March, 2007

REEEVALUATING LEASING RESTRICTIONS IN COMMON INTEREST DEVELOPMENTS: REJECTING REASONABLENESS IN FAVOR OF CONSENT

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RE_EVALUATING LEASING RESTRICTIONS IN COMMON INTEREST DEVELOPMENTS: REJECTING REASONABLENESS IN FAVOR OF CONSENT

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INTRODUCTION

The popularity of Common Interest Developments (“CIDs”) in residential markets across the country has magnified the legal importance of restrictive covenants, which play a significant role in defining the character of developments and in maintaining property values. CIDs house more than 42 million Americans in 16.4 million residential units, and most new housing developments require membership in some form of Property Owners’ Association (“POA”). CIDs describe a variety of housing forms, including planned communities, condominiums, and cooperatives; however, the defining characteristic of all CIDs is the extensive use of servitudes, most commonly in the form of Contracts, Conditions & Restrictions (“CC&Rs”), to enforce reciprocal obligations among property owners.

By purchasing property in a CID, owners automatically bind themselves to the terms of the CC&Rs, thereby forfeiting “certain rights and privileges which traditionally attend fee ownership of real property, and agree[ing] to subordinate them to the group’s interests.” Property owners sacrifice those rights in order to enjoy the potential benefits of: (1) collective ownership and management of common property, including recreational facilities; (2) social community, using CC&R restrictions to discourage potential buyers with dissimilar lifestyle

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3 Approximately 64% of CID units are single-family homes, 31% are condominiums, 5% are cooperatives. REESE, supra note 1, at 3.
preferences to existing owners; and (3) superior ambience, employing reciprocal land use
regulations to reduce neighborhood effects below levels tolerated by zoning and nuisance law.\(^6\)

The enjoyment of social community and superior ambience in a development depends
heavily upon the stability of residency in a CID. Owner-occupants who intend to live in a CID
for an extended period have a strong incentive to develop relationships with their neighbors, to
avoid antagonizing them by causing nuisances, and to maximize the value of their home by
maintaining and improving their property. In contrast, renters are generally highly mobile and
have a finite legal and economic interest in their leased residence. As a result, renters may be
less likely to build relationships within a development, to subordinate their interests to those of
their neighbors by abstaining from nuisance-like behavior, and to maintain or improve their
residences.\(^7\) While POAs have the ability to issue and to enforce rules to mitigate nuisances
caused by renters directly, enforcement may be costly and bitterly contentious, further
undermining social community.\(^8\)

As a prophylactic measure, a growing number of CIDs are enacting restrictions or
prohibitions on leasing to avoid the problems associated with renters.\(^9\) Such prohibitions likely

\(^7\) “The . . . conclusion that as a rule renters are more neglectful and cause more property damage than owner-
occupants is common knowledge among all people with even a lick of experience in real estate development.”
NATELSON, supra note 4, at 160. However, those problems should vary inversely with the (1) duration of the lease;
and (2) length of a settled tenant’s occupancy. Robert C. Ellickson, Cities and Homeowners Associations, 130 U.
Pa. L. Rev. 1519, 1552 (1932). First, the market value of a tenant’s leasehold is affected by community policy, and
if rent is fixed, the tenant’s stake in the community varies directly with the length of his remaining term. Second,
“[a] settled tenant is likely to have sentimental ties with neighborhood people and places . . . [that give] the tenant a
stake in community affairs.” Id.
\(^8\) Id. at 158 (describing the leasing of units as “a fertile source of dispute between resident owners, nonresident
owners, and lessees”).
Marshall L. Rev. 443, 461-465 (1998). An alternative explanation for the adoption of leasing prohibitions is that
developers and POA’s are not motivated to prohibit leasing because of how renters behave but because of who they
are. See David E. Grassmick, Note, *Minding the Neighbor’s Business: Just How Far Can Condominium Owners’
facially neutral leasing prohibitions have a disparate impact on minorities and should be attacked under the Fair
Housing Act). At the federal level, the 14th Amendment, the 1866 Civil Rights Act, and the Fair Housing Act of
1968 with its 1988 Amendments prohibit intentional discrimination in CIDs. See Rosemarie Maldonado & Robert
improve the quality of life for owner-occupants within developments and may translate into higher property values. When those restrictions are recorded in the development’s declaration CC&Rs and purchasers buy property subject to them, the enforcement of leasing restrictions is relatively uncontroversial. Analyzed within a contract paradigm, CC&Rs are a set of reciprocal agreements between owners adopted by unanimous consent through the purchase of property. Applying a contractual framework, however, is more problematic to analysis of retrospective amendments to CC&Rs approved by a supermajority or even a simple majority of property owners. Those amendments allow the majority to benefit at the expense of a minority of owners who value their property’s income-generating potential and who did not expressly consent to the restrictions imposed on their property at the time of purchase. As a consequence, the enforceability of retrospective restrictions remains highly controversial, leading many to decry the “tyranny of the ‘commonality.’”

The legal standard applied to determine the enforceability of leasing restrictions has profound fairness and efficiency implications. This comment argues that both considerations are ultimately a matter of consent: fairness demands that property owners agree to be bound by a restrictive covenant before it burdens their land; and efficiency requires that current and future property owners be allowed to enter voluntarily into the contractual arrangements that optimize their individual well-being. Resolving the issue of consent in the context of CID governance is
problematic because CC&Rs run with the land and must be responsive to the preferences of both current and future property owners. Part I discusses the processes by which CC&Rs are implemented and the governing structures they create. Part II analyzes the substantive arguments concerning the enforceability of leasing restrictions. Part III presents and critiques the majority rule of reasonableness review. Part IV surveys two statutory alternatives and advocates adoption of the Restatement rule limiting the enforceability of leasing restrictions to those contained in or authorized by: (1) declaration CC&Rs; (2) amendments ratified or Board of Directors’ rules issued pursuant to declaration CC&R provisions explicitly authorizing the future adoption of leasing restrictions; or (3) amendments adopted by a unanimous vote of property owners.

I. STRUCTURE & PROCESSES OF CID GOVERNANCE: A HIERARCHY OF AUTHORITY

CIDs include a wide variety of residential and commercial forms of property ownership; however, this comment focuses on leasing restrictions in condominiums and cooperatives. The likelihood of negative neighborhood effects associated with renters varies directly with the density of housing in a development. Because of the high population densities in condominiums and cooperatives, owners in those types of developments have stronger incentives than owners of single family residences to restrict leasing to avoid the negative neighborhood effects associated with renters.

In a condominium, property owners hold title to their specific units in fee simple absolute and an undivided interest in the development’s common property. Common property typically includes exteriors of the development’s building or buildings, grounds and recreational

valuable resources. Such exchange is socially desirable because it moves resources to ‘higher valued uses,”’ thereby increasing ‘allocative efficiency.’ By pursuing self-interest, then, people promote the interests of society.” PERILLO, supra note 12, at 9-10 (quoting ROBERT A. HILLMAN, THE RICHNESS OF CONTRACT LAW: AN ANALYSIS AND CRITIQUE OF CONTEMPORARY THEORIES OF CONTRACT LAW 214 (1997)).
facilities. In contrast, in a cooperative, a corporation or trust holds title to the entire development, including both the individually occupied units and the common property. Owners purchase shares in the corporation and receive proprietary leases for exclusive use of units for a specified period of time. An elected Board of Directors manages the development pursuant to the corporation’s bylaws.

The governing systems of both condominiums and cooperatives share two common goals: (1) the protection of owners’ investment-backed expectations; and (2) the fulfillment of owners’ social community or lifestyle preferences. Those goals are necessarily in tension when a majority of owners in a development wish to adopt leasing restrictions to promote their social preferences over a minority of owners’ objections. A court’s resolution of that tension depends both upon the legal and economic structures of the development and the manner in which a leasing restriction is imposed. In general, a court may be more willing to look beyond contractual provisions to protect the alienability of property owned in fee simple than when occupied under a proprietary leasehold. A court is likely to enforce a leasing restriction contained in declaration CC&Rs, but it may scrutinize closely subsequent restrictions adopted by amendment or promulgated by a Board of Directors.

A. Condominiums

Condominium governance operates within a clear hierarchy of legal authority, consisting of: (1) state enabling statutes; (2) declaration CC&Rs; (3) post-declaration amendments to CC&Rs; and (4) regulations promulgated by Boards of Directors. Leasing restrictions may be adopted at any level of that hierarchy and may not be overridden by lesser authority. Because of

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procedural differences employed in rule making at each level of authority, the hierarchy reflects the degree of property owners’ consent to CID rules. The origin of a leasing restriction within the hierarchy of authority, therefore, strongly influences a court’s willingness to enforce that restriction as a contractual obligation between property owners.

State statutes establish condominiums as a valid form of real estate ownership and set the procedural and substantive parameters for the private governing systems that manage them.\(^\text{17}\) Within this statutory framework, the foundation of condominium governance is the declaration, or master deed, which contains the CC&Rs and may include the bylaws of the development’s POA.\(^\text{18}\) A developer drafts and records the CC&Rs prior to the sale of any units. Prospective purchasers have notice of the CC&Rs, and the voluntary act of purchase implies consent to their provisions.\(^\text{19}\) CC&Rs impose reciprocal obligations among owners, which: (1) define the character of the community through use and occupancy restrictions, including leasing restrictions, and (2) empower a POA to manage the operations of the condominium development.\(^\text{20}\) Because declaration CC&Rs are approved by the unanimous consent of property owners through the act of purchase and delegate administrative and rule making powers to a

\(^{17}\) State enabling statutes facilitate condominium development by: (1) recognizing divided ownership in condominium units and undivided ownership of common property; (2) providing for enforcement of declaration CC&Rs, which run with the land as equitable servitudes; (3) prohibiting the partition of common property; (4) mandating individual assessments of units for property taxes; and (5) creating adequate legal safeguards to encourage institutional lenders to issue loans secured by mortgages on condominium units. Clurman et al., supra note 15, at 14.

\(^{18}\) Evan McKenzie, Privatopia: Homeowner Associations and the Rise of Residential Private Government 127 (1994). The declaration typically consists of six legal documents: (1) CC&Rs; (2) POA bylaws; (3) articles of incorporation for the POA; (4) plats demarcating common areas and individual owned units; (5) unit floor plans; and (6) deeds granting title to individually units in fee simple and an undivided interest in common areas. Hyatt, supra note 16, at 24-26.

\(^{19}\) See, e.g., Timberstone Homeowners Ass’n v. Summerlin, 467 S.E.2d 330 (Ga. 1996) (“Where a restrictive covenant is recorded, the purchaser is charged with legal notice of the covenant, even if it is not stated in his own deed.”).

\(^{20}\) Hyatt, supra note 16, at 205.
POA, the CC&Rs are analogous to a constitution.21 Accordingly, leasing restrictions contained in the declaration CC&Rs are presumptively valid.22

Since developments may exist in perpetuity and CC&Rs run with the land, condominium governance must be responsive to the evolving preferences of property owners in a development.23 To accommodate the changing needs of a community, new or modified leasing restrictions may be adopted by an amendment to the CC&Rs or by a vote of the Board of Directors. The declaration CC&Rs typically define an amendment procedure, which must balance satisfaction of the preferences of the majority of owners with preservation of the property rights of the minority.24 A simple majority vote standard is undesirable because it would provide a potentially large minority of owners with little protection from redistributive policies enacted by the majority. A unanimous consent requirement is equally unsatisfactory because it would encourage a minority of strategic holdouts to frustrate the enactment of policies beneficial to the majority of owners.25 As an imperfect compromise, most CC&Rs require a supermajority vote by property owners to ratify amendments, recognizing that some beneficial amendments will fail and some redistributive amendments will succeed. Leasing restrictions passed as CC&R amendments by a supermajority vote are generally afforded

25 Ellickson, supra note 7, at 1531; RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES §6.10 cmt. A, rationale (2000) (“The power to amend the governing documents in a common-interest community prevents a small number of holdouts from blocking changes regarded by the majority to be necessary to adapt to changing circumstances and thereby permit the community to retain its vitality over time.”)
deference by courts; however, because amendments are not approved by unanimous consent, they are scrutinized more carefully than restrictions contained in the declaration CC&Rs.\footnote{See Breene v. Plaza Tower Association, 310 N.W.2d 730, 731 (N.D. 1981) (holding that leasing restrictions adopted by amendment were valid only when applied prospectively to owners who purchased after their adoption).}

If CC&Rs are analogous to a constitution, regulations issued by a Board of Directors are comparable to statutes.\footnote{Kress, supra note 21, at 840.} Property ownership in a condominium development includes membership in a POA and entitles owners to elect a Board of Directors by majority vote.\footnote{Brower, supra note 10, at 211-212.} A Board of Directors serves both legislative and executive functions by issuing regulations to control the use of common areas and to prevent nuisances and by enforcing those regulations and CC&R restrictions.\footnote{More specifically, the duties of the Board of Directors includes: (1) preparing an annual budget and overseeing finances; (2) assessing and collecting POA dues; (3) maintaining common property; (4) making personnel decisions and contracting for services and repairs; (5) issuing regulations; and (6) enforcing regulations and CC&R restrictions. Hyatt, supra note 16, at 82-83.} CC&Rs typically limit the substantive rule making authority of a Board of Directors; however, they may grant it general rule making power to advance the interests of the community.\footnote{See, e.g., Beachwood Villas Condo. v. Poor, 448 So. 2d 1143 (Fla. Dist. Ct. App.1984).} When leasing restrictions issued by a Board of Directors are disputed, courts must determine whether those restrictions are within the scope of a Board’s delegated powers.\footnote{See, e.g., Shorewood West Condo. Ass’n v. Sadri, 140 Wn.2d 47, 57 (Wash. 2000) (“[U]se restrictions appearing in unrecorded amendments to bylaws and not in the declaration are invalid. . . . The statute does not allow an association of apartment owners to restrict leasing in a bylaw where the declaration itself permits leasing.”).}

Those restrictions generally receive less judicial deference because of property owners’ attenuated consent to them.

B. Cooperatives

State cooperative or corporate law provides the framework for residential cooperative governance. A certificate of incorporation creates the legal entity that holds title to the real estate and authorizes an elected Board of Directors to manage the operations of the cooperative
development according to procedures established in corporate bylaws.\textsuperscript{32} The legal structure of cooperatives produces greater financial interdependence among owners than in condominiums. A single corporation holds title to the entire development, including both common areas and individually occupied units, so the failure of any individual shareholder to pay his percentage of the corporation’s liabilities threatens the interests of all of the cooperative’s shareholders.\textsuperscript{33}

Because of this interdependence among owners, cooperative bylaws almost universally require approval by the Board of Directors before shareholders may sublet, or even sell, their units.\textsuperscript{34} In part because the restrictions are contained in the cooperative’s founding documents, the enforceability of subletting restrictions is uncontroversial.\textsuperscript{35} Courts remain deferential to those restrictions even when they are used by a Board of Directors to screen potential residents based on purely social criteria.\textsuperscript{36} As the New York Court of Appeals held in 1959, “there is no reason why the owners of the co-operative apartment house [cannot] decide for themselves with whom they wish to share their elevators, their common halls and facilities, their stockholders’ meetings, their management problems and responsibilities and their homes.”\textsuperscript{37}

C. Private Governments Not State Actors

\textsuperscript{32}See, e.g., NY CLS Co-op Corp. §11 (2005).
\textsuperscript{33}DUKE MINIER ET AL., supra note 13, at 942-943.
\textsuperscript{34}CLURMAN ET AL., supra note 15, at 212. For an example of cooperative bylaws see Kelley v. Broadmoor Coop. Apartments, 676 A. 2d 453 (D.C. 1996). “The primary object of this Corporation is to operate and maintain its property on a mutual and cooperative basis for the housing needs of resident members. . . . The right of occupancy under the use contract is, nevertheless, a matter of discretionary decision of the Board of Directors and every transfer to resident membership, with its right of occupancy. . . is subject to the approval of the Board of Directors.” Id. at 457 n. 2. Furthermore, an owner “will not lease or permit the sub-leasing of the purchased apartment, or transfer the use or possession thereof without the written consent of the Co-operative, and any approved leasing shall be on standard contract form prepared and furnished by the Co-operative.” Id. at 455. See also Weisner v. 791 Park Ave. Corp., 6 N.Y.2d 426 (N.Y. 1959).
\textsuperscript{35}68 Beacon St., Inc. v. Sohier, 289 Mass. 354, 360 (Mass. 1935) (“The validity of a stipulation in a lease against assignment or subletting has been recognized and upheld for many years.”)
\textsuperscript{36}See N. R. Kleinfield with Tracie Rozhon, In Flat Market, Co-op Life Has Steep Ups and Downs, N.Y. TIMES, Oct. 30, 1995, at A1 & Oct. 31, 1995, at A1 (citing brokers who say Co-op boards are increasingly refusing to approve sales to qualified buyers, and describing boards’ behavior as “instusive, autocratic and quixotic”).
A POA serves many of the functions of a municipal government within a CID. Like a traditional local government, the POA is responsible for maintaining common property, issuing rules to monitor land use and minimize nuisances, providing public utilities, and funding its activities by taxing property owners through both periodic and special assessments.\(^{38}\) A POA may enforce a development’s rules by charging fines or late fees, by prohibiting the use of common facilities, by posting notices of violations to increase social sanctions, or by suing in court.\(^{39}\) Like delinquent taxes, unpaid POA assessments and fines create liens against a property owner’s unit, which enable the POA to foreclose on the property.\(^{40}\) Because of the parallels between municipal governments and POAs, commentators have argued that POAs should be treated as state actors, subject to Constitutional limitations on their powers.\(^{41}\)

Two theories of state action could potentially apply to POAs: (1) the judicial enforcement theory; and (2) the governmental function theory. The Supreme Court articulated the first theory in *Shelley v. Kraemer*,\(^ {42}\) finding state action where there was judicial enforcement of a racially restrictive covenant.\(^ {43}\) The Court articulated the second theory in *Marsh v. Alabama*,\(^ {44}\) finding state action where a company-owned town prosecuted a pamphleteer for refusing to leave after being told not to disseminate religious material on the town’s streets. Despite the express finding of state action in judicial enforcement of CC&Rs in *Shelley* and the parallels between POAs and the company-owned town in *Marsh*, courts have been reluctant to hold that POAs are state actors

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\(^{38}\) *RESTATEMENT (THIRD) OF PROP.: SERVITUDES* §6 intro. note (2000).

\(^{39}\) HYATT, supra note 16, at 157.

\(^{40}\) Id. at 129.


\(^{42}\) 334 U.S. 1 (1948).

\(^{43}\) Id. at 19.

\(^{44}\) 326 U.S. 501 (1946).
absent discrimination against a constitutionally protected class.45 Instead, by analyzing CID governance within a private contractual framework, courts have enabled POAs to appeal to idiosyncratic property owners’ preferences by imposing stricter property use and occupancy restrictions than would be within a state actor’s power. Whether allowing POAs to exercise that discretionary authority is socially desirable remains the subject of academic debate.

II. SUBSTANTIVE MERITS OF LEASING RESTRICTIONS

Freedom of contract and satisfaction of consumer preferences are the most frequently cited justifications for the enforcement of leasing restrictions.46 In the CID housing market, individuals reveal their preferences by voting with their dollars. The aggregation of individuals’ votes produces a market price. Developers in turn adjust their production of housing based upon the market price of new CIDs in relation to the expense of their creation.47 Because peoples’ housing preferences vary, profit incentive motivates developers to create CIDs with a variety of living arrangements from which individual purchasers may choose.48 Purchasers in turn buy property in the CID that best satisfies their preferences.49

45 RESTATEMENT (THIRD) OF PROP.: SERVITUDES §6 intro. note (2000). See, e.g., Brock v. Watergate Mobile Home Park Ass’n, 502 So. 2d 1380, 1382 (Fla. Dist. Ct. App. 1987) (“A homeowner’s association lacks the municipal character of a company town. . . . [T]he services provided by a homeowners association, unlike those provided in a company town, are merely a supplement to, rather than a replacement for, those provided by local government. As such, it cannot be said that the homeowners’ association in this case acts in a sufficiently public manner so as to subject its activities to a state action analysis.”).
46 Ellickson, supra note 7, at 1527; Grassmick, supra note 9, at 202-206.
47 For a comprehensive treatment of the role of prices in a market economy see MILTON FRIEDMAN, PRICE THEORY (1976). The creation of new CIDs may require new construction or the conversion of existing property, often either rental or commercial, into CID housing.
48 But see EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT 12 (1994) (“As CIDs spread, and as old housing is replaced by new CID housing, consumer choice is increasingly restricted. In short, growing numbers of Americans who wish to purchase new houses are going to be living in CIDs, and under the rule of private governments, regardless of their preferences.”).
49 Adam Smith generally receives credit for identifying the connection between profit incentives and allocative efficiency, describing the workings of the market as an “invisible hand” promoting the common good. ADAM SMITH, THE WEALTH OF NATIONS 484-85 (Edwin Cannan ed., Modern Library 1994) (1776) (“[E]very individual, therefore, endeavours as much as he can . . . to employ his capital in the support of . . . his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his
A. Public Policy Against Restraints on Alienation

In free markets, voluntary exchanges of goods and services take place until no further mutually beneficial trades are possible and an efficient allocation of resources is achieved.\(^{50}\) It is surprising, therefore, that leasing restrictions, a form of restraint on alienation, are justified in free market terms. The common law has disfavored restraints on alienation since medieval times.\(^{51}\) Four policy justifications underlie that negative predisposition by courts against enforcing restraints on alienation: (1) restraints prevent creditors from reaching property; (2) restraints perpetuate the concentration of wealth by preventing sale of property and the improvident consumption of the proceeds; (3) restraints discourage improvement of property; and (4) restraints make property unmarketable.\(^{52}\) While restraints on alienation of property prohibiting transfer in fee simple violate all of those policy considerations, leasing restrictions in condominiums and cooperatives generally do not seriously implicate any of them.

First, leasing restrictions are likely advantageous to lenders because they may protect the value of lenders’ security by maintaining property values. Institutional lenders may actually condition loan approval on satisfaction of a minimum percentage of owner-occupants within a CID. In order to sell mortgages on the secondary market to the Federal National Mortgage Association (“FNMA”), a lender must comply with FNMA’s underwriting standards for CID developments. FNMA’s guidelines disfavor condominium projects dominated by absentee


\(^{51}\) JOHN CHIPMAN GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY 1-5 (2d ed. 1895).

\(^{52}\) DUKEMINIER ET. AL., supra note 14, at 942-943.
owners, requiring additional review before purchasing a mortgage in a development that is less than 70 percent owner-occupied. FNMA guidelines also allow cooperatives to reserve an approval right over subleasing as long as that right is not “unreasonably restrictive.” Because restrictions are usually recorded in CC&Rs, lenders have constructive notice of them and can adjust their lending behavior accordingly. Lenders who want additional protection may contract with CIDs for exemptions from leasing restrictions. Rather than preventing creditors from reaching property as security, the overall effect of leasing restrictions may be to increase the availability of mortgage financing, which facilitates the free alienation of CID units.

Second, leasing restrictions in CIDs do not perpetuate the concentration of wealth. The goal of leasing restrictions is to promote owner-occupancy, which necessarily frustrates the interests of absentee landlords who own multiple units. Leasing restrictions may also encourage owners of inherited property to sell their units, further diluting the concentration of wealth in real property. The creation of new CIDs or the conversion of rental property into CIDs requires the subdivision of real property, which necessarily expands ownership. To the extent that leasing restrictions increase the value of CIDs, and therefore encourage new CID development, public policy against concentrated real property wealth should favor the enforcement of leasing restrictions.

Third, leasing restrictions likely encourage property improvements because of the different incentives of owner-occupants, absentee owners, and renters. Both the present

54 Id. at 148, Appendix 2.
55 Id. at 69.
58 DiLorenzo, supra note 56, at 410-412.
enjoyment of improvements and the promise of increased property values motivate owner-occupants to improve their property.\textsuperscript{59} In contrast, absentee landlords maximize rental income, which leads them “rarely [to] do more than minimal rehabilitation when leases end.”\textsuperscript{60} Renters have a finite legal interest in property and maximize their enjoyment of a property for the duration of their lease. Renters are not significantly affected by changes in property value, and therefore, they do not internalize most of the benefit or harm caused by their behavior to their leased property. As a result, renters are more prone than owners to neglect, or even affirmatively to misuse, their property. Public policy encouraging the improvement of real property should favor leasing restrictions that promote owner-occupancy.

Fourth, leasing restrictions have a theoretically ambiguous effect on the marketability of property; however, restrictions may increase the value of and expand the market for CID units. The market for condominiums consists of roughly three groups of prospective buyers: (1) owner-occupants who have no intention of ever leasing their property; (2) owner-occupants who value the right to lease their property; and (3) absentee owners who value their property’s income generating potential. At one extreme, an absolute leasing restriction may appeal to the first group of owner-occupants, but alienate the other two. Cooperatives have essentially adopted this option because Boards of Directors usually have an absolute approval right over subleasing. Empirical evidence suggests restraints on alienation, in the form of absolute approval rights by a Board of Directors before sale or leasing, reduce the value of cooperatives by 12% compared to similar condominiums.\textsuperscript{61} At the other extreme, the absence of any leasing restrictions may appeal to the third group of absentee owners, but alienate the first two. Apartment buildings provide some insight into the effect of large numbers of renters on property value; the conversion

\textsuperscript{59} Id. at 415.
\textsuperscript{60} CLURMAN ET. AL, supra note 15, at 41.
of an apartment building into condominiums may increase the aggregate value of the property by 200-300%. Comparisons across forms of property ownership, however, provide only minimal insight into the more limited effects of leasing restrictions on condominium marketability.

Absent empirical data, predicting the impact of leasing restrictions on the value of CID units requires insight into local housing markets and understanding of prospective buyers’ preferences. Developers predict what leasing restrictions will optimize the marketability of units during the drafting of declaration CC&Rs. CID owners may subsequently modify those restrictions by amending the CC&Rs, and courts may override both decision makers by refusing to enforce leasing restrictions. Developers likely have the best information about housing markets, and their incentive is to maximize their profits by increasing the sale price and marketability of units. CID owners have the best information about their own subjective preferences, and they have a strong incentive to maximize the value of their units; however, CID owners may be willing to sacrifice home value and marketability in exchange for the ability to screen their future neighbors. Courts likely have inferior information about housing markets and CID owners’ preferences, making them the least competent decision makers. Perhaps, for that reason, states have moved away from analyzing leasing restrictions as restraints on alienation either by statute or by judicial decision.

B. Tiebout Model and the Problem of Public Goods

Rather than functioning as an impediment to the operation of a free housing market, leasing restrictions may promote market efficiency by solving the collective action problem.

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62 DiLorenzo, supra note 56, at 411 n. 30.
63 See, e.g., Conn. Gen. Stat. §47-70(c) (“[T]he rule against perpetuities and the rule restricting unreasonable restraints on alienation shall not be applied to defeat any rights given by the condominium instruments or by this chapter.”)
64 See Breezy Point Holiday Harbor Lodge-Ceachside Apartment Owners’ Ass’n v. B.P. Partnership, 531 N.W.2d 917 (Minn. Ct. App. 1995) (classifying prohibition on leasing as a use restriction, not a restraint on alienation); LeFebvre v. Osterndorf, 87 Wis. 2d 525, 531-32 (Wis. Ct. App. 1979) (holding that leasing restrictions encourage the sale of property and do not constitute a restraint on alienation).
associated with the provision of public goods. Public goods are “goods or services which, if they are provided at all, are open to use by all members of society.” Standard examples include parks, roads, and law and order. Because people may consume those benefits without paying for them, the price system fails to embody their true social value, and public goods are systematically under produced. To cure this market failure, communities typically rely on governments to provide public goods allocated by a political process and financed by taxation.

In the context of CIDs, common areas, social community and superior ambience are public goods. For those benefits to exist, a CID needs a high percentage of owner-occupants. CC&R leasing restrictions in a CID are analogous to taxes in a municipal setting because they enable a CID to provide public goods within a community and to allocate the costs of those public goods, in the form of the foregone property rights, to the community members who enjoy them.

In the free market, exchange only occurs if all parties to a transaction benefit; market participants receive the benefit of goods or services of at least equivalent value to what they pay for them. In contrast, a majoritarian political process enables the majority to benefit itself at the expense of a minority. Because the majority may subsidize its enjoyment of public services by taxing the minority, people do not necessarily receive governmental benefits comparable to what they pay in taxes. As a consequence, political processes generally do not result in an efficient allocation of resources; however, Charles Tiebout has theorized that efficient allocation of public goods by municipal governments may be possible if individuals are highly mobile and there are a large number of competing jurisdictions.

According to the Tiebout Model, when choosing where to live, a prospective homebuyer purchases a residence in the municipality that offers the combination of public goods and

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taxation that best satisfies his preferences. Individuals’ mobility forces municipalities to compete for residents by providing an appealing combination of public goods and taxes; in essence, this competition creates a market for public goods and converts taxes into user fees. By analogy to the Tiebout Model, competition among CIDs for potential residents is likely to produce an efficient allocation of public goods within private developments. Developers’ profit incentive encourages the creation of a variety of housing options with different combinations of common property, social community, and ambience. Prospective purchasers choose the combination of public goods that best satisfies their preferences and pay for them by foregoing a commensurate degree of freedom, which may require compliance with leasing restrictions.

Six assumptions underlie the Tiebout Model: (1) there are a large number of communities; (2) communities are optimally sized to provide member households with their desired bundle of public goods at the lowest average cost; (3) communities’ provision of public goods produces no external effects; (4) households are fully mobile; (5) household employment does not restrict mobility; and (6) households have perfect knowledge of community characteristics. The private housing market for CIDs likely satisfies the first three assumptions of the Tiebout Model better than the market for municipal governments. First, there are more than 205,000 CIDs in the United States, providing households with more housing options than choices in municipal governments. Second, developers’ profit incentive likely encourages the creation of CIDs that appeal optimally to prospective purchasers more effectively than the political mechanisms employed by municipalities. Third, the external effects produced by

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67 Id. at 418.
68 Id. at 419.
69 REESE, supra note 1, at 3.
70 Fennell, supra note 6, at 857.
CIDs on neighboring communities are likely less severe than externalities created by municipalities competing for residents.

Critics argue that CIDs produce negative externalities by draining surrounding communities of wealth and by denying the public access to traditional public goods like roads enjoyed by CID residents. In particular, leasing restrictions may impose costs on society by depriving renters, who tend to be poorer than homeowners, of quality housing. Because CIDs are self-selecting communities, CIDs generally target discrete economic groups and provide valuable public goods to households commensurate with their willingness and ability to pay for them. The exclusive character of CIDs allows residents to internalize the benefits of public goods, and it prevents less wealthy non-resident households from enjoying those public goods at a subsidized price. That outcome indicates that the housing market is working properly; voluntary market transactions occur in order to satisfy individual preferences, not to redistribute wealth to parties outside the transaction. The prevention of wealth redistribution may be less desirable in the municipal context where “fiscal zoning” intended to exclude low-income renters from municipalities prevents members of those renting households from benefiting from public goods such as strong public schools and safe neighborhoods.

The Tiebout Model’s fourth and fifth assumptions about household mobility are satisfied better in the private housing market than in the choice of municipalities. Prospective homebuyers likely have greater mobility between CIDs than they do between municipalities because movement between CIDs may involve shorter distances and may not require changing municipalities. Whether moving between municipalities or moving between CIDs within a

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71 See also Kennedy, supra note 40, at 775 (arguing that CIDs impose external costs by “assuming control over facilities created at public expense” and “siphon[ing] additional public resources through tax deductions.”)
72 See Grassmick, supra note 9, at 190 (arguing that condominiums “crowd out” rental properties from the market and leasing restrictions further limit housing opportunities for low income families).
73 Id. at 864-65.
municipality, relocating households incur realty fees, transportation expenses, potential tax liabilities, and loss of subjective value in a home and neighborhood relationships; however, households moving between municipalities may incur additional costs like switching school districts. To the extent that moves across municipalities involve greater distances than relocations within a municipality, households may tend to incur larger losses in subjective value caused by leaving familiar neighborhoods, and their mobility may be more constrained by employment market rigidity. In either case, the existence of moving expenses introduces some inefficiency into the market for public goods.

Violation of the sixth assumption of perfect information further threatens the optimal allocation of public goods in the Tiebout Model. The market system allocates housing resources efficiently when the price fully internalizes the benefits and potential burdens for property owners. Accurate housing prices require that consumers have perfect information about community characteristics. In the context of CID leasing restrictions, property owners’ access to information is fundamentally different regarding the content of restrictions: (1) recorded in the CC&Rs at the time of purchase; and (2) future restrictions adopted through a majoritarian political process. This disparity in the cost of information affects the accuracy of CID property prices, and therefore, the efficient allocation of housing resources.

1. Leasing Restrictions in Recorded CC&Rs at Time of Purchase

By the act of purchase, owners of property in a CID unanimously consent to the restrictive covenants recorded in the CC&Rs or articles of incorporation at the time of purchase. The CC&Rs establish binding contractual obligations among owners, but they also circumscribe the permitted uses of the property, limiting the extent of the property interest

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74 Ellickson, supra note 7, at 1526-1527
acquired.\textsuperscript{75} CC&R restrictions are therefore embedded into the purchase price of property within a CID.\textsuperscript{76} To the extent that purchasers expect that leasing restrictions will succeed in promoting sound management of common property, in fostering social community, and in maintaining superior ambience, those restrictions will elevate property values. To the extent that purchasers believe leasing restrictions will prove excessively burdensome, those restrictions will alienate prospective buyers and depress property values. Through that evaluation process, CC&R restrictions effectively screen buyers for compatibility so that buyers with similar preferences purchase property in the same developments and form the community atmosphere they desire.

When restrictive covenants are recorded at the time of purchase, the information costs of learning them are low, and consumers adjust their willingness to pay based on the desirability of those restrictions. As a consequence, the benefits and burdens of recorded restrictions will likely be internalized in the price, and the market will allocate housing efficiently.

2. Leasing Restrictions Adopted After Purchase by CID Political Process

The potential for adoption of future leasing restrictions by an amendment to CC&Rs or by a Board of Directors’ regulation approved by less than unanimous consent of the property owners poses a greater challenge to efficient resource allocation based on market price. Unlike a voluntary market transaction, in which all parties must benefit for exchange to take place, the political amendment and rule making processes employed in most CIDs allow the majority of

\textsuperscript{75} Woodside Vill. Condo. Ass’n, Inc. v. Jahren, 806 So. 2d 452, 456 (Fla. 2002).

\textsuperscript{76} Courts have recognized the incorporation of contractual restrictions into the purchase price as early as 1848: “[T]he question is . . . whether a party shall be permitted to use the land in a manner inconsistent with the contract entered into by his vendor, and with notice of which he purchased. Of course, the price would be affected by the covenant, and nothing could be more inequitable than the original purchaser should be able to sell the property the next day for a greater price, in consideration for the assignee being allowed to escape from the liability which he had himself undertaken.” Tulk v. Moxhay, (1848) 41 Eng. Rep. 1143, (Ch.). William A. Fischel argues that not just restrictive covenants, but the quality of all local governmental services are capitalized into home prices within a political unit. For a summary of Fischel’s theory, see Richard Schragger, Book Review, 101 Mich. L. Rev. 1824 (2003) (reviewing William A. Fischel, Consuming Government: The Homevoter Hypothesis: How Home Values Influence Local Government Taxation, School Finance, and Land Use Policies).
owners to benefit themselves at the expense of the losing minority. Minority owners may avoid restrictions by exiting the development; however, some redistribution may occur whenever minority owners: (1) face high moving costs; (2) subjectively value their property for more than its market price; or (3) cannot avoid the negative impact of a redistributive policy because the policy lowers the market value of their property.\textsuperscript{77} At the time of purchase, prospective buyers must calculate the expected benefits and burdens of future amendments and adjust the price they are willing to pay for the property accordingly; however, calculating those risks may be impossible or costly.\textsuperscript{78} Unlike obtaining copies of recorded CC&Rs, predicting future amendments requires prospective buyers to undertake the expensive and most likely prohibitively cumbersome task of surveying other owners in the CID to determine their probable voting behavior.\textsuperscript{79} The uncertainty of future redistributive policies should lead risk averse buyers to discount their willingness to pay;\textsuperscript{80} however, poor information prevents buyers from discounting those expected harms accurately.

3. Homebuyer Ignorance

Critics of the Tiebout Model analogy to the market for CIDs emphasize that prospective purchasers of CID units are often either: (1) ignorant of the content of CC&R restrictions; or (2) aware of undesirable CC&R restrictions but involuntarily accept them because those restrictions are bundled with other housing characteristics like location and architectural style that make a unit more desirable than housing alternatives.\textsuperscript{81} Both arguments have empirical support. When asked in a Gallup survey: “How well did you understand the community’s covenants, rules, and

\textsuperscript{77} Ellickson, \textit{supra} note 7, at 1525.
\textsuperscript{78} Breene v. Plaza Tower Association, 310 N.W.2d 730, 734 (N.D. 1981) (“[K]nowledge of the provisions for amendment does not, without more, constitute the degree of knowledge necessary to establish a voluntary and intentional relinquishment of the statutory right to notice of a restriction prior to the purchase of a condominium unit.”).
\textsuperscript{79} \textit{Id.}
\textsuperscript{80} Ellickson, \textit{supra} note 7, at 1525.
\textsuperscript{81} Fennell, \textit{supra} note 6, at 873-82.
restrictions before buying?”, 23% of CID residents surveyed responded that they had an extremely good understanding, 40% had a very good understanding, 24% had a fair understanding, and 6% had a poor understanding. When asked to identify the “Factors Influencing Home Purchases,” the CID residents surveyed listed in decreasing order of priority: (1) Safe Neighborhood; (2) Location; (3) Purchase Price; (4) Good Investment; (5) Architectural Style; (6) Strong Sense of Community; (6) Schools; (7) Social Reasons; and (8) Amenities. While that survey data appears to be evidence of market failure, the existence of homebuyer ignorance and the bundling of CC&R restrictions with other housing characteristics do not necessarily prohibit the market from allocating housing efficiently.

A housing market characterized by imperfect information may still produce an efficient price if developers compete for a subset of buyers willing to expend the resources necessary to obtain accurate information. The significance of CID units as major household investments ensures that a substantial and reliable minority of prospective buyers are willing to undertake the search costs necessary to maintain efficient prices. In the housing market, the 23% of well-informed CID residents comprise a sufficiently important segment of the market to require CIDs to compete for their business or to suffer significant declines in property values. As a result, the minority of informed buyers set the market price and thereby protect uninformed buyers from undesirable restrictions. Given the presence of a significant minority of informed buyers, the

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83 Id. at 20.
85 Ellickson, supra note 7, at 1524 n. 24.
86 Protection by marginal consumers works most effectively in markets for homogeneous goods. Leasing restrictions exist along a continuum, which poses analytical challenges to reliance on the marginal consumer. The marginal consumer still may generate efficient prices in a market for heterogeneous goods if the housing market tends to divide into discrete classes of living arrangements. For example, exclusive owner-occupied developments,
decision by a majority of prospective CID unit buyers to forego their own investigation of CC&R restrictions may be entirely rational.\textsuperscript{87} That analysis substantially weakens claims that CC&R restrictions should be subject to substantive review by courts to protect ignorant homebuyers from overreaching by POAs.

The fact that CC&R restrictions are bundled with other characteristics is also not fatal to efficient market operation. As long as there are numerous CIDs, prospective buyers will have significant choices about the degree of freedom they are willing to sacrifice in order to enjoy strong social community or superior ambience. According to survey data, good investment, strong sense of community, social reasons, and amenities are among the top eight motivations for CID purchase, and all four relate directly to CC&R restrictions. Even when bundled with other characteristics like location, CC&R restrictions are a sufficiently important determinate of price that a minority of informed buyers will capitalize the benefits and costs of CC&R restrictions into an efficient market price. Remaining inefficiencies caused by bundling decline as the number of diverse CID living arrangements increases.

The legal standard for enforcing CC&R restrictions, however, may limit the diversity of living arrangements that the market offers to property owners. If courts require leasing restrictions to be recorded in CC&Rs and enforce them as written, developers will compete for buyers on the basis of those restrictions, and consumers will be more likely to read the recorded CC&Rs and to select the living arrangements that optimize their well-being.\textsuperscript{88} If courts impose

\footnotesize{primarily owner-occupied developments, and investor friendly developments likely form three largely distinct CID submarkets. Assuming an uninformed investor undertakes the minimal search costs necessary to identify his preferred submarket, marginal investors within those submarkets will produce efficient prices. Schwartx & Wilde, supra note 82, at 658-62. \textit{But see} James L. Winokur, \textit{The Mixed Blessings of Promissory Servitudes: Toward Optimizing Economic Utility, Individual Liberty, and Personal Identity}, 1989 Wis. L. Rev. 1, 31-33 (disputing the theory that marginal purchasers ensure allocative efficiency by protecting uninformed buyers from suboptimal servitude regimes). \textsuperscript{87} \textit{Id.} \textsuperscript{88} Ellickson, supra note 7, at 1524 n. 24.}
external norms, such as substantive reasonableness, to limit the enforceability of leasing restrictions, developers will compete less vigorously for buyers on the basis of those restrictions, and consumers will tend to rely on the courts to protect them from any unusual restriction rather than investigating the content of CC&Rs themselves.

III. REASONABLENESS REVIEW

Commentators have analogized POAs to municipal governments, fiduciary trusts, business corporations, and closely held corporations; however, courts generally analyze POA governance within the private law of servitudes and contracts. As a result, the focus of judicial inquiry is whether property owners consented to a disputed leasing restriction and whether that restriction is consistent with the bargain property owners made by purchasing units in a CID.

The enforcement of prospectively applied leasing restrictions contained in recorded CC&Rs is both fair and efficient. Enforcement is fair because by the act of purchase, property owners unanimously consented to restrictions contained in the recorded CC&Rs, and enforcement is efficient because consumers had perfect information about the content of those restrictions and adjusted their willingness to pay accordingly. The enforcement of retrospectively applied restrictions adopted by majoritarian amendment procedures or by a Board of Directors’ vote is more problematic because consent to those restrictions is not unanimous, and owners had imperfect information about the content of those restrictions at the time of purchase. Judicial inquiry into the enforceability of retrospectively applied leasing restrictions may consist of

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90 Purchasers in CIDs have constructive notice of amendment procedures contained in declaration CC&Rs; “[h]owever, knowledge of the provisions for amendment does not, without more, constitute the degree of knowledge necessary to establish a voluntary and intentional relinquishment of the . . . right to notice of a restriction prior to the purchase of a condominium unit.” Breene v. Plaza Tower Ass’n, 310 N.W.2d 730, 734 (N.D. 1981).
91 Schwartz & Wilde, supra note 82, at 633. (“When a condition of imperfect information exists, decisionmakers should feel less constrained in substituting their view of what constitutes a fair exchange for the outcomes reached by private agreement”).
review of both the procedural fairness of a restriction’s adoption and the substantive efficiency implications of its application.

Reasonableness is the majority rule for judicial review of CID leasing restrictions. When leasing restrictions are not contained in declaration CC&Rs, courts apply a reasonableness standard as a substitute for the actual consent of property owners. The object of the inquiry is to determine if a restriction “can be integrated into a hypothetical bargain.” The reasonableness standard involves both: (1) internal review in which courts analyze the consistency of a restriction with the provisions of the CC&Rs and the powers granted to the POA’s Board of Directors; and (2) external review in which courts compare CID restrictions with external social norms, customs and state legislation.

Florida and California, which respectively comprise 20% and 18% of the national condominium market, both apply the reasonableness standard to determine the enforceability of leasing restrictions. The reasonableness standard by definition requires a fact specific inquiry; however, the hierarchy of CID governing authority shapes the nature of judicial review in both jurisdictions. Leasing restrictions contained in the declaration CC&Rs are “clothed with a very strong presumption of validity which arises from the fact that each individual unit owner purchases his unit knowing of and accepting the restrictions to be imposed.” Subsequently adopted restrictions are subject to less deferential review to determine whether they are

92 Natelson, supra note 87, at 44.
93 Brower, supra note 10, at 232-234. For an example of external review, see Hidden Harbour Estates, Inc. v. Norman, 309 So.2d 180, 182 (Fla.Dist.Ct.App.1975) (upholding a CID restriction on alcohol consumption after finding that “restrictions on the use of alcoholic beverages are widespread throughout both governmental and private sectors; there is nothing unreasonable or unusual about a group of people electing to prohibit their use in commonly owned areas”).
94 Reese, supra note 1, at 18.
95 BLACK’S LAW DICTIONARY 1293 (Deluxe 8th ed. 2004) (defining reasonable as “[f]air, proper, or moderate under the circumstances.”)
“reasonably related to the promotion of the health, happiness and peace of mind of the unit owners.” Courts enforce restrictions as reasonable unless “they are wholly arbitrary, violate a fundamental public policy, or impose a burden on the use of affected land that far outweighs any benefit.”

A. Florida

Florida courts have recognized the promotion of owner-occupancy as a legitimate interest of CIDs and have generally been deferential to leasing restrictions passed by CC&R amendment or Board of Directors’ vote. In *Seagate Condominium Association v. Duffy*, a Florida court upheld an amendment to CC&Rs prohibiting all leasing absent undue hardship as reasonable:

Given the unique problems of condominium living . . . appellant’s avowed objective—to inhibit transiency and to impart a certain degree of continuity of residence and a residential character to their community—is, we believe, a reasonable one, achieved in a not unreasonable manner by means of the restrictive provision in question. The attainment of this community goal outweighs the social value of retaining for the individual unit owner the absolutely unqualified right to dispose of his property in any way and for such duration or purpose as he alone so desires.

As long as CIDs adhere to the amendment procedures defined by their declaration CC&Rs, Florida courts are likely to enforce amendments containing leasing restrictions.

Florida courts have also been deferential to rules restricting leasing issued by CID Boards of Directors. Florida courts will enforce leasing restrictions adopted by a Board of Directors if: (1) the CC&Rs grant the Board at least a general rule making power; (2) the leasing restrictions do not contradict explicit provisions or reasonably inferable rights contained in the CC&Rs; and (3) the leasing restrictions themselves are reasonable.

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97 *Id.* at 640. See also *Nahrstedt v. Lakeside Vill. Condo. Ass’n*, 8 Cal. 4th 361, 376-77 (Cal. 1994).
98 *Nahrstedt*, 8 Cal. 4th at 382.
100 *Id.* at 486-87.
Beachwood Villas Condominium v. Poor, a Board of Directors enacted two rules restricting the leasing of units to terms greater than one month and to a maximum of six unit rentals per year. The Board of Directors acted pursuant to a CC&R provision authorizing it to “from time to time, adopt or amend previously adopted rules and regulations governing and restricting the use and maintenance of the condominium units.” The court upheld the rules as reasonable and within the Board’s rule making power, seeking to preserve “unfettered the concept of delegated board management.”

Florida’s deference to leasing restrictions adopted at all levels of the hierarchy of CID authority has the benefit of predictability; however, Florida law compromises protection of the property rights and reliance interests of the absentee owners who purchased CID units for their income generating potential. The Florida Supreme Court’s response to that criticism is that purchasers are “on notice of the unique form of ownership they acquired” and are “subject to” and “bound by” subsequently adopted amendments and rules. While that consent argument has appeal, it does not take into account that purchasers have imperfect information regarding future amendments or rules at the time of purchase. Without that information, purchasers who value the right to lease their units are unable to discount accurately the amount they are willing to pay for a CID unit and allocation of housing will not be optimal.

B. California

California courts have modeled their judicial review of CID use restrictions on the Florida reasonableness standard. However, California classifies leasing restrictions both as

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102 Id. at 1143.
103 Id.
104 Id. at 1144.
105 Id. at 1145. See Mohani v. La Cancha Condo. Ass’n, 590 So. 2d 36 (1991) (holding that leasing restrictions issued by the CID’s Board of Directors contradicted express terms of the CC&Rs and were therefore unenforceable).
use restrictions and as restraints on alienation. The California Civil Code provides: “Conditions restraining alienation, when repugnant to the interest created, are void.”

That statute requires courts to apply a reasonableness standard to both leasing restrictions contained in the declaration CC&Rs and restrictions subsequently adopted by CC&R amendment or Board of Directors’ regulation.

Like Florida, California recognizes the promotion of owner-occupancy as a valid justification for restricting or prohibiting leasing. In Oceanside v. McKenna, the court upheld declaration CC&R provisions for an affordable housing development that required owners to occupy their units as principal residences and prohibited all leasing. In its holding, the court emphasized that because the restrictions were recorded, the plaintiff “had constructive notice of the restriction on leasing and the requirement of owner occupancy.”

Case law concerning the enforceability of retroactively adopted leasing restrictions is limited; however, the quality of the procedures used to adopt restrictions may be determinative in a court’s analysis. In Ritchey v. Villa Nueva Condominium Association, a POA amended its bylaws to prohibit occupancy by anyone under 18 years of age for more than a 14 day period. The original POA bylaws provided that the bylaws could be amended by approval of 75 percent of the total value of the units, and the disputed amendments passed with 76 percent of the vote. The court upheld the occupancy restrictions as reasonable because “at the time of [the plaintiff’s] purchase, the enabling declaration specifically provided that the bylaws could be

110 Id.
112 Id. at 1423.
113 Id. at 1429.
115 Id. at 691.
116 Id.
amended, and that [the plaintiff] would be subject to any reasonable amendment that was properly adopted.” 117

In contrast, in Rancho Santa Paula Mobilehome Park, Ltd. v. Evans,118 the court declined to enforce a prohibition on subleasing adopted unilaterally by the manager of a mobilehome park.119 The court distinguished the case from Ritchey on two grounds: (1) the restriction limiting occupancy by children in Ritchey was less restrictive than a total prohibition on subleasing; and (2) the restriction in Ritchey was approved by 76 percent of the ownership instead of by the unilateral decision of a park manager.120 The quality of the procedures used to adopt the restrictions was particularly influential in the court’s holding: “There is a significant difference between submitting oneself to the future wishes of a community of which one is a part and shares a general community of interest, and of being subject to future regulations imposed by a park owner who may or may not have goals in accord with homeowners and residents.”121

In some cases, the California procedural inquiry may provide more protection for minority interests than the Florida standard; however, it achieves those protections at the expense of predictability. In order to value CID units accurately, prospective buyers must know both the content of leasing restrictions and the probability that they will be enforced. The California standard exaggerates the problem of imperfect information by creating an uncertain legal standard. In addition, by subjecting leasing restrictions contained in declaration CC&Rs to reasonableness review, courts undermine the legitimate reliance of prospective buyers on the enforceability of recorded leasing restrictions, which are approved by unanimous consent and known with certainty. Judicial second guessing of declaration CC&Rs frustrates the intentions

117 Id. at 696.
119 Id. at 1141.
120 Id. at 1144.
121 Id.
of the parties and may encourage developers to defer to majoritarian amendment procedures rather than to compete for prospective buyers on the basis of recorded leasing restrictions. Consent to CC&R amendments and Board of Directors rules is not unanimous, and information about the probability of future restrictions is imperfect. California’s deference to majoritarian political processes, therefore, threatens both fairness and efficiency.

C. Other Jurisdictions

Case law regarding the enforceability of leasing restrictions in other jurisdictions is less well-developed; however, Florida precedent is highly persuasive in many state courts. For example, in *Apple II Condominium Association v. Worth Bank and Trust Co.*, an Illinois court explicitly adopted the Florida two-tiered mode of analysis for condominium restrictions; leasing restrictions contained in declaration CC&Rs are presumptively valid, while leasing restrictions not contained in the CC&Rs must be “reasonably related to the promotion of the health, happiness and peace of mind of the unit owners.” The Illinois standard is likely more deferential than Florida’s standard because Illinois treats amendments to declaration CC&Rs as presumptively valid, while Florida subjects CC&R amendments to reasonableness review.

Florida precedent also has been influential in the development of Ohio case law. In *Worthinglen*

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122 Aside from restraints on alienation, restrictions recorded in declaration CC&Rs receive deference from the courts. The California Supreme Court established the standard of presumptive validity for recorded restrictions to protect the reliance interests of the contracting parties and to promote legal certainty. The court noted: “Fewer lawsuits challenging such restrictions will be brought, and those that are filed may be disposed of more expeditiously, if the rules courts use in evaluating such restrictions are clear, simple, and not subject to exceptions based on . . . peculiar circumstances or hardships . . .” *Nahrstedt v. Lakeside Vill. Condo. Ass’n*, 8 Cal. 4th 361, 383 (Cal. 1994).

123 *contra* Paula A. Franzese, *Building Community in Common Interest Communities: The Promise of the Restatement (Third) of Servitudes*, 38 Real Prop. Prob. & Tr. J. 17, 42 (2003) (“[D]eliberately malleable constructs such as reasonableness and fairness [help to] vindicate members’ legitimate expectations, protect against association overreaching, and honor the integrity of the collective decision-making processes . . . . Reinvention of common interest communities requires that rigid rules yield to dynamic, fluid policies rooted in the resolve to restore trust, cooperation, and connection.”).


125 *Id.* at 98 (citing Hidden Harbour Est., Inc. v. Basso, 393 So. 2d 637, 640 (Fla. Dist. Ct. App. 1981)).
Condominium Unit Owners’ Association v. Brown, an Ohio court cited Seagate for the proposition that condominium leasing restrictions are subject to reasonableness review. The Ohio court formalized the Florida reasonableness inquiry based on the quality of the process used to adopt a leasing restriction. The Ohio standard requires courts to engage in a three part analysis to determine whether a rule is: (1) arbitrary and capricious; (2) discriminatory or evenhanded; and (3) made in good faith for the common welfare of the condominium owners. Both Apple II and Worthinglen involved leasing restrictions adopted by CC&R amendments, so it remains unclear how much deference leasing restrictions adopted by a Board of Directors’ vote receive under Illinois and Ohio law.

A minority of states, including Washington and North Dakota, have departed from Florida precedent with respect to leasing restrictions adopted after the recording of declaration CC&Rs. In Shorewood West Condominium Association v. Sadri, the Washington Supreme Court held: “use restrictions appearing in unrecorded amendments to bylaws and not in the declaration are invalid.” Recorded CC&R amendments restricting leasing, however, likely would be enforceable in Washington. In contrast, North Dakota is hostile to all leasing restrictions not contained in the original declaration CC&Rs. In Breene v. Plaza Tower Association, the North Dakota Supreme Court held: “a restriction adopted after the purchase of a condominium unit [is] not enforceable against the purchaser except through the purchaser’s acquiescence.” North Dakota is unique in its protection of the reliance interests of condominium owners in recorded CC&R restrictions at the time of purchase; nonetheless,

127 Id. at 75.
128 Id. at 76.
129 140 Wn.2d 47 (Wash. 2000).
130 Id. at 57.
131 310 N.W.2d 730 (N.D. 1981).
132 Id. at 734.
concern about retroactively applied leasing restrictions has influenced the drafting of two proposed uniform statutory alternatives to reasonableness review.

IV. STATUTORY ALTERNATIVES TO REASONABLENESS REVIEW

In order to better protect the reliance interests of property owners and to promote clarity in the law, the Uniform Common Interest Ownership Act (“Uniform Act”) and the Restatement (Third) of Property (“The Restatement”) replace the fact specific reasonableness standard with universal rules for the enforceability of leasing restrictions. Under both regimes, leasing restrictions contained in declaration CC&Rs are presumptively valid. The Uniform Act prohibits subsequent leasing restrictions unless adopted by unanimous consent, and the Restatement employs a rule of narrow construction to determine whether the declaration CC&Rs authorize subsequently adopted leasing restrictions.

A. Uniform Common Interest Ownership Act

Variations of the Uniform Act have been adopted in seven states. The Uniform Act requires the declaration CC&Rs to include “any restrictions . . . on alienation of the units, including any restrictions on leasing.” Amendments restricting leasing may be adopted only by unanimous consent of the property owners. The Uniform Act’s unambiguous legal standard for the enforceability of leasing restrictions protects property owners’ reliance interests on leasing restrictions in force at the time of purchase and provides buyers with perfect information about the content of those recorded restrictions. The rigidity of leasing restrictions

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136 Id. cmt. (13).
frozen at the time the declaration CC&Rs are recorded, however, may introduce allocative inefficiencies if property owners’ preferences change. The requirement of unanimous consent for amendments gives every individual veto power over an amendment, creating a nearly insurmountable obstacle to the adoption of future leasing restrictions. Even when amendments produce clearly superior outcomes for all property owners, individual unit owners will have an incentive to hold out for additional payment in exchange for their forbearance from the exercise of their veto power. That bargaining dynamic introduces unnecessary transaction costs into the amendment process and likely prohibits CIDs from adopting some efficient amendments regarding leasing restrictions.

Under the Uniform Act, the unanimous consent requirement for leasing restrictions enacted subsequent to the declaration CC&Rs may not be altered by contract.\textsuperscript{137} This legislative interference with the freedom of contract of the parties may produce stability at the expense of satisfaction of consumer preferences. Rational consumers value both stability and flexibility. An optimal legal standard would empower the contracting parties to determine their preferred balance of those competing values by allowing them to design their own amendment procedures and to define the substantive limits of those amendments.

The Uniform Act provides some relief from the inflexibility of the unanimous consent requirement by creating an exception for rules adopted by a Board of Directors to comply with the underwriting requirements for institutional lenders.\textsuperscript{138} This provision allows the Board of Directors to save the POA from itself by overcoming the hold out problem when leasing policies threaten to cut off credit to prospective buyers. Precluding buyers from accessing funds from

\textsuperscript{137} \textit{Id.} cmt. (13).

\textsuperscript{138} A Board of Directors may issue leasing restrictions not contained in the declaration CC&Rs only if “those rules are reasonably designed to meet underwriting requirements of institutional lenders who regularly lend money secured by first mortgages on units in common interest communities or regularly purchase those mortgages.” \textit{Id.} § 3-102 (d)(3). \textit{See supra} notes 53-57 and accompanying text.
institutional lenders would significantly reduce the alienability of units by limiting the potential market to cash or alternatively financed buyers, and property values would decline appreciably.

B. Restatement (Third) of Property: Servitudes

The Restatement adopts a rule of narrow construction for CC&Rs allowing the contracting parties, rather than a legislature or a court, to determine the scope of permissible leasing restrictions. The default rule requires unanimous consent for amendments that “prohibit or materially restrict the use or occupancy of, or behavior within, individually owned lots or units.” Unlike the Uniform Act, the Restatement’s default rule of unanimous consent does not override amendment procedures contained in the declaration CC&Rs. Amendments containing leasing restrictions are enforceable if they “are expressly authorized by the declaration,” which requires that the declaration CC&Rs define both the procedural and substantive parameters of permissible future use and occupancy restrictions. Two factual scenarios illustrate the express authorization requirement of the Restatement:

Scenario 1: The declaration CC&Rs of condominium development A are silent with respect to leasing restrictions but contain an amendment provision requiring future CC&R amendments to be ratified by two-thirds of all unit owners. The unit owners subsequently adopt an amendment prohibiting all leasing in the development by more than a two-thirds supermajority. Under reasonableness review, the amendment would be enforceable because it was adopted according to procedures contained in the declaration CC&Rs. Under the Restatement, the amendment would not be enforceable because the original CC&Rs did not expressly authorize the future adoption of leasing restrictions.

140 Id. §6.10 cmt. g (2000).
141 Id. §6.10(3)(1) (2000).
Scenario 2: The declaration CC&Rs of condominium development B do not contain leasing restrictions but include an amendment provision authorizing the future imposition of leasing restrictions, including a prohibition on leasing, by CC&R amendments ratified by two-thirds of all unit owners. Pursuant to that authority, the unit owners subsequently adopt an amendment prohibiting all leasing in the development by the necessary two-thirds supermajority. Under both reasonableness review and the Restatement, that leasing prohibition would be enforceable because its adoption was expressly authorized by the declaration CC&Rs.

The substantive authorization requirement of the Restatement puts buyers on notice of potential changes in a CID’s leasing policy and limits the possibility of detrimental reliance on the policy in effect at the time of purchase. It also improves the quality of the information relating to the probability and scope of future leasing restrictions and enhances consent, because buyers purchase CID units subject to defined substantive limits on future amendments. The Restatement’s rule of narrow construction also applies to the rule making power of a Board of Directors. In the absence of explicit authorization to adopt use or occupancy restrictions, a Board’s power under a generally worded rule making authority is limited to the maintenance of common property and the prevention of nuisance-like activities.142 Two additional factual scenarios illustrate the Restatement’s treatment of leasing restrictions issued by a Board of Directors:

Scenario 3: The declaration CC&Rs of condominium development C, located in a resort town, are silent with respect to leasing restrictions, but they grant the Board of Directors authority to promulgate rules intended to promote the general welfare of the development’s unit owners. A significant number of owners subsequently rent their units to vacationers for terms of a few weeks. Owner-occupants in the development complain about noise and harm to common

142 Id. §6.7(3) (2000). See id. §6.7 cmt. b rationale (2000).
areas caused by the renters. In response to those complaints, the Board of Directors issues a rule pursuant to its general rule making power to prohibit the leasing of any unit for a term of less than one year. Under reasonableness review, the Board of Directors’ rule likely would be enforceable because it was intended to promote the general welfare of unit owners and was not inconsistent with leasing provisions contained in the declaration CC&Rs. Under the Restatement, a general rule making power would be insufficient to allow a Board of Directors to restrict leasing.

Scenario 4: The declaration CC&Rs of condominium development D, also located in a resort town, do not impose leasing restrictions, but they explicitly grant the Board of Directors the authority to regulate the terms of leases, including the duration of allowable leaseholds. The development experiences problems with short-term renters, and the Board of Directors votes to prohibit the leasing of any unit for a term of less than one year. That restriction would be enforceable under both reasonableness review and the Restatement because the declaration CC&Rs expressly authorized the Board of Directors to restrict the terms of leases.

Like the Uniform Act, the Restatement provides an exception from the rule of narrow construction for leasing restrictions necessary to comply with the underwriting requirements of institutional lenders.\textsuperscript{143} When the level of owner-occupancy jeopardizes the availability of credit to prospective purchasers from institutional lenders, the reliance interests of the majority and minority directly conflict. The majority purchased units relying on the right to sell them in fee simple for fair market value, while the minority purchased units relying on the right to lease them. When those rights of alienation clash, it is appropriate for a Board of Directors, elected by

\textsuperscript{143} Id. §6.7 (2)(b).
the majority, to have the authority to enact leasing restrictions necessary to secure credit from institutional lenders and to preserve the marketability of units in fee simple.\footnote{Id. §6.7 cmt. b rationale.}

C. VIRTUES OF THE RESTATEMENT

CID governance must balance the interests of the majority of owners with the rights of the minority and adapt to the changing requirements of property owners over time. Protection of the reliance interests of the minority requires stable governing arrangements, while promotion of the majority’s interests requires flexibility to accommodate changing circumstances. The requirements of stability and flexibility are necessarily in tension over the course of a CID’s existence. The law must determine whether courts or contracting property owners are responsible for achieving the optimal balance.\footnote{Id. at 1366.} The majority rule of reasonableness review chooses courts, while the Restatement empowers the contracting parties. Both sets of legal rules seek to preserve the intentions of the property owners, enforcing leasing restrictions only when owners have consented to them. Accordingly, under both standards, restrictions contained in the declaration CC&Rs are presumptively enforceable because property owners unanimously consent to those provisions at the time of purchase. Leasing restrictions, however, may be adopted at two points in time: (1) at the recording of the declaration CC&Rs, or (2) subsequent to the recording by political processes. Determining the enforceability of subsequent restrictions requires a legal standard to define “what ought to be looked upon as a tacit consent, and how far it binds.”\footnote{LOCKE, supra note 12, at ¶119.}

The reasonableness standard interprets tacit consent broadly. Courts generally conclude that property owners have consented to leasing restrictions whenever they are ratified by an amendment procedure or issued pursuant to a general rule making power contained in the
declaration CC&Rs. The Restatement interprets tacit consent narrowly, enforcing leasing restrictions only when they are issued pursuant to express authorization contained in the declaration CC&Rs. Such express authorization defines both the amendment or rule making procedures and the substantive limits of future restrictions.

Both fairness and efficiency favor the Restatement’s rule of narrow construction. Fairness demands that CID unit owners consent to the restrictions placed on the alienability of their property; explicit consent to future amendments with contractually defined limitations is preferable to tacit consent to any future amendment deemed reasonable by a court. Efficiency requires that prospective purchasers have accurate information regarding the content of future leasing restrictions at the time of purchase. The reasonableness standard’s deference to CID political processes provides little guidance to buyers. Prospective owners must undertake the costly, if not impossible, task of determining the likely voting behavior of existing owners. They must then discount their willingness to pay based on the expected cost of redistributive policies. The uncertainty of this calculation limits the ability of the market to allocate housing properly. The efficient outcome is for buyers with similar preferences to purchase in the same CIDs so that majority and minority interests do not conflict over fundamental property rights like the ability to lease CID units. When those interests conflict, the minority must suffer under majoritarian rule or exit the CID. Because moving involves high transaction costs, that result is inefficient.

In contrast, the Restatement provides prospective buyers with accurate information about the substantive limits on leasing restrictions, allowing the operation of the market to sort buyers more effectively into CIDs that satisfy their preferences. For example, a prospective owner-

147 Patrick A. Randolph, Jr., Changing the Rules: Should Courts Limit the Power of Common Interest Communities to Alter Unit Owners’ Privileges in the Face of Vested Expectations? 38 SANTA CLARA L. REV. 1081, 1085 (1998) (“[T]he ability to rent one’s unit in a common interest association ought to be viewed as one of the most fundamental of buyers’ expectations.”).
occupant hostile to leasing will purchase a unit in a CID with declaration CC&Rs that contain leasing restrictions or authorize the future prohibition of leasing. In contrast, a prospective absentee owner will purchase a unit in a CID with declaration CC&Rs that do not contain leasing restrictions or authorize only minimal leasing restrictions, such as a requirement that the term of leases exceed one month. Efficient allocation at the time of purchase reduces conflict and the accompanying cost of litigation, and it minimizes the probability of an aggrieved minority being forced to incur the transaction costs of exiting a development.

The Restatement encourages developers to draft declaration CC&Rs carefully to appeal to the market that would maximize the value of a development. Knowing that CC&Rs are enforceable as written, prospective purchasers would have a strong incentive to understand the CC&Rs and to adjust their willingness to pay accordingly. This interaction of buyers and developers would facilitate competition based on restrictive covenants and increase the diversity of living arrangements available to homeowners. This diversity of arrangements made possible by the Restatement is likely superior to the housing variety achievable in a reasonableness jurisdiction even if two contractual innovations, a CID owners’ bill of rights and a private takings clause, were more widely adopted.

1. Bill of Rights

Analogizing declaration CC&Rs to a constitution for a CID, Susan French advocates the inclusion of a bill of rights in the declaration CC&Rs to protect minority rights from majoritarian

148 Nahrstedt v. Lakeside Vill. Condo. Ass’n, 25 Cal. App. 4th 1473, 1497-98 (Cal. Ct. App. 1992) (Hinz, J., dissenting) (“Even limited or ‘small’ litigation undertaken pursuant to [a POA’s] enforcement duty can be expensive. The money to pay for such litigation comes from mandatory fees paid by each and every property owner.”).

149 McKenzie, supra note 21, at 128 (noting that CC&Rs “give a developer the power to create a distinct lifestyle in a development, which the developer can use as a powerful marketing tool.”).
political processes.150 Widespread inclusion of bills of rights would encourage developers to compete for different groups of prospective buyers and to increase the variety of options available to homeowners.151 With regard to leasing restrictions, a bill of rights might read: “The association shall not adopt rules that prohibit transfer of any lot or unit, or require consent of the association for transfer of any lot or unit, for any period greater than [two] months.”152 The degree of protection afforded would vary based on the intended market for the CID. In reasonableness jurisdictions, the inclusion of a bill of rights would offer some protection to minority property owners from the otherwise expansive discretion of POAs under general amendment and rule making powers.

The Restatement’s rule of narrow construction facilitates the goal of diverse living arrangements by transforming “islands of rights surrounded by a sea of governmental powers” in a reasonableness jurisdiction into “islands of governmental powers surrounded by a sea of individual rights.”153 Under the Restatement, by default, the POA has no power to restrict leasing unless explicitly authorized to do so. Instead of the enumerated rights of property owners, declaration CC&Rs would include the enumerated powers of the POA to restrict leasing.Enumerated powers would specify the procedural and substantive limits on leasing restriction. The procedural component could authorize future restrictions by either CC&R amendment or Board of Directors’ rule and specify the voting requirements for both. The substantive component could disallow all leasing restrictions, set minimum limits on the term of leases, require Board of Directors’ approval of tenants, or allow a blanket prohibition on leasing.

151 Id.
152 Id. at 352.
Unlike reasonableness review, the Restatement would not allow developers to defer to judicial determinations of the scope of permissible leasing restrictions. The rule of narrow construction would require developers to address leasing restrictions in declaration CC&Rs and encourage competition based on the content of those restrictive covenants. The result likely would be a greater diversity of living arrangements available to property owners even if bills of rights were widespread in reasonableness jurisdictions.

2. Private Takings Clause

A theoretical solution to the problem of redistributive policies in CID governance is a private takings clause which would reconcile “majoritarian flexibility with minority rights.” The clause would allow CIDs to adopt restrictions only where the restrictions increased the aggregate well-being of homeowners by forcing the majority to compensate the aggrieved minority for their loss of valuable property rights. The compensation would be calculated “to leave the owner in a position of indifference between the taking by the government and retention of the property.” As a consequence, “[e]ach and every dollar of gain from social intervention is in principle uniquely appropriated to some individual by [takings clause] command, so the problem of rent-seeking and faction is fully counteracted.” Because aggrieved owners would be compensated for any future loss of property rights, prospective buyers would not have to discount their willingness to pay based upon their expectation of suffering from future redistributive policies. Prospective buyers might be willing to pay more because of the potential for future adoption of restrictions that would increase aggregate value to property owners.

Ordinarily, calculating the correct amount of compensation is a costly, if not impossible, task. Providing an owner with compensation that makes him indifferent to the taking requires

154 Id. at 1535.
156 Id. at 199.
payment for both diminution of market value and loss of subjective value. Subjective value by definition is not capable of objective quantification by a third party.157 Robert Ellickson, the chief proponent of the private takings clause, proposes payment of a bonus “equal to what a ‘reasonable person’ in the claimant’s particular life situation would lose in irreplaceable surplus” to serve as a proxy for lost subjective value.158 Compulsory arbitration would determine the amount of the damages.159 Ellickson admits that the bonus is a “crude estimate”160 of actual damages, and the cost of administering the system is high.161 As a result of those impracticalities, CIDs have not adopted takings clauses, and courts have not imposed them as a matter of law.162

A compensatory award for a private taking may be more appropriate in the context of leasing restrictions than in other use or occupancy restrictions. The fundamental problem of administering a private takings clause is the determination of an owner’s subjective valuation of his property. Subjective value generally increases commensurate with the duration of occupancy in a home.163 The owners most directly affected by leasing prohibitions, however, are absentee landlords who own their property as investments, not as residences. In the case of an absentee owner who does not subjectively value his property above the market price, full compensation requires only payment for the transaction costs involved in the sale of his property, which may

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157 Randy E. Barnett, Contracts: Cases and Doctrine 123 (3d ed. 2003) (“The difference between the value of the price paid (the costs incurred) and that of the goal attained is called . . . profit. . . . Profit in this primary sense is purely subjective, it is an increase in the acting man’s happiness. . . . A judgment of value does not measure, it arranges in a scale of degrees . . . . It is expressive of an order of preferences and sequence, but not expressive of measure and weight.”) (quoting LUDWIG VON MISES, HUMAN ACTION 97, 204-205 (Rev. Ed. 1963).
158 Ellickson, supra note 7, at 1538.
159 Id. at 1536.
160 Id. at 1538.
161 Id. at 1535.
162 Id.
163 For example, a property owner may value relationships with neighbors, proximity to favorite local shops and restaurants, memories in a home accumulated over time.
no longer be leased, and for the impact of the leasing restriction on market price, which may be positive.

In reasonableness jurisdictions, judicial imposition of a private takings clause as a matter of law might reduce the negative impact of redistributive policies on minority property owners. Imperfections in the determination of damages, even in the context of leasing restrictions, and the requirement of costly arbitration limit the appeal of this alternative. The Restatement better safeguards the subjective value of property owners by empowering them to bargain for desirable terms rather than by allowing CID political processes to redistribute wealth and relying on third party arbiters to determine compensation for the resulting damages.

E. Statutory Exceptions to the Rule of Narrow Construction

In most situations, legal deference to the intentions of the parties through a rule of narrow construction will achieve fair and efficient results; however, the Restatement recognizes an exception to that rule to allow a Board of Directors to restrict leasing to comply with the owner-occupancy requirements of institutional lenders. Because of the financial interdependence of CID owners, additional statutory exceptions may be desirable to protect CIDs from unforeseen problems with renters at the time declaration CC&Rs are recorded. Renters and absentee owners generally are less involved in the community aspects of CID living, and consequently, they are less susceptible to the informal social pressures that encourage prompt payment of dues and compliance with regulations. If renters are late paying their rent, financially motivated absentee-owners will not be anxious to pay out of pocket monthly POA dues. While unpaid dues create a lien on the property, initiating foreclosure proceedings imposes additional costs on the POA and further delays recovery by several months.\(^{164}\)

\(^{164}\) Olin L. Browder, Jr., *Restraints on the Alienation of Condominium Units (The Right of First Refusal)*, 1970 U. Ill. L. F. 231, 231 (1970) ("The project depends upon the total collective response to charges for the maintenance of..."
Two possible statutory exceptions to the rule of narrow construction would be to grant the Board of Directors: (1) an approval right over tenants based on objective criteria; (2) enforcement power directly against tenants for violations of POA rules and unpaid dues. An approval right based on objective criteria, like credit rating, would allow a POA to screen tenants by their financial capacity to pay rent and POA dues. Absolute approval rights over leasing are relatively common in condominium developments.\textsuperscript{165} A more limited right would prevent the social screening common in cooperatives, but would advance the POA’s legitimate interest in ensuring its financial stability.\textsuperscript{166} Granting a POA direct enforcement power against a tenant is more likely to result in compliance with rules and prompt payment of dues than indirect enforcement by placing liens on the absentee owner’s unit and by threatening to foreclose.\textsuperscript{167} The Uniform Act, for example, extends a POA’s power to enforce CID rules directly against tenants, and it grants the POA any enforcement powers for violation of rules that landlords would have under the terms of their leases. Both provisions introduce only minimal interference with the freedom of contract of the homeowners, and they may substantially reduce common problems associated with renters.

\textsuperscript{165} See, e.g., Pacitti v. Seapointe Condo. Ass’n, 584 So. 2d 212, 212 (Fla. Dist. Ct. App. 1991); (“All rentals, leases and transfers require notification to, and approval of, the Board of Directors.”); Le Febvre v. Osterndorf, 87 Wis. 2d 525, 528 (1979) (“In order to preserve high standards of maintenance and care and the other benefits from a low turnover of occupants, no unit may be rented without the prior written consent of the Board of Directors.”).

\textsuperscript{166} In addition to credit rating, legislatures might consider allowing additional objective criteria like a prospective tenant’s criminal record. The current law regarding the validity of restrictions prohibiting residency by criminals under the reasonableness standard is uncertain. In 2001, a New Jersey court declined to rule on the merits of an amendment prohibiting residence in a CID by convicted sex offenders, but refused to enforce the provision on procedural grounds. Mulligan v. Panther Valley Prop. Owners Ass’n, 337 N.J. Super. 293, 304-07 (N.J. Super. Ct. App. Div. 2001).

\textsuperscript{167} Duncan R. McPherson, \textit{Drafting Considerations for Community Association Documents}, 15 PROB. & PROP. 25, 27 (2001) (“The desire of an association to have increased powers to deal with tenants is often moderated by a concern that the association will be drawn into disputes that should be dealt with by the owner-landlord”).
CONCLUSION

Millions of Americans enjoy the benefits of common property, social community, and superior ambience made possible by the enforcement of restrictive covenants in CIDs. Particularly in high density developments like condominiums and cooperatives where neighborhood effects may be pronounced, stability of residency and high owner-occupancy rates are important to the maintenance of those public goods. Leasing restrictions may be necessary to preserve desirable community characteristics; however, they are “a fertile source of dispute”168 because of the conflicting interests of owner-occupants, absentee landlords and renters.

Fairness demands that property owners consent to the restrictions imposed on their property, and efficiency requires that property owners have perfect information about the content of restrictions so that they may adjust their willingness to pay based on the value of benefits they will receive. Prospective buyers unanimously consent to declaration CC&Rs and have perfect information about their contents at the time of purchase. Buyers choose the living arrangements that best satisfy their preferences and form optimal self-selecting communities. CIDs may exist in perpetuity, however, and must be able to adapt to the changing preferences of property owners. Any political process for adopting leasing restrictions creates the potential for the majority to benefit itself at the expense of the minority, raising both fairness and efficiency concerns.

The legal standard determines whether courts or the parties themselves decide the parameters for future restrictions. The majority rule favors judicial decision-making by subjecting retrospectively adopted leasing restrictions to reasonableness review. The application of an objective reasonableness standard is likely inappropriate to analysis of contractual living arrangements intended to appeal to the idiosyncratic preferences of CID property owners. In

168 NATELSON, supra note 4, at 158.
practice, courts are generally highly deferential to CID political processes, providing little protection to an aggrieved minority when the majority imposes leasing restrictions pursuant to an amendment procedure or general rule making authority contained in the declaration CC&Rs. The level of discontent among CID owners may evidence the failure of the current reasonableness standard to protect the property rights and legitimate expectations of CID property owners. Twenty-six percent of current members of POAs would not purchase another home in a CID. The restrictiveness of POA rules is the most common reason for dissatisfaction with CID ownership.

Adoption of the Restatement would likely improve CID owner satisfaction by enhancing the contractual rather than political nature of CID governance. The Restatement creates a rule of narrow construction, which requires that to be enforceable leasing restrictions derive their authority from enumerated powers in the declaration CC&Rs. By requiring developers to define the scope of future restrictions when drafting the declaration CC&Rs, the Restatement facilitates the functioning of the CID housing market by providing prospective buyers with better information about the content of future restrictions. Owner-occupants will tend to purchase units in CIDs that impose or authorize leasing restrictions, and absentee landlords will purchase units in CIDs that do not authorize leasing restrictions. Forcing buyers to reveal their preferences at the time of purchase, rather than through subsequent amendments or Board of Directors’ elections, protects the minority from unexpected redistributive policies and facilitates the efficient sorting of prospective buyers into compatible communities. The Restatement enhances fairness and efficiency by rejecting judicial reasonableness review in favor of property owners’ consent.

169 COMMUNITY ASSOCIATIONS INSTITUTE, supra note 82, at 12.