See, for example, Sandra Block, "Homeowners associations are short on cash," *Kiplingers*, April 2014, <http://www.kiplinger.com/article/real-estate/T029-C000-S002-homeowners-associations-are-short-on-cash.html>; and Bill Turque, "Condominiums in crisis: Financial troubles put many communities at risk," *Washington Post*, September 18, 2016. [https://www.washingtonpost.com/local/md-politics/condominiums-in-crisis-financial-troubles-put-many-communities-at-risk/2016/09/17/07ba32ac-6972-11e6-ba32-5a4bf5aad4fa\\_story.html?utm\\_term=.e5884bf85eb7](https://www.washingtonpost.com/local/md-politics/condominiums-in-crisis-financial-troubles-put-many-communities-at-risk/2016/09/17/07ba32ac-6972-11e6-ba32-5a4bf5aad4fa_story.html?utm_term=.e5884bf85eb7)

California have given us examples of what can happen when association leaders make expensive mistakes.

On January 17, 1994, an earthquake measured at 6.7 on the Richter Scale struck Southern California's San Fernando Valley. It was centered near the city of Northridge, a densely populated area with many condominium buildings. The quake caused 57 deaths and 5000 injuries; 112,000 buildings were damaged, many of them having collapsed; 20,000 people lost their homes; and the total property damage was estimated at \$20 billion, making it the most expensive earthquake in US history to date.<sup>15</sup>

Many condominium buildings were severely damaged or completely destroyed, and this required CID directors and officers to file and manage huge insurance claims. Disputes inevitably arose, and the legal aftermath of the Northridge earthquake played out in the California courts for several years. Three cases in particular are instructive, all of which involved developments that are in or near Los Angeles, California.

In 1998, the Le Parc Simi Valley HOA was hit with an arbitration award of over \$6.6 million after losing a lawsuit against ZM Contracting, a firm that the association directors claimed had mishandled repairs on the project.<sup>16</sup> ZM claimed that the association had broken their agreement, interfered in ZM's relationship with subcontractors, and committed trade libel. The association's insurance company disputed coverage for contract-based liability and an intentional tort, which left the association entirely liable to pay the judgment. The association's board of directors refused to assess the owners to pay it, and instead the association filed for

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<sup>15</sup> Michael Martinez, "Six things we've learned since 1994 Northridge earthquake." September 8, 2014. CNN.com. <http://www.cnn.com/2014/01/16/us/northridge-earthquake-things-learned/>

<sup>16</sup> This account of the facts is summarized from "Brief of owners of homes in Simi Valley Le Parc HOA in opposition to ZM Corporation's Motion to Amend Judgment to include 'Le Parc Community Association' as judgment debtor," May 7, 1999, Simi Valley Le Parc Homeowners Association v. ZM Corporation, Ventura County Case No. CIV 159037. See also Milo Peinemann, "Le Parc Condos Legal Tangle Resolved," Los Angeles Times, January 27, 2000. <https://www.latimes.com/archives/la-xpm-2000-jan-27-me-58080-story.html>

bankruptcy, but the bankruptcy court refused to confirm a 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.<sup>17</sup> The insurance company paid the judgment as a business decision, without acknowledging that the claim was a covered loss.

Le Parc Simi Valley's plight was followed by other similar situations. Oak Park Calabasas Condominium Association suffered serious damage in the Northridge earthquake, and retained ECC Construction to do repairs. The association was to pay the contractor with the proceeds from a settlement with the association's property insurance company, State Farm Insurance. However, the association and the contractor ended up in litigation, and a six-month

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<sup>17</sup> 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 *Le Parc Simi Valley Le Parc H.O.A. v. ZM Corp*, Ventura County Superior Court Case No. CIV 159037; Bankruptcy case--Central District of California Case No. SV 97-20190; see also AB 1859 Assembly Analysis, April 26, 2000. 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 Section 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.

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.<sup>18</sup> The association filed for bankruptcy protection, but once again, as with Simi Valley Le Parc, the court refused to confirm a bankruptcy plan, finding that the association actually had assets to pay the judgment. And, as in the Le Parc case, the court held that the power to levy a special assessment on the owners, forcing them to pay or lose their homes in foreclosure, was an asset that could be used to pay the judgment.<sup>19</sup> The net result, as in Le Parc, is that when a judgment is rendered against the association for mistakes made by the board of directors, the owners are responsible for paying that judgment. If the association members, or the board, vote not to specially assess themselves, the court will appoint a receiver who will do it.

But there were more miscalculations to follow. The association then proceeded to lose another lawsuit, when it sued State Farm Insurance under the directors' and officers' coverage. In that case, the association tried to force State Farm—which had already paid for repairs under the association's first party property insurance policy--to pay ECC's judgment against the association. The theory was that this judgment against the association was a liability of the association's board of directors. They lost this claim, with the appellate court saying that there was no coverage under their liability insurance policy for breaching a contract. The court also pointed out that the association was seeking unjust enrichment. State Farm had already paid for

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<sup>18</sup> *ECC v. Oak Park Calabasas Condominium Association* (2004) 118 Cal.App.4th 1031.

<sup>19</sup> See "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 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.

the property damage, but the association chose not to pay the contractor with those funds, which led to the lawsuit that the association lost. They could not now go back and seek more money from State Farm yet again.<sup>20</sup>

The Los Angeles Kingsbury Court condominium project was also damaged in the Northridge earthquake, and the association hired a private insurance adjuster to help them handle a claim against their property insurance company for the cost of repairs. The Association agreed to pay this independent adjuster 10 percent of the proceeds that he helped them recover from the carrier. They received \$1.4 million from the insurance company, but then refused to pay the adjuster his 10 percent, so he 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.<sup>21</sup> Kingsbury Court appealed and lost, with the appellate court approving the trial court's approach. This published opinion may be considered binding authority for similar cases in California.<sup>22</sup>

These cases, where associations made serious mistakes in dealing with insurance-related issues, illustrate certain uncomfortable facts about the potential liabilities that unit owners assume when they buy a CID unit, and they are facts that very few home-buyers understand. First, the responsibility of unit owners to pay the debts of the association includes multi-million dollar uninsured judgments against the association. Second, associations cannot avoid judgments by claiming that they have no assets, because from a judicial perspective, the association's power to assess its owners is a very valuable asset that can be used to pay a judgment. Third, filing for

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<sup>20</sup> *Oak Park Calabasas Condominium Association v. State Farm* 137 Cal. App. 4th 557 (2006).

<sup>21</sup> *O'Toole v. Los Angeles Kingsbury Court Owners Association*, Superior Court of Los Angeles County, No. LC050749, Richard B. Wolfe, Judge.

<sup>22</sup> *O'Toole v. Los Angeles Kingsbury Court Owners Assn.* 126 Cal.App.4th 549 (2005).

bankruptcy is a dangerous path, because it puts the association's main asset, the power to assess, in the hands of a bankruptcy judge. 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."<sup>23</sup> And fourth, if the association board refuses to specially assess the owners to pay a judgment, the trial court judge can simply appoint a receiver to run the association, and the receiver will impose the assessment. Owners who fail to pay their share of any such judgment will lose their homes in foreclosure.

All of that flows from the basic responsibilities of all CID unit owners. They are responsible for paying the costs of maintaining and repairing the common elements in their community, and for paying the debts of their association. They can seek outside sources of revenue, but those sources are limited. The association can file insurance claims for property damage, they can pursue litigation against third parties who caused that damage, and if the association loses a lawsuit they can seek to have their liability insurance carrier pay it. However, property insurance covers only certain types of damage to the association's property and there is usually no coverage for the cost of maintaining or replacing anything that has simply worn out over time. Liability insurance protects the association against sudden and accidental losses, such as slip and fall accidents on association property, but there is no insurance coverage for intentional actions such as defamation and breach of contract. And if the association resorts to litigation and loses, owners are responsible not just for the association's attorney fees, but potentially for any judgment that is not covered by insurance, such as intentional torts or breaches of contract committed by the board members.

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<sup>23</sup> Pinkerton, "Escaping the death spiral of dues and debt," 26 Emory Bankr. Dev. J. 125



### The Las Vegas HOA takeover ring

There have been many cases of embezzlement and fraud in CIDs, where association officers, managers, or other employees have been convicted in cases involving tens or hundreds of thousands of dollars. Most of these cases involved an insider with access to the association's accounts simply stealing money. 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 even brought in Southern Nevada."<sup>24</sup> This case highlighted an additional risk: the potential for CID elections to be rigged by criminals in order to take over the association and use it for illegal purposes.

A ring of white-collar criminals, led by a construction contractor named Leon Benzer, took over eleven homeowners' associations and used their powers as HOA directors to bilk insurance companies out of \$10 million. 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. From August 2003 through February 2009, the ring conspired to take over 11 condominium projects that had potential construction defect claims. They used straw purchasers to buy 37 units in the associations and rigged elections using forged ballots and attorneys who were complicit in the scheme to monitor the elections and count the ballots. Members of the ring were elected to the boards of directors of the associations. They then used their control over the associations to hire particular property managers, construction contractors, and construction defect attorneys. They filed \$10 million in fraudulent insurance claims and channeled over \$7 million in repair business to Silver Lining Construction, owned by Leon

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<sup>24</sup> Jeff German, "How Las Vegas HOA fraud costs are calculated could boost prison terms," *Las Vegas Review-Journal*, June 15, 2015. <https://www.reviewjournal.com/local/local-las-vegas/how-las-vegas-hoa-fraud-costs-are-calculated-could-boost-prison-terms/>

Benzer. They directed millions of dollars in legal fees to attorneys who were part of the scheme.<sup>25</sup> (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 other associations. Although the actual losses in fraudulent claims amounted to \$10 million, had the ring not been raided it would have gone as high as \$60 million. The conspirators included high-profile CID attorneys and several former police officers. 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. Steve Wark, the former chair of the Nevada Republican Party, was part of the ring, pled guilty and was sentenced to 366 days in federal prison.<sup>26</sup>

This massive criminal scheme is significant for several reasons. It shows how easy it can be for a committed group of people with a corrupt motive to take control of a CID private government. This is because in many associations the majority of owners pay little attention to association activities at all, do not vote in elections, and know little or nothing about association finances. Many owners behave as if they lived in an apartment building where the landlord is responsible for everything, not recognizing that the association's vitality and even its survival as an organization depend on their efforts and attention. 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, because owners who decide to get involved in

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<sup>25</sup> Federal Bureau of Investigation Office of Public Affairs, Press Release, March 18, 2015. "Las Vegas Attorney and Three Others Convicted for Their Roles in a Fraudulent Scheme to Take Over Homeowners' Associations." <https://www.fbi.gov/contact-us/field-offices/lasvegas/news/press-releases/las-vegas-attorney-and-three-others-convicted-for-their-roles-in-a-fraudulent-scheme-to-take-over-homeowners-associations>

<sup>26</sup> Jeff German, "Former Republican official gets prison in HOA fraud case," *Las Vegas Review-Journal*, May 11, 2015. <https://www.reviewjournal.com/local/local-las-vegas/former-republican-official-gets-prison-in-hoa-fraud-case/>

running their association need to devote considerable time and attention to the job, and to learning how to do it, but they are not compensated. Even voting in association elections can be a burden to many owners. Consequently, a committed group of like-minded people with their own agenda can take over an association board of directors and make decisions that favor themselves or their associates without most owners knowing that it is going on. And once in control, boards can obstruct member access to records and prevent people from penetrating the scheme.

The scale of the Benzer ring's fraud led to prosecution, but only after considerable efforts to get law enforcement interested.<sup>27</sup> There 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 exchange for kickbacks, impose bogus fees on owners and prospective buyers, and (as in Las Vegas) make fraudulent insurance claims.<sup>28</sup>

It is also notable that many of these swindlers were established, well-known professionals who had been making their livings for many years serving HOAs in the Las Vegas area. This raises a question concerning whether there is adequate supervision and regulation of the lawyers, managers, and contractors who work for HOAs. The fact that a scheme this enormous and brazen could go on for six years suggests that industry self-regulation is insufficient, and that

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<sup>27</sup> 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. See Jeff German, "Lawyer kick-started massive HOA probe with private investigation," *Las Vegas Review-Journal*, July 13, 2013) <https://www.reviewjournal.com/crime/courts/lawyer-kick-started-massive-hoa-probe-with-private-investigation/>

<sup>28</sup> 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.

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.

### Condo fraud, Chicago style

A massive condominium-related fraud in the state of Illinois led to enactment of a law that can be used to reorganize failed condominium projects. From about 2000 to 2007, during the housing boom that preceded the crash, many of Chicago's former industrial buildings and old apartment buildings were converted into condominiums. 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, but not the actual renovations. They prepared beautiful advertising materials full of photos depicting all the accoutrements of trendy urban condos and listed the units for sale. But 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. Crooked appraisers certified fake valuations of the units, and straw purchasers were paid to fill out loan applications supported by fraudulent documentation. Lending institutions, either because they were fooled or by virtue of misconduct of their own employees, would approve loans for straw purchasers to buy the fictitious condo units. The fraudulent condo converter would pocket hundreds of thousands of dollars for each unit, paying off the straw purchaser. In some situations, absentee investors bought these units without ever

seeing them, only to later discover that their investment was worthless. Hundreds of millions of dollars went directly from banks into the pockets of criminals.<sup>29</sup>

The US Attorney for the Northern District of Illinois prosecuted a number of these rings. In a press release concerning one of these numerous prosecutions, the US Attorney noted that, “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...”<sup>30</sup> (US Department of Justice 2012)

These prosecutions did not solve the ensuing problems 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 conversions. 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. The situation showed perfectly what can happen when a condominium association stops functioning. In these buildings, utility bills were not being paid and services were disconnected. Tenants draping extension cords across gangways and burning wood indoors for heat and cooking. There were vermin infestations and fire hazards. Banks did not bother to foreclose on the loans because the buildings were valueless and constituted nothing but a liability.

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<sup>29</sup> For a detailed description of one of the largest such schemes, see the indictment in *United States of America v. Mohammad Taghie Kadvand*, United States District Court for the Northern District of Illinois Case No. 04 CR 0896, October 14, 2004.

<sup>30</sup> United States Department of Justice Press Release, July 24, 2012. “Seven defendants, including three loan originators, indicted in alleged \$8.5 million mortgage fraud scheme.” <https://archives.fbi.gov/archives/chicago/press-releases/2012/seven-defendants-including-three-loan-originators-indicted-in-alleged-8.5-million-mortgage-fraud-scheme>

This crisis led to a new Illinois statute that allows for non-functional condominium associations to be placed in court-monitored receivership. The City of Chicago, the Illinois state legislature, and Community Investment Corporation (CIC), a not-for-profit lending institution, worked together to get the law passed. CIC had extensive experience working with the City to renovate run-down apartment buildings. They began to encounter the dilapidated buildings that resulted from fraudulent condo conversions and realized that the normal approach for troubled apartment buildings wouldn't work. There was no building owner to cite for code violations, and the condominium association didn't even exist. Ownership of the units was spread across a bewildering array of absentee investor owners and mortgagees, and mortgages were being sold and resold constantly. <sup>31</sup>

CIC and the City of Chicago worked with 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 locate all the property interests in the building and buy them. Once title is unified, all the liens can be extinguished and the building is then "de-converted," meaning that it is turned back into an apartment building. Condominium ownership and the association are dissolved by court order and the property is put 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. A building is considered distressed if it is "a parcel containing condominium units which are operated in a manner or have conditions which may constitute a danger, blight, or nuisance to the surrounding community or to the general public." This is further defined in terms of utilities

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<sup>31</sup> David Roeder, "A Cure for Crumbling Condos; Units ruined by mortgage fraud acquired for rehab, rental to lower-income tenants," *Chicago Sun-Times*, Aug. 16, 2010, at News 2.

being shut off, major building code violations, occupation by squatters, many foreclosures, non-payment of property taxes, and recordation of non-existent units.<sup>32</sup> CIC estimated that at least 250 buildings fit these the criteria, scattered all over the city.<sup>33</sup>

This program, which appears to be unique to Illinois, is effective as a pragmatic solution to a serious problem. However, it is important to note that the nature of condominium ownership and governance is part of the problem. When a condominium association ceases to function for any reason, the loss of their voluntary governance functions creates problems for local government, all the people who reside in the complex, and perhaps the entire neighborhood. The solution of condemnation and public acquisition of buildings, using eminent domain, has in fact been adopted in a number of cases, including condominium developments that disintegrated into gang-ridden slums full of abandoned units.<sup>34</sup>

#### The consequences of inadequate reserves

It may be the case that most association directors display more wisdom than those at the places where horrendous decisions have exposed owners to draconian liabilities, or where lack of participation allowed crime to take root. But the simple passage of time and the inevitable deterioration of major building components can lead to the same outcome. Many associations have insufficient reserve funds, 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

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<sup>32</sup> The Illinois Distressed Condominium Property Act is part of the Illinois Condominium Property Act at 765 ILCS 605/14.5.

<sup>33</sup> Mary Ellen Podmolik, "City turning vacant condos into affordable apartments," *Chicago Tribune*, January 6, 2012, p. 1.

<sup>34</sup> Tyler Berding, *The Uncertain Future of Community Associations: Thoughts on Financial Reform*. Berding & Weil, Alamo, CA.

and moved on, and the new roof will benefit somebody else? And it must be kept in mind that nearly all the CID units in the US were built during the last thirty years, and their main components will wear out at a fairly predictable rate.

An attorney and author who has studied this situation systematically has concluded that many CIDs are time bombs because of insufficient reserve funds. When the time comes, and major building components 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 because the statute of limitations has long since run, a loan will be difficult if not impossible to obtain, and the owners will be faced with the need to impose large special assessments that will drive many of them into foreclosure .<sup>35</sup>

It can be argued that somehow “the market” will solve this problem, based on the assumption that fully informed buyers will not purchase homes in under-reserved developments or places in need of major repairs. That is a faulty assumption, because in the real world there are barriers to buyers becoming fully informed. The condition of major components of a multi-unit building, such as plumbing, electrical systems, and roofs, are often either invisible or not easily discoverable without special expertise. There may be no association records that reflect the condition of the common areas. And prospective purchasers have no right of access to association financial information until after they have signed a contract to buy a unit and placed a

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<sup>35</sup> Berding, in *Uncertain Future*, describes the seriousness of the problem. “Ten years ago, we wrote an article entitled ‘No Plan for the Future.’ It was essentially a warning about the hidden costs of maintaining common interest developments. We stated that reserve accounts might be seriously underfunded, especially for the unexpected costs of replacing some of the major building systems... In the years that followed that article's first appearance, the concern over component longevity has not lessened. In fact, as we have learned more, our concern has increased. It is now clear that many common interest developments will not live up to the expectations of their owners or the governing document provisions that assume the project's "perpetual" life. However, while a project's failing physical systems are certainly cause for concern, they are only a symptom of larger problems affecting the future of common interest developments.”



cash deposit down. At that point they acquire the right to request detailed information from the association about its financial status. This means that buyers must commit to the purchase before they are able to learn all the facts. They may or may not be able to back out of a purchase contract after learning of impending special assessments. In either event, that is hardly an adequate incentive to make associations reserve properly for the future.

Other association failures in Illinois demonstrate the consequences of inadequate reserves. There is a provision in the Illinois Condominium Property Act that allows for the sale of an entire condominium project by vote of owners holding 75% or more of the ownership interests. The remaining owners who oppose the sale are required to execute necessary documents to facilitate the sale of their units, but they are entitled to receive the fair value of their unit, based on appraisal.<sup>36</sup> This process is referred to as “deconversion,” and it is basically the same process as in the Distressed Condominium Property Act, Section 14.5 of the Illinois Condominium Property Act, except that the Section 15 deconversion process is voluntary instead of being imposed by a court at the application of the city, as with Section 14.5.

Section 15 has been in the ICPA since the Act was first passed in 1963, but in recent years it has been used extensively. Housing market conditions in the city of Chicago shifted so that moderately priced condominium complexes became more valuable as apartment buildings than as condominiums. Real estate investment groups began to seek out associations that were facing major repairs with inadequate reserves, where large special assessments would soon be necessary. The procedure is to acquire as many units as possible, seeking first a majority, so they can control the association, and then the target of 75%, so they can sell the entire building regardless of what the remaining owners want to do. Often, non-consenting owners are in a

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<sup>36</sup> This procedure is described in Section 15 of the Illinois Condominium Property Act, and Section 16 allows for removal of the property from the provisions of the Act upon sale of the project. 765 ILCS 605/15-16

difficult financial position, with an underwater mortgage, or a share of the sale that will not allow them to purchase another home, such that selling is a disaster for them. A number of deconversions have led to litigation, with allegations of vote-buying and other improprieties.<sup>37</sup> There have been so many such deconversions that the Illinois Department of Financial and Professional Regulation has put out an explanatory publication for the public titled, “How Does a Deconversion Work?”<sup>38</sup> To the extent that moderately priced condominiums are the target of deconversions, this phenomenon has the potential to reduce the supply of affordable, entry-level housing for new home buyers. Deconversions are evidence that some condominium developments are no longer financially viable because most of the owners would rather sell their units than continue to fund repairs.

#### Institutions protecting themselves against association failure

Although individual unit owners are unaware of the risks they face if associations fail, those risks are familiar to large institutions, particularly those involved in the housing and lending industries. Federal quasi-public agencies active in the secondary mortgage market known as “GSEs” or “government sponsored enterprises,” such as the Federal National Mortgage Association, or “Fannie Mae,” had long been active with CID promotion. They require

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<sup>37</sup> There have been numerous articles in the business press covering the wave of deconversions and the ensuing conflicts. See Dennis Rodkin, “Developer makes third run at River City condos,” *Crain’s Chicago Business*, August 24, 2017; and see Matt Baker, “Deconstructing Deconversion,” *RE Journals*, October 23, 2018, regarding a conference held in Chicago on how to do a deconversion “Condo deconversion is a undeniable trend in Chicago. That’s why over 150 people came out to the Montgomery Club on October 18, 2018 to hear expert speakers discuss the ins and outs of this often complex, often lucrative real estate practice at the first annual Deconstructing Deconversion conference.” Joe Ward, “With legal battles resolved, River City deconversion moving forward,” *The Real Deal*, November 27, 2018. <https://therealdeal.com/chicago/2018/11/27/with-legal-battles-resolved-river-city-deconversion-moving-forward-%E2%80%A8/>. Gary Lucido, “The Mystery of Chicago’s Condo Deconversion Boom,” *Chicago Now*, June 12, 2018 accessed 5/29/19 at <http://www.chicagonow.com/getting-real/2018/06/the-mystery-of-chicagos-condo-deconversion-boom/>.

<sup>38</sup> Illinois Department of Financial and Professional Regulation, Division of Real Estate. “How Does a Deconversion Work?” No date.

standardized 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. Association financial problems led Fannie Mae to reduce 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. Instead of just rating the housing unit involved in the loan, the agency began evaluating the association as a whole. In 2008, the agency announced its concerns and imposed a new set of requirements in order for the agency to purchase a loan on a unit in a given association. These included an owner-occupancy rate of at least 51%; no more than 15% of the units can be more than 30 days delinquent on association assessments (later lengthened to 60 days); no more than 10% of the units owned by a single entity; and reserves equal to at least 10% of its budget.<sup>39</sup> The Federal Housing Administration followed suit with similar requirements issuance of federal mortgage insurance.<sup>40</sup>

While these provisions serve to protect agencies from the risk of association failure, they place the owners of units in non-qualifying buildings in a difficult position, because prospective buyers of their units will be unable to qualify for a conventional loan, and this restricts the pool of purchasers for the most part to cash buyers.

Banks have also taken steps to protect themselves against association insolvency. When unit owners in CID projects fail to pay either the association or a bank, 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. In many cases, 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 Uniform

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<sup>39</sup> Federal National Mortgage Association, "Project eligibility review service and changes to condominium and cooperative project process." December 16, 2008. The project approval process continues to evolve and the criteria change from time to time.

<sup>40</sup> Federal Housing Administration, Mortgage Letter 2009-46 B.

Law Commission has promulgated a series of recommended codes on the law of common interest housing. The ULC has tried to protect the financial health of associations by awarding them a “super lien” that takes precedence 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.<sup>41</sup> However, Fannie Mae and other lending institutions have challenged these super lien provisions in court. In 2014, the federal Court of Appeals for the District of Columbia ruled that the super-priority lien extinguished the first mortgage.<sup>42</sup> Litigation continues as lenders challenge the application of super lien provisions in multiple states. 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.

Conclusion: The inadequacy of current governmental oversight to protect owners

Here, then, is the situation in which owners of CID units find themselves. They are ultimately responsible for the debts of the association at least up to the value of their unit, on pain of possible foreclosure. Although owners are aware of their obligation to pay for operating expenses of the association, typically they do not understand that they could also be forced to pay their share of court judgments due to mistakes made by boards and officers. Association

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<sup>41</sup> For a detailed analysis of this complex issue, see Aušra Gaigalaitė, “Priority of Condominium Associations’ Assessment Liens vis-à-vis Mortgages: Navigating in the Super-Priority Lien Jurisdictions,” 40 Seattle U. L. R. 841 (2017).

<sup>42</sup> *Chase Plaza Condominium Association v. J. P. Morgan Chase* 98 A 3d 166 (2014).

directors are unpaid amateurs who are not required to have any special education or training, and who will sometimes make such mistakes. Owners, directors, and officers have the power, and the incentive, to underfund reserves for future repairs, which could lead to massive special assessments that all owners eventually must pay. There is ample evidence of association failure, including multi-million dollar uninsured judgments; associations being taken over by swindlers; association governments ceasing to function and falling into disrepair; associations being placed into receivership and forcibly de-converted; and associations being so under-reserved that owners decide to sell the entire project rather than pay to keep it going.

Some large institutions are aware of this situation. Federal agencies operating in the housing industry have taken steps to protect themselves from the consequences of associations becoming insolvent. Banks have done likewise. At least one state, Illinois, has set up a streamlined process for dissolving insolvent or dysfunctional condominium projects and turning them into apartment complexes.

Given all those facts, it would be reasonable to expect that state governments would have by now put in place laws that would protect unit owners from the risks that institutions are securing themselves against. But this is not the case. Here is the status of state regulations that might address this situation and protect owners against the risks associated with association financial problems. A mere six states have ombudsman-type offices that assist with low-cost dispute resolution, dissemination of information to owners and officers, or keep data on associations. There are only seven states where associations are required to conduct reserve studies, to determine what their levels of reserves should be, or to maintain any particular level of reserves. Only nine states require CID property managers to obtain state licensing or certification to ensure at least minimal competency. Twenty-one states have some lien priority

requirement that guarantees associations at least some share of bank-initiated foreclosure proceedings.<sup>43</sup>

Not only are there few states where laws like this are in place, but there are no states where information on association finances is systematically gathered and disseminated, so that owners can take that information into account while they shop for a home. Many state and local governments do not even know how many associations there are in their jurisdiction, much less how much money they have in the bank. And there are no states where associations are required to publicly disclose their basic financial information to potential buyers who have not yet entered into a contract to buy a particular unit. Association financial health is treated as if it were a confidential matter, instead of an important factor that people shopping for homes should be able to take into consideration, as they do with property taxes, school districts, and room sizes.

Any agenda for addressing the problems outlined in this article should begin with gathering basic information on association finances such as reserve levels and the length of time since the last professional reserve study and making that information public. There should be laws mandating that all associations must disclose this information upon annual corporate registration. The information can be disseminated on real estate listing forms, or on a state-run database. This would enable home-buyers to consider association finances before they are under a contract to purchase, which would create an incentive for associations to be more mindful of the need to fund reserves. There should also be laws mandating that professional reserve studies

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<sup>43</sup> This is the result of the author's review of state legislation, in combination with a similar review of state laws conducted by the Community Associations Institute and summarized here: <https://www.caionline.org/Advocacy/StateAdvocacy/PriorityIssues/Pages/default.aspx>

be done at least every three to five years, so that associations do not remain in the dark about their future repair issues.

There must be more public institutional support for CID owners and their volunteer board members and directors, in the form of affordable education, consultation, and dispute resolution services. This would tend to reduce the likelihood of disastrous decisions that lead to major uninsured liabilities.

State and local governments need to give serious consideration to relying less on CID housing, especially condominium ownership, in affordable housing programs. People with little or nothing by way of savings are not the best candidates for CID housing, because they can find themselves in a situation where they must contribute to special assessments for major repairs. Lacking the funds, they may be in foreclosure in short order. For several decades, local governments have over-relied on CID housing in new construction because it offers a tax windfall. This policy needs to be reconsidered in light of the risks of association insolvency that are coming to light. The use of special districts to fund infrastructure may be a more realistic approach than CID private governments in many situations, because special districts are governmental. Special districts collect their revenues through property tax bills, they have the power to issue bonds, and they can file for bankruptcy without losing control over their finances.

The most important step, which is necessary for any of the foregoing policy ideas to even be considered, is for state and local governments to recognize that CIDs cannot be expected to remain financially sound indefinitely, and that they are in need of support and consumer protection measures. The truth is that the entire housing sector rests on a fragile foundation, which is the resources of the owners. In many cases, those resources have proven to be

inadequate. Unless and until this fact is more widely recognized, and taken into account in framing public policy, the future of common interest housing is in question.

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