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AMERICAN DREAM IN FLUX: THE ENDANGERED RIGHT TO LEASE A HOME

Andrea J. Boyack*

Author's Synopsis: Homeownership in the US is on the decline and the percentage of the population that rents their residence is growing. Renters present a distinct demographic compared to owners, and most of the more vulnerable segments of society rent their homes. But the law prohibits renting a home in some neighborhoods. Occasionally, zoning provisions hamper the ability of would-be tenants and would-be landlords to rent. More typically, however, community restrictive covenants are what block rentals. Zoning prohibitions on rentals have been attacked as violations of property rights. But in condominiums and other privately governed neighborhoods, segregation of renters from owner occupants has been continually upheld by the courts and has been consistently promoted as policy by government and quasi government entities. These policies and legal structures harm not only the rights of would-be landlords but also would-be tenants in such communities. Community rental restrictive covenants perpetuate broader social harms as well. It is time to rethink the desirability of these restrictions, even in the "private" context of neighborhood covenants.

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I. INTRODUCTION

Homeownership—long touted as the American Dream[1] and promoted through government policies[2]—is on the decline.[3] Although more than 69% of Americans owned their homes in 2005, the financial crisis, plummeting property values, and rampant foreclosures have worked in

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[1] *See* U.S. DEP'T OF HOUS. & URBAN DEV. , Message from the President in National Home Ownership Strategy: Partners in the American Dream (1995), www.Globalurban.org/National_Homeownership_Strategy.pdf ("Expanding homeownership will strengthen our nation's families and communities, strengthen our economy, and expand this country's great middle class. Rekindling the dream of homeownership for America's working families can prepare our nation to embrace the rich possibilities of the twenty-first century."); *see also* LEIGH GALLAGHER, THE END OF THE SUBURBS: WHERE THE AMERICAN DREAM IS MOVING 9 (2013) (claiming that the American Dream "immediately brings to mind images of the single-family home with a white picket fence").

[2] Homeownership and owner occupancy are widely presumed public benefits and are supported, and even subsidized, at multiple levels of government. *See generally* Dorothy A. Brown, *Shades of the American Dream*, 87 WASH. U. L. REV. 329 (2009) (detailing the various ways that federal tax policies attempt to encourage homeownership, but concluding that these policies are costly and ineffective); *see also* A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership Is Not Always a Good Thing*, 84 IND. L.J. 189, 190 (2009) (explaining that homeowners create the perception of "positive externalities" by caring for their property, thereby promoting neighborhood property values); Stephanie M. Stern, *Reassessing the Citizen Virtues of Homeownership*, 111 COLUM. L. REV. 890, 890 (2011) (stating that homeowners are widely viewed as "(much) better local citizen[s]," even though this assumption may not be warranted).

[3] *See* U.S. CENSUS BUREAU RESIDENTIAL VACANCIES AND HOMEOWNERSHIP IN THE SECOND QUARTER 2013 (2013), http://www.census.gov/housing/hvs/files/currenthvspress.pdf [hereinafter 2013 CENSUS BUREAU NEWS RELEASE]; Prashant Gopal & John Gittelsohn, *U.S. Homeownership Rate Falls to Lowest Since 1995*, BLOOMBERG (Apr. 30, 2013, 11:55 AM), http://www.bloomberg.com/news/2013-04-30/u-s-home-vacancies-fell-in-first-quarter-from-prior-year.html.

combination to decrease that rate to 64.7% today.[4] As the percentage of homeowners drops, the number of rental households increases significantly—five to ten million more Americans rent today than a decade ago.[5] Previously, the primacy of homeownership as a policy and personal goal was both unchallenged and widespread,[6] but economic realities of the past several years have tarnished the homeownership ideal.[7] Furthermore, homeownership has increasingly become financially unattainable.[8] Today's renters may either be unable to purchase a home or simply opt out of the property ownership model.[9] The American Dream is in flux.

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[4] *See* U.S. CENSUS BUREAU RESIDENTIAL VACANCIES AND HOMEOWNERSHIP IN THE SECOND QUARTER 2014 (2014), http://www.census.gov/housing/hvs/files/currenthvspress.pdf [hereinafter 2014 CENSUS BUREAU NEWS RELEASE]. The U.S. homeownership rate peaked in the fourth quarter of 2004 at 69.2% and the homeownership rate today is 64.7%. *Id.* Renter-occupied housing units are measured as the fraction of the total number of "occupied units which are not owner occupied, whether they are rented for cash rent or occupied without payment of cash rent." U.S. Census Factfinder, http://factfinder2.census.gov/help/en/glossary/r/renter_occupied_housing_unit.htm (last visited Oct. 15, 2014).

[5] *See Single-Family Housing – The Fastest Growing Component of the Rental Market*, FANNIE MAE (March 16, 2012), http://www.fanniemae.com/resources/file/research/datanotes/pdf/data-note-0312.pdf [hereinafter *Fannie Mae Data Note*]. Fannie Mae notes that "every one percentage point drop in the homeownership rate represents a change in the living situation of about 1.1 million American households." *Id.;* NATIONAL MULTI HOUSING COUNCIL, QUICK FACTS: RESIDENT DEMOGRAPHICS 1 (2013) [hereinafter NMHC QUICK FACTS].

[6] *See* Douglas G. Baird, *Technology, Information, and Bankruptcy*, 2007 U. ILL. L. REV. 305, 307 (calling owner occupancy an "integral part of the American Dream" and referencing "explicit government policy" promoting homeownership); Brown, *supra* note 2, at 332 (explaining that homeownership historically was viewed as both a solid investment and "as a means of living the American Dream"); Allison D. Christians, *Breaking the Subsidy Cycle: A Proposal for Affordable Housing*, 32 COLUM. J.L. & SOC. PROBS. 131, 145 (1998) (citing sources that call homeownership "a basic value in American society" and "a 'national good"'); Michael S. Knoll, *Taxation, Negative Amortization and Affordable Mortgages*, 53 OHIO ST. L.J. 1341, 1378 (1992) (calling homeownership "a cherished part of the American dream").

[7] *See* Grace W. Bucchianeri, *The American Dream or The American Delusion? The Private and External Benefits of Homeownership for Women* (April 1, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1877163.

[8] *See* Michael A. Valenza, *Digest of Selected Articles*, 41 REAL EST. L.J. 246, 247 (2012).

[9] *See* GALLAGHER, *supra* note 1, at 158 (detailing the preference for renting among millennials, explaining that "millennials don't see home ownership the way generations before them did" and asserting that "[s]ome demographers have taking to calling them 'Generation Rent'").

Compared to owner occupants, renters represent a distinct demographic.[10] Renters are typically younger[11] and more likely to be unmarried[12] and female.[13] The median income of renters is lower than that of homeowners.[14] Additionally, renters are more likely to be non-white.[15] Moreover, many specific, vulnerable populations in our society are far more likely to rent than own their homes, including single mothers,[16] new immigrants,[17] and uneducated and unskilled persons.[18]

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[10] The statistics cited in this paragraph refer to renters as a group, but the distinctiveness of the renter population demographic becomes more pronounced when renter occupants of single-family homes are separated out from renter occupants of apartment dwelling units. *See Fannie Mae Data Note*, *supra* note 5. This issue is discussed more at *infra* notes 21–28 and accompanying text.

[11] *See* U.S. CENSUS BUREAU, HOUSING VACANCIES AND HOMEOWNERSHIP, Table 17, *available at* http://www.census.gov/housing/hvs/data/ann13ind.html [hereinafter CENSUS BUREAU STATISTICS] (78% of the population under 25 years of age rents and 63% of the population under 35 years age rents).

[12] *See id.* Although only half of the unmarried population own their residences, 81% of married couples own their homes. *See id.*

[13] *See id.* In nearly every age-group category, other than females over 55, male homeownership outpaces female homeownership. *See id.*

[14] *See* NMHC QUICK FACTS, *supra* note 5, at 2.

[15] *See* CENSUS BUREAU STATISTICS, *supra* note 11, at 9. U.S. Census data for the first quarter of 2014 shows that the homeownership rate of White non-Hispanic residents is 72.9% as compared to a homeownership rate of 43.3% for Black residents, 55.8% for residents of "all other races," and a homeownership rate for Hispanic residents (of any races) of 45.8%. *See id.*; *see also* Lewis M. Segal & Daniel G. Sullivan, *Trends in Homeownership: Race, Demographics, and Income*, ECONOMIC PERSPECTIVES (1998) *available at* http://geography.tamu.edu/class/bednarz/ep2Q98_4.pdf (discussing the "growing gap between white and black homeownership rates"). Black homeowners are also more likely to become renter occupants in the future. Thomas P. Boehm & Alan M. Schlottmann, *The Dynamics of Race, Income, and Homeownership*, 55 J. OF URBAN ECON. 113, 114–15 (2004).

[16] *See* Eric Kiefer, *Solo on Mother's Day in Essex County*, MONTCLAIR TIMES (May 8, 2014), at B3, www.northjersey.com/towns/solo-on-mother-s-day-1.1013652?page=all (discussing rental housing expenses for single mothers and explaining that a single-parent household is at "an economic disadvantage"); Matthew Strozier, *That New Renter? Probably a Single Mom*, WALL ST. J. (Nov. 2, 2011, 11:52 PM), http://blogs.wsj.com/developments/2011/11/02/that-new-renter-probably-a-single-mom/ (citing data showing the growth of renters by demographic group indicates the largest increase in the category of "single mom").

[17] *See* Kathleen M. Howley, *Housing Sales Hurt as Fewer Immigrants Chase Owner Dream*, BLOOMBERG (June 30, 2014), http://www.bloomberg.com/news/2014-06-30/housing-sales-hurt-as-fewer-immigrants-chase-owner-dream.html.

[18] *See* Emily Badger, *A 'Nationwide Gentrification Effect' is Segregating Us by Education*, WASH. POST (July 11, 2014), http://www.washingtonpost.com/blogs/wonk

The financial crisis has likely exacerbated the demographic divide between renters and owners because the recent decrease in home-ownership in the United States—and the associated increase in renter occupancy—has not been uniformly distributed.[19] During the past decade, racial and ethnic minorities were disproportionately harmed by the financial crisis and lost their homes in far greater proportion than white homeowners.[20]

Today, renters are increasingly seeking housing in single-family homes rather than apartments.[21] The household demographic of renters of single-family homes differs from the demographic of apartment dwelling renter households.[22] Although renters are more likely to be younger than owner-occupants, tenants of single-family homes are relatively older than apartment dwellers.[23] Renters between thirty-five and sixty-four years old comprise 56.8% of single-family home renters.[24] The average income of a single-family renter is also higher than that of apartment dwellers.[25] Most of these single-family home rentals involved

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blog/wp/2014/07/11/college-graduates-are-sorting-themselves-into-cities-increasingly-out-of-reach-of-everyone-else/; Segal & Sullivan, *supra* note 15.

[19] *See* Debbie Gruenstein Bocian et al., *Foreclosures by Race and Ethnicity: The Demographics of a Crisis*, CENTER FOR RESPONSIBLE LENDING (June 18, 2010), http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-andethnicitiy.pdf; California Reinvestment Coalition et al., *Paying More for the American Dream: The Subprime Shakeout and Its Impact on Lower-Income and Minority Communities*, WOODSTOCK INSTITUTE (March 2008), http://www.nedap.org/resources/documents/MultistateHMDAReport-Final21.pdf [hereinafter *Paying More for the American Dream*].

[20] *See* Bocian, *supra* note 19; *Paying More for the American Dream*, *supra* note 19.

[21] *See Fannie Mae Data Note*, *supra* note 5, at 2 (explaining that "from 2005 to 2010, single family units as a share of the renter-occupied stock grew from 30.8 percent to 33.5 percent, which was the largest increase among all rental property types"); Brenton Hayden, *Who is the Modern Day Tenant? Census Bureau Has New Data*, THEBIGGERPOCKETS.COM, Jan. 12, 2013, http://www.biggerpockets.com/renewsblog/2013/01/12/modern-day-tenant/.

[22] *See* Hayden, *supra* note 21 (discussing the American Community Survey).

[23] *See id.*

[24] *See id.*

[25] *See Fannie Mae Data Note*, *supra* note 5, at 3. Note that single-family rental households generally are also larger than multifamily unit rental households. *See* Hayden, *supra* note 20. The most common household size for any rental household is one member (37%), but the most common household size for single-family rentals is two members (25.7%). *See id.* (referencing ACS data).

tenure of more than five years.[26] In terms of age, income, and transience, a renter of a single-family home is a closer match with single-family homeowners than with apartment dwelling renters.[27] To some extent, the difference between rental and owner occupancy is financial: renters finance their residential occupancy through a lease rather than through a mortgage loan.[28]

Distribution of rental housing is geographically concentrated, based on both market and legal constraints. Market factors include proximity to public transportation and jobs, rental rates, and rental housing availability. Some legal structures skew the availability of rental housing as well, including zoning and community covenant prohibitions on rental occupancy. Zoning can be particularly hostile to rental housing. The early seminal zoning decision, *Village of Euclid, Ohio v. Ambler Realty Co.*,[29] involved a zoning restriction that segregated multi-family housing from single-family home neighborhoods.[30] In *Euclid*, the court held that local governments had the power to segregate according to "use," and specifically opined that it was perfectly appropriate to protect single family homes from the nuisance of nearby multi-family rental housing.[31] The court explained that the enjoyment and value of single-family home property is threatened by proximate apartment houses that often act as a community "parasite," taking advantage of the "open space and attractive surroundings created by the residential character of the district."[32]

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[26] *See* Nick Timiraos, *Survey: Single-Family Renters More Likely to Stay Longer*, WALL ST. J. (Feb. 25, 2013) *available at*, http://blogs.wsj.com/developments/2013/02/25/survey-single-family-renters-more-likely-to-stay-longer/.

[27] *See id.* Renters are, however, more likely to be persons of color. *See* CENSUS BUREAU STATISTICS, *supra* note 11.

[28] *See* ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 519–25 (3d ed. 2007). In each such structuring, the provider of capital obtains a set rate of return from the party in possession. *See* Andrea J. Boyack, *Community Covenant Alienation Restraints and the Hazard of Unbounded Servitudes*, 42 REAL EST. L. J. 450, 478 n.104 (2014) [hereinafter *Unbounded Servitudes*]. Of course, there are numerous variations in structuring these arrangements that will determine ultimate rights of the parties to title, whether and how much interest a party pays for possession, and use of the other's capital, etc. *See id.*

[29] 272 U.S. 365 (1926).

[30] *See id.* at 379–83.

[31] *See id.* at 394–95.

[32] *Id.* at 394.

Euclid brought legitimacy to single-use zoning, whereby commercial and industrial uses were segregated from residential uses.[33] Specifically, *Euclid* permitted municipalities to create separate residential neighborhoods based on housing type.[34] But *Euclid* also lent legitimacy to the theory that rental residential occupancy somehow presents a different use of land than does owner residential occupancy. Under *Euclid*, a city can mandate that single-family homes (earmarked for owner occupancy) be quarantined and segregated from neighborhoods of multi-family apartment buildings (earmarked for rental occupancy).[35] This sort of zoning is widespread,[36] and apartment buildings are often zoned out of neighborhoods of single-family homes. It is less common—but still theoretically permissible—for municipalities to enact restrictions that mandate owner occupancy for (and prohibit rental of) single-family homes.[37] Zoning regulations that control *who* resides in a home rather than *how* the property is used have recently come under constitutional attack.[38]

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[33] *See* Michael Lewyn, *Zoning and Land Use Planning*, 42 REAL EST. L. J. 512, 515–16 (2014) (explaining "single-use zoning"); Katherine A. Woodward, *Form Over Use: Form-Based Codes and the Challenge of Existing Development*, 88 NOTRE DAME L. REV. 2627, 2634 (2013).

[34] *See Euclid*, 272 U.S. at 394–95.

[35] *See id.* at 380. A recent Congressional Hearing discussed the problem of municipalities using zoning to discriminate against rental housing. *See Protecting the American Dream Part III: Advancing and Improving the Fair Housing Act on the 5-Year Anniversary of Hurricane Katrina: Hearing Before the Subcomm. on the Constitution, Civil Rights, and Civil Liberties of the H. Comm. on the Judiciary*, 111th Congress (2010).

[36] *See* GALLAGHER, *supra* note 1, at 39–42 (criticizing single-use zoning, but averring that its popularity was fed by the FHA required single-use zoning as a condition for granting mortgages).

[37] *See, e.g.*, Dean v. City of Winona, 843 N.W.2d 249 (Minn. Ct. App. 2014), *review granted* (No. A13-1028) (Minn. May 20, 2014). While styled as a zoning case, the rental regulation in *Dean v. City of Winona* is a licensing requirement that provides no new licenses to lease one's home will be granted if 30% or more of the neighborhood in which the home is located are renter-occupied. *See id.* at 256 (citing WINONA, MINN. CITY CODE § 33A.03(h)(i) (2013). The appellate court in *Dean v. City of Winona* held that this sort of municipal leasing limitation was proper because it served a legitimate public purpose, namely owner occupancy. *See id.* at 260–61. The court explained that the concentration of rental-occupied properties in certain neighborhoods can "have a negative impact on the quality and liveability of those neighborhoods." *Id.* at 257.

[38] *See* Brief for CATO Institute and the Minnesota Free Market Institute at the Center of the American Experiment as Amici Curiae Supporting Appellants at 2, Dean v. City of Winona, No. A13-1028 (Minn. 2014), *available at* http://object.cato.org/sites/cato.org/

Although municipalities are empowered to protect the health, safety, and well-being of their communities, regulations that limit owners' ability to lease are arbitrary alienation restrictions that operate as inexact proxies, not sufficiently tailored to legitimate community concerns.[39] The municipality in a current case pending in the Minnesota Supreme Court, *Dean v. City of Winona*,[40] claimed that imposing municipal restrictions on owners' ability to rent was justified in order to "preserve 'community character' and to stop 'rental housing [from] spreading like a virus throughout the community.'"[41] However, opponents to the ordinance pointed out that the municipality did not show that rental restrictions achieve public welfare, and the City's bare assertion "that 'landlords and students often do not have any interest in how their properties appear and the effect they have on the community'" is completely unsupported.[42] Even if promoting better property maintenance is a legitimate purpose behind municipal leasing restrictions, this purpose must be achieved in the least restrictive way, not using a "sledgehammer approach" that is "indiscriminate and arbitrary."[43]

The constitutionality of zoning restrictions that limit rentals remains an open question, but the question of enforceability of covenant-based restrictions on leasing seems settled. In privately governed communities

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files/pubs/pdf/dean_v_city_of_winona_28sc_minn29.pdf. [hereinafter *Dean v. City of Winona* Amici Brief] (calling zoning law that limits an owner's ability to rent her home "an arbitrary, inefficient, and unconstitutional restraint on an essential and fundamental property right").

[39] *See id.* at 6 ("Restrictive rules such as this must be carefully tailored to achieve a legitimate government purpose because the right to use and enjoy property is so fundamental.").

[40] 843 N.W.2d 249 (Minn. Ct. App. 2014).

[41] *Dean v. City of Winona* Amici Brief, *supra* note 38, at 7 (citing Trial Court Order at 4).

[42] *Id.* (citing Trial Court Order at 4–6).

[43] *Id.* at 8 ("The City has stripped many people of their right to rent without giving any consideration to their circumstances or providing a process to exercise objections to their exclusion from a rental market."). *Id.* Other courts have found that municipal rental restrictions are unreasonably broad when alleged public concerns could be addressed in a more narrowly tailored way. *See, e.g.*, Coll. Area Renters & Landlord Ass'n, 50 Cal. Rptr. 2d 515, 521 (Cal. Ct. App. 1996) (invalidating a rental restriction while explaining that overcrowding problems could be addressed through separate regulations); Kirch Holding Co. v. Borough of Manasquan, 281 A.2d 513, 519 (N.J. 1971) (striking down an unreasonable zoning regulation that limited rentals to a family).

(common interest communities, or CICs),[44] such as condominiums and neighborhoods governed by homeowners' associations, community covenants may legally mandate owner occupancy. While not as common as the nearly ubiquitous bans on short-term leasing, many common interest communities have explicitly restricted their member owners from leasing their homes.[45] This practice is common enough to seem normal, and yet it can be problematic—both jurisprudentially and practically.

Courts and commentators routinely assert that rental restrictions create community benefits at little or no cost.[46] However, prohibitions on leasing not only limit the owners' ability to fully access the value of their property[47] but also exclude the renting population from living in the restricted community.[48] Notwithstanding these effects, enforcement of community covenants that preclude rental occupancy in a CIC is relatively uncontroversial. Unlike public zoning, neighborhood covenants are considered private rather than public acts, free from Constitutional scrutiny. Such covenants are usually upheld as valid contracts and real property servitudes that run with the land.[49]

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[44] "Common interest community" is defined by the *Restatement (Third) of Property* to be a "development or neighborhood in which individually owned lots or units are burdened by a servitude . . . that cannot be avoided by nonuse or withdrawal." RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 (2000). Sometimes the term common interest development or "CID" is used to refer to the same thing. *See, e.g.*, CAL. CIV. CODE § 4100 (West 2014). CICs include condominiums and homeowner associations, also known as PUDs (planned unit developments). *See* WAYNE S. HYATT, CONDOMINIUMS AND HOMEOWNERS ASSOCIATIONS—A GUIDE TO THE DEVELOPMENT PROCESS 5–6 (1985) [hereinafter A GUIDE TO THE DEVELOPMENT PROCESS]. While structured differently, cooperative ownership developments are often included within the rubric of CIC. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 cmt. a-b. This Article, however, does not discuss restrictions on rental within a cooperative. *See infra* notes 80, 244–47 and accompanying text.

[45] Zachary M. Rawling, *Reevaluating Leasing Restrictions in Community Associations: Rejecting Reasonableness in Favor of Consent*, 5 J.L. ECON. & POL'Y 223, 224 (2009).

[46] *See, e.g.*, Flagler Fed. Sav. & Loan Ass'n of Miami v. Crestview Towers Condo. Ass'n, Inc., 595 So. 2d 198 (Fla. Dist. Ct. App. 1992); Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93 (Ill. App. Ct. 1995) (upholding no-lease covenant amendment); Rawling, *supra* note 45, at 225 (stating that leasing restrictions "likely improve the quality of life for owner-occupants"); *see also infra* Part V.

[47] *See infra* notes 398–401 and accompanying text (discussing property value decrease and income stream problems from rent restrictions).

[48] *See infra* Part IV.A.

[49] *See infra* Part III.A.

Nevertheless, privately governed community covenants are not, in fact, as private as they at first appear. Government and quasi-government policies actively encourage covenant-based leasing prohibitions, both as a reflection of owner occupancy and homeownership policies and as an underwriting strategy.[50] Rather than merely reflecting private neighborhood preference for owner occupancy, the CIC leasing restriction trend is—and for decades has been—fueled by lender underwriting requirements. These requirements are crafted and imposed by the Federal Housing Administration (FHA)[51] and secondary market powerhouses—and quasi-government entities—Fannie Mae and Freddie Mac.[52] In the name of promoting owner occupancy as a property value enhancer, government policies punish would-be renters and landlords as well as entire communities that become majority-renter-occupied by denying them access to mortgage capital.

Unscrutinized enforcement of community covenants, based on a theory of owner consent, oversimplifies and falsifies the contracting reality associated with CIC ownership. Furthermore, this type of enforcement ignores the public impact of such private ordering. Leasing restrictions in community covenants perpetuate de facto housing segregation and drive up the cost of rental housing.[53] They also tie up owner equity, stymie market efficiencies, and perpetuate a financially distressed

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[50] *See infra* notes 293–99 and accompanying text (discussing FHA/Fannie/Freddie owner occupancy requirements).

[51] The Federal Housing Administration (generally known as "FHA") is an agency within the Department of Housing and Urban Development that provides mortgage insurance on certain qualified loans to homebuyers. *The Federal Housing Administration (FHA)* HUD.GOV, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory.

[52] Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation) were chartered by Congress and regulated by federal agencies and since 2008 have been in conservatorship with the federal government. *See* Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1499–02 (2011) [hereinafter *Role and Control*] (giving an overview of the market role and enumerated purposes of Fannie Mae and Freddie Mac).

[53] *See infra* notes 127–31 and accompanying text; Part IV.C (discussing segregation & rental rate increases); *see also* The State of the Nation's Housing 2014, JOINT CENTER FOR HOUSING STUDIES AT HARVARD UNIVERSITY, http://www.jchs.harvard.edu/research/state_nations_housing [hereinafter *2014 State of Nation's Housing Study*] (detailing the increase in rental rates due to restricted rental supply).

owner's inability to meet financial commitments.[54] History shows that limits on transferability can pit the government's, the developer's, and the neighbor's preferences against the desires of owners and would-be occupants in a way that perpetuates societal prejudices and intergenerational inequities.[55] Therefore, the costs of no-lease covenants are unjustifiable when legitimate community and lender concerns can be addressed through other, less costly and intrusive means. In recognition of the realities surrounding CIC membership and rental housing needs, agencies should reconsider their owner-occupancy mandates. In addition, courts and legislatures should act to appropriately constrain CIC governments from disallowing renting in their communities.

Part I of this Article discusses the trend of enacting no-lease covenants, as well as the government and quasi-government policies that fuel this trend. Part I also discusses historic judicial validation of no-lease covenants. Part II explores the realities behind the asserted choice to be bound to CIC covenants, as well as the impacts—positive and negative—that no-lease covenants have on communities and their members. Part III focuses on the oft-ignored costs that CIC occupancy restrictions can impose on nonmembers, including would-be occupants of a community and society as a whole. Part IV suggests that communities, courts, and agencies adopt a more justifiable and precisely tailored approach to addressing community harms in order to minimize the costs that no-lease covenants can impose.

II. LEASING PROHIBITIONS IN PRIVATELY GOVERNED COMMUNITIES

A. CIC Leasing Prohibitions: Three Snapshots

Three stories, from three cases, illustrate how lease prohibitions can create hardships for individuals and raise socially difficult questions. Several years ago, Barbara Bailey, the owner and occupant of a condominium unit located in Georgia, purchased a second unit in her building and rented it out to a single mother of two who happened to be

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[54] *See infra* Part IV.B (discussing financial harms suffered by owners who cannot rent and, therefore, cannot pay mortgage and assessments payments).

[55] *See, e.g.*, *infra* notes 471–79 and accompanying text (discussing historic occupancy restraints based on race); *see also* Stewart E. Sterk, *Freedom from Freedom of Contract: The Enduring Value of Servitude Restrictions*, 70 IOWA L. REV. 615, 617 (1985) (explaining the "difficult questions of intergenerational fairness" that arise in the context of CIC restraints).

African-American.[56] Although there were no community rules or covenants prohibiting rental occupancy in the condominium at the time, her choice of tenant apparently disturbed and upset some of her neighbors.[57] These neighbors informed Bailey that occupancy by an African-American single mother reduces property values in the community.[58] They told Bailey that they did not want to "that kind of person" living in the building and that they would stop her from renting her property by amending the CIC declaration.[59] Bailey's neighbors rallied and passed an amendment to the community covenants prohibiting leasing.[60] Bailey brought suit under Georgia's state fair housing legislation[61]—virtually identical to the federal Fair Housing Act[62]—claiming that the amendment was a mere pretext and that her community was engaging in intentional discrimination on the basis of race.[63]

The court noted that had Bailey asserted a mere discriminatory *impact*, her claim likely would not have survived, but Bailey alleged a discriminatory *intent* and adequately made a prima facie case for discrimination on the basis of race.[64] Unfortunately, the court held that the association refuted her discrimination claim by asserting a legitimate reason for the no-lease covenant.[65] The "legitimate reason" asserted by the association was "to maintain [the community's] status as a predominantly owner-occupied community."[66] The court found this reason compelling because the community believed that "an increase in the

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[56] *See* Bailey v. Stonecrest Condo. Ass'n, 696 S.E.2d 462, 465 (Ga. Ct. App. 2010).

[57] *See id.* at 465–66.

[58] *See id.* at 465.

[59] *See id.* Bailey alleged that racial epithets were used when her neighbors complained about her African-American tenant. *See id.*

[60] *See id.*

[61] *See* GA. CODE ANN. §§ 8-3-202(a) (2014) and 8-3-222 (2004).

[62] Fair Housing Act of 1968, 42 U.S.C. §§ 3601-19 (2006).

[63] *See Bailey*, 696 S.E.2d at 469.

[64] *See id.* at 468 (emphasis added). In making this claim, Bailey relied on circumstantial evidence (the comments by her neighbors and the amendment of the declaration to prohibit leasing). *See id.*

[65] *See id.* at 469.

[66] *Id.* at 468.

number of units being rented would have a detrimental effect on property values."[67]

In an Indiana case, a retired couple, Algie and Edna McGlothin, purchased a duplex-style condo home.[68] The condominium association declaration specifically stated that the unit had to be occupied by an owner and "their immediate family."[69] Eventually both Edna and Algie McGlothin developed health issues and relocated to a nursing home.[70] Soon thereafter, Algie died.[71] In order to pay for the costs of staying in the nursing home, Edna McGlothin started renting out the condominium unit, but the association objected and brought suit seeking injunctive relief.[72] McGlothin pleaded for the court to strike down the leasing restriction because she would lose her Medicaid benefits if she lost the income from leasing her home.[73]

McGlothin also raised a counterclaim, asserting that the no-lease covenant violated the Fair Housing Act because it created an adverse impact based on race.[74] McGlothin submitted extensive data showing a clear disparate impact in two ways.[75] First, McGlothin showed that African-Americans are more likely to rent than purchase a home, and have a vastly lower homeownership rate than white persons.[76] Because more African-Americans are renters, McGlothin averred that a no-lease provision would have a greater adverse effect on would-be community residents who are African-American than on would-be residents who are white.[77] Second, McGlothin showed that African-American homeowners are far more likely (twice as likely in Kokomo, the city where this

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[67] *Id.* at 468–69. Although the case was remanded to allow Bailey to prove that the asserted reason was a mere pretext, no further proceedings appear in the case. *See id.* at 484.

[68] *See* Villas W. II of Willowridge v. McGlothin, 841 N.E.2d 584, 588 (Ind. Ct. App. 2006), *vacated as moot*, 885 N.E.2d 1274 (Ind. 2008) [hereinafter *Willowridge I*].

[69] *See Willowridge I*, 841 N.E.2d at 588.

[70] *See id.* at 588 n.2.

[71] *See id.*

[72] *See id.* at 589.

[73] *See id.*

[74] *See id.*

[75] *See id.* at 592.

[76] *See id.* at 592–93. The data submitted to the court by McGlothin showed this to be true in the City of Kokomo, where the property was located, but Census Bureau demographic data indicates that these conclusions hold true nationwide. *See supra* note 15.

[77] *See id.* at 593–94, 602–03.

condominium was located) to rent out their home than a white homeowner.[78] Therefore, the no-lease provision created a greater adverse effect on community members who are African-American than on community members who are white.[79]

The condominium association claimed that the statistical impact data was irrelevant because there had been no discriminatory intent associated with enacting the no-lease provision.[80] The association asserted that racial animus played no part in the decision to prohibit leasing, but rather that the true motivation behind the provision was to support better-maintained homes and higher property values.[81]

The Indiana Court of Appeals found McGlothin's data compelling and held that the no-lease covenant violated the Fair Housing Act because of its adverse racial effect.[82] The court reasoned that the asserted legitimate neighborhood goal of well-maintained homes could be achieved directly through covenants and rules that required adequate property maintenance.[83] Therefore, there was no need for a community to resort to leasing prohibitions—and endure their problematic discriminatory impact—in order to achieve, by proxy, what could be addressed directly through upkeep rules.

The Indiana Supreme Court reversed, however, holding that even though property maintenance covenants would have been "less discriminatory alternatives" to achieving adequate property upkeep, there was no "equally effective means of maintaining property values" other than by prohibiting leasing.[84] The court merely stated this conclusion without any

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[78] *See id.* at 593. In the local market, data showed that African-American owners are 68% likely to rent their homes, and white owners are only 34% likely to rent their homes. *See id.*

[79] This second discriminatory impact is important because courts are far more likely to consider the costs of CIC covenants *to community members* than costs that CIC covenants may impose on nonmembers of the community. *See infra* Part III.

[80] *See Willowridge I*, 841 N.E.2d at 604.

[81] *See id.*

[82] *See id.* at 608.

[83] *See id.* at 607. The CC&R provisions already assured "a neat, clean and visually attractive environment, and a high degree of property maintenance." *Id.* Based on the direct regulation of offending uses and behaviors, the court called the leasing restriction "unnecessary and useless." *Id.*

[84] Villas W. II of Willowridge Homeowners Ass'n, Inc. v. McGlothin, 885 N.E.2d 1274, 1284 (Ind. 2008) [hereinafter *Willowridge II*]. The CC&Rs recited that the "congenial and residential character" of the community were the purposes of the restriction. *Id.* at 1283.

supporting data showing rental occupancy *sine qua non* drives down property values.[85] Finding no adequate non-discriminatory alternative, the court upheld the no-lease provision in spite of its proven discriminatory effects.[86]

CIC leasing prohibitions can not only reflect discriminatory motives and cause discriminatory effects, they can create adverse economic consequences for both owners and the community as a whole. For example, Marsha DeVaughn, a homeowner in a Tennessee CIC, found herself unable to keep current on her mortgage and assessment payments in 2010.[87] DeVaughn decided to live elsewhere and rent out her home for an amount that would cover the property's monthly costs, but her CIC had recently passed a no-leasing amendment.[88] The association sued for an injunction to prevent DeVaughn from leasing her home.[89] DeVaughn argued that the rental of her home was in the best economic interest of both her and her community, and that upholding the leasing prohibition would impose financial harm on both the owner and the CIC.[90] DeVaughn explained that her inability to rent the home would inevitably lead to default on her mortgage and assessment obligations, and her mortgage default would eventually lead to mortgage foreclosure.[91] Mortgage foreclosure and post-foreclosure unoccupied, lender-held property in the CIC would drive down property values in the community.[92] Therefore, DeVaughn reasoned that enforcing the no-lease covenant in this case would harm both her, individually, and the community as a whole.[93]

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[85] *See id.* at 1284. The belief that rental occupancy leads to lower community housing values is widespread and strongly held, but has not been shown by any compelling data. *See infra* notes 374–80 and accompanying text.

[86] *See Willowridge II*, 885 N.E.2d at 1284.

[87] *See* Pres. at Forrest Crossing Townhome Ass'n v. DeVaughn, 2013 WL 396000, at *7 (Tenn. Ct. App. Jan. 30, 2013).

[88] *See id.* at *1–2.

[89] *See id.* The amendment was passed two years after DeVaughn had purchased her home. *See id.* at *1.

[90] *See id.* at *7 (noting that allowing DeVaughn to rent may avoid foreclosure of her home, and admitting that, to the community, foreclosure is likely a more costly and undesirable result than leasing of her unit).

[91] *See id.*

[92] *See infra* notes 420–30 and accompanying text (discussing owners' financial distress can cause spillover financial harm to community).

[93] *See Forrest Crossing*, 2013 WL 396000, at *7.

The court agreed with DeVaughn's predictions, stating that enforcement of the leasing restriction would likely create financial distress for her and for the CIC.[94] Nevertheless, the court enforced the restriction on freedom of contract grounds.[95] The court, using familiar reasoning, held that DeVaughn assented to be bound to all current and future CIC governing provisions when she purchased the home.[96] The court noted that the association followed the enumerated procedures when the amendment was passed, and the amendment was equally applicable to all CIC members.[97] The court reasoned, without further explanation or supporting evidence, that enforcing leasing prohibitions benefits the community because the amendment could be "reasonably relate[d] to the health, happiness and peace of mind" of neighborhood owners.[98]

B. Private Zoning and Common Interest Communities

Common Interest Communities (CICs) have proliferated over the past few decades. Today, over 63 million people in the United States (approximately 20% of the country's population) live in privately governed CICs.[99] In a CIC, all parties are bound under a system of real covenants and share certain financial obligations and property rights.[100]

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[94] *See id.* at *7.

[95] *See id.*

[96] *See id.*

[97] *See id.* at *8.

[98] *Id.* at *3.

[99] *See* CMTY. ASS'NS INST., *Industry Data*, www.caionline.org/info/research/Pages/default.aspx (last visited Aug. 18, 2013). The Community Associations Institute (CAI) tracks the number of CICs and their residents. *See id.* CAI's data indicates that the number of residents of common interest communities has increased from 2.1 million in 1970 to 63.4 million in 2012. *See id.* This figure represents 20.2% of the population of the U.S.A., estimated by the U.S. Census Bureau in 2012 to be approximately 313.9 million. *See U.S. and World Population Clock*, U.S. CENSUS BUREAU, http://www.census.gov/popclock/ (last visited Aug. 18, 2013). The percentage of the population residing in a CIC continues to grow. *See* Andrea J. Boyack, *Community Collateral Damage: A Question of Priorities*, 43 LOY. U. CHI. L.J. 53, 58 (2011) [hereinafter *Community Collateral Damage*].

[100] *See Community Collateral Damage*, *supra* note 99, at 60. ("All types of CICs . . . share the same essential service and payment structure: homeowner-elected directors manage common upkeep, and all homeowners contribute their pro rata portion of the common costs."); *see also* WAYNE S. HYATT & SUSAN F. FRENCH, COMMUNITY ASSOCIATION LAW: CASES AND MATERIALS ON COMMON INTEREST COMMUNITIES 11 (2d ed. 2008) [hereinafter CASES AND MATERIALS ON CICs] (discussing the power of an elected board of directors); WAYNE S. HYATT, CONDOMINIUMS AND HOME OWNER

CICs are creatures of both property law and contracts. Every property owner within a CIC is also a mandatory member of a contractually defined association that provides private governance for the community.[101] The power to govern, to assess owners for upkeep, and to enforce rules regarding use and appearance of individual properties is established through a recorded declaration of covenants (sometimes called Covenants, Conditions and Restrictions or CC&Rs).[102] These covenants run with the land.[103] Although framed much like a multilateral contract, CIC covenants transcend contractual obligations to become obligations of the property itself, binding its successive owners.[104] The covenant obligations in CICs are not static because the association can amend the CC&Rs or pass rules to further clarify or carry out the purposes of the community.[105]

Although their legal structures are similar, privately governed neighborhoods of single-family homes have a different history and property law basis than privately governed condominiums.[106] The

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ASSOCIATIONS PRACTICE 105, 122 (3d ed. 1998) [hereinafter CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE (discussing assessments and other collection devices).

[101] *See* Robert Kratovil, *The Declaration of Restrictions, Easements, Liens, and Covenants: An Overview of an Important Document*, 22 J. MARSHALL L. REV. 69, 78 (1988).

[102] *See id.* The term "CC&Rs" is widely used but is legally a misnomer. Typical CIC declarations do not contain any "conditions," but rather are comprised of real covenants imposing restrictions on burdened properties. *See id.* (providing an overview of the development and use of such declarations in real property development).

[103] *See id.*

[104] Any associated financial obligations typically are secured by a lien on the subject property. *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 120–21. For a discussion of the perpetual nature of CIC covenants, see *infra* notes Part III.A.2 and accompanying text.

[105] Recorded covenants typically provide a method for amendment, often by supermajority vote of the owners in the community. In addition, the purposes of the community can be fleshed out by rules and regulations passed by the board of directors that conducts day-to-day governance in the community. *See* discussion at *infra* Part III.A.3. CIC purposes are almost always defined as preserving and promoting property values and owner lifestyle. *See infra* notes 130–54 and accompanying text (discussing the harmony/property value purposes of no-lease covenants).

[106] In condominium ownership, every member owns his or her unit in fee simple and all members collectively hold the remainder of the condominium (the roof, lobby, elevators, amenities, parking garage, electrical system, etc.) as tenants in common. *See* Andrea J. Boyack, *Common Interest Community Covenants and the Freedom of Contract Myth*, 22 J.L. & POL'Y 779 n.41 (2014) [hereinafter *Freedom of Contract Myth*]. In planned unit development of privately governed single-family neighborhoods, typically

popularity of privately governed communities has grown for several reasons, most of which track the justifications for public zoning laws. Changes in production brought by the Industrial Revolution exacerbated the problem of incompatible land use,[107] and when nuisance law proved too unpredictable and cumbersome to appropriately solve these problems, local governments took it upon themselves to regulate the use of land.[108] Occasionally, landowners banded together to solve land use issues themselves through contract and servitude law.[109] Later, developers recognized the potential to solve incompatible use problems *ex ante* and created whole neighborhoods inoculated against such problems using the tool of protective community covenants.[110]

Initially, both public (zoning) and private (covenant) methods of controlling land use had dual protectionist aims—to keep the community safe from undesirable uses (industrial and commercial)[111] and to keep the

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the lot owners do not own common areas as tenants in common; instead, the association owns the common areas. *See id.* Although cooperatives are typically lumped together with condominiums under the rubric of Common Interest Communities, in fact, cooperative ownership is distinct because cooperative owners lack fee simple title, instead holding a perpetual leasehold with an appurtenant membership interest in the owning entity. *See id.* at 779. In all three forms of CICs, property ownership is synonymous with membership in the governing association, and in all three ownership forms, members must abide by recorded covenants and rules established by the association's board. *See id.* at 779 n.41. The association is generally responsible for maintenance of the CIC and it is funded in full by assessments levied on the members. *See id.* The obligation to pay assessments is secured by a lien on the real property owned by the member. *See id. See generally* CASES AND MATERIALS ON CICS, *supra* note 100; *Community Collateral Damage*, *supra* note 99.

[107] *See* EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT 31–32 (1994). The Industrial Revolution heralded changes in land use that increased potential negative externalities on neighbors. *See id.* Property law expanded the law of servitudes as an adaptation to these new developments. *See id.*; JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY 959–61 (3d ed. 1993).

[108] *See supra* notes 30–35 and accompanying text.

[109] *See* Carol M. Rose, *Property Law and the Rise, Life, and Demise of Racially Restrictive Covenants*, ARIZONA LEGAL STUDIES DISCUSSION PAPER NO. 13–21, (March 13, 2013), *available at* http://ssrn.com/abstract=2243028; MCKENZIE, *supra* note 107, at 31–32. Initially, courts were concerned that enforcing this new brand of servitude would adversely affect alienability of land. *See* McKenzie, *supra* note 107, at 32. "Many early generation covenant communities were created by obtaining the unanimous consent of all neighborhood residents." *Freedom of Contract Myth*, *supra* note 106, at 777.

[110] *See* MCKENZIE, *supra* note 107, at 31–32.

[111] *See Unbounded Servitudes*, *supra* note 28, at 457. Community covenants are very useful in addressing negative external impacts that the use of one parcel imposes

community safe from undesirable occupants (racial minorities).[112] Early on, municipalities, neighbors, and developers recognized that private zoning through a comprehensive set of restrictive covenants could achieve more expansive ends than public zoning. In 1917, the Supreme Court declared that municipalities could no longer use zoning police power to limit residential occupancy to certain populations in order to achieve neighborhood homogeneity.[113] However, the use of private zoning, through restrictive covenants to achieve these same segregationist goals, continued unabated for almost fifty years. Race-based occupancy restrictions became increasingly more common during the first half of the 20th century and were routinely enforced and upheld.[114] Such occupancy restrictions were very effective tools against housing desegregation and proved popular with developers and white property owners alike.[115]

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upon other proximate parcels, and are preferable to reliance on nuisance law to protect property from such negative externalities. *See id.*

[112] *See id.* at 464 ("Occupancy restrictions perhaps were the *raison d'être* of early-generation covenant-based communities."); *see also* LEE ANNE FENNELL, THE UNBOUNDED HOME: PROPERTY VALUES BEYOND PROPERTY LINES 123 (2009); David E. Grassmick, Note, *Minding the Neighbor's Business: Just How Far Can Condominium Owners' Associations Go in Deciding Who Can Move into the Building?*, 2002 U. ILL. L. REV. 185 (2002).

[113] *See* Buchanan v. Warley, 245 U.S. 60, 80 (1917).

[114] In 1926, the Supreme Court found no constitutional basis to invalidate race-based occupancy restrictions. *See* Corrigan v. Buckley, 271 U.S. 323, 332 (1926). Nearly all courts followed this approach in upholding such restrictions. An outlier California federal court decision in 1894 struck down restrictions prohibiting residence by "Chinamen" based on an equal protection clause and a treaty provision. *See* Gandolfo v. Hartman, 49 F. 181, 182 (C.C.S.D. Cal. 1892). However, other courts ignored this decision. *See, e.g.*, Title Guarantee & Trust Co. v. Garrett, 183 P. 470, 471 (Cal. Dist. Ct. App. 1919) (upholding a racial covenant with no mention of *Gandolfo*); Queensborough Land Co. v. Cazeaux, 67 So. 64 (La. 1915) (upholding a racial covenant with no mention of *Gandolfo*); Parmalee v. Morris, 188 N.W. 330, 331 (Mich. 1922) (distinguishing *Gandolfo*); Kraemer v. Shelley, 198 S.W. 679, 683 (Mo. 1946) (asserting that *Gandolfo* was not valid). For a thorough discussion and analysis of historic racial occupancy restrictions in CICs, see RICHARD R.W. BROOKS & CAROL M. ROSE, SAVING THE NEIGHBORHOOD: RACIALLY RESTRICTIVE COVENANTS, LAW, AND SOCIAL NORMS (2013).

[115] *See, e.g.*, Corrigan v. Buckley, 271 U.S. 323, 332 (1926). In neighborhoods without covenants, some neighbors attempted to privately segregate by characterizing the act of renting to African-Americans as a "nuisance" under tort law, but these claims were completely unsuccessful. The most famous example is *Falloon v. Shilling*, in which one white homeowner, after a dispute with a neighbor, charged that the neighbor was attempting to create a nuisance by renting to "worthless negroes." 29 Kan. 292, 295 (1883). The court, however, held that residential use by a particular person could not constitute a

In the 1948 decision of *Shelley v. Kraemer*,[116] the Supreme Court finally declared that a court could not constitutionally enforce race-based occupancy restrictions in community covenants.[117] This seminal case involved a Missouri neighborhood's race-based occupancy restriction.[118] When one neighbor sold his property to the Shelleys, an African-American family, another neighbor sued to specifically enforce the neighborhood's restriction.[119] The Supreme Court of Missouri upheld the covenant, enjoined the Shelleys from taking possession, and ordered divestment of their title.[120] The Shelleys appealed to the U.S. Supreme Court, arguing that the Fourteenth Amendment barred judicial enforcement of the covenant, and that the covenant was an undue restraint on alienation.[121] Adopting an expansive view of state action, the Supreme Court unanimously held that enforcement of the race-based occupancy

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nuisance. *See id.* at 297. Treatise writers of the day unanimously agreed that a person could not just *be* a nuisance because of her identity but only could *cause* a nuisance based on her acts. *See* Rose, *supra* note 109, at 4 n.8 (citing JOSEPH A. JOYCE & HOWARD C. JOYCE, TREATISE ON THE LAW GOVERNING NUISANCES 49 n.22 (1906) (emphasis added)). The writers noted: "Nuisance law was (and still is) notoriously case-by-case and post hoc." *Id.* at 4. Even Jim Crow courts were unable to muster legal arguments to hold that a person could be a nuisance per se based on his race. *See* Rachel D. Godsil, *Race Nuisance: The Politics of Law in the Jim Crow Era*, 105 MICH. L. REV. 505, 516–25 (2006).

[116] 334 U.S. 1 (1948).

[117] *See id.* Judicial prohibition of race-based covenants was a long time in coming and was a culmination of decades of work by civil rights activists and the NAACP to hold racially restrictive covenants repugnant to constitutional protections. *See* CLEMENT E. VOSE, CAUCASIANS ONLY: THE SUPREME COURT, THE NAACP, AND THE RESTRICTIVE COVENANT CASES (1959) (detailing the efforts of civil right activists and the NAACP).

[118] *See Shelley*, 334 U.S. at 5. The recorded covenant purported to "restrict the use of said property for said period of time against the occupancy as owners or tenants of any portion of said property for resident or other purpose by people of the Negro or Mongolian Race." *Id.*

[119] *See id.* at 6.

[120] *See id.* at 10.

[121] *See* Brief for Petitioners, at 4–6, McGhee v. Sipes, 331 U.S. 804 (1947) (No. 1363) 1947 WL 44154 at *4–6 (The *McGhee v. Sipes* case was consolidated with the *Shelley v. Kraemer* case and presented virtually identical facts.). Various amicus curiae briefs also raised the free alienation argument in the case. *See, e.g.*, Brief for the United States as Amicus Curiae at 44, J.D. Shelley v. Kraemer, 334 U.S. 1 (1948), (Nos. 72, 87) 1947 WL 30432, at *44; Motion for Leave to File Brief and Brief for the American Association for the United Nations as Amicus Curiae at 27–28, Shelley v. Kraemer, 334 U.S. 1 (1948) (Nos. 72, 87), 1948 WL 47412, at *27–28; Motion for Leave to File and Brief for the National Bar Association as Amicus Curiae at 8–9, Shelley v. Kraemer, 334 U.S. 1 (1948) (Nos. 72, 87), 1948 WL 47413, at *8–9.

restriction would violate the Fourteenth Amendment.[122] While admitting that private parties are unconstrained by constitutional provisions in their private contracting, the Court opined that enforcement of the real covenant through the courts was state action proscribed by the Fourteenth Amendment.[123] The court reasoned, "But for the active intervention of the state courts," "petitioners would have been free to occupy the properties in question without restraint."[124]

Despite *Shelley v. Kraemer*, race-based occupancy restrictive covenants continued to have a segregating effect after 1948. The *Shelley v. Kraemer* decision did not preclude voluntary adherence to race-based occupancy restrictive covenants.[125] In fact, the existence of such

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[122] *See Shelley*, 334 U.S. at 19–20. Although the *Shelley* decision was unanimous, three Justices recused themselves. *See id.* at 23. Because its decision was based on finding a Constitutional violation, the Court did not reach the question of whether an occupancy restriction impermissibly restrained alienation. *See Unbounded Servitudes*, *supra* note 28, at 470–72.

[123] *See Shelley*, 334 U.S. at 13 ("[R]estrictive agreements standing alone cannot be regarded as a violation of any rights guaranteed to petitioners by the Fourteenth Amendment. So long as the purposes of those agreements are effectuated by voluntary adherence to their terms, it would appear clear that there has been no action by the State and the provisions of the Amendment have not been violated."). The Court extended the holding of *Shelley* in the case of *Barrows v. Jackson*, ruling that the Constitution not only prohibits injunctions and other specific enforcement of contractual obligations, but also prohibits a court from awarding damages for breach of a racially restrictive covenant. *See* 346 U.S. 249, 258–60 (1953).

[124] *Shelley*, 334 U.S. at 19. The Court in *Shelley* distinguished *Corrigan* based on the fact that the covenant in *Corrigan* was on property located in the District of Columbia, and the Fourteenth Amendment applies only to actions of one of the Fifty States. *See id.* at 8. In a companion case, however, the Court found that under public policy and the Civil Rights Act of 1866, the same result is mandated for communities located in the District of Columbia. *See* Hurd v. Hodge, 334 U.S. 24, 35–36 (1948). Nevertheless, *Hurd* was decided on the grounds of public policy and equity, not on the Fourteenth Amendment. *See id.*; *see also Unbounded Servitudes*, *supra* note 28, at 471–72 (calling *Shelley* "a tremendous win in terms of racial equality," but explaining that the Court's "failure to opine on the free alienation issue . . . left unsettled the question of whether community covenants restricting occupancy overly impair the right to transfer"); Mark D. Rosen, *Was* Shelley v. Kraemer *Incorrectly Decided? Some New Answers*, 95 CALIF. L. REV. 451, 453–55 (2007) (pointing out that *Shelley* creates a difficult precedent in terms of contract enforcement and calling it hopeless to try to find state action on *Shelley*'s facts).

[125] *See, e.g.*, Correll v. Early, 237 P.2d 1017, 1022–23 (Okla. 1951) (refusing to grant relief on the grounds that the restrictions were unenforceable or that they represented a conspiracy to prevent minority buyers from residing in a neighborhood).

covenants inspired realtor steering;[126] mortgage lending restrictions, such as redlining;[127] and neighbor grass-roots resistance to community diversity.[128] These problems persisted at least until the Fair Housing Act of 1968 made discriminatory sales and mortgage restrictions illegal.[129]

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[126] *See, e.g.*, Cabrera v. Jakabovitz, 24 F.3d 372 (2d Cir. 1994); City of Chicago v. Matchmaker Real Estate Sales Ctr., Inc., 982 F.2d 1086 (7th Cir. 1992).

[127] *See, e.g.*, Laufman v. Oakley Bldg. & Loan Co., 408 F. Supp. 489 (S.D. Ohio 1976); Margery Turner & Stephen Ross, *How Racial Discrimination Affects the Search for Housing*, *in* THE GEOGRAPHY OF OPPORTUNITY 81-100 (2005). Redlining—the practice of refusing to make home loans in neighborhoods based on community racial composition—originated with color-coded maps prepared by the Home Owner's Loan Coalition. *See Historical Shift from Explicit to Implicit Policies Affecting Housing Segregation in Eastern Massachusetts*, THE FAIR HOUS. CTR. OF GREATER BOS., http:www.bostonfairhousing.org/timeline/1934-FHA.html (last visited Oct. 11, 2014). These maps were based on the assumption that lending on homes in neighborhoods with more minority residents was more risky. *See id.* The FHA incorporated these residential security maps into their 1934 Underwriting Handbook and used them to determine where FHA mortgages could or could not be issued. *See id.*; Sam Smith, *Making Cities Black and Poor: The Hidden Story*, THE PROGRESSIVE REVIEW (January 2000), http://prorev.com/blackcities.htm.

[128] Resistance to neighborhood diversity is ugly and difficult to eradicate. *See, e.g.*, Halprin v. Prairie Single Family Homes of Dearborn Park Ass'n, 208 F. Supp. 2d 896 (N.D. Ill. 2002), *rev'd* 388 F.3d 327 (7th Cir. 2004); Catherine Silva, *Racial Restrictive Covenants: Enforcing Neighborhood Segregation in Seattle*, SEATTLE CIVIL RIGHTS & LABOR HISTORY PROJECT (2009), http://depts.washington.edu/civilr/covenants_report.htm (discussing neighbor efforts that successfully prevented Richard Ornstein, a Jewish refugee, from purchasing a home in 1952). For a thorough discussion of *Halprin* and other acts of community discrimination, see Rigel C. Oliveri, *Is Acquisition Everything? Protecting the Rights of Occupants Under the Fair Housing Act*, 43 HARV. C.R.-C.L. L. REV. 1 (2008). One reason that housing integration has been so elusive is that minority residents may be reluctant "to endure the discrimination and hostility they believe they would face if they moved into a majority white neighborhood or building." *Id.* at 30. Despite of this worry, most African-Americans indicate that they would prefer to live in diverse, integrated communities. *See* Maria Krysan & Reynolds Farley, *The Residential Preferences of Blacks: Do They Explain Persistent Segregation?* 80 SOC. F. 937, 937 (2002).

[129] *See* Fair Housing Act of 1968, 42 U.S.C. §§ 3601-3619 (2006). The Act, as amended, prohibits discrimination in the sale, rental, and financing of dwellings and in other housing-related transactions, based on race, color, national origin, religion, sex, familial status (including children under the age of 18 living with parents or legal custodians, pregnant women, and people securing custody of children under the age of 18), and disability. *See* 42 U.S.C. § 3604 (2006). Under the Act, it is illegal to lie about housing availability, advertise discriminatorily, steer buyers to or from housing based on a suspect criteria, or choose not to rent or sell property based on such a criteria. *See id.* States also passed fair housing legislation, in many cases expressly invalidating race-based occupancy restrictive covenants. *See, e.g.*, CAL. CIV. CODE § 53(b) (1982) (stating that "[e]very restriction . . . whether by way of covenant . . . or upon transfer of title to

Past and present housing segregation is not just the result of sporadic acts and private actors. It was orchestrated by federal government agencies and quasi-governmental entities. In the 1920s and 1930s, the FHA openly encouraged communities to include racial occupancy restrictions, ostensibly in the name of preserving property values and neighborhood harmony.[130] In its 1938 manual of underwriting standards, the FHA instructed developers and communities about the value and efficacy of using racial occupancy restrictions to segregate neighborhoods.[131] In its 1938 manual, the FHA explained that "it is necessary that properties shall continue to be occupied by the same social and racial classes" and that a change in "racial occupancy generally contributes to instability and a decline in values."[132] Racial covenants were so widespread and so socially acceptable that in 1937 a leading magazine, with nationwide circulation, awarded ten communities a "shield of honor" for having occupancy restrictions to protect its residents from the "wrong kind of people."[133]

Today, nearly fifty years after the Fair Housing Act created a statutory ban on such overt practices of race-based discrimination, housing in the United States remains highly segregated, and is likely aided by recorded (even if legally impotent) covenants and private

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real property, which restriction . . . directly or indirectly limits the acquisition, use or occupation of that property because of [the acquirer's, user's or occupier's sex, race, color, religion, ancestry, or national origin] . . . is void."); N.J. STAT. ANN. § 46:3-23 (1989) (stating that "[a]ny promise, covenant or restriction in a contract, mortgage, lease, deed or conveyance or in any other agreement affecting real property . . . which limits, restrains, prohibits or otherwise provides against the sale, grant, gift, transfer, assignment, conveyance, ownership, lease, rental, use or occupancy of real property to or by any person because of race, creed, color, national origin, ancestry, marital status, or sex is hereby declared to be void as against public policy, wholly unenforceable."). The Supreme Court's directive for interpreting the FHA is that its terms are "broad and inclusive" and must be construed generously. Trafficante v. Metro. Life Ins. Co., 409 U.S. 205, 209, 212 (1972).

[130] FEDERAL HOUSING ADMINISTRATION, UNDERWRITING MANUAL (Government Printing Office 1938), § 937 [hereinafter 1938 FHA Manual]. Because racial zoning had been declared unlawful, the FHA advised developers to "supplement zoning" through restrictive covenants in order to deal with "adverse influences" such as racial integration. *Id.* § 934; *see also* BROOKS & ROSE, *supra* note 114.

[131] 1938 FHA Manual, *supra* note 130, at § 937.

[132] *Id.*

[133] U.S. COMMISSION ON CIVIL RIGHTS, UNDERSTANDING FAIR HOUSING 4 (1973). By 1940, 80% of properties in Chicago and Los Angeles were burdened by covenants that restricted occupancy by black individuals or families. *See id.*; *see also* THE FAIR HOUS. CTR. OF GREATER BOS., *supra* note 127.

communities. The early years of covenant communities set the baseline for community demographics and bred a taste in buyers, realtors, and capital providers for neighborhood "exclusivity." These patterns and preferences persisted, even when direct race-based exclusions became impermissible.[134] Although legally impotent, race-based occupancy restrictions in recorded covenants send implicit psychological and social segregationist signals, and some of today's so-called "lifestyle covenants" may serve as a proxy for racial segregation prohibitions, whether by coincidence or by design.[135] Mandated neighborhood amenities and behavioral conformity can further effect de facto segregation.[136] For example, golf course communities have become increasingly more common, and CIC covenants in some of these communities affirmatively require each property owner to become a paid member of a golf club.[137] One scholar claims that these golf course covenants have a racially discriminatory purpose and lead to de facto housing segregation by race.[138] Similarly, since minorities and immigrants are significantly more likely to rent than buy, no-leasing occupancy restrictions also effectively stymie racial integration of the community.[139] For whatever reason, minorities continue to make up a smaller percentage of CIC residents than demographics would predict.[140]

Although community restrictive covenants have been instrumental in perpetuating housing segregation, such covenant systems can achieve

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[134] *See* MCKENZIE, *supra* note 107, at 72–78.

[135] *See* Raynolds Farley et al., *The Residential Preferences of Blacks and Whites: A Four-Metropolitan Analysis*, 8 HOUS. POL'Y DEBATE 763 (1997); Richard Thompson Ford, *The Boundaries of Race: Political Geography in Legal Analysis*, 107 HARV. L. REV. 1841, 1853–54 (1994); Oliveri, *supra* note 128, at 29–30; Silva, *supra* note 128.

[136] *See infra* Part IV.C.

[137] *See, e.g.*, Leon Hoke, Brian T. Kench, & Charles Skipton, *The Moral Hazard of Mandatory Membership in Private Clubs*, RESEARCH IN BUS. & ECON. J., *available at* http://www.aabri.com/manuscripts/121431.pdf (last visited Oct. 12, 2014).

[138] *See* Lior Jacob Strahilevitz, *Exclusionary Amenities in Residential Communities*, 92 VA. L. REV. 437, 437–38 (2006). Interestingly, linking club membership to land-ownership means that a private club can no longer discriminate without violating the Fair Housing Act and the Civil Rights Act of 1866. *See id.*

[139] *See supra* note 15 and accompanying text; *infra* Part IV.C.

[140] *See* Lee Anne Fennell, *Homes Rule*, 112 YALE L.J. 617, 626 (2002) (noting that homeownership rates for African-American households are significantly lower than for white, non-Hispanic households (47.7% as compared with 74.3% in 2002)); Segal & Sullivan, *supra* note 15. The homeownership rate for African-Americans has fallen to 43.3%. *See* CENSUS BUREAU STATISTICS, *supra* note 11, at 9.

laudable community goals as well. For example, covenants allow communities to offer residents shared amenities, funded by mandatory neighborhood assessments.[141] Systems of restrictive covenants can also bolster property values by providing an effective method to address incompatible property uses.[142] Furthermore, systems of covenants may indeed protect residents' quality of life of residents by precluding certain activities that really do impair the residential enjoyment of homes.[143]

In the suburbs, developers pioneered the use of servitude law to achieve their visions of community planning and design, relying on restrictive covenants to limit land uses as a way to preserve values, particularly for affluent suburban communities.[144] Servitude law had a huge impact on the urban landscape as well, through innovating the condominium ownership form and making private ownership of apartment units possible. By the 1970s, legislatures in every state had passed condominium-enabling statutes that permitted ownership of an apartment unit in fee simple.[145] Unlike the common law, these statutes allowed ownership of land to be carved up along three dimensions.[146] With the

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[141] For example, it is more cost effective to have one community swimming pool used by all residents in a neighborhood than for each household to build and maintain its own pool.

[142] For example, certain commercial activities can create neighborhood costs due to increased traffic and parking demands, noxious odors, and land subsistence.

[143] *See* David B. Ezra, *"Get Your Ashes Out of My Living Room!": Controlling Tobacco Smoke in Multi-Unit Residential Housing*, 54 RUTGERS L. REV. 135, 137–39 (2001) (Failure to properly maintain a home in a community can cause adverse spillover effects, such as vermin or crime or unsecured garbage. Unduly loud uses of property can impair the ability of nearby residents to quietly enjoy their property. Smoking in public areas, or even in private areas, of multi-family buildings can create adverse secondhand smoke effects.).

[144] *See* Neponsit Prop. Owners Ass'n v. Emigrant Indus. Sav. Bank, 15 N.E.2d 793 (N.Y. 1938). After the *Neponsit* case, covenant regimes evolved into common amenity regimes providing upkeep through assessments and associations. MARK A. WEISS, THE RISE OF THE COMMUNITY BUILDERS: THE AMERICAN REAL ESTATE INDUSTRY AND URBAN LAND PLANNING 3 (1987); *see also* MCKENZIE, *supra* note 107, at 36–45.

[145] *See* CASES AND MATERIALS ON CICS, *supra* note 100, at 11 (Every state adopted a condominium statute in the 1960s, paving the way for a huge condominium "boom" during the next few decades.). The earliest state condominium statutes tracked the FHA Model Act and in some key aspects were insufficient, ambiguous and ineffective. *See* Kratovil, *supra* note 101, at 75–76; *see also* Andrea J. Boyack & William E. Foster, *Muddying the Waterfall: How Ambiguous Liability Statutes Distort Creditor Priority in Condominium Foreclosures*, 67 ARK. L. REV. 225, 238 n.75 (2014).

[146] *See Freedom of Contract Myth*, *supra* note 106, at 778 n.36 ("The Condominium is a creature of statute that permits fee simple ownership defined along three-dimensional

creation of the condominium, urban home ownership skyrocketed.[147] The condominium ownership structure not only made ownership of urban apartments possible, but has proven to be so flexible that it permits fee simple ownership to exist with respect to any defined area of space, including parking spaces, air rights units, and stand-alone buildings.[148] During the last few decades, the law governing condominiums, and CICs in general, has matured and become somewhat more standardized.[149]

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planes, rather than common law two-dimensionally defined land ownership boundaries."). Under the common law, the third dimension is *ad coelom*: a column of space "from the center of the earth to the [heavens]." Ben H. Crowley, *Property: Condominium: What Place - - Space*, 1 TULSA L.J. 73, 73–78 (1964); *see also* William Schwartz, *Condominium: A Hybrid Castle in the Sky*, 44 B.U. L. REV. 137, 141 (1964) (noting the traditional view that "whatever is attached to the land belongs to the land" and, consequently, to the person who owns the land itself); Charles W. Pittman, Note, *Land Without Earth—The Condominium*, 15 U. FLA. L. REV. 203, 205–06 (1962) (noting the general hostility expressed in European civil codes to the concept of horizontal property).

[147] *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 11. Prior to the 1970s, the cooperative ownership structure approximated property ownership through the use of perpetual leases linked with ownership of shares in the landlord entity that owned an entire building. This form of ownership became popular in earlier urbanized areas, predominantly New York City. Although cooperatives are typically lumped together with condominiums under the rubric of Common Interest Communities, in fact, cooperative "ownership" is distinct because cooperative owners lack fee simple title. There have been numerous legislative and tax code tweaks and fixes designed to create parity between cooperative ownership and condo ownership, particularly in communities where a significant amount of the housing stock remains structured in cooperatives. *See* Susan Stellin, *Co-op vs. Condo: The Differences are Narrowing*, N.Y. TIMES Oct. 5, 2012, at RE9.

[148] *See Freedom of Contract Myth*, *supra* note 106, at 778 n.36. Condominium ownership has made apartment unit ownership possible. *See id.* This ownership structure is very flexible and allows ownership of any three-dimensionally defined space, including "postage stamp" buildings (the outlines of the building alone without any surrounding land), parking spaces, interior store spaces, and even air space for telecommunications equipment. *See id.*

[149] *See id.*, at 778. In 1977, the National Conference of Commissioners on Uniform State Laws began drafting the Uniform Condominium Act basing the Act on the 1974 Virginia model act. *See* UNIF. CONDO. ACT prefatory note (1980), 7 U.L.A. 487–88 (2009). Subsequently, the Conference prepared uniform laws governing the three forms of CICs (condominiums, cooperatives, and homeowners associations) and combined the resulting three acts (the Uniform Condominium Act, the Uniform Planned Community Act, and the Model Real Estate Cooperative Act) into the Uniform Common Interest Ownership Act (UCIOA). *See* Unif. Common Interest Ownership Act §§ 47-200 to 47-299 (1994). To date, eight states have adopted UCIOA. *See Freedom of Contract Myth*, *supra* note 106, at 100 (identifying the eight states as Alaska, Colorado, Connecticut, Delaware, Minnesota, Nevada, Vermont, and West Virginia). Other states have retained

Governments are not only implicit in promoting race-based occupancy restrictions, they actively encourage the spread of the CIC ownership form as well.[150] This statement is particularly true for municipal governments with respect to new suburban residential developments, where mandating a CIC structure for a new neighborhood allows the county to privately finance community services.[151] Additionally, municipalities continue to fuel the creation of CICs by mandating a CIC structure in exchange for granting zoning approval for new projects.[152] Developers, anxious to obtain zoning approval for new projects, incorporate local government desires regarding the existence and content of CC&Rs whenever possible. These municipal requirements are motivated by financial realities,[153] as local governments have long

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their early condominium statutes or have made updates thereto, but have not adopted the uniform statute. *See Community Collateral Damage*, *supra* note 99, at 100–01; *see also* Boyack & Foster, *supra* note 145, at 254 n.166.

[150] *See generally* Susan F. French, *Making Common Interest Communities Work: The Next Step*, 37 URB. LAW. 359 (2005) (Attributing the growth of CICs to the fact that they allow local governments to shift the cost of municipal services to the homeowners.).

[151] *See id.* at 360. Once municipalities perceived the benefit of creating taxable housing that provided its own community maintenance framework (including snow removal, paving, and in some cases even fire and safety), local governments actively encouraged the spread of the CIC ownership structure as a way to privately finance community services. *See id.* at 359, 363; *see also* Clifford Treese et al., *Changing Perspectives on Community Association Mortgage Underwriting and Credit Analysis* 3 (Nov. 2001), RESEARCH INST. FOR HOUS. AM., *available at* http://www.housingamerica.org/RIHA/RIHA/Publications/48502_ChangingPerspectivesonCommunityAssociationMortgageUnderwriting.pdf (discussing methods that communities utilize to minimize taxes); Treese et al., *supra*, at 6 (stating that government privatizes its functions, requiring community associations to fulfill an otherwise municipal obligation); *Community Collateral Damage*, *supra* note 99, at 60 ("The CIC structure enables more community amenities and upkeep, permitting neighborhoods to self-fund and allowing local governments to avoid raising taxes in response to more housing developments."); *Community Collateral Damage*, *supra*, at 121 (comparing the function of associations to that of local governments and comparing association assessments to property taxes).

[152] *See* Steven Siegel, *The Public Role in Establishing Private Residential Communities: Towards A New Formulation of Local Government Land Use Policies That Eliminates the Legal Requirements to Privatize New Communities in the United States*, 38 URB. LAW. 859, 877–95 (2006) [hereinafter *The Public Role*] (calling the CIC ownership form "a form of 'grand bargain' between developers and municipalities" and citing to several local zoning statutes that require use of the CIC form).

[153] *See* French, *supra* note 150, at 360. The primary municipal motive in promoting CIC structuring of new developments is to lower (or avoid raising) property taxes. *See id.* 360–64. For example, California's Proposition 13 limited municipal ability to increase property taxes to meet demand for community services, and CIC governance was a way to provide community amenities without draining tax revenue. *See* CAL. CONST. ART. 13A

realized that the CIC ownership structure can be used as a vehicle for privatizing traditional public functions.[154] In this way, public zoning authority is used to actively encourage the creation of privately zoned neighborhoods.

C. Judicial Treatment of Covenant Leasing Restrictions

Despite the involvement of governmental and quasi-governmental entities in CIC formation, courts unanimously treat CIC covenants as purely private, voluntary, and presumptively enforceable agreements.[155] Courts have adopted the argument of some prominent scholars,[156] that because community members have specifically assented to terms in a recorded declaration of covenants—by purchasing a home in the community—there should be minimal judicial oversight with respect to the content of covenant restrictions.[157] Some courts reserve judicial oversight to cases of covenant amendments and board rulemaking, requiring that any changes that impact owner property rights be

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§ 1 (2013); French, *supra* note 150, at 360–64. The trend away from property tax funded amenities is self-perpetuating because residents in CICs, who have to pay community assessments in addition to property taxes, are strong, local voting blocks against property tax increases. *See* David L. Callies & Adrienne I. Suarez, *Privatization and the Providing of Public Facilities Through Private Means*, 21 J.L. & POL. 477, 493 (2005).

[154] *See* CASES AND MATERIALS ON CICs, *supra* note 100, at 13–14 (explaining how CICs function like local governments); *Community Collateral Damage*, *supra* note 99, at 60 ("The CIC structure enables more community amenities and upkeep, permitting neighborhoods to self-fund and allowing local governments to avoid raising taxes in response to more housing developments."); *The Public Role*, *supra* note 152, at 879; Treese et al., *supra* note 151, at 3 (discussing methods that communities utilize to minimize taxes).

[155] *See* Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d 637, 639–40 (Fla. Dist. Ct. App. 1981) (asserting that CIC restrictions "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").

[156] *See, e.g.*, *id.*

[157] *See, e.g.*, Robert C. Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519, 1526–27 (1982) (reasoning that "members of a homeowners association, by their voluntary acts of joining, unanimously consent to the provisions in the association's original governing documents"); *see also* Richard A. Epstein, *Covenants and Constitutions*, 73 CORNELL L. REV. 906, 919–20 (1988) [hereinafter *Covenants and Constitutions*] (arguing that because of freedom of contract, there should be no real substantive judicial oversight of CIC governing acts and provisions). *But see Freedom of Contract Myth*, *supra* note 106, at 790–98.

reasonable.[158] Even when policed for reasonableness, however, covenant terms are enforced as long as they can be said to promote "the health, happiness and peace of mind . . . of the unit owners."[159]

Although judicial discussions often analyze CIC covenants as a sort of multilateral contract, emphasizing parties' assent to be bound, CIC covenants are not mere contracts, but rather they are servitudes that bind successive owners.[160] As such, these covenants are specifically enforceable in perpetuity.[161] However, in order for CIC covenants to transcend mere contracts and run with the land, they must qualify as servitudes.[162] Traditionally, in order to run with the land, a covenant had to "touch and concern the land";[163] be made in writing,[164] with the specific intent to run to successive owners;[165] be adequately publicized (usually by recordation of the writing);[166] and be among parties who were linked in horizontal privity.[167] Modern courts and legal theory have moved away from requiring such formalities in servitude formation, particularly with respect to the requirement of privity and, to some extent, the requirement that the substance of a real covenant touch and concern the subject real

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[158] *See* Villa De Las Palmas Homeowners Ass'n v. Terifaj, 90 P.3d 1223, 1233–34 (Cal. 2004); Noble v. Murphy, 612 N.E.2d 266, 270 (Mass. App. Ct. 1993); *see also* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 89–97 (discussing the different standards generally applied to original and amended CIC covenant terms).

[159] *See, e.g.*, Hidden Harbour Estates, Inc. v. Norman, 309 So. 2d 180, 181–82 (Fla. Dist. Ct. App. 1975); Preserve at Forrest Crossing Townhome Ass'n v. DeVaughn, No. M2011-02755-COA-R3-CV, 2013 WL 396000, at *3 (Tenn. Ct. App. Jan. 30, 2013).

[160] *See Freedom of Contract Myth*, *supra* note 106, at 798–805.

[161] *See id.*

[162] *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.1 (2000).

[163] *See* RESTATEMENT (FIRST) OF PROP. § 537 (1944). The requirement that a covenant touch and concern the land requires that the substance of the covenant relate to the real property itself. *See id.* cmt. b. By requiring that a covenant touch and concern the land in order to run with the land, the common law sought to ensure that personal obligations unrelated to the ownership of the property would only bind the original parties—in contract—and would not be deemed servitudes that would continue as specifically enforceable obligations for all landowners. *See id.* cmt. a.

[164] *See id.* § 532.

[165] *See id.* § 531.

[166] *See id.* § 533.

[167] *See id.* § 534. Horizontal privity requires both parties to simultaneously hold an interest in the same property, such as a landlord and tenant or buyer and seller. BLACK'S LAW DICTIONARY 1394 (10th ed. 2014). Neighbors, for example, would not be in horizontal privity.

property.[168] To the extent that the touch and concern requirement is abandoned or watered down through a broader understanding of what this requirement means, the potential scope of covenant coverage would be essentially unbounded.[169]

Adequately created real covenants are presumptively enforceable based on the theory that an owner objectively manifests his or her assent to be bound to all terms of the recorded covenants by buying property burdened thereby.[170] But unlike early generation covenants, which were static, CIC covenants are dynamic and can change over time.[171] The presumptive enforceability of CIC covenants extends not only to those covenants actually on the record as of the date of a buyer's property purchase, but also to any amendments thereto as long as the procedures prescribed in the original covenants are followed.[172] Specifically, the governing association of a CIC can pass rules to achieve the purposes of the community pursuant to authority granted in the original covenants, and the owners' assent to these rules is presumed through the act of knowingly buying in a CIC.[173] All duly adopted CIC rules and covenant

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[168] *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 2.1, 3.1, 3.7 (2000). Courts adopting the new Restatement of Property approach no longer closely examine concepts of privity and touch and concern in order to deny servitude enforcement. *See, e.g.*, Oliver v. Schultz, 885 S.W.2d 699, 701 (Ky. 1994); *In re* Matter of Parcel of Land Located on Geneva Lake, 477 N.W.2d 333, 339 (Wis. Ct. App. 1991); RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 2.1, 3.1, 3.7. Some scholars likewise argue that the touch and concern test is unnecessary. *See, e.g.*, Richard A. Epstein, *Notice and Freedom of Contract in the Law of Servitudes*, 55 S. CAL. L. REV. 1353, 1359–60 (1982). The approach of The Restatement (Third) is still controversial and several jurisdictions have refused to embrace its approach. *See, e.g.*, Nickerson v. Green Valley Recreation, Inc., 265 P.3d 1108, 1115 (Ariz. Ct. App. 2011); Regency Homes Ass'n v. Egermayer, 498 N.W.2d 783, 791 (Neb. 1993). For an example of the rare case where a court finds that a covenant does *not* touch and concern the land and therefore does not run with the land, see Ebbe v. Senior Estates Golf & Country Club, 657 P.2d 696, 701 (Or. Ct. App. 1983).

[169] *See generally Unbounded Servitudes*, *supra* note 28.

[170] *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 50–51. This conclusion is based on the assumption that owners voluntarily obligate themselves to CIC governance when they buy into the community. *See id.* Based on this presumption, courts explain that owners voluntarily agree to relinquish a certain degree of freedom of choice when they became members of the CIC. *See id.* (explaining that this assumption is widely cited).

[171] *See Freedom of Contract Myth*, *supra* note 106, at 806.

[172] *See id.* at 808–10.

[173] *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 82–88 (discussing the powers of a board of directors of a CIC association). CIC purposes are almost always defined as preserving and promoting property values and owner lifestyle.

amendments are thus "clothed with a very strong presumption of validity" based on the single act of purchasing property in the community.[174]

Throughout the history of CICs, courts have considered the question of whether and to what extent the acts of private governments and the provisions of private neighborhood covenants can be constitutionally constrained. In the context of a CIC, it is difficult to prove sufficient state action in order to find that the U.S. Constitution has been violated.[175] Although CICs do perform some functions reminiscent of municipalities, and even though government and quasi-government policies inform the content of CIC covenants, most courts have been reticent to fully equate CIC governance with state action.[176] The two main theories under which the Constitution would apply to CICs have generally been rejected.[177] The first state action theory, made in reference to *Shelley v. Kraemer*, suggests that state action arises from the specific enforcement of CIC

See Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93, 95–97 (Ill. App. Ct. 1995); Ngai Pindell, *Home Sweet Home? The Efficacy of Rental Restrictions to Promote Neighborhood Stability*, 29 ST. LOUIS U. PUB. L. REV. 41, 43–46 (2009); Rawling, *supra* note 45, at 224–25.

[174] Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d 637, 639 (Fla. Dist. Ct. App. 1981). Note that "CIC obligations can therefore either from the terms of the original recorded declaration, from amendments to the declaration, or from the rules promulgated by the board of directors to carry out the general purposes of the association." *Freedom of Contract Myth*, *supra* note 106, at 773; *see* Todd Brower, *Communities Within the Community: Consent, Constitutionalism, and Other Failures of Legal Theory in Residential Associations*, 7 J. LAND USE & ENVTL. L. 203, 242 (1992) (noting that CIC enforcement is justified based on the unanimous assent of its members to covenant terms and explaining that later amendments "pose special problems"); *see also* Nahrstedt v. Lakeside Vill. Condo. Ass'n., 878 P.2d 1275, 1283 (Cal. 1994); CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 50–51.

[175] There must be state action to enforce constitutional rights. *See* Comm. for a Better Twin Rivers v. Twin Rivers Homeowners' Ass'n, 929 A.2d 1060, 1067 (N.J. 2007); *see also* CASES AND MATERIALS ON CICS, *supra* note 100, at 62–63. For example, one court specifically explained that a covenant limiting occupancy that would violate constitutional rights if created by the local government through a zoning ordinance did not create a constitutional problem because it was privately enacted. *See* White Egret Condo., Inc. v. Franklin, 379 So. 2d 346, 349–50 (Fla. 1979).

[176] *See* Laura T. Rahe, *The Right to Exclude: Preserving the Autonomy of the Homeowners' Association*, 34 URB. LAW 521, 545 (2002).

[177] *See White Egret*, 379 So. 3d at 349; Pines of Boca Barwood Condo. Ass'n v. Cavouti, 605 So. 2d 984, 985 (Fla. Dist. Ct. App. 1992); CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 67.

covenants.[178] Extending state action to private acts through judicial enforcement is jurisprudentially troubling, however, and this conception of state action rarely succeeds outside the specific context of race-based occupancy restrictions in CICs.[179] Although *Shelley v. Kraemer* has not been overruled nor has its reasoning been clarified, discriminatory covenants today are typically struck down under the force of the Fair Housing Act, not the Constitution itself.[180] The second state action theory reasons that CICs are the functional equivalent of local governments, similar to the company town in *Marsh v. Alabama*,[181] in which the company owned all the land, buildings, utilities, and provided law

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[178] *See* 334 U.S. 1, 18 (1944); *see also* Midlake on Big Boulder Lake Condo. Ass'n v. Cappuccio, 673 A.2d 340, 342 (Pa. Super. Ct. 1996) (holding that the owners "contractually agreed to abide by the provisions in the Declaration at the time of purchase, thereby relinquishing their freedom of speech concerns regarding placing signs on th[e] property"). *But see* Goldberg v. 400 E. Ohio Condo. Ass'n, 12 F. Supp. 2d 820 (N.D. Ill. 1998) (holding that "there is no state action inherent in the possible future state court enforcement of a private property agreement").

[179] *See* Katherine Rosenberry, *An Introduction to Constitutional Challenges to Covenant Enforcement*, 1 J. COMM. ASS'N 23 (1998). Outside the context of racially discriminatory covenants, courts have been reticent to apply the state action rule of *Shelley*, and scholars have long struggled with the state action reasoning of the case. *See, e.g.*, Francis A. Allen, *Remembering* Shelley v. Kraemer*: Of Public and Private Worlds*, 67 WASH. U. L. REV. 709, 710–12 (1989); Lino Graglia, *State Action: Constitutional Phoenix*, 67 WASH. U. L. REV. 777, 787–88 (1989); Louis Henkin, Shelley v. Kraemer*: Notes for a Revised Opinion*, 110 U. PA. L. REV. 473, 481 (1962); Roderick M. Hills Jr., *The Constitutional Rights of Private Governments*, 78 N.Y.U. L. REV. 144, 157 (2003); Thomas P. Lewis, *The Meaning of State Action*, 60 COLUM. L. REV. 1083, 1115 (1960); William P. Marshall, *Diluting Constitutional Rights: Rethinking 'Rethinking State Action,'* 80 NW. U. L. REV. 558, 560–61 (1985); Carol Rose, *Property Stories:* Shelley v. Kraemer, *in* PROPERTY STORIES 189–95 (Gerald Komgold & Andrew P. Morriss eds., 2004); Mark Tushnet, Shelley v. Kraemer *and Theories of Equality*, 33 N.Y.L. SCH. L. REV. 383, 391 (1988). Some scholars advocate applying the legal rule of *Shelley* in order to, essentially, eliminate the public and private divide with respect to the Fourteenth Amendment. *See, e.g.*, Paul Schiff Berman, *Cyberspace and the State Action Debate: The Cultural Value of Applying Constitutional Norms to "Private" Regulation*, 71 U. COLO. L. REV. 1263 (2000); Erwin Chemerinsky, *Rethinking State Action*, 80 NW. U. L. REV. 503 (1985); Richard S. Kay, *The State Action Doctrine, The Public-Private Distinction, and the Independence of Constitutional Law*, 10 CONST. COMMENT. 329 (1993).

[180] *See* Fair Housing Act of 1968, 42 U.S.C. §§ 3601-3619 (2012). The Act, as amended, prohibits discrimination in the sale, rental, and financing of dwellings, and in other housing-related transactions, based on race, color, national origin, religion, sex, familial status (including children under the age of 18 living with parents or legal custodians, pregnant women, and people securing custody of children under the age of 18), and disability. *See id.* § 3604.

[181] 326 U.S. 501 (1946).

enforcement.[182] Although periodically asserted, this theory has garnered almost no support in the CIC context.[183] Thus, other than in contexts where specific legislation, like the Fair Housing Act, provides an alternate basis of oversight, the U.S. Constitution is fairly impotent to constrain CIC governance.[184]

Despite the state action hurdle, some state courts have invalidated certain CIC covenants based on a violation of *state* constitutional provisions,[185] particularly in cases where CIC governance interferes with state constitutionally guaranteed freedoms of speech.[186] The lack of a

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[182] *See id.* at 502–03.

[183] *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 64–65; *see also*, *e.g.*, *Goldberg*, 12 F. Supp. 2d at 823 ("Demonstrating that condominiums do certain things that state governments also do doesn't show that condominiums are acting as the state or in the state's place."). The holding in *Marsh* has been applied in the context of public accommodations. *Id.*; *see also* Amalgamated Food Emp. Union Local 590 v. Logan Valley Plaza, Inc., 391 U.S. 308 (1968), *abrogated by* Hudgens v. Nat'l Labor Relations Bd., 424 U.S. 507 (1976).

[184] *See Freedom of Contract Myth*, *supra* note 106, at 783–87. The only cases that do apply the U.S. Constitution to constrain CIC governance appear to be outliers. For example, in *Gerber v. Longboat Harbour North Condominium, Inc.*, a veteran's right to fly the American flag in violation of CIC covenants was upheld by the court striking down the covenant prohibition as a violation of the Constitution. 724 F. Supp. 884, 887 (M.D. Fla. 1989), *aff'd in part on reh'g*, Gerber v. Longboat Condo., 757 F. Supp. 1339, 1341 (M.D. Fla. 1991). The *Goldberg* court criticized the *Gerber* court for basing its decision on emotion, not on law. *See Goldberg*, 12 F. Supp. 2d at 821–23. During the post-9/11 patriotic fervor, Congress passed The Freedom to Display the American Flag Act. 4 U.S.C. § 5 (2012). The act prohibits a CIC from adopting or enforcing any policy that would unreasonably restrict or prevent a member of the association from displaying the flag of the United States. *See id.* Therefore, challenges to CIC policies barring the display of the U.S. flag can be brought under this Act rather than the Constitution. *See* Robin Miller, Annotation, *Restrictive Covenants or Homeowners' Association Regulations Restricting or Prohibiting Flags, Signage, or the Like on Homeowner's Property as Restraint on Free Speech*, 51 A.L.R. 6th 533 (2010) (cataloguing the various statutes that impact flag display and other free speech rights in CICs).

[185] *See, e.g.*, Comm. for a Better Twin Rivers v. Twin Rivers Homeowners Ass'n, 929 A.2d 1060, 1072 (N.J. 2007) (explaining that the application of the New Jersey constitution does not necessarily require a public actor); *see also* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, 67–71; Frank Askin, *Free Speech, Private Space, and the Constitution*, 29 RUTGERS L.J. 947, 960–61 (1998).

[186] *See, e.g.*, Laguna Publ'g Co. v. Golden Rain Found. of Laguna Hills, 182 Cal. Rptr. 813 (Cal. Ct. App. 1982); Guttenberg Taxpayers & Rentpayers Ass'n v. Galaxy Towers Condo. Ass'n, 688 A.2d 156, 158–59 (N.J. Super. Ct. Ch. Div. 1996); Midlake on Big Boulder Lake Condo. Ass'n v. Cappuccio, 673 A.2d 340, 342 (Pa. Super. Ct. 1996); *see also* Pruneyard Shopping Ctr. v. Robins, 447 U.S. 74, 84 (1980) (explaining that a state's constitution may protect individuals from private actors even when the U.S.

typical sort of state action in the CIC context also plagues state constitutional claims, however, and case law in this area is inconsistent.[187]

Theoretically, public policy provides another outer boundary for CIC governing acts and covenants. Public policy limits the substance of covenants in the same way that public policy limits the substance of any contract.[188] For example, although covenants may freely limit property uses, courts can strike down non-compete covenants based on public policy grounds.[189] Similarly, covenant-based alienation restraints can theoretically be invalidated under the long-held public policy goal of promoting free transferability of land.[190] In modern practice, however, courts rarely apply public policy limits to invalidate CIC covenants.[191]

Constitution would not). Recent cases have sought to apply state constitutional protections to freedom of religion in a CIC, but the majority of such claims have been unsuccessful. *See, e.g.*, Bloch v. Frischholz, 587 F.3d 771, 780, 787 (7th Cir. 2009) (holding that a condominium rule prohibiting "objects of any sort" outside a resident's door, although "facially neutral," caused a state constitutional violation because "the clearing of all objects from doorposts [namely the mezuzah] was intended to target the only group of residents [devout Jews] for which the prohibited practice was religiously required."); *see also* Angela C. Carmella, *Religion-Free Environments in Common Interest Communities*, 38 PEPP. L. REV. 57, 68 (2010) (discussing "aesthetic controls on signs, symbols, decorations, statuary, or items of any kind"); *Freedom of Contract Myth*, *supra* note 106, at 785–86.

[187] Wayne S. Hyatt, *Common Interest Communities: Evolution and Reinvention*, 31 J. MARSHALL L. REV. 303, 339–40 (1998) [hereinafter *Common Interest Communities*] (explaining that the property application of constitutional principles to CIC governance is an unsettled area of the law).

[188] For example, some covenants not to compete have been held unenforceable as a matter of public policy. *See* Beilfuss v. Huffy Corp., 685 N.W.2d 373, 377 (Wis. Ct. App. 2004) (quoting Bush v. Nat'l Sch. Studios, Inc., 407 N.W.2d 883, 887 (Wis. 1987)). *Cf.* Davidson Bros., Inc. v. D. Katz & Sons, Inc., 579 A.2d 288 (N.J. 1990) (holding that covenants not to compete are unenforceable if they are contrary to public policy, but finding insufficient evidence to determine whether the operation of a supermarket constituted a public purpose). Theoretically, public policy should also restrain covenants that unduly limit alienation of real property. *See, e.g.*, Riste v. E. Washington Bible Camp, Inc., 605 P.2d 1294 (Wash. Ct. App. 1980), *superseded by statute*, Garn-St. Germain Depository Institutions Act of 1983, 12 U.S.C. § 1701 (2012), *as recognized in* McCausland v. Bankers Life Ins. Co. 757 P.2d 941 (Wash. 1988).

[189] *See, e.g.*, *Davidson Bros.*, 579 A.2d at 288 (striking down a covenant not to compete for a grocery store property).

[190] *See, e.g.*, *Riste*, 605 P.2d at 1296 (striking down a restriction on conveying property without church approval).

[191] *See, e.g.*, Powell v. Washburn, 125 P.3d 373, 376–77 (Ariz. 2006); Vulcan Materials Co. v. Miller, 691 So. 2d 908, 913 (Miss. 1997); Runyon v. Paley, 416 S.E.2d 177, 188 (N.C. 1992). The standard for review is whether any category one restriction is wholly arbitrary, in violation of public or in violation of an individual's constitutional

The history of free transferability policy challenges to restrictive covenants is particularly illuminating. First generation neighborhood covenants were often subject to judicial scrutiny based on the concern that such servitudes would unduly restrict the alienability of land.[192] Courts announced that because owners in CICs held property in fee simple covenants, restricted transfer would be unenforceable unless they were deemed reasonable.[193] In order to avoid public policy concerns regarding restraints on alienation, early covenants that restricted occupancy were carefully characterized as restrictions on a property's use rather than on property transfer.[194] Today, it is clear that enforcement of racial occupancy restraints can never be justified by the specious argument that occupancy by a member of a certain race is somehow a distinct use, incompatible with the residential use of the white neighbors.[195]

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rights. *See* Nahrstedt v. Lakeside Vill. Condo. Ass'n, 878 P.2d 1275, 1283–84 (Cal. 1994); Pines of Boca Barwood Condo. Ass'n v. Cavoutl, 605 So. 2d 984, 985 (Fla. Dist. Ct. App. 1992); Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d at 637, 639–640 (Fla. Dist. Ct. App. 1981); Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93, 98 (Ill. App. Ct. 1995).

[192] *See, e.g.*, Hutchinson v. Ulrich, 34 N.E. 556, 558 (Ill. 1893) (holding that since limitations on free alienability are disfavored at law, ambiguities are to be resolved against the restrictive covenants); Carol M. Rose, *Property Law and the Rise, Life, and Demise of Racially Restrictive Covenants*, ARIZ. LEGAL STUDIES DISCUSSION PAPER NO. 13-21 (Mar. 13, 2013), *available at* http://ssrn.com/abstract=2243028. Initially, courts were concerned that enforcing this new brand of servitude would adversely affect alienability of land. *See* MCKENZIE, *supra* note 107, at 32.

[193] Fee simple ownership, by definition, is presumptively incompatible with alienation restrictions. *See, e.g.*, Kenney v. Morgan, 325 A.2d 419, 423 (Md. 1974); Nw. Real Estate Co. v. Serio, 144 A. 245, 247 (Md. 1929); City of Lincoln v. Townhouser, Inc., 534 N.W.2d 756, 759 (Neb. 1995) (stating that any condition restraining alienation of the property, directly or indirectly, is void, but upholding use restrictions with respect to the property); DePeyster v. Michael, 6 N.Y. 467, 508 (1852) (holding that it is repugnant to an estate to limit the right to lease "except where a reversion remains in the grantor"). *Cf.* Alby v. Banc One Fin., 82 P.3d 675, 678 (Wash. Ct. App. 2003) (stating that reasonable restraints are valid and enforceable in the context of a defeasible fee). The Restatement provides that prohibitions on transfer or requiring consent to transfer or a first refusal right directly restrain alienation and will not be enforced unless reasonable. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 (2000).

[194] *See, e.g.*, Title Guarantee & Trust Co. v. Garrott, 183 P. 470, 473–75 (Cal. Dist. Ct. App. 1919) (explaining that racial restrictions were suspect because of their likelihood of prohibiting transfer to large groups of people, but racial covenants restricting use and occupancy did not count as alienations of the property but merely restrained the special use of property that was occupancy by an African-American).

[195] *See* L.A. Inv. Co. v. Gary, 186 P.596, 597–98 (Cal. 1919); Stratton v. Cornelius, 277 P. 893, 893 (Cal. Ct. App. 1929); Porter v. Barrett, 206 N.W. 532, 536 (Mich. 1925).

Leasing is not a use of the property; it is a use of the landlord's investment capital.[196] Property use turns on how the party in possession enjoys and employs the property.[197] This means—and courts agree—that leasing property to a residential occupant who will use the property as a home is in no way a commercial use, nor does it change the property's use from the way it would be used by a residential owner.[198] In *Shelley v. Kraemer*,[199] the Supreme Court confirmed that occupancy of property by a "designated class of persons" was a restriction on transfer, not a restriction on use, because residential occupancy was not forbidden.[200]

Free alienability policy has worked to invalidate a handful of covenants that restrict an owner's ability to sell her home.[201] However,

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Tortured legal reasoning led these courts to conclude that an African-American could buy a home (because courts upheld alienability) but could not live in it (because occupancy by an African-American was a prohibited use). *See* Rose, *supra* note 109, at 21–22. Carol Rose points out that the use/transfer restriction affected the way that racially restrictive covenants were worded. *See id.*

[196] A resident who leases a home, like a mortgagee, uses a third party's capital to pay for the acquisition cost of the home, paying a monthly cost for the use of such capital. Economically, a borrower paying a mortgage is similarly situated to a tenant paying rent under a lease, and courts have recognized that "agreement[s] calling for a series of payments for the transfer and use of property may either be described as an installment sale or as a lease." *In re* James, No. 12-23121, 2014 WL 5785316, at *3 (Bankr. D. Kan. Nov. 4, 2014). Likewise, lenders and landlords similarly use an initial outlay of capital in order to obtain an investment stream of income. *See* Shu-Yi Oei, *Context Matters: The Recharacterization of Leases in Bankruptcy and Tax Law*, 82 AM. BANKR. L.J. 635, 639–42 (2008) (noting the similarities between leases and secured loans).

[197] In land use terms, clearly the possessor's utilization of the property is paramount in determining what a property's use is. *See, e.g.*, Clegg v. City of Durham, No. COA06-700, 2007 WL 1246599, at *3 (N.C. Ct. App. 2007) (Westlaw); Graham Court Assoc. v. Town of Chapel Hill, 281 S.E.2d 418, 421 (N.C. Ct. App. 1981); Mariner's Museum v. City of Newport News, 495 S.E.2d 251, 254–55 (Va. 1988). A different rule applies, however, when assessing whether a property owner can obtain tax exempt status for owned real property. *See* Sisters of Providence v. Municipality of Anchorage, 672 P.2d 446, 449–50 (Alaska 1983) (holding that an owner cannot achieve tax exempt status through renting to a tenant who will make qualifying public use of the property).

[198] *See Unbounded Servitudes*, *supra* note 28, at 477; *see also, e.g.*, Kiekel v. Four Colonies Homes Ass'n, 162 P.3d 57, 63 (Kan. Ct. App. 2007); Lowden v. Bosley, 909 A.2d 261, 266 (Md. 2006); Kaufman v. Fass, 302 A.D.2d 497, 498 (N.Y. App. Div. 2d Dep't 2003); Scott v. Walker, 645 S.E.2d 278, 282 (Va. 2007).

[199] 334 U.S. 1 (1948).

[200] *Id.* at 10 (citing Buchanan v. Warley, 245 U.S. 60, 73 (1917)).

[201] *See Unbounded Servitudes*, *supra* note 28, at 460–63. Courts analyze an owner's right to sell in terms of the sale event itself. *See id.* Sellers in CIC may not have the right to choose a particular buyer to whom property would be transferred. *See id.* at 453.

this policy in the realm of restrictions has had far less impact on an owner's ability to transfer possession through a lease. Associations sometimes characterize no-lease covenants as restrictions on use,[202] in reasoning reminiscent of the occupancy-as-use justifications used to uphold occupancy restrictions pre-*Shelley*. But limits on a fee simple owner's ability to transfer a leasehold is clearly an alienation restraint,[203] and the power to lease is "an inseparable incident of an estate in unqualified fee" that must be protected by public policy.[204] However, even when correctly characterized as a transfer restriction, restrictions on leasing are almost always upheld by courts, particularly if the restriction was part of the recorded covenants at the time of purchase.[205]

Some courts demand that any no-lease restriction—as a restraint on alienation—must be reasonable, whether or not contained in the original covenants.[206] Other courts, either stressing freedom of contract or mischaracterizing leasing restrictions as mere use regulations, only check to see if an association has acted in good faith in enacting or enforcing such

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[202] *See, e.g.*, Williams v. Paley, 442 S.E.2d 558, 562 (N.C. Ct. App. 1994); Le Febvre v. Osterndorf, 275 N.W.2d 154, 159 (Wis. Ct. App. 1979).

[203] *See id.* at 452–53; *see also Shelley*, 334 U.S. at 10 (explaining that residential occupancy is the use of property no matter who the resident is); Seagate Condo. Ass'n v. Duffy, 330 So. 2d 484, 485 (Fla. Dist. Ct. App. 1976) (analyzing a restriction on leasing under the "ancient rule against restraints on alienation"); Kristine S. Tardiff, *Analyzing Every Stick in the Bundle: Why the Examination of a Claimant's Property Interests Is the Most Important Inquiry in Every Fifth Amendment Takings Case*, FED. LAW 30, 30–31 (October 2007) (defining the bundle of sticks as including the right of possession, the right to use, the right to dispose of or transfer and the right to exclude others).

[204] Libby v. Winston, 93 So. 631, 632 (Ala. 1922).

[205] *See* Shorewood W. Condo. Ass'n v. Sadri, 966 P.2d 372, 375 (Wash. Ct. App. 1998), *rev'd*, 992 P.2d 1008 (Wash. 2000) (stating that leasing restrictions are always "reasonable in the context of a residential condominium"); Rawling, *supra* note 45, at 224 (calling enforcement of a leasing restriction contained in recorded CC&Rs "relatively uncontroversial"); Lewis A. Schiller, *Limitations on the Enforceability of Condominium Rules*, 22 STETSON L. REV. 1133, 1157 (1993) (citing 17 A.L.R. 4th 1247 (1982)); *see also Unbounded Servitudes*, *supra* note 28, at 479 (explaining that many courts reflexively uphold no-lease covenants because they promote owner occupancy, which is presumed to be a public good). Note that because owners in a cooperative do not hold fee simple title, most courts have no difficulty in finding that they have no inherent right to lease without consent of their landlord, the association entity who owns the building. *See, e.g.*, Kelley v. Broadmoor Coop. Apartments, 676 A.2d 453, 457 (D.C. 1996) (holding that neither the "perpetual use contract nor the bylaws grant an equity right of rental").

[206] *See, e.g.*, Villa De Las Palmas Homeowners Ass'n v. Terifaj, 90 P.3d 1233, 1234 (Cal. 2004); Noble v. Murphy, 612 N.E.2d 266, 270 (Mass. Ct. App. 1993).

a restriction.[207] When it comes to leasing restrictions enacted after recordation of the original covenants, most courts demand that such restrictions be adopted through properly enacted amendments of the recorded covenants, rather than by mere rule-making or bylaw amendment.[208] Some courts also purportedly require that no-lease amendments be reasonable.[209]

Based on the widespread adoption of a reasonableness requirement regarding covenant amendment for leasing restraints, it appears that courts exercise some substantive judicial oversight over limitations on a CIC's owner's right to rent. In fact, nearly every covenant and properly enacted covenant amendment prohibiting leasing in a CIC is upheld.[210] The reasonableness requirement suggests that a rule or law or term

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[207] *See, e.g.*, Woodside Village Condo. Ass'n v. Jahren, 806 So. 2d 452, 460 (Fla. 2002); Kroop v. Caravelle Condo, Inc., 323 So. 2d 307 (Fla. Dist. Ct. App. 1975); Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93 (Ill. App. Ct. 1995); Worthinglen Condo. Unit Owners' Ass'n v. Brown, 566 N.E.2d 1275, 1278 (Ohio App. Ct. 1989). Robert C. Ellickson opined that reasonableness in CIC jurisprudence means different things to different courts, calling reasonable the "most ubiquitous legal adjective" and explaining that it is "not self-defining." Ellickson, *supra* note 157, at 1530. Additionally, he opposed reasonableness review in the name of freedom of contract, asserting that judges should not be authorized "to undertake an independent cost-benefit analysis," because this type of analysis "ignores the contractarian under-pinnings of the private association." *Id.*

[208] *See, e.g.*, Matter of 560 Ocean Club, L.P., 133 B.R. 310, 320 (Bankr. D.N.J. 1991); Kiekel v. Four Colonies Homes Ass'n, 162 P.3d 57, 62 (Kan. Ct. App. 2007); Strathmore Ridge Homeowners Ass'n, Inc. v. Mendicino, 63 A.D.3d 1038, 1039 (N.Y. 2009); Shorewood W. Condominium Ass'n v. Sadri, 992 P.2d 1008, 1013 (Wash. 2000). Most courts engage in a sort of procedural due process review of covenant amendments to ensure that changes to owner rights and expectations occur according to the enumerated process. *See, e.g.*, *Kiekel*, 162 P.3d at 61–62. If regulations and amendments apply equally to all members and are promulgated according to the procedures set forth in the governing documents, courts will generally uphold them. *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 173–74; *see also e.g.*, Kroop v. Caravelle Condo. Inc., 323 So. 2d 307, 309 (Fla. Dist. Ct. App. 1975) (holding that amendments severely limiting an owner's right to lease his unit were valid because the amendment was passed according to the procedure set forth in the CIC declaration).

[209] *See, e.g.*, Cape May Harbor Vill. & Yacht Club Ass'n v. Sbraga, 22 A.3d 158, (N.J. Super. Ct. App. Div. 2011) (asserting that covenant amendments restricting leasing must be reasonable); *Worthinglen Condo.*, 566 N.E.2d at 1278 (holding that amendments restricting leasing will be upheld if they are reasonable, evenhanded and made in good faith). Most courts apply a reasonableness standard of review for non-unanimous covenant amendments, even if original covenants are presumptively enforceable. *See* Brower, *supra* note 174, at 242–43 (1992); Rawling, *supra* note 45, at 228.

[210] *See Common Interest Communities*, *supra* note 187, at 354.

would be upheld only if its benefits seem to outweigh its costs;[211] but, in the context of litigation regarding CIC leasing restrictions, costs are rarely examined and benefits are assumed, even when reasonableness review is applied.[212]

For example, in *Cape May Harbor Village and Yacht Club Ass'n v. Sbraga*,[213] the court carefully explained why a reasonableness standard of review is more appropriate standard, with respect to a no-lease covenant amendment, than the more deferential business judgment rule standard.[214] The court cited to the reasonableness factors listed in the Restatement of Property (Third),[215] and agreed that "[r]easonableness is determined by weighing the utility of the restraint against the injurious

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[211] *See* Joseph William Singer, *The Rule of Reason in Property Law*, 46 U.C. DAVIS L. REV. 1369, 1415 n.142 (2013).

[212] *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 88–97 (explaining that a complaining owner bears the burden of proving that a particular covenant is unrelated to the broadly stated community purposes of neighborhood harmony and property values); *Freedom of Contract Myth*, *supra* note 106, at 788.

[213] 22 A.3d 158 (N.J. Super. Ct. App. Div. 2011).

[214] *See Cape May Harbor*, 22 A.3d at 164 (explaining that while other sorts of amendments may be appropriately reviewed under the Business Judgment Rule, amendments that limit leasing impair an important property right and should be reviewed under the standard of reasonableness). The Business Judgment Rule is a deliberately deferential standard of review used in corporate law. *See* Lamden v. LaJolla Shores Clubdominium Homeowners Ass'n, 980 P.2d 940, 946 (Cal. 1999) (finding the Business Judgment Rule applies regardless of corporate form for CIC association board actions); Schwarzmann v. Ass'n of Apartment Owners of Bridgehaven, 655 P.2d 1177, 1181 (Wash. Ct. App. 1982) (describing the Business Judgment Rule and mandating that "absent a showing of fraud, dishonesty, or incompetence, it is not the court's job to second-guess the actions of directors"). The hands-off Business Judgment Rule is more commonly applied in the context of cooperatives. *See, e.g.*, Levandusky v. One Fifth Ave. Apartment Corp., 553 N.E.2d 1317, 1321 (N.Y. 1990) (specifically rejecting the reasonableness standard adopted by the appellate court and adopting the Business Judgment Rule in the context of cooperatives). Under the Business Judgment Rule standard, any CIC governing decisions made in good faith based on an honestly held rational belief that the decision is in the best interest of the entity will be enforced. *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 90 (Noting that CICs are really not corporations in the traditional sense. For example, they are not staffed by professional corporate directors and there are no disinterested directors.); *Freedom of Contract Myth*, *supra* note 106, at 787–89 (arguing that although deference to business experts may be justified in the corporate context it may be an unjustifiable standard for CIC governance performed by volunteer laypersons rather than trained executives).

[215] *See Cape May*, 22 A.3d at 167–68 (citing RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 (2000)).

consequences of enforcing the restraint."[216] But the court in *Cape May* merely articulated this rule; it did not actually engage in any balancing of costs and benefits with respect to the contested no-lease amendment. It merely parroted the conventional conclusion that a leasing restriction "accomplishes a worthwhile purpose by preserving the stable residential character of the community,"[217] and concluded that the enforcement cost was minimal because only one homeowner had complained, and thus, "the number of persons to whom the alienation is prohibited is small."[218] While noting that the restraint was perpetual (a factor suggesting unreasonableness), the court reasoned that because CIC covenants can be further amended, perpetuity was not worrisome in this case.[219] In upholding the no-lease amendment, the court emphasized that the rule applied equally to all community members and that the plaintiff had not shown that the amendment was motivated by any malice.[220] The court's focus on the lack of bad faith,[221] rather than a cost-benefit balancing, makes its standard of review appear to be a good faith standard of review rather than a true test of reasonableness. Like most courts considering such restrictions, the court in *Cape May* cites no authority for its conclusion that the "stable residential character" of a community can be achieved *only* through a leasing prohibition.[222]

The court in *Worthinglen Condo. v. Brown Unit Owners' Ass'n*[223] also eschewed any actual cost-benefit analysis in applying its reasonableness review.[224] The court explained that it would decide the reasonableness of a no-lease amendment by determining (1) "whether . . . the rule was arbitrary or capricious,"[225] (2) "whether the . . . rule was

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[216] *Id.* at 168 (citing RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 (2000)).

[217] *Id.* at 169.

[218] *Id.*

[219] *See id.* ("Of course, if sentiments change in the future, the amendment could be undone or modified by a supermajority.").

[220] *See id.*

[221] *See id.* at 164.

[222] *Id.*

[223] 566 N.E.2d 1275 (Ohio Ct. App. 1989).

[224] *Id.* at 1277–79.

[225] *Id.* at 1277. The court explained that this means there must be "some rational relationship of the decision or rule to the safety and enjoyment of the condominium." *Id.* (citing Hidden Harbour Estates, Inc. v. Norman, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975); Ryan v. Baptiste, 565 S.W.2d 196 (Mo. App. 1978)).

discriminatory,"[226] and (3) "whether the . . . rule was made in good faith."[227] Although the court discusses these factors under the rubric of reasonableness, in fact, this standard approximates the Business Judgment Rule in substance. In addition, the benefit-only focus of the court is reminiscent of a Business Judgment Rule or good faith standard of review because it does not balance purported benefits with costs—the leasing prohibition's adverse effects.

The court in *Woodside Village Condo. Ass'n v. Jahren*[228] took a similar approach in analyzing a no-lease amendment.[229] The court reasoned that by purchasing in the community, the owner had manifested his assent to be bound, not only to the restrictions in force at the time, but also to any future restrictions adopted in accordance with the recorded declaration.[230] The court then easily upheld the amendment because it had been duly enacted according to enumerated procedures, applied to all members of the community equally, did not violate any specific law (such as fair housing legislation), and was not unrelated to the association's purpose—defined as promoting property values and neighborhood harmony.[231] There is no cost-benefit analysis involved in determining that a provision bears a rational relationship with stated purposes of a

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[226] *Id.* at 1277–78. The court explained that this standard was used to protect dissenting owners against "tyranny of the majority." *Id.* at 1278 (holding that its standard "protects against the imposition by a majority of a rule or decision reasonable on its face, in a way that is unreasonable and unfair to the minority because its effect is to isolate and discriminate").

[227] *Id.* (analogizing good faith in this context to that required for a board of directors in corporate governance).

[228] 806 So. 2d 452 (Fla. 2002).

[229] *See id.*

[230] *See id.* at 461 (explaining that the owners "were on notice" that the contents of the declaration could change from time to time, "and that they would be bound by properly adopted amendments").

[231] *See id.* at 462. *Cf. Unbounded Servitudes*, *supra* note 28, at 467 (encouraging racial segregation as an acceptable way to promote property values and social harmony). It is true that it would be difficult to quantify the amorphous benefits, such as happiness, lifestyle, and property values, but few courts attempt to quantify such benefits or costs from leasing restrictions. *See, e.g.*, Villa De Las Palmas Home Owners Ass'n v. Terifaj, 90 P.3d 1233 (Cal. 2004); White Egret Condo. Inc. v. Franklin, 379 So. 2d 346 (Fla. 1979); Flagler Fed. Sav. & Loan Ass'n of Miami v. Crestview Towers Condo. Ass'n, 595 So. 2d 198 (Fla. Dist. Ct. App. 1992); McElveen-Hunter v. Fountain Manor Ass'n, 386 S.E.2d 435, 435 (N.C. Ct. App. 1989), *aff'd*, 399 S.E.2d 112 (N.C. 1991); *see also* Rawling, *supra* note 45, at 225.

CIC. Yet, this same approach has been adopted in nearly every case involving no-lease amendments in CICs.[232]

A 1981 North Dakota trial court decision stands alone in pushing back against the near universal validation of lease prohibitions in CIC covenant amendments.[233] The court in *Breene v. Plaza Tower*[234] held that a no-lease covenant amendment is valid only prospectively to owners who purchase a unit after the amendment is passed, or with respect to owners who vote in favor of the provision.[235]

Additionally, the Florida legislature, in reaction to the 2002 *Woodside Village*[236] case, passed a statute requiring that no-lease covenant amendments grandfather in existing leasing.[237] Similarly, some recent declaration amendments that restrict leasing have specifically provided that any owners who are leasing at the time of the amendment can continue to do so, even though the law outside of Florida does not mandate that concession.[238]

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[232] *See Unbounded Servitudes*, *supra* note 28, at 482; see *also, e.g.*, Kroop v. Caravelle Condo., Inc., 323 So. 2d 307, 309 (Fla. Dist. Ct. App. 1975) (holding that amendment severely limiting an owner's right to lease his unit was valid because the amendment was passed according to the procedure set forth in the CIC declaration); Apple II Condo Ass'n v. Worth Bank & Trust, 659 N.E.2d 93, 99 (Ill. App. Ct. 1995) (holding that all properly adopted declaration amendments are presumptively valid and enforceable and will be enforced by the court unless they are "arbitrary, against public policy or violate a fundamental constitutional right of the owners").

[233] *See* Breene v. Plaza Tower Ass'n, 310 N.W.2d 730 (N.D. 1981).

[234] *See id.*

[235] *See id.* at 734–35.

[236] 806 So. 2d 452.

[237] *See* FLA. STAT. § 718.110(13) (2014). A few courts have construed statutory prohibitions against changing an owner's unit without that owner's consent to bar enforcement of a no-leasing amendment against a non-consenting owner. *See, e.g.*, Matter of 560 Ocean Club, L.P., 133 B.R. 310, 325 (Bankr. D.N.J. 1991); Charter Club on River Home Owners Ass'n v. Walker, 689 S.E.2d 344, 347 (Ga. Ct. App. 2009).

[238] *See, e.g.*, Preserve at Forrest Crossing Townhome Ass'n v. DeVaughn, No. M2011-02755-COA-R3-CV, 2013 WL 396000, at *8 (Tenn. Ct. App. Jan. 30, 2013) (citing with approval a grandfathering provision in a no-leasing amendment).

III. COVENANT CHOICE AND BENEFITS

A. CICs and the Freedom of Contract Disconnect

Freedom of contract is a paramount and protected legal right allocated to capable parties in our society.[239] This right is a foundational component of personal liberty and a key characteristic of almost every legal system.[240] Allowing individuals to have the power to contract as they choose, substantially free from regulatory interference or oversight,

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[239] Each person with freedom to contract has the power to be her own legislature and create binding obligations that will be enforced by the court. *See, e.g.*, RICHARD CRASWELL & ALAN SCHWARTZ, FOUNDATIONS OF CONTRACT LAW 1 (1994); ROBERT A. HILLMAN, THE RICHNESS OF CONTRACT LAW 2 (1997); Jay M. Feinman, *The Significance of Contract Theory*, 58 U. CINN. L. REV. 1283, 1286 (1990); Michel Rosenfeld, *Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769, 825 (1985). Courts have recognized that freedom of contract is "fundamental to our society." *See* Royal Indem. Co. v. Baker Protective Servs., Inc., 515 N.E.2d 5, 7 (Ohio App. Ct. 1986). Freedom of contract is a Constitutionally protected liberty. *See* Board of Regents v. Roth, 408 U.S. 564, 572 (1972) (quoting Meyer v. Nebraska, 262 U.S. 390, 399 (1923)). U.S. case law is replete with citations to freedom of contract as a primary public policy underlying the law. *See, e.g.*, Venegas v. Mitchell, 495 U.S. 82, 87 (1990) (finding no specific direction by Congress to limit freedom of contract); Chambers Dev. Co. v. Passaic Co. Util. Auth., 62 F.3d 582, 589 (3d Cir. 1995) ("The sanctity of a contract is a fundamental concept of our entire legal structure. Freedom of contract includes the freedom to make a bad bargain."); City & County of Denver v. Dist. Court of Denver, 939 P.2d 1353, 1361 (Colo. 1997) ("The right of parties to contract freely is well developed in our jurisprudence."); DeVetter v. Principal Mut. Life Ins., 516 N.W.2d 792, 794 (Iowa 1994) (opining that freedom to contract is a "weighty societal interest."); Weber v. Tillman, 913 P.2d 84, 89 (Kan. 1996) (quoting Foltz v. Struvness, 215 P.2d 133 (Kan. 1950)) ("[T]he paramount public policy is that freedom to contract is not to be interfered with lightly.").

[240] All common law jurisdictions have cases that reiterate the primacy of the principle of freedom of contract. *See, e.g.*, News Ltd. v. Australian Rugby Football League Ltd. (1996) 64 FCR 410 (Austl.) (explaining judicial hesitancy to interfere with the general freedom of contract under the law). Freedom of contract is a foundational piece of European contract law and the contract jurisprudence of all EU Member States of the European Union. *See* THE COMMISSION ON EUROPEAN CONTRACT LAW, THE PRINCIPLES OF EUROPEAN CONTRACT LAW PART I AND II, art. 1:102, 99 (Ole Lando & Hugh Beale eds., 2000). Freedom of contract is also the cornerstone of international law. *See* United Nations Convention on Contracts for International Sale of Goods, art. 1, Apr. 11, 1980, 19 I.L.M. 668 (setting forth the general principles for international transactions); I. I. Lukashuk, *The Principle Pacta Sunt Servanda and the Nature of Obligation Under International Law*, 83 AM. J. INT'L L. 513, 513 (1989) (explaining the principle that treaty obligations must be fulfilled as a baseline concept in international law); K.M. Sharma, *From "Sanctity" to "Fairness": An Uneasy Transition in the Law of Contracts?*, 18 N.Y.L. SCH. J. INT'L & COMP. L. 95, 97–99 (1999).

advances liberty interests.[241] Economic theory posits that optimal efficiency results when individuals may contract freely,[242] and judicial protection of the future expectations created by contracts increases societal wealth.[243]

Although both autonomy and efficiency generally justify enforcing contracts and CIC covenants,[244] these freedom-of-contract justifications are less compelling in the context of CIC covenants and covenant amendments.[245] Owners of subject properties do not necessarily elect the

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[241] Richard Epstein defends the right to freedom of contract by stating that "one of the first functions of the law is to guarantee to individuals a sphere of influence in which they will be able to operate, without having to justify themselves to the state or to third parties." Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 293–94 (1975). According to theories of autonomy and individual will, it is empowering to grant contracting parties quasi-legislative powers *inter se*. *See, e.g.*, BRIAN A. BLUM, CONTRACTS § 1.4.1, at 9 (6th ed. 2013) ("The power to enter contracts and to formulate the terms of the contractual relationship is . . . an integral part of personal liberty."). *See generally* E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576 (1969) (drawing parallels between legislation and contract).

[242] *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 3, 9, 48–49 (8th ed. 2010) (explaining that rational self-interest and voluntary contracting is why transactions are efficient); Howard C. Ellis, *Employment-at-Will and Contract Principles: The Paradigm of Pennsylvania*, 96 DICK. L. REV. 595, 596–97 (1992) (explaining that voluntary contracting promotes efficiency).

[243] Freedom of contract meshes well with American primacy of personal freedom and capitalist economic theory of market self-regulation that considers each contracting party the best judge of his or her own interests. *See* LAWRENCE M. FRIEDMAN, CONTRACT LAW IN AMERICA: A SOCIAL AND ECONOMIC CASE STUDY 10, 22–23 (1965). Wealth maximization through contract enforcement is a foundational concept in the law. *See, e.g.*, HERNANDO DE SOTO, THE MYSTERY OF CAPITAL 157 (2000) ("Law is the instrument that fixes and realizes capital."); Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 562–63 (1933) ("[A] regime in which contracts are freely made and generally enforced gives greater scope to individual initiative and thus promotes the greatest wealth of a nation."). Economic theory also asserts that unfairness and social inefficiencies in form contracts will be winnowed out through market competition, but this theory incorrectly assumes unbounded rationality of the consumer. *See* Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1203 (2003). The realities of adhesion contracting processes and consumer rationality undercut this theory and permit inefficient and socially unjustified terms to persist even in a free market. *See id.*

[244] *See, e.g.*, Nahrstedt v. Lakeside Vill. Condo. Ass'n, 878 P.2d 1275, 1286–87 (Cal. 1994); Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d 637, 639–40 (Fla. Dist. Ct. App. 1981); Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93, 96 (Ill. App. Ct. 2006).

[245] *See generally Freedom of Contract Myth*, *supra* note 106.

content of their neighborhood covenants—meaning that the enforcement of these covenants does not necessarily serve liberty interests. Furthermore, lack of market choice renders economic justifications for covenant enforcement more tenuous. In addition, CIC covenants differ from contracts in terms of their duration, their specific enforceability, and their changeable and unpredictable scope.[246] Negative externalities may justify enforcing servitudes that restrict certain uses of property, but there is no economic justification to enforce servitude restrictions on who can be a property user.[247]

1. Realities of Consumer Choice and CIC Covenant Terms

Courts universally presume that the act of purchasing real property within a CIC is "adequate manifestation of assent to be bound" to the terms of the applicable recorded covenants.[248] This is unrealistic. CIC covenants are non-negotiable contracts of adhesion,[249] drafted and recorded with an eye to government and quasi-government mandates before any buyer is even identified.[250] It is specious to claim that a homebuyer in fact chooses these terms at the closing of the purchase transaction; most homebuyers are unaware of the terms of such covenants at purchase.[251] Furthermore, covenant terms are bundled with

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[246] *See Freedom of Contract Myth*, *supra* note 106, at 798–805.

[247] *See* James L. Winokur, *The Mixed Blessings of Promissory Servitudes: Toward Optimizing Economic Utility, Individual Liberty, and Personal Identity*, 1989 WIS. L. REV. 1, 20–21 (1989) (explaining that CIC covenants can often lead to "segregation of users which our society collectively censures"); *see also infra* Part III.C.

[248] *Freedom of Contract Myth*, *supra* note 106, at 770.

[249] CIC declarations clearly fit the definition of a contract of adhesion. *See* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1174, 1177 [hereinafter *Contracts of Adhesion*] (indicating a contract of adhesion is often created when a standard form drafted by one party, who engages in repeated transactions of the sort, is presented as non-negotiable to the adhering party who enters into relatively few transactions of the sort, that when signed by the adhering party principally obligates the adhering party to pay money). No party to a CIC declaration has any ability to diverge from the recorded provisions in any respect. *See Freedom of Contract Myth*, *supra* note 106, at 796 (calling CIC covenants "a perfect example of 'take-it-or-leave-it' contracting").

[250] Before any contracting parties are identified, covenant terms are prescribed and recorded in the land records. *See* MCKENZIE, *supra* note 107, at 127. Prior recordation is required to legally sell a condominium unit and is prudent in order to create a binding servitude on subsequent property owners. *See* Winokur, *supra* note 247, at 90.

[251] *See Freedom of Contract Myth*, *supra* note 106, at 797–98.

the emotional, expensive, and complicated act of buying a home.[252] Unlike most other contracts of adhesion, CIC covenants lack market checks to protect and promote consumer preferences.[253] In this environment, the rhetoric of consumer choice and voluntary assent fails to provide an adequate justification for covenant enforcement.

It is widely accepted that manifesting assenting to a contract of adhesion is not a truly voluntary assent to its terms.[254] Yet, adhesion contracts are, in fact, enforceable absent some special circumstance.[255] Even though consumers typically are unaware of the content of adhesion contracts to which they manifest assent,[256] the judicial safety net of

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[252] *See Freedom of Contract Myth*, *supra* note 106, at 796 (explaining that a would-be buyer can only reject the terms of the declaration by relinquishing the right to purchase that unique parcel of real property).

[253] *See* Andrea J. Boyack, Freedom of Contract and the Endangered Right to Transfer p.20–21 (Aug. 23, 2013) (unpublished manuscript), *available at* http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=2315238 [hereinafter *Endangered Right to Transfer*].

[254] Generally, courts find that a non-negotiable standard form contract "offered on a take-it-or-leave-it basis" by a party with superior sophistication and bargaining power is an adhesion contract. David Horton, *Flipping the Script: Contra Proferentem and Standard Form Contracts*, 80 U. COLO. L. REV. 431, 432 (2009). In adhesion contracts, "[a]ctual assent is not just a fiction because of voluntary choices by consumers; it is effectively impossible." Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 242 (2002); *see also* Shelley Smith, *Reforming the Law of Adhesion Contracts: A Judicial Response to the Subprime Mortgage Crisis*, 14 LEWIS & CLARK L. REV. 1035, 1035 (2010); Batya Goodman, Note, *Honey, I Shrink-Wrapped the Consumer: The Shrink-Wrap Agreement as an Adhesion Contract*, 21 CARDOZO L. REV. 319, 331–32 (1999). Several scholars have articulated the problematic disconnect between freedom of contract rhetoric and theory and the realities of the contracting process in the context of standard, non-negotiable forms. *See, e.g.*, Russell A. Hakes, *Focusing on the Realities of the Contracting Process—An Essential Step to Achieve Justice in Contract Enforcement*, 12 DEL. L. REV. 95, 96 (2011).

[255] *See* Nw. Nat'l. Ins. Co. v. Donovan, 916 F.2d 372, 377 (7th Cir. 1990). Modern contractual theory is based on objective manifestation of assent rather than subjective "meeting of the minds." Hakes, *supra* note 254, at 99–100. An indication of assent such as clicking "I accept" to posted terms or by initialing a form contract is clearly sufficient for legally binding obligation. *See id.*

[256] For example, one April Fools' Day, British retailer, GameStation, added a clause to its posted terms and conditions providing that customers were selling their "immortal souls" to the retailer. *See 7,500 Online Shoppers Unknowingly Sold Their Souls*, FOX NEWS (Apr. 15, 2010), http://www.foxnews.com/tech/2010/04/15/online-shoppers-unknowingly-sold-souls/. Consumers could opt out by clicking a box, but approximately 88% of the contracting customers apparently did not read the terms and did not opt out. *See id.* Scholarly consensus supports the conclusion that standard form contracts are rarely read. *See* Hakes, *supra* note 254, at 100; Margaret Jane Radin, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1223, 1231–32

unconscionability is reserved for extreme cases where the process was tainted and substantive unfairness shocks the judicial conscience.[257] In recognition of this lack of knowledge and voluntary assent, some scholars advocate for more substantive judicial oversight in the adhesion contract context.[258] Although few courts agree,[259] this sort of judicial paternalism markedly differs from the traditional hands-off enforceability approach to contracts.[260]

(2006); Todd D. Rakoff, *The Law and Sociology of Boilerplate*, 104 MICH. L. REV. 1235, 1237–38 (2006); Edith R. Warkentine, *Beyond Unconscionability: The Case for Using "Knowing Assent" as the Basis for Analyzing Unbargained-for Terms in Standard Form Contracts*, 31 SEATTLE U. L. REV. 469, 495 (2008). Recently, Judge Richard Posner publicly admitted that he never read the documents he signed at his mortgage loan closing. David Lat, *Do Lawyers Actually Read Boilerplate Contracts?*, ABOVE THE LAW (June 22, 2010, 2:42 PM) http://abovethelaw.com/2010/06/do-lawyers-actaully-read-boilerplate-contracts-judge-richard-posner-doesnt-do-you/. Even in sophisticated sovereign debt transactions, neither contracting parties nor lawyers carefully read or negotiate boilerplate terms. *See generally* MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (2012); Andrea J. Boyack, *Sovereign Debt and The Three and a Half Minute Transaction: What Sticky Boilerplate Reveals About Contract Law and Practice*, 35 WHITTIER L. REV. 1, 1–2 (2013).

[257] "Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965).

[258] *See, e.g.*, *Contracts of Adhesion*, *supra* note 249, at 1176 (advocating that adhesion contracts should be considered presumptively unenforceable).

[259] *See, e.g.*, C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 174–75 (Iowa 1975) (explaining that the court is responsible to exercise oversight with respect to the fairness and content of terms in a contract of adhesion); Stelluti v. Casapenn Enters., LLC, 975 A.2d 494, 502 (N.J. Super. Ct. App. Div. 2009), *aff'd*, 1 A.3d 678 (N.J. 2010) (citing Delta Funding Corp. v. Harris, 912 A.2d 104, 120 (N.J. 2006)) (explaining that in adhesion contracts, a court should consider the "context and contents of the agreement itself" as well as the process that led to its execution).

[260] This has led some observers to opine that contract law is now evolving along two tracks: (1) a traditional assessment of process-based oversight for agreements between equally situated parties and (2) a protective, regulatory approach with respect to "unsophisticated parties" in contracts of adhesion. *See* L & L Wings, Inc. v. Marco-Destin, Inc., 756 F. Supp. 2d 359, 363–64 (S.D.N.Y. 2010) (holding that party sophistication and bargaining power should be a factor to consider in determining whether a liquidated damages provision is enforceable); Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493, 493 (2010); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 545 (2003). This latter approach has more in common with the European policy of prospectively approving the substance of form contracts prior to enforcement.

Generally, courts enforce contracts of adhesion according to their terms, whether consumer parties were aware of those terms or not.[261] In cases where party autonomy fails to provide a compelling justification for enforcement, economic theory provides an enforcement rationale. Enforceability of contracts, in general, creates market efficiencies and wealth through permitting party reliance on objectively agreed-to terms.[262] Most consumers will not read terms of standard forms,[263] but economic theory posits that in a robust market, as long as a few market actors (marginal consumers) do read terms, contracts with preferable terms will enjoy a comparative advantage among consumers.[264] Thus, standard forms will evolve to reflect consumer preferences even without the knowledge or participation of most consumers. In other words, market forces will act to monitor and constrain the content of form contracts.[265]

Applying this market justification in the context of CIC covenant provisions is problematic for three reasons. First, consumers' primary concern in purchasing a home is the physical property itself, not the content of recorded covenants. In general, "[h]omebuyers consider numerous factors in choosing which parcel of real property to buy, including school districts, lot size and configuration, tax assessment and appraisal, quality of construction, and even such things as the smell of the home and the orientation and exposure to natural light."[266] However, buyers likely do not consider content of CIC covenants and rules prior to purchase.[267] The Department of Housing and Urban Development (HUD) has promulgated a homebuyer checklist to help purchasers track

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See LEONE NIGLIA, THE TRANSFORMATION OF CONTRACT IN EUROPE 2 (2003) (explaining how contract law in Europe has evolved to deal with standard form contracts).

[261] *See, e.g.*, Erickson v. Aetna Health Plans of Cal., Inc., 84 Cal. Rptr. 2d 76 (Cal. Ct. App. 1999).

[262] *See* Deborah Zalesne, *Enforcing the Contract at All (Social) Costs: The Boundary Between Private Contract Law and the Public Interest*, 11 TEX. WESLEYAN L. REV. 579, 596 (2005).

[263] *See* Rakoff, *supra* note 249, at 1179.

[264] *See* Winokur, *supra* note 247, at 31 (citing Don Dewees and Michael J. Trebilcock, *Judicial Control of Standard Form Contracts*, *in* THE ECONOMIC APPROACH TO LAW 93, 105 (Paul Burrows & Cento Veljanovsky, eds., 1981)).

[265] *See id.* (explaining the theory that "marginal consumers" will operate as market checks on overreaching by drafters of non-negotiable forms).

[266] *Freedom of Contract Myth*, *supra* note 106, at 797.

[267] *See id.*

important aspects of properties they may buy.[268] While extensive, the checklist does not explicitly discuss CIC governing provisions as factors to be weighed in making a purchase decision, although it does bring up "pet restrictions" as a line item for consideration.[269] Aside from pet restrictions, however, the only reference to neighborhood covenants is a line item as to whether they are "good, average or poor" (whatever that means).[270] In addition, obtaining and reviewing covenants before entering into a contract is difficult, even if a buyer was so inclined.[271] It is also important to note that homebuyers are typically unrepresented by legal "counsel in home purchase negotiations, and legal counsel conducting real estate closings generally do not undertake to review and advise the buyer with respect to CIC obligations."[272] This makes actual

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[268] *See Buying a Home*, HUD.GOV, http://www.hud.gov/buying/checklist.pdf (last visited Sept. 23, 2014).

[269] *Id.*

[270] *Id.* For more information on the HUD homebuyer checklist and related documents, see also *Buying a Home*, HUD.GOV, http://portal.hud.gov/hudportal/HUD?src=/topics/buying_a_home. (last visited Oct. 13, 2014).

[271] Most states mandate disclosure of CIC covenants at or shortly before closing. *See, e.g.*, UNIFORM COMMON INTEREST OWNERSHIP ACT § 4 (1994); COLO. REV. STAT. ANN. § 38-35.7-102 (2014); FLA. STAT. ANN. § 720.401 (West 2010); HAW. REV. STAT. § 508D-3.5 (2012); N.C. GEN. STAT. ANN. § 47E-4 (2013). However, delivering a copy of lengthy CC&Rs does little to actually inform homebuyers regarding the true impact of the CIC governance form. *See Freedom of Contract Myth*, *supra* note 106, at 797–98; *see also, e.g.*, Debra Pogrund Stark et al., *Ineffective in Any Form: How Confirmation Bias and Distractions Undermine Improved Home-Loan Disclosures*, 122 YALE L.J. ONLINE 377, 379 (2013) (explaining that studies of home loan consumers show that they "miss the critical information that disclosure forms were designed to communicate"); Stephanie Stern, *Temporal Dynamics of Disclosure: The Example of Residential Real Estate Conveyancing*, 2005 UTAH L. REV. 57, 88 (2005) (arguing that disclosures made after a buyer has made an offer on a home are of diminished effectiveness); Melvin Aron Eisenberg, Comment, *Text Anxiety*, 59 S. CAL. L. REV. 305 (1986) (concluding that "consumers who are faced with the dense text of form contracts characteristically respond by refusing to read [them]").

[272] *Freedom of Contract Myth*, *supra* note 106, at 798; *see also* Debra Pogrund Stark et al., *Dysfunctional Contracts and the Laws and Practices That Enable Them: An Empirical Analysis*, 46 IND. L. REV. 797, 801 (2013) (discussing need to have legal counsel at closing). Nor do realtors involved in a home purchase transaction owe buyers any fiduciary duty to explain CIC covenants and governance. *Cf.* Ann Morales Olazabal, *Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses*, 40 HARV. J. ON LEGIS. 65, 66 (2003) (discussing that in most real estate closings the real estate agent is often the subagent of the seller).

pre-contracting consideration of CIC covenants unlikely, even for marginal consumers.[273]

Second, market checks only work when the market provides choices, and in many areas of the country most new home purchases are within CICs.[274] Many factors drive the proliferation of the CIC form, including municipal zoning authorities' budget-conscious push for private funding of public functions.[275] Municipal involvement in the creation of CICs makes it more problematic to characterize the decision of developers to build and buyers to purchase in CICs as truly voluntary.[276] As more new developments are necessarily structured as a CIC, buyers preferring to live outside a CIC are increasingly unable to make that choice.[277]

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[273] *See* Winokur, *supra* note 247, at 33 (concluding that such "built-in, substantive limitations on modification of uniform servitude forms present obstacles to market discipline by marginal consumers").

[274] *See* Paula A. Franzese & Steven Siegel, *Trust and Community: The Common Interest Community as Metaphor and Paradox*, 72 MO. L. REV. 1111, 1113–14 (2007); Steven Siegel, *The Constitution and Private Government: Toward the Recognition of Constitutional Rights in Private Residential Communities Fifty Years After* Marsh v. Alabama, 6 WM. & MARY BILL RTS. J. 461, 469 (1998) [hereinafter *The Constitution and Private Government*]; *see also* ROBERT JAY DILGER, NEIGHBORHOOD POLITICS: RESIDENTIAL COMMUNITY ASSOCIATIONS IN AMERICAN GOVERNANCE 38 (1992) ("Although [CICs] do provide more consumer options in the abstract, in many areas of the country [association-related housing] now dominate[s] the local housing market and [is] increasingly offering fairly uniform levels and types of services."); JOEL GARREAU, EDGE CITY: LIFE ON THE NEW FRONTIER 189 (1991) ("If you want a new home, it is increasingly difficult to get one that doesn't come with a homeowners' association."); *Community Collateral Damage*, *supra* note 99, at 59 ("The states with recent growth booms . . . have the highest percentage of citizens residing in privately governed CICs.").

[275] *See The Public Role*, *supra* note 152, at 877–95 (calling the CIC ownership concept "a form of 'grand bargain' between developers and municipalities" and citing to several local zoning statutes that require use of the CIC form); Treese et al., *supra* note 151, at 3; *see also Community Collateral Damage*, *supra* note 99, at 60; *supra* notes 151–54 (discussing zoning authorities pushing for CICs).

[276] *See* NORMAN WILLIAMS JR., AMERICAN LAND PLANNING LAW: LAND USE AND THE POLICE POWER § 49.2, at 254–55 (rev. ed. 2003) (explaining that in a CIC, "the actual decisions on land use and building forms in the district, and perhaps also on density, are explicitly to be made, not by a general public policy adopted in advance, but by negotiation between the municipality and the developer").

[277] "In addition, owners in CICs effectively are taxed twice—once through municipal property taxes and once through CIC assessments." *Freedom of Contract Myth*, *supra* note 106, at 780–81. In New Jersey, taxpayers have successfully claimed the right to offset a portion of their community assessments from property taxes, claiming that they were penalized by double taxation without this offset. CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 133 (citing Borough of Englewood Cliffs v. Estate of Allison, 174 A.2d 631, 640–41 (N.J. Super Ct. App. Div. 1961))

Although it is often asserted that CIC developments reflect consumer preferences,[278] some commentators vehemently refute that explanation, citing development trends that have little to do with what buyers want to buy.[279] Even among CICs, there is little choice in terms of covenant content because most declarations track virtually identical forms.[280] Therefore, the reality of covenant creation suggests that consumer preferences are not necessarily reflected by the options the market provides.[281]

Third, because home financeability is perhaps the key attribute of any home and the key consideration of any home purchase, the underwriting requirements of the FHA, Fannie Mae, and Freddie Mac, rather than developer marketing strategies or consumer preferences, most

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(reasoning that a property's true value does not include the value of rights transferred to a community).

[278] Market theory suggests that developers rationally take into account buyer preferences as a way to maximize their return on home sales. *See* Julia Patterson Forrester & Jerome Michael Organ, *Promising to Be Prudent: A Private Law Approach to Mortgage Loan Regulation in Common-Interest Communities*, 19 GEO. MASON L. REV. 739, 744–45 (2012).

[279] *See* Grassmick, *supra* note 112, at 189 (asserting that "[i]n a sort of Gresham's Law [that is, bad money drives out good] condominium or owners' association-governed community is crowding other types of housing from the market").

[280] *See Freedom of Contract Myth*, *supra* note 106, at 795–96; *see also The Constitution and Private Government*, *supra* note 274, at 1113–14 ("[T]here exists no meaningful consumer choice amongst CIC organizational structures. In general, developer-imposed CIC templates are remarkably uniform."). Even if buyers could shop around based on the particular provisions of a given CIC regime, this would likely have no impact. Buyers often do not see the CIC declaration and associated documents until at or close to closing, and at closing, disclosure requirements mandate that a tremendous amount of paperwork be given to buyers. *See* Note, *Judicial Review of Condominium Rulemaking*, 94 HARV. L. REV. 647, 650 (1981). The sheer volume provided minimizes the likelihood that the buyer will review or understand the disclosures. *See id.*

[281] *See generally* A GUIDE TO THE DEVELOPMENT PROCESS, *supra* note 44 (explaining the developer's process of creating a CIC and explaining how home buyers are recipients of, rather than shapers of, the initial servitude regime). In a section titled "Developer-Appointed Boards Should Actively Lead the Owners," Hyatt notes that "[m]ost people, by obvious logic, are followers in most aspects of their lives—some in virtually all respects. Social order would not be obtained without that condition." *Id.* at 331; *see also The Constitution and Private Government*, *supra* note 274, at 1127–30 ("CIC residents play no direct role in the critical decision-making process leading to the organization of the CIC."); MCKENZIE, *supra* note 107, at 21, 127 (describing the developer's role in establishing CC&Rs and bemoaning lack of resident input into the governing terms); Winokur, *supra* note 247, at 58–60 (explaining the complete lack of homeowner input with respect to the content of CIC covenants).

directly influence the content of CIC declarations.[282] Developers closely watch and quickly react to the preferences of the FHA and secondary mortgage market giants, Fannie Mae and Freddie Mac, when designing CIC provisions.[283] These agencies and entities greatly impact the housing market, including CIC development decisions, because the vast majority of mortgage loans made today are insured by the FHA or earmarked for resale to Fannie Mae or Freddie Mac.[284]

The FHA is a government agency, and Fannie Mae and Freddie Mac were once private entities, albeit heavily regulated at the federal level and established by the government to promote homeownership and given an implicit government financial guaranty.[285] The implicit government support of Fannie Mae and Freddie Mac became explicit in September 2008 when the entities were put under conservatorship with the Federal Government as a response to entity insolvency and to guard against entity failure.[286] Although Fannie Mae and Freddie Mac have repaid all

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[282] *See Freedom of Contract Myth*, *supra* note 106, at 813–22; *Unbounded Servitudes*, *supra* note 28, at 480.

[283] *See The Federal Housing Administration*, HUD.GOV, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory. The FHA "is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934." *Id.* Fannie Mae and Freddie Mac are by far the largest secondary mortgage market players. David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab*, 42 GA. L. REV. 1019, 1019, 1022 (2008). The very definition of "prime" mortgages (now, "qualified mortgages") signifies a mortgage that meets the requirements for sale to Fannie Mae or Freddie Mac. *See id.*

[284] *See* The Mortg. Fin. Working Grp., Center for American Progress, *A Responsible Market for Housing Finance: A Progressive Plan to Reform the U.S. Secondary Market for Residential Mortgages*, CENTER FOR AMERICAN PROGRESS (Jan. 27, 2011), www.americanprogress.org/issues/housing/report/2011/01/27/8929/a-responsible-market-for-housing-finance-2/; *see also Community Collateral Damage*, *supra* note 99, at 82–84, 105–06 (noting that the Fannie Mae and Freddie Mac and FHA are involved in most new mortgages); Jody Shenn & John Gittelsohn, *FHA Home-Loan Volume Is Sign of 'Very Sick System,' Agency's Stevens Says*, BLOOMBERG (May 24, 2010), www.bloomberg.com/news/2010-05-24/fha-home-loan-volume-is-sign-of-very-sick-system-agency-s-stevens-says.html (stating that the FHA, Fannie Mae, and Freddie Mac have been financing 90% of home lending since the 2008 market collapse).

[285] *See* Reiss, *supra* note 283, at 1022–25; *Role and Control*, *supra* note 52, at 1495.

[286] *See FHFA as Conservator of Fannie Mae and Freddie Mac*, FEDERAL HOUSING FINANCE AUTHORITY, http://www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx (last visited Sept. 25, 2014). "[T]he [Federal Housing Finance Authority] [was] authorized to take such action as may be: (i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry

federal funds used to bail them out of financial ruin, they remain in conservatorship and under direct control of the Federal Government.[287] As such, the policies and requirements of Fannie Mae and Freddie Mac can be considered "quasi-governmental."[288] Typically, Fannie Mae and Freddie Mac are collectively referred to as the "GSEs," indicating that these two companies are "Government Sponsored Entities."[289]

Historically and today, the FHA and the GSEs do more than encourage mortgage lending in general and funnel money into the residential mortgage market. They also dictate the terms of housing arrangements.[290] For example, in crafting CIC declarations, developers lift language directly from government forms and model documents and mirror precisely GSE and FHA underwriting requirements.[291] The content of the quasi-governmental form documents drives almost every residential mortgage loan transaction, and the GSEs indirectly—but extremely effectively—dictate the content of CIC declarations and covenants as well.[292]

In order to qualify for resale to one of the GSEs, a mortgage must be secured by an acceptable property, and in the CIC context, acceptable means that the community in which the property is located must meet the

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on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." *Id.* (quoting 12 U.S.C., § 4617 (2008)).

[287] *See* Chris Isidore, *Mortgage Bailout Now Profitable for Taxpayers*, CNN.COM, (Feb. 21, 2014, 12:19 PM) http://money.cnn.com/2014/02/21/news/economy/fannie-profit-bailout/ (discussing that Fannie Mae and Freddie Mac have now paid back more than the amount of the bailout funds, creating a taxpayer profit on the bailout "investment"); Paul Kiel & Dan Nguyen, *Bailout Tracker*, PROPUBLICA (Sept. 19, 2014) http://projects.propublica.org/bailout/ ("The total amount invested in Fannie and Freddie so far is $187B. The Treasury has been earning a return on its investments, which has resulted in a profit. So far the companies have paid $213B in dividends to the Treasury."). John Prior, *Fannie, Freddie to Pay Back Taxpayers*, POLITICO.COM, (Feb. 21, 2014, 11:30 AM) http://www.politico.com/story/2014/02/fannie-mae-Freddie-mac-bailouts-102768.html ("More than five years after being taken over by the government and receiving billions in bailouts, housing giants Fannie Mae and Freddie Mac are about to pay back taxpayers.").

[288] *See* Jason T. Strickland, *The Proposed Regulatory Changes to Fannie Mae and Freddie Mac: An Analysis*, 8 N.C. Banking Inst. 267, 272 (2004).

[289] *See History of the Government Sponsored Enterprises*, FEDERAL HOUSING FINANCE AGENCY OFFICE OF THE INSPECTOR GENERAL, http://fhfaoig.gov/LearnMore/History (last visited Sept. 25, 2014).

[290] *See, e.g.*, Winokur, *supra* note 247, at 59.

[291] *See id.*

[292] *See The Public Role*, *supra* note 152, at 878.

quasi-governmental structural mandates.[293] The Department of Housing and Urban Development (HUD) maintains a list of "Approved Condominium Projects," and the GSEs are permitted to purchase mortgages secured by units in these developments.[294] Properties in CICs that have a high percentage of non-owner-occupied units, or a high percentage of members in default on assessment payments, may not qualify for quasi-governmental mortgage funds.[295] "The precise threshold percentages vary from time to time, and precise mandates of Fannie Mae and Freddie Mac may differ, but the GSEs typically preclude mortgage loans secured by properties in CICs where more than 15% of the owners are delinquent in their assessments or where more than 50% of units are non-owner-occupied."[296] Motivated by these restrictions, CIC declarations often provide for some level of control over owners' ability to lease, ranging from complete or near-complete prohibition of leasing to

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[293] *See Freddie Mac Condominium Unit Mortgages*, FREDDIEMAC (Sept. 2014), www.freddiemac.com/learn/pdfs/UW/condo.pdf. Both Fannie Mae and Freddie Mac prohibit any ownership concentration in condominiums, meaning that if one owner holds title to 10% or more of the units, no unit in the CIC may secure a GSE mortgage. *See id.* at 2. Additional requirements include required community majority owner occupancy for loans to owner-investors, at least 10% of the association's budget earmarked to fund reserves, and no more than 15% of the members being delinquent on paying their assessments. *See id.* at 3, 4.

[294] *See Condominiums*, HUD.GOV, https://entp.hud.gov/idapp/html/condlook.cfm (last visited Sept. 26, 2014). Until recently, Fannie Mae and Freddie Mac would not purchase mortgages secured by property in CICs with a high percentage of non-owner-occupied units. *See Freddie Mac Condominium Unit Mortgages*, *supra* note 293, at 3; Mortgagee Letter 2012-18 from Carol J. Galante, Acting Assistant Sec'y for Hous. Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 6–10 (Sept. 13, 2012), *available at* http://portal.hud.gov/hudportal/documents/huddoc?id=12-18ml.pdf [hereinafter 2012 Mortgagee Letter]. Recently, the underwriting requirements with respect to community owner occupancy have been softened for purchasers intending to become owner occupants themselves. Nevertheless, for decades, CIC owner occupancy levels have been factors in mortgage funding decisions of Fannie Mae and Freddie Mac. *See, e.g.*, Mortgagee Letter 2009-19 from Brian D. Montgomery, Assistant Sec'y for Hous. Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 1 (June 12, 2009), *available at* www.bestfhalender.com/wp-content/uploads/2010/01/09-19ml.pdf; Mortgagee Letter 2009-46B from David H. Stevens, Assistant Sec'y for Hous. Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees & All FHA Roster Appraisers 1 (Nov. 6, 2009), *available at* www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-46bml.pdf [hereinafter Mortgagee Letter 2009-46B.

[295] *See Community Collateral Damage*, *supra* note 99, at 105–06.

[296] *Freddie Mac Condominium Unit Mortgages*, *supra* note 293, at 1, 3; *Freedom of Contract Myth*, *supra* note 106, at 816; 2012 Mortgage Letter, *supra* note 294.

nearly ubiquitous (and mandated) restrictions on short-term rentals.[297] Where CICs have been formed without such restrictions, community efforts to amend the declaration by adding leasing restrictions are spearheaded by a grassroots effort to make a community's homes more financeable.[298]

The underwriting requirements of the GSEs and the FHA can make or break a CIC project. Properties in qualifying communities have access to vastly more mortgage capital and this liquidity bolsters property values. Conversely, a property in a community with too many tenants or non-paying owners essentially will be cut off from mortgage funds, decreasing its liquidity and market price.[299] In general, "[d]evelopers across the nation want their products sold for the highest prices and therefore, need their would-be buyers to have access to funds."[300] Access to mortgage capital is crucial for home sales, so "developers will frame . . . CC&Rs to match the guidelines of the GSEs and the FHA whenever possible."[301] Indeed, when the GSEs and FHA make a

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[297] "The FHA views a complete ban on leasing as an unlawful restraint on alienation, but the GSEs and the FHA require high community owner occupancy rates" as part of their underwriting standards. *Freedom of Contract Myth*, *supra* note 106, at 817. Many CIC declarations carefully walk this line, prohibiting most, but not all, units from being leased. *See id.*

[298] In discussing zoning restrictions on neighborhood rentals, CATO's Ilya Shapiro stated that his condominium had "established a similar rule a few years ago because, due to federal regulation, it's hard to get lenders to approve mortgages to finance purchases in buildings with a high rental quotient." Ilya Shapiro, *The Right to Own Includes the Right to Rent Out*, CATO.ORG, (July 2, 2014, 4:29 PM) http://www.cato.org/blog/right-own-include-right-rent-out.

[299] This sets up a strange dichotomy: In communities with no-leasing covenants, owners cannot legally rent, but in communities without such covenants, too many neighborhood rentals will make it practically impossible for an owner to sell. *See, e.g.*, Shorewood W. Condo. Ass'n v. Sadri, 992 P.2d 1008, 1010 (Wash. 2000) (explaining that a no-leasing amendment was passed after the board of directors "received information from realtors and financial institutions that having a high percentage of rental units in a condominium can adversely affect the value of the units and affect the ability of prospective buyers of units to obtain financing"). The existence of GSE guidelines on owner occupancy thus necessarily restricts (practically, if not legally) the owners' ability to transfer.

[300] *Freedom of Contract Myth*, *supra* note 106, at 817.

[301] *Id.* at 817. The FHA prescribed numerous initial terms for CC&Rs and also "strongly advocated the imposition of supermajority requirements to amend CIC governing documents." *The Constitution and Private Government*, *supra* note 274, at 1128 n.76. Such supermajority requirements were aimed at promoting predictability preferred by FHA insurers and "prevent[ed] owners from banding together." *Id.* (quoting

policy-based change in their underwriting requirements with respect to permitted CIC covenant provisions, developers and CIC associations quickly fall in step with the new government (and quasi-government) policies.[302]

Government involvement in CIC structuring is not new. The FHA has been issuing guidelines for CIC covenant content since the advent of privately governed communities.[303] Indeed, the entire concept of single-family residential communities governed by private homeowners associations can be traced to an influential FHA publication in 1963.[304] FHA involvement in crafting neighborhood restrictions dates back to the early days of zoning,[305] and this government involvement has historically been morally troubling, particularly with respect to FHA promotion of housing segregation and discriminatory occupancy covenants.[306] Today, the FHA and the GSEs no longer require occupancy restrictions, but they remain hostile to rental-occupancy and majority-renter-occupied

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MCKENZIE, *supra* note 107, at 127). These "recommendations" came backed with "the promise of FHA mortgage insurance," and were widely followed. *Id.*; *see also* Winokur, *supra* note 247, at 59.

[302] For example, in the first decade of the 21st century, private transfer fee covenants (PTF covenants) became a popular way to defer and privatize development costs. *See* Burke T. Ward & Jamie P. Hopkins, *Private Transfer Fees: Developer Exploitation or Legitimate Financing Vehicle?*, 56 VILL. L. REV. 901, 901 (2012). These covenants required that a fee equal to a percentage of the sale price be paid upon resale of the property. *See id.* The use of PTF covenants grew quickly, and more than eleven million homes are currently encumbered thereby. *See id.* However, popular opinion and government policies turned against the PTF covenant concept in 2010, and by 2012, thirty-six states passed legislation limiting their validity. *See id.* at 921. Although no federal agency is authorized to outlaw PTF covenants, in March 2012, the Federal Housing Finance Agency, regulator for Fannie Mae and Freddie Mac, prohibited the GSEs from purchasing mortgage loans secured by properties encumbered by PTF covenants payable to third parties. *See* FHFA Restrictions, 12 C.F.R. § 1228.2 (2012). This "policy change" regarding GSE underwriting "has been tremendously effective, virtually wiping out privately directed PTF covenants in CICs formed after March 2012." *Freedom of Contract Myth*, *supra* note 106, at 820–21. For an excellent and thorough discussion of PTFs, see R. Wilson Freyermuth, *Private Transfer Fee Covenants: Cleaning Up the Mess*, 45 REAL PROP. TR. & EST. L.J. 419 (2011).

[303] *See* MCKENZIE, *supra* note 107, at 107; *The Public Role*, *supra* note 152, at 878.

[304] *See* U.S. FEDERAL HOUSING ADMINISTRATION, PLANNED UNIT DEVELOPMENT (1963); MCKENZIE, *supra* note 107, at 89–93 (tracking a detailed and deliberate policy plan by the FHA to promote CICs according to their enumerated requirements); *The Public Role*, *supra* note 152, at 878 (discussing the FHA's role in dictating community covenants).

[305] *See* MCKENZIE, *supra* note 107, at 89–93.

[306] *See, e.g.*, BROOKS & ROSE, *supra* note 114, at 107–11.

communities. Their policies continue to have an enormous impact on CIC covenant structuring.[307]

Judicial assertions that CIC covenants represent private contractual choices of a given community obscure the reality that GSE and FHA policies drive the content of CIC covenants.[308] As such, CIC leasing limitations are a direct reflection of government and quasi-governmental policies and judgments about the value of owner occupancy (and the hostility to rental housing in communities).[309] The power of the FHA and the GSEs to effectively control CIC covenant content undermines any market-driven impulse to craft such covenants to reflect consumer's true preferences.[310] In the case of CIC covenants, the content is determined by the government, who is essentially a third party, rather than by any contracting party or marginal consumer.[311]

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[307] *Supra* notes 293–97 and accompanying text.

[308] *See The Constitution and Private Government*, *supra* note 274, at 1128 n.76; *The Public Role*, *supra* note 152, at 873–98; *see also* DILGER, *supra* note 274, at 38 (explaining that CICs "are increasingly offering fairly uniform levels and types of services").

[309] *See The Constitution and Private Government*, *supra* note 274, at 1112 ("[T]he CIC phenomenon is, increasingly, the direct product of conscious and deliberate government policy"); *The Public Role*, *supra* note 152, at 879–80.

[310] To the contrary, numerous studies have shown that homeowners are dissatisfied with the content of their community covenants and, as a general rule, the provisions of CC&Rs diverge markedly from community preferences. *See* STEPHEN E. BARTON & CAROL J. SILVERMAN, COMMON INTEREST HOMEOWNERS' ASSOCIATIONS MANAGEMENT STUDY (1987) [hereinafter BARTON & SILVERMAN STUDY]; Winokur, *supra* note 247, at 62–63, n.260–64. A report published by the Urban Land Institute found that a majority of residents in CICs were greatly dissatisfied with their community. *See* CARL NORCROSS, TOWNHOUSES & CONDOMINIUMS: RESIDENTS' LIKES AND DISLIKES 80 (1973). The report characterized residents as "unhappy, resentful, discouraged, and disillusioned about their associations," with "[a] considerable number of families . . . so angry or fed up with their association operation that they are selling their homes and moving away, . . . to get away from what they think of as strait-jacket controls on their lives." *Id.* at 80.

[311] Andrew A. Schwartz, *Consumer Contract Exchanges and the Problem of Adhesion*, 28 YALE J. ON REG. 313, 346 (2011) ("[T]here are instances where the terms [of a covenant] are proffered by a third party and both contracting parties are reduced to the humble role of adherent."); *see The Constitution and Private Government*, *supra* note 274, at 1112 ("[T]he CIC phenomenon is, increasingly, the direct product of conscious and deliberate government policy"); *Id.* at 1121 ("[I]t is difficult to conceive of a more heavy-handed public interference in the private marketplace than a government rule or practice that mandates a highly particularized form of governance on new housing development.").

2. Perpetuity and Specific Enforceability

Judicial emphasis on freedom of contract as a justification to enforce CIC restrictions obscures another facet of these restrictions. Community covenants are not mere contracts—they are servitudes.[312] Unlike contracts, servitudes presumptively enjoy perpetual duration and can be specifically enforced.[313] Because covenants run with the land, they cannot be terminated by breach, nor are they mere personal obligations that terminate at the end of a lifetime.[314] The very purpose of all contracts is to restrain personal liberty in the future.[315] Protections against involuntary contracting seek to ensure that a party's freedom is only restricted to the extent that she so chooses.[316] The policy of allowing contractual non-performance in exchange for payment of compensatory damages further ameliorates concerns about limitations on future freedom.[317] Efficiency justifies not only freedom to enter a contract, but

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[312] *See Freedom of Contract Myth*, *supra* note 106, at 798–05.

[313] *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 1.1, 8.3 (2000).

[314] A servitude obligation is binding against current and future owners of the land—breach alone does not terminate them. *See Freedom of Contract Myth*, *supra* note 106, at 799–800; Sterk, *supra* note 55, at 617 (explaining that "difficult questions of inter-generational fairness" arise in the context of CIC restraints); *see also* Citizens for Covenant Compliance v. Anderson, 906 P.2d 1314, 1320 (Cal. 1995); Nahrstedt v. Lakeside Vill. Condo. Ass'n, 878 P.2d 1275, 1283 (Cal. 1994); Thodos v. Shirk, 79 N.W.2d 733, 739 (Iowa 1956); Arnold v. Chandler, 428 A.2d 1235, 1237 (N.H. 1981).

[315] Contractual freedom presents a temporal autonomy paradox: by exercising freedom of contract today, one's future self is bound. *See* Winokur, *supra* note 247, at 50 n.212 (explaining this concept in terms of Ulysses tying himself to his ship's mast, deliberately robbing his future self of the freedom to react to the sirens' song).

[316] For example, the doctrines of duress, undue influence, unconscionability, incapacity, and fraud all protect a contracting party from involuntarily limiting her future freedom of action.

[317] Courts generally award expectation damages for a breach of contract equal to the economic difference between what the non-breaching party expected to obtain from the breaching party's performance and what actually was obtained (plus foreseeable costs resulting from the breach less any cost savings from avoiding reciprocal performance and from mitigation). The theory behind expectation damages has been explained as best approximating the value of both retrospective and prospective reliance, and as the economic equivalent of the bargained-for interest of the contracting parties. *See* David W. Barnes, *The Net Expectation Interest in Contract Damages*, 48 EMORY L.J. 1137, 1139 (1999); L.L. Fuller & William R. Purdue Jr., *The Reliance Interest in Contract Damages (pt. 1)*, 46 YALE L.J. 52, 57–62 (1936).

also the freedom to breach a contract upon paying the nonbreaching party's expectation interest.[318]

Freedom to breach a contract and pay damages is a widely touted American innovation that supports the dual values of efficiency and personal liberty, and solves the temporal autonomy paradox of contract law.[319] Although contracting parties are obligated to the financial effect of a contract, they typically can use breach to exit the contracting relationship.[320] However, a party cannot opt out of a servitude obligation by paying contract damages, because servitudes are specifically enforceable.[321] CIC covenants endure and are inescapable; thus, the threshold for their enforcement should be higher than mere contracts.

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[318] *See* Justice Oliver Wendell Holmes, Supreme Judicial Court of Mass., Address at the Dedication of the New Hall of the Boston University School of Law (Jan. 8, 1897), *in* 10 HARV. L. REV. 457, 462 (1897) (positing that breach of contract is viewed by the law as immoral, and is essentially an option purchased through payment of expectation damages). Theorists of the law and economics school have seized upon this concept and expanded it into the theory of efficient breach, holding that "it is uneconomical to induce completion of performance of a contract after it has been broken" and explaining that the law should encourage (or at least not discourage) any breach that is efficient. *See* POSNER, *supra* note 242, at 149–51.

[319] The default remedy in contract breach actions in the United States is a monetary award of expectation damages, but under civil law in Continental Europe, breach of contract is typically remedied by an order of specific performance rather than a monetary calculation of damages. *See* Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co., Inc., 313 F.3d 385, 389 (7th Cir. 2002), *cert. denied*, 540 U.S. 1068 (2003) ("[T]he civil law grants specific performance in breach of contract cases as a matter of course.").

[320] Breach as a tool for flexibility justifies other aspects of contract law such as judicial reluctance to excuse obligation based on changed circumstances. *See* John D. Wladis, *Common Law and Uncommon Events: The Development of the Doctrine of Impossibility of Performance in English Contract Law*, 75 GEO. L.J. 1575, 1611 n.169 (1987).

[321] *See* Winokur, *supra* note 247, at 37 ("[T]he general availability of specific performance as a remedial alternative to damages precludes an owner's unilateral election to breach the servitude and pay damages."). Issuing a mandatory injunction is the typical way that restrictive covenants are enforced. *See, e.g.*, Depeyster v. Town of Santa Claus, 729 N.E.2d 183, 190 (Ind. Ct. App. 2000); Metzner v. Wojdyla, 886 P.2d 154, 158 (Wash. 1994). Servitude law draws a distinction between specifically enforceable equitable servitudes and real covenants that are enforceable through a grant of money damages, but this distinction is without a difference. A given covenant-based servitude can be the subject of an action either in equity or in law at a plaintiff's election, and it is easier to prove equitable grounds for recovery. *See* Runyon v. Paley, 416 S.E.2d 177, 182–83 (N.C. 1992); JAMES L. WINOKUR ET AL., PROPERTY AND LAWYERING 642–43 (2002); Alfred L. Brophy, *Contemplating When Equitable Servitudes Run with the Land*, 46 ST. LOUIS U. L.J. 691, 698 (2002). Contracts, on the other hand, generally cannot be specifically enforced. *See supra* note 318 and accompanying text. Specific performance

Judicial tools to limit the scope and duration of CIC covenants are rarely employed. Because property interests and obligations can theoretically persist indefinitely, property law has gradually developed temporal limitations to address the problem of dead-hand control.[322] Although the (in)famous Rule Against Perpetuities does not apply to constrain the duration of servitudes,[323] under the common law, courts are empowered to strike down servitudes that unduly restrain alienation.[324] In addition, most states have statutes granting judiciaries the power to invalidate restraints on alienation.[325] In recognition of the public policy limitation of indefinite alienation restraint, early generation covenants contained expiration dates.[326] Modern CICs, however, are usually organized to exist perpetually, and the law's hostility to perpetual CICs has disappeared. Today, courts will not strike down community covenants that lack expiration dates.[327] Furthermore, courts will not find an

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is only available when an award of damages would not be adequate and various equitable requirements are met. *See* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 16.1-.6 (4th ed. 1998); *see also* Ben Depoorter & Stephan Tontrup, *How Law Frames Moral Intuitions: The Expressive Effect of Specific Performance*, 54 ARIZ. L. REV. 673, 675–76 (2012). For a thorough discussion of how remedies for CIC covenant violations unjustifiably diverge from contract damages, see Amos B. Elberg, Note, *Remedies for Common Interest Development Rule Violations*, 101 COLUM. L. REV. 1958 (2001).

[322] *See* HERBERT T. TIFFANY & BASIL JONES, 2 TIFFANY REAL PROP. § 392 (3d ed. 2013); *see also* Earle v. Int'l Paper Co., 429 So. 2d 989, 995 (Ala. 1983).

[323] *See, e.g.*, Laguna Royale Owners Ass'n v. Darger, 174 Cal. Rptr. 136 (Cal. Ct. App. 1981).

[324] *See, e.g.*, City of Oceanside v. McKenna, 264 Cal. Rptr. 275, 279 (Cal. Ct. App. 1989) (balancing the purposes of a restriction against the level of restrictiveness to determine validity); Cast v. Nat'l Bank of Commerce Trust & Savs. Ass'n of Lincoln, 183 N.W.2d 485, 490 (Neb. 1971) (finding restrictions on alienation in a fee simple estate "void and against public policy"); Mountain Springs Ass'n of N.J. v. Wilson, 196 A.2d 270, 276 (N.J. Super. Ct. Ch. Div. 1963) (invalidating an unreasonable restraint on alienation); Eagle Enters., Inc. v. Gross, 349 N.E.2d 816, 819 (N.Y. 1976) (refusing to enforce an affirmative covenant as an unreasonable restraint on alienation); Gregory v. State Dep't of Mental Health, Retardation & Hosps., 495 A.2d 997, 1000, 1002 (R.I. 1985) (reinterpreting a covenant to promote free alienability).

[325] *See, e.g.*, CAL. CIV. CODE § 711 (West 2012).

[326] *See* Welshire, Inc. v. Harbison, 91 A.2d 404, 405 (Del. 1952) (containing an expiration date of eight years); Easton v. Careybrook Co., 123 A.2d 342, 343 (Md. 1956) (containing an eight-year initial term, then continuing until modification by vote of majority of owners).

[327] Typically, CIC restrictions provide for automatic renewal after a given initial term. Under Louisiana law, however, restrictions imposing affirmative obligations cannot

abandonment of covenants absent widespread violations and complete lack of enforcement.[328]

Traditionally, the subject matter of servitudes was strictly limited by the touch and concern doctrine.[329] This doctrine held that even if parties specifically intended to create a servitude and complied with all formalities of their creation, no covenant would in fact bind future landowners unless it directly related to the use of the land itself.[330] It is now well established that a covenant to pay money to maintain common areas and amenities adequately relates to the use of property in a community.[331] However, it is difficult to logically conclude that a restriction on occupancy—controlling who can reside on the land rather than how land is used—adequately relates to the land itself.[332]

Rental residential occupancy is not a land use distinct from owner residential occupancy. The use *of the property* turns on how it is enjoyed and employed by the party in possession.[333] For example, between a landlord and a tenant, it is the *tenant's* use that defines the use to which

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exist in perpetuity. *See* Diefenthal v. Longue Vue Found., 865 So. 2d 863, 882 (La. Ct. App. 2004), *writ denied*, 869 So. 2d 883 (La. 2004).

[328] *See* Ridgewood Homeowners Ass'n v. Mignacca, 813 A.2d 965, 972 (R.I. 2003) (quoting Kalenka v. Taylor, 896 P.2d 222, 226 (Alaska 1995)) (holding that a covenant can only be terminated through non-enforcement if there had been waiver and "substantial and general noncompliance"); Mueller v. Hoblyn, 887 P.2d 500, 509–10 (Wyo. 1994) (holding that there must be an intent to waive a servitude; mere nonuse is insufficient to terminate the servitude). Furthermore, changed conditions must be so substantial as to completely thwart the purposes of a covenant before they give judicial power to terminate the servitude. *See* Gladstone v. Gregory, 596 P.2d 491, 494 (Nev. 1979).

[329] *See supra* notes 163–67 and accompanying text. The Third Restatement advocates eschewing the touch and concern test. *See* RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES §§ 3.2 (2000). The approach of the Third Restatement is still controversial and many courts have refused to embrace its approach. *See supra* note 168.

[330] *See* Gerald Korngold, *Privately Held Conservation Servitudes: A Policy Analysis in the Context of in Gross Real Covenants and Easements*, 63 TEX. L. REV. 433, 448 n.67, 449 (1984) (citing RESTATEMENT OF PROP. § 537 cmt. h (1944)) (The *Restatement of Property* "justifies the touch and concern requirement as a means to reduce the number of permissible real covenants."). Courts adopting the newer Restatement approach, however, no longer closely examine concepts of privity and touch and concern in order to deny servitude enforcement. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 2.1, 3.1, 3.7 (2000).

[331] *See supra* note 144 and accompanying text.

[332] Scholars who argue that covenants should be completely analogized to contracts have been the most vocal critics of the touch and concern test in the context of common interest communities. *See, e.g.*, Epstein, *Covenants and Constitutions*, *supra* note 157.

[333] *See Freedom of Contract Myth*, *supra* note 106, at 834 n.235.

the property is being put. Courts have held that renting a unit in a CIC (even short-term rentals) does not render the use of that unit commercial rather than residential.[334] Clearly, leasing and occupancy restrictions are restraints on alienation and limit would-be residents' right to possess and reside in a home. They are not mere restrictions on property use. A residential occupant, regardless of her race and whether she holds legal title or a leasehold interest, possesses and uses the property in the same way as another residential occupant.[335]

Courts did not use the touch and concern test to strike down occupancy restrictive covenants when they first appeared because society at that time was complicit in establishing a widespread system of racial housing segregation. The use of covenants to this effect was initially one of the main goals of community servitudes.[336] Now that public policy purports to eschew discriminatory housing practices, it is time for courts to reconsider whether the touch and concern requirement really applies to provisions that restrict *who* can reside on a property—for example, a rental occupant—rather than what acts can be done on the land.[337]

Servitudes protect the status quo, both in terms of use of property, and, to the extent they restrain occupants, in terms of who can use the property. Today's de facto housing segregation illustrates the lasting effect of occupancy restraints in preserving the baseline neighborhood demographics. This lengthy and durable effect of CIC covenants requires more attentive judicial oversight, particularly with respect to covenants that have a discriminatory impact.

3. *Expectations and Dynamic Community Governance*

The reliance interest—the valuable ability of contracting parties to expect and rely upon enforcement of its terms—justifies judicial contract enforcement.[338] Courts generally refrain from interfering with the terms of a contract because to do so would impact the parties' expectations and reduce the contract's reliance value. In the context of CIC covenants,

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[334] *See, e.g.*, Kiekel v. Four Colonies Homes Ass'n, 162 P.3d 57, 64 (Kan. Ct. App. 2007); Lowden v. Bosley, 909 A.2d 261, 266 (Md. 2006); Kaufman v. Fass, 756 N.Y.S.2d 247, 248 (N.Y. App. Div. 2003); Scott v. Walker, 645 S.E.2d 278, 283 (Va. 2007).

[335] *See supra* notes 116–24 and accompanying text (discussing the *Shelley* decision and holding that occupancy by anyone is still rental use).

[336] *See supra* notes 111–40 and accompanying text.

[337] *See Unbounded Servitudes*, *supra* note 28, at 491–92.

[338] *See Freedom of Contract Myth*, *supra* note 106, at 805–06.

however, the value of parties' expectations is already tempered by the fact that the CIC covenants are not static provisions, but rather represent a dynamic private governing system.[339] Reliance means something different when the rules can always change.

Nearly all CIC covenants provide that a majority or super-majority of the CIC members can amend covenant terms.[340] Furthermore, governing boards of directors can pass rules and regulations implementing the general provisions of the CIC covenants.[341] The ability of CC&Rs and related rules to change over time to reflect the will of the board or a majority of participating voters is beneficial because it provides flexibility to the regime.[342] This flexibility is necessary for a system that is set up to persist across generations.[343] Although this dynamic governance aspect of CIC covenants renders them less rigid than the stagnant provisions of an unchangeable set of restrictive covenants, the changing nature of obligation in the case of CICs renders the obligation itself more difficult to justify on contractual reliance grounds.[344]

The dynamic aspect of CIC governance poses three potential problems. First, the theoretical ability to adjust an obligation over time may overstate the reality of how easy it is to change community covenants, leading courts to take an even more hands-off approach with respect to CIC provisions than they would if those provisions were

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[339] *See id.* at 803–05.

[340] CIC declarations can be amended by prescribed procedures, typically by supermajority vote of the owners. *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 2-117 (1994). UCIOA provides that the declaration may be amended with a 67% affirmative vote unless the declaration specifies a different percentage or certain occupancy rules are impacted (threshold in that case is 80%). *See id.* In addition to amending covenants, association boards enact (and change) implementing rules and regulations from time to time as they see fit. *See Freedom of Contract Myth*, *supra* note 106, at 805 n.141.

[341] *See* Paula A. Franzese, *Building Community in Common Interest Communities: The Promise of the Restatement (Third) of Servitudes*, 38 REAL PROP. PROB. & TR. J. 71, 20 (2003).

[342] *See Freedom of Contract Myth*, *supra* note 106, at 805 (noting that such "flexibility mitigates some of the concerns otherwise posed by the unlimited duration of CIC servitudes").

[343] *See id.*

[344] *See* Brower, *supra* note 174, at 242 (noting that CIC enforcement is justified based on the unanimous assent of its members to covenant terms, and explaining that later amendments "pose special problems").

static.[345] In reality, changing governing terms may be quite difficult, even when members in a community so desire, mainly because the level of participation in CIC governance is quite low.[346] Second, because participation in CIC governance is uneven,[347] changes to covenant terms and implementing rules may not reflect the preferences of the majority.[348] Third, even if amendments do reflect the majority's will, such amendments will operate to bind and govern the dissenting minority over their objection. Although this is true for any government, it is not typically the case in contract law, where enforcement of an agreement is justified by a party's voluntary assent to be bound.[349] In the case of CIC amendments, parties assent to the amending process, and only indirectly are deemed to have agreed to the content of any future changes to the governing scheme.[350] As a practical matter, this means that members' reasonable expectations—and the value of their reliance on the governing status quo as of their purchase—can be frustrated when rules change.

Unanticipated amendments and rules can impose compelling hardship on homeowners in a community. For example, in *Ritchey v. Villa Nueva Condominium Ass'n*,[351] a mother and her two children were forced to abandon occupancy of their home when the association passed a covenant amendment prohibiting occupancy by anyone under 18 years

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[345] *See, e.g.*, Cape May Harbor Vill. & Yacht Club Ass'n v. Sbraga, 22 A.3d 158, 169 (N.J. Super Ct. App. Div. 2011).

[346] *See generally* Sterk, *supra* note 55.

[347] *See* BARTON & SILVERMAN STUDY, *supra* note 310.

[348] *See id.* at 30–31 (showing low levels of participation in community governance and concluding that many communities are not governed according to majority desires but rather the idiosyncratic concerns of a vocal minority).

[349] *See Freedom of Contract Myth*, *supra* note 106, at 824.

[350] *See* Kroop v. Caravelle Condo., Inc., 323 So. 2d 307, 309 (Fla. Dist. Ct. App. 1975) (upholding amendment prohibiting leasing because "[p]laintiff acquired title to her condominium unit with knowledge that the Declaration of Condominium might thereafter be lawfully amended"); Hill v. Fontaine Condo. Ass'n, 334 S.E.2d 690, 691 (Ga. 1985) (holding that an amendment restricting residence only to adults is enforceable on all owners); McElveen-Hunter v. Fountain Manor Ass'n, 386 S.E.2d 435, 436 (N.C. Ct. App. 1989) (holding that an amendment prohibiting leasing "does not infringe upon any legal right of the plaintiff's; for she had notice before the units were bought that the declaration was changeable").

[351] *See* 146 Cal. Rptr. 695 (Cal. Ct. App. 1978).

of age.[352] Similarly, no-lease covenant amendments often frustrate the expectations of CIC owners who planned on being able to rent or who are already renting a property.[353] In spite of these conceptual difficulties, courts almost always hold that buying into a CIC connotes assent not just to knowable, recorded terms, but to whatever future restrictions a majority of voting neighbors in the community see fit to impose in the future.[354]

The unpredictability and dynamic majority-rule aspects of CICs resemble a social contract or constitution, and this raises issues such as minority voting rights and limits to governing power. These issues are typically considered in constitutional law or entity governance theory rather than within basic contract law. Protection of individual and minority group rights in a democratic government is often accomplished through constitutional guaranties akin to the Bill of Rights, and there have been some calls for a protective bill of rights for homeowners in CICs.[355] Legislation could solve much discontentment with respect to the

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[352] *See id.* at 700. Age-based restrictions were not prohibited by statute in 1978, but a later amendment of the Fair Housing Act created a statutory basis for striking down such restrictions. *See* Fair Housing Act of 1968, 42 U.S.C. §§ 3601-3619 (2012). The Act, as amended, prohibits discrimination in the sale, rental, and financing of dwellings, and in other housing-related transactions, based on race, color, national origin, religion, sex, familial status (including children under the age of 18 living with parents or legal custodians, pregnant women, and people securing custody of children under the age of 18), and disability. *See id.* § 3604.

[353] *See* Woodside Vill. Condo. Ass'n v. Jahren, 806 So. 2d 452, 461 (Fla. 2002) (finding that a recorded condominium declaration puts owners on notice that the restrictions governing the subject properties are "subject to change through the amendment process" and that owners have thereby agreed "that they would be bound by properly adopted amendments"). Such changes can also frustrate expectations of tenant residents in the CIC.

[354] *See, e.g.*, *Ritchey*, 146 Cal. Rptr. at 700; Cape May Harbor Vill. & Yacht Club Ass'n. v. Sbraga, 22 A.3d 158, 166 (N.J. Super Ct. App. Div. 2011); Burgess v. Pelkey, 738 A.2d 783, 787 (D.C. 1999); Flagler Fed. Sav. & Loan Ass'n of Miami v. Crestview Towers Condo. Ass'n, 585 So. 2d 198, 199 (Fla. Dist. Ct. App. 1992); Breezy Point Holiday Harbor Lodge-Beechside Apt. Owners' Ass'n v. B.P. P'ship, 531 N.W.2d 917, 920 (Minn. Ct. App. 1995); Worthinglen Condo. Unit Owners' Ass'n v. Brown, 566 N.E.2d 1275, 1277 (Ohio Ct. App. 1989). *Cf.* Breene v. Plaza Tower Ass'n, 310 N.W.2d 730 (N.D. 1981).

[355] Perhaps the first advocate of a homeowners' bill of rights solution to the constitutional governance gap in CICs was Professor Susan French. *See* Susan F. French, *The Constitution of a Private Residential Government Should Include a Bill of Rights*, 27 WAKE FOREST L. REV. 345, 350 (1992). Professor French suggested that CICs be bound by a quasi-constitutional guaranty of personal freedoms to ensure against private governance overreaching and protect individuals in these communities from unjustifiable

scope of CIC governance by proceeding in this vein—identifying and guarantying important individual rights in the context of private CIC governance.[356]

Some courts and commentators analogize CICs to corporations rather than to governments. After all, community associations are legal persons, often structured as non-profit corporations or other business entities.[357] Additionally, shareholders in corporations do not typically enjoy a corporate bill of rights.[358] Fairness in such group decision-making turns on dissenting members having sufficient "voice" (participation) and "exit" (the ability to leave).[359] From its appearance, the CIC model seems to satisfy the requirements of voice and exit. Every owner has a vote (voice).[360] In addition, owners theoretically can vote with their feet and leave if dissatisfied (exit).[361] However, CIC membership is bundled with homeownership, and the only way to exit is to sell one's

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majoritarian control. *See id.* More recently, the American Association of Retired Persons and other groups have called for state legislatures to enact a homeowners' bill of rights that would apply to all CICs in the state. *See Freedom of Contract Myth*, *supra* note 106, at 837–38 n.249. The AARP's proposed Bill of Rights includes, "[t]he [r]ight to [r]esolve [d]isputes without [l]itigation," the right to be informed of any changes to the rules, and "[t]he [r]ight to [o]versight of [a]ssociations and [d]irectors." *Id.* For a summary of the proposed bill, see ANDREW KOCHERA, *A Bill of Rights for Homeowners in Associations: Base Principles of Consumer Protection and Sample Model Statute*, AARP PUBLIC POLICY INSTITUTE, (2006), *available at* http://assets.aarp.org/rgcenter/consume/inb128_homeowner.pdf. The National Conference of Commissioners on Uniform State Laws has considered including a bill of rights for homeowners in CICs as part of its UCIOA revision as well. *See Common Interest Ownership Act Summary*, UNIFORM LAW COMM'N, http://www.uniformlaws.org/ActSummary.aspx?title=Common%20Interest%20Ownership%20Act (last visited Sept. 28, 2014).

[356] *See Freedom of Contract Myth*, *supra* note 106, at 838 ("Creating special legislative protection for owners in CICs . . . would also bring clarity to the contentious issue of constitutional applicability to CIC governance.").

[357] *See* FOUNDATION FOR COMMUNITY ASSOCIATION RESEARCH, *2013 Community Association Fact Book*, 5 (2014), http://www.cairf.org/research/factbook/introduction.pdf.

[358] *See generally* Carl. J. Mayer, *Personalizing the Impersonal: Corporations and the Bill of Rights*, 41 HASTINGS L.J. 577 (1990) (summarizing the constitutional rights of corporations).

[359] The terms "voice" and "exit" are borrowed from the corporate governance classic, ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY 21, 30 (1970).

[360] *See* Brower, *supra* note 174, at 245 (noting that "[p]articipatory consent substitutes democratic decisionmaking and consensus building for state regulation over substantive terms").

[361] *See id.* at 243 (explaining the argument that assent exists even for amendments because dissatisfied owner members in a CIC are always free to leave the community if they disagree with its rules).

home and move.[362] The illiquidity of real property, coupled with the psychological and emotional toll of home loss, makes exiting a CIC tremendously burdensome.[363] In some cases, restrictive covenants create legal barriers to CIC exit as well by limiting an owner's ability to sell or lease.[364] Therefore, there is a very real practical barrier to exit in CICs.

Freedom of contract is an inadequate justification for covenant enforcement in the context of private communities. Such covenants are not voluntary owner obligations and do not necessarily reflect neighborhood preferences.[365] Rather, they are perpetual contracts of adhesion with terms imposed by developers and governments.[366] Furthermore, community covenants do not expire, are specifically enforceable, and are unpredictable in scope and content.[367] Although CICs are beneficial ownership forms in many ways, their unique brand of obligation warrants increased judicial oversight. Certain types of restrictions—including restrictions on the occupancy of a home—do not impact use of the property itself. Covenants containing occupancy restraints and lease prohibitions should only be enforceable if their benefits truly outweigh their harms.

B. Alleged Benefits, Community Costs, and Owner Harms

Leasing restrictions are one of the most common type of occupancy restriction in CICs today.[368] There are several cited reasons that developers and neighbors may want to the control the owners' ability to lease. For one thing, as long as the GSEs, the FHA, or both, require a

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[362] *See id.* at 224.

[363] *See Freedom of Contract Myth*, *supra* note 106, at 811–13; Brower, *supra* note 174, at 224 (referring to the "financial and psychological stakes raised" by requiring a home sale to exit). Much of the impetus behind defaulting mortgagor rescue efforts has been the individual harms from forced home sales. *See* Forrester & Organ, *supra* note 278, at 739 (describing a forced sale of a home as "clearly devastating to the homeowner").

[364] "When restrictions constrain an owner's ability to exit a CIC regime, it no longer is valid to say that continued membership or occupancy in the private community is truly voluntary and necessarily manifests a continuing desire to be bound by the governance regime. This calls into question the continuing legitimacy of the CIC social contract." *Freedom of Contract Myth*, *supra* note 106, at 812.

[365] *See supra* notes 274–81 and accompanying text.

[366] *See supra* notes 274–81 and accompanying text.

[367] *See Freedom of Contract Myth*, *supra* note 106, at 798–05.

[368] *See* Katharine N. Rosenberry, *Home Businesses, Llamas and Aluminum Siding: Trends in Covenant Enforcement*, 31 J. MARSHALL L. REV. 443, 461–65 (1998).

certain percentage of owner occupancy in a community to qualify for mortgage funds, owners in a CIC are tangibly harmed by having too many of their neighbors choose to lease.[369] Lower rental-occupancy in a neighborhood directly sustains value by increasing home finance options.[370] If an owner's decision to rent his property renders a neighbor's property unqualified for GSE or FHA mortgage funding, this is clearly a cost externality created by the decision to rent. Furthermore, when a property is unable to qualify as collateral for government and quasi-government mortgage funding, the property's value will decrease.

Nevertheless, this does not necessarily mean that leasing restrictions create owner and community benefits that transcend GSE and FHA underwriting policies. In other words, there is little evidence that leasing restrictions can be justified as reasonably benefitting owners and neighborhoods if the GSEs and FHA would stop requiring majority community owner occupancy. If there are no significant benefits to owners or neighborhoods extrinsic to GSE and FHA underwriting restraints, then upholding leasing restrictions merely becomes an exercise in enforcing quasi-governmental preferences as if they were private choices. Even if leasing restrictions do create community benefits in addition to GSE and FHA financeability, perhaps these benefits may be achieved in a more direct and less costly way.

In upholding leasing restrictions, courts often cite neighborhood harmony as a benefit arising from leasing restrictions.[371] Courts and commentators alike assert that lease restrictions "likely improve the quality of life for owner occupants within developments and may translate into higher property values."[372] This axiom is usually left unsupported by any evidence of its veracity, although there is one 1987 California study by Stephen Barton and Carol Silverman that has been occasionally referenced to support this claim.[373] For example, Professor

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[369] *See* Rawling, *supra* note 45 and accompanying text; *see also Unbounded Servitudes*, *supra* note 28, at 480; *see also*, *e.g.*, McElveen-Hunter v. Fountain Manor Ass'n, 386 S.E.2d 435, 435 (N.C. Ct. App. 1989) (upholding a prohibition on "the leasing of units to corporations, to persons for less than a year, and sub leasing").

[370] *See supra* note 294 and accompanying text.

[371] *See* Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93, 98 (Ill. App. Ct. 1995) (citing Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d 637, 640 (Fla. Dist. Ct. App. 1981)).

[372] Rawling, *supra* note 45, at 226–27 (calling leasing restrictions "a prophylactic measure").

[373] *See* BARTON & SILVERMAN STUDY, *supra* note 310.

Natelson cited the Barton and Silverman Study to support his assertion that "[a] high number of leased units (over 30%) can significantly impair the market position of the subdivision."[374] A 2002 California Research Bureau Study also referenced the Barton and Silverman Study to support its conclusion that "there are serious consequences for a CI[C's]" property values when 25-30% of homes are rented.[375]

Interestingly, the Barton and Silverman Study, upon which these various conclusions seem to be based, is based upon survey responses of California CIC board presidents and interviews of California property managers.[376] In addition, the highly touted "30% renter threshold" for driving down property values derives solely from assertions by "a number of professional managers" interviewed claiming that there would be "serious consequences for [any CIC] reaching the 30 percent renter threshold."[377] But the Barton and Silverman Study also states that these managers explained the reason why they predicted "serious consequences" resulting from too many renters in a given community.[378] This prediction was based *solely* on the fact that the GSEs and the FHA (as of 1987) set a 70% owner occupancy threshold as a requirement for properties in a community in order for it to qualify for FHA mortgage insurance or GSE-earmarked mortgage funding.[379] Failure to adhere to GSE and FHA guidelines reduces financing opportunities for properties within a CIC—quite significantly.[380] But these "serious consequences"

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[374] Robert G. Natelson, *Consent, Coercion, and "Reasonableness" in Private Law: The Special Case of the Property Owners Association*, 51 OHIO ST. L.J. 41, 73 n.150 (1990) (citing BARTON & SILVERMAN STUDY, *supra* note 310). Natelson also cites *Le Febvre v. Osterndorf* to support his conclusion that a high percentage of rentals adversely impacts neighborhood property values, *see id.* at 63–64, but the only evidence to this effect of rentals in that case is that the would-be landlord reported that "[h]e was informed . . . by a resident unit owner that rental of his units would have an adverse effect on the value of the other units." 275 N.W.2d 154, 159 (Wis. Ct. App. 1979).

[375] JULIA LAVE-JOHNSTON & KIMBERLY JOHNSTON-DODDS, CAL. RESEARCH BUREAU, COMMON INTEREST DEVELOPMENTS: HOUSING AT RISK? (2002) (citing BARTON & SILVERMAN STUDY, *supra* note 310) [hereinafter CRB REPORT].

[376] *See* BARTON & SILVERMAN STUDY, *supra* note 310, at 8.

[377] *Id.* at 15.

[378] *See id.*

[379] *See id.*

[380] *See id.*; *see also supra* notes 293–304 (discussing Fannie Mae, Freddie Mac, and FHA market impact) and accompanying text.

are entirely and artificially created by the policies of the GSEs and the FHA.[381]

Despite the dearth of hard evidence that community rentals cause property values to decline (other than those based on FHA and GSE requirements) and neighborhood disharmony, this belief is still widely held, asserted by commentators and judicial opinions upholding CIC leasing restraints. In *Franklin v. Spadafora*,[382] the court used the typical analysis to uphold a covenant amendment that prohibited any one owner from acquiring more than two units in a CIC.[383] After asserting that every member of the community had constructively agreed to be bound to all duly enacted covenant amendments, the court rejected the assertion that this sale restriction unduly hampered alienation of land.[384] The court reasoned that the restriction was merely a justifiable effort to promote the widely supported public policy of community owner occupancy.[385]

Community owners claim there are legitimate reasons for preferring owner-occupant neighbors. For example, owners who supported the condominium's no-lease restriction in one case filed affidavits with the court in support of the association's suit for a rental injunction, claiming that they strongly preferred owner occupancy based on a "long-term financial stake in this community" and "the sense of community that comes with a stable neighborhood."[386] Restrictions on rental occupancy

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[381] Not only is the 30% threshold an artificial constrict deriving from the GSE and FHA underwriting requirements of the day, but the cited 30% number has become irrelevant even with respect to financeability, because the GSEs and FHA now only require a 50% (not 70%) owner-occupancy level. *See* Mortgagee Letter 2009-46B, *supra* note 294, at 5.

[382] 447 N.E.2d 1244 (Mass. 1983).

[383] *See id.* at 1246–50.

[384] *See id.* at 1249.

[385] *See id.* at 1247. The court did note that there was some impact on the unit seller's ability to find a buyer, but concluded that this impact was quite small because the plaintiff was, in fact, the only person who currently owned two units in the condominium. *See id.* at 1247–50. Courts have reached the same conclusion for the same reasons in the context of a cooperative. *See, e.g.*, Sanders v. Tropicana, 229 S.E.2d 304, 309 (N.C. Ct. App. 1976). Another example of a court upholding a transfer restriction based on public policy is a CIC prohibition against occupancy by a Tier 3 sex offender. *See* Mulligan v. Panther Valley Prop. Owners Ass'n, 766 A.2d 1186, 1192 (N.J. Super Ct. App. Div. 2001).

[386] Preserve at Forrest Crossing Townhome Ass'n v. DeVaughn, No. M2011-02755-COA-R3-CV, 2013 WL 396000, at *7 (Tenn. Ct. App. Jan. 30, 2013); *see also* Lyons v. King, 397 So. 2d 964, 967 (Fla. Dist. Ct. App. 1981) (upholding a condominium's refusal to consent to sale when the purchaser intended to rent, even though no covenant

ensure that only voting and assessment-obligated members of a CIC reside in the community. There may be benefits in requiring residents to be the same people who make governing decisions and pay for those decisions. Owners may be more personally invested in a community in which they reside rather than in which they merely hold a real estate investment. Additionally, renter occupants may care little about community maintenance, upkeep, and keeping association rules.

Owners also frequently allege that the character of a community changes when residents are tenants.[387] For example, tenants may be less invested in the community's long-term health and welfare, preferring to maximize their short-term enjoyment of the property rather than long-term preservation of value.[388] Absentee owners may be interested in minimal maintenance in order to maximize their rental profits.[389] Because renters typically are more mobile and may reside for shorter periods in one home, more renters may mean more neighborhood move-ins and move-outs.[390] There is a widespread perception that renters do not respect or maintain property to the same degree as owners and are not as involved in a community.[391] Many believe that neighborhoods consisting of owner-occupants are safer because owners are more likely

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prohibited leasing); Brower, *supra* note 174, at 205–06 (theorizing that purchasers in a CIC expect a primarily owner-occupied neighborhood).

[387] *See* City of Oceanside v. McKenna, 264 Cal. Rptr. 275, 279 (Cal. Ct. App. 1989) (prohibiting leasing is reasonable where intended to foster a stabilized community).

[388] Rawling, *supra* note 45, at 226.

[389] *See* Jordan I. Shifrin, *No–Leasing Restrictions on Condominium Owners: The Legal Landscape*, 94 ILL. B.J. 80, 80–81 (2006) (leasing restrictions are aimed at forbidding absentee ownership); CRB REPORT, *supra* note 375, at 26 (absentee owners more likely to object to "quality of life" improvements). The CRB Report cites a CIC "gone bad" because of absentee ownership, but the details of the community's downward spiral show that the true sources of decline were widespread assessment default and mismanagement. *See* CRB REPORT, *supra* note 375, at 26.

[390] *See* Villas West II of Willowridge Homeowners Ass'n v. McGlothin, 885 N.E.2d 1274, 1279 (Ind. 2008) (quoting Shifrin, *supra* note 389, at 80–81) (explaining that leasing limitations are motivated by "concerns about the negative effects of high resident turnover and renters' perceived lack of attention to the property").

[391] *See id.* at 1283–84; *see also* Rawling, *supra* note 45, at 226 n.7 (quoting ROBERT G. NATELSON, LAW OF PROPERTY OWNERS ASSOCIATIONS 160 (1989)) ("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 investment."). *But see* Ellickson, *supra* note 157, at 1551–52 (reasoning that the length of occupancy, not owner occupancy, is the true determinative factor with respect to neighborhood connectivity).

to establish relationships with their neighbors.[392] Also, owners have a greater incentive to become involved in neighborhood watch and oversight efforts than do renters.[393] Owner occupancy is of particular concern in areas with high tourism, where communities have cited the goal of inhibiting transiency as paramount motivation for a lease restriction.[394]

All of these factors may bolster values for property in rental-restricted communities.[395] Rental restrictions enhance property values is a popular mantra,[396] but it appears to lack any actual supporting data.[397] In fact, in contrast to this conclusion, at least one study suggests that imposing association consent requirements for occupancy changes significantly decreases its market price.[398] The holdings and data referenced in zoning cases suggest that rental restrictions lead to property value decline.[399] For example, the home appraisal data cited in the

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[392] *See* Rawling, *supra* note 45, at 237.

[393] *See* CRB REPORT, *supra* note 375, at 39–40; Rawling, *supra* note 45, at 226.

[394] *See* Seagate Condo. Ass'n v. Duffy, 330 So. 2d 484, 486 (upholding a leasing restriction, in the context of "a tourist oriented community in South Florida"); *see also* Grassmick, *supra* note 112, at 212 (arguing that Florida leasing restrictions are based on high levels of tourism).

[395] Some claim that even if there are individual costs to lease limits, these are offset by economic gains enjoyed by the entire community. *See* Rawling, *supra* note 45, at 234.

[396] *See* Pindell, *supra* note 173, at 46; *see also Freedom of Contract Myth*, *supra* note 106, at 790.

[397] Rawling claims that the increased aggregate value of a building structured as a condominium shows that leasing lowers property values, but this is an unjustified conclusion from the data (which measures value of multi-family rental buildings compared with condominium conversions), and even Rawling admits that his comparisons across property types "provide only minimal insight into the more limited effects of leasing restrictions on condominium marketability." Rawling, *supra* note 45, at 234. The repeated assertion that non-owner occupancy diminishes community property values upon close inspection devolves into (a) mere unsubstantiated opinion and (b) a necessary conclusion driven and created by owner occupancy requirements of the FHA, Fannie Mae and Freddie Mac. *See Freedom of Contract Myth*, *supra* note 106, at 816.

[398] Rawling cites a study that shows that consent rights "reduce the value of units in cooperatives by 12% compared to . . . condominiums." Rawling, *supra* note 45, at 236 n.60 (citing Allen C. Goodman & John L. Goodman, *The Co-op Discount*, 14 J. REAL EST. FIN. & ECON. (SPECIAL ISSUE) 223, 231 tbl.3 (1997)).

[399] *See, e.g.*, Gangemi v. Zoning Bd. of Appeals of Fairfield, 763 A.2d 1011, 1015–16 (Conn. 2001) (explaining that a "'no rental' condition" not only restricts an owner's ability to rent, but "also significantly reduces [the] [market] value").

pending case of *Dean v. City of Winona*[400] demonstrates that the inability to lease decreases the value of the plaintiff's home by 20%.[401] To the extent that leasing limitations support property values in a CIC, this support is likely due to the increased financeability that comes from qualifying under FHA and GSE community owner occupancy standards.

Although there is insufficient evidence that rental occupancy drives down property values, evidence does show that property values decrease when a neighborhood becomes more than 10% minority occupied.[402] This disturbing fact should not justify race-based occupancy restrictions. Protecting higher property values is—and always has been—an important goal of neighborhood covenants. Nevertheless, this goal does not overshadow other, broader policy values, like combatting housing discrimination and increasing housing desegregation. Thus, even if rental occupancy and minority occupancy does in fact translate to lower property values, that in itself is not justification for a covenant scheme that may perpetuate even greater social ills.

Even if community values increase due to leasing limitations, such limitations impose economic costs on individual owners who lose the ability to rent out their property.[403] Free transferability (including the freedom to lease) is an essential part of fee simple title, and curtailing the ability to lease interferes with this important property right.[404] In addition

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[400] *See* Dean v. City of Winona, 843 N.W.2d 249 (Minn. Ct. App. 2014), *review granted* (May 20, 2014).

[401] *See Dean v. City of Winona* Amici Brief, *supra* note 38, at 11.

[402] *See* Brown, *supra* note 2, at 355; *see also* Abraham Bell & Gideon Parchomovsky, *The Integration Game*, 100 COLUM. L. REV. 1965, 1984 (2000) (citing David R. Harris, *Property Values Drop When Blacks Move in Because: Racial and socioeconomic Determinants of Neighborhood Desirability*, 64 AM. SOC. REV. 461, 461 (1999)) (discussing a study that found that "prices of residential units drop by 16% when the percentage of blacks in a neighborhood changes from less than 10% to 10-60%"); Nancy A. Denton, *The Role of Residential Segregation in Promoting and Maintaining Inequality in Wealth and Property*, 34 IND. L. REV. 1199, 1207–208 (2001) (explaining that "both blacks and whites are penalized for living in neighborhoods that are more heavily black" and noting that the extent of property value decrease varies by region); Thomas M. Shapiro, *Race, Homeownership and Wealth*, 20 WASH. U. J.L. & POL'Y 53, 67–68 (2006).

[403] *See Gangemi*, 763 A.2d at 1015–16.

[404] "Without doubt, the concept of free alienability is a cornerstone of modern Anglo-American civilization." Michael D. Kirby, *Restraints on Alienation: Placing a 13th Century Doctrine in 21st Century Perspective*, 40 BAYLOR L. REV. 413, 413 (1988). "Since an early date in the history of the English common law, it has been thought socially and economically desirable that the owner of a present fee simple in land, or of a

to limiting an owner's autonomy,[405] lease restrictions make it more difficult for an owner to reap the financial fruits of her real property investment.[406] Any limitation on alienability prevents full maximization of wealth through transfer because it imposes barriers to transferring property to its highest valued user.[407] Efficiency justifies judicial protection of transferability, and the *Restatement (Second) of Property* asserts that "[m]uch of modern property law operates on the assumption that freedom to alienate property interests which one may own is essential to the welfare of society."[408]

If a transfer restriction significantly impairs an owner's ability to obtain the economic benefits of real property ownership, courts can—and should—strike down the restriction.[409] Courts' primary concern in policing restraints on alienation in a CIC context is economic impact.[410] Covenant restrictions can dictate the identity of a transferee, but cannot rob an owner of her right to transfer her property at all.[411] If an alienation restraint fails to give the owner a prompt market return on her

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corresponding absolute interest in chattels, should have the power to transfer his interest." Merrill I. Schnebly, *Restraints Upon the Alienation of Legal Interests: I*, 44 YALE L.J. 961, 961 (1935). Limitations on leasing are alienation restraints. *See, e.g.*, Libby v. Winston, 93 So. 631, 632 (Ala. 1922) (finding limits on sales or leases inconsistent with fee simple title); Davis v. Geyer, 9 So. 2d 727, 729–30 (Fla. 1942) (invalidating a deed restriction as repugnant to fee simple ownership); Cast v. Nat'l Bank of Commerce Trust & Sav. Ass'n of Lincoln, 183 N.W.2d 485, 490 (Neb. 1971) (finding restrictions on alienation in a fee simple estate "void and against public policy"); N. Coast R.R. Co. v. Aumiller, 112 P.384, 386 (Wash. 1910) (explaining the importance of property owners' right to rent).

[405] *See* Geoffrey Graber, *Choosing the Chosen: The Validity of Race Restrictions on the Alienation of Property in Israel and the United State*, 73 S. CAL. L. REV. 437, 453 (2000).

[406] *See Unbounded Servitudes*, *supra* note 28, at 452.

[407] *See* Eirik G. Furubotn & Svetozar Pejovich, *Property Rights and Economic Theory: A Survey of Recent Literature*, 10 J. OF ECON. LITERATURE 1137, 1146 (1972) (explaining that transferability of initially allocated entitlements is prerequisite for value maximization); *see also* Steven N.S. Cheung, *Transaction Costs, Risk Aversion, and the Choice of Contractual Arrangements*, 12 J.L. & ECON. 23 (1969); Richard Epstein, *Why Restrain Alienation?*, 85 COLUM. L. REV. 970 (1985); POSNER, *supra* note 242, at 32; Winokur, *supra* note 247, at 25.

[408] RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS Pt. II, intro. note (1981).

[409] *See Unbounded Servitudes*, *supra* note 28, at 463.

[410] *See id.*

[411] *See id.*

investment, the alienation restraint is unreasonable and voidable on public policy grounds.[412]

A stream of rental income is a reasonable and measurable return on real property investment, even if that property is within a CIC. Some courts state that CIC leasing restrictions create a positive economic effect on owners, including owners who are prohibited from leasing their property.[413] But this statement, standing alone, ignores the fact that restrictions on leasing impose negative economic effects on owners who are deprived of a return on investment and unable to obtain value from a highly illiquid real estate asset.[414] Courts sometimes ignore the anti-alienation effect of leasing restrictions, stating that owners who cannot lease are still free to sell their property.[415] Not only does this statement discount the value of owner autonomy with respect to electing to lease out rather than sell property, but this proposition also overstates the ease with which real property can be sold, particularly in a tight market.[416] Leasing prohibitions also limit an owner's ability to obtain a stream of income from her home.[417]

In addition to imposing a financial hardship on an individual owner in a CIC, such restrictions can sometimes impose costs on the entire financially linked community.[418] If one owner is unable to contribute to community expenses, other owners end up making up the deficit.[419]

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[412] *See id.*; *see also, e.g.*, Lakeside Manor Condo. Ass'n v. Forehand, 513 So. 2d 1104, 1106 (Fla. Dist. Ct. App. 1987); Anderson v. 50 E. 72nd St. Condo., 505 N.Y.S.2d 101, 105 (N.Y. App. Div. 1986), *appeal dismissed*, 504 N.E.2d 700 (N.Y. 1987). Courts will invalidate rights of first refusal that fix the price for sale when the price is "greatly disproportionate to the market value of the property" and the restraint has a long duration. *See, e.g.*, Urquhart v. Teller, 958 P.2d 714, 718 (Mont. 1998) (quoting Edgar v. Hunt, 706 P.2d 120, 122 (Mont. 1985)).

[413] *Unbounded Servitudes*, *supra* note 28, at 479.

[414] *See* Gangemi v. Zoning Bd. of Appeals of Fairfield, 763 A.2d 1011, 1015–16 (Conn. 2001) (explaining that there are three productive ways to use residential property: live on it, rent it, or sell it, and holding that a zoning restriction that precluded rentals was too great an imposition on owners' property rights and economic freedoms).

[415] *See, e.g.*, Franklin v. Spadafora, 447 N.E.2d 1244, 1248 (Mass. 1983) (noting that while the no-lease covenant prohibited the owner from leasing his condo, he was still free to sell it).

[416] *See Unbounded Servitudes*, *supra* note 28, at 486–87.

[417] *See id.*

[418] *See id. See generally Community Collateral Damage*, *supra* note 99 (positing that the current system forces people lacking the ability to control their neighbors' defaults to bear increasing association expenditures).

[419] *See Community Collateral Damage*, *supra* note 99, at 56–57.

Furthermore, if an owner is financially unable to maintain a home, the lack of adequate upkeep will drive down neighborhood property values to a far greater extent than would mere rental occupancy.

Foreclosure and poorly maintained homes drive down property values and create health and safety concerns in any neighborhood.[420] In a CIC, financial hardship of one owner has even more pronounced spill-over effects.[421] Foreclosure sales result in a below-market price that can drive down comparable values for purposes of community appraisals.[422] A defaulting homeowner may abandon her home pending foreclosure, and prior to the post-foreclosure sale, the property will likely be held by the foreclosing lender who cannot reside in the home.[423] If the community prohibits rentals, then REO property (property titled in a foreclosing lender) will remain vacant.[424] Vacant homes create a plethora of problems for nearby properties.[425] They are poorly maintained, can

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[420] *See id.* at 64–69; *see also* John Cutts, *Neighborhood Cleanup Might Improve Cheap Houses for Sale Numbers*, REAL ESTATE PRO ARTICLES (July 7, 2010), http://www.realestateproarticles.com/Art/19024/278/Neighborhood-Cleanup-Might-Improve-Cheap-Houses-for-Sale-Numbers.html (discussing foreclosures in San Antonio); Ivana Kottasova, *A House Dies and a Block Sinks*, BROOKLYN INK (Mar. 9, 2011), http://thebrooklynink.com/2011/03/09/23899-a-house-dies-and-a-block-sinks/ (quoting Josiah Madar) ("Vacant properties are often not maintained properly and show signs of physical distress. . . . That itself causes property values to go down—and then the area becomes less attractive for residents."); Seth Slabaugh, *High Vacancy Rates in Inner-City Muncie*, THE STAR PRESS 1A (Feb. 26, 2011), *available at* http://pqasb.pqarchiver.com/thestarpress/access/2276988201.html?FMT=ABS&FMTS=ABS:FT&date=Feb+26%2C+2011 (reporting on the numerous vacancies in Muncie, Indiana); Yepoka Yeebo, *Coping With Chicago's Foreclosure 'War Zone's*, HUFFINGTONPOST.COM (Mar. 2, 2011), http://www.huffingtonpost.com/2011/03/02/chicago-vacant-reo-property_n_829343.html (lamenting vacancies in Chicago).

[421] *See generally Community Collateral Damage*, *supra* note 99 (referencing the problem of contagious declines in property values preceded by defaults in homeowner repayment obligations).

[422] *See* John Y. Campbell et al., *Forced Sales and House Prices* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14866, 2009), *available at* http://www.nber.org/papers/w14866.pdf (showing that foreclosure sale prices averaged 28% lower than the appraised value for the home). Traditionally, home values are based on comparable sales, meaning that "any below-market sale creates a drag on neighboring values and sale prices." *Community Collateral Damage*, *supra* note 99, at 65; *see also* John Harding, Eric Rosenblatt & Vincent Yao, *The Contagion Effect of Foreclosed Properties*, 66 J. URB. ECON. 164, 172 (2009).

[423] *See Unbounded Servitudes*, *supra* note 28, at 484.

[424] *See id.*

[425] "[N]egative externalities caused by failure of an owner to exercise adequate property oversight are among the many justifications for the doctrine of adverse

become magnets for vagrant and criminal use, and can create health hazards due to pest infiltration and unsafe physical conditions.[426] In CICs, the presence of pre-foreclosure "abandoned properties often means unpaid assessments as well,"[427] which creates community budget deficits that must be filled through special assessments of those neighbors who can and do pay.[428] CIC Associations may never recover these unpaid assessments, even when the home eventually is transferred to a financially solvent owner, because recovery of pre-foreclosure unpaid dues is either statutorily capped or is precluded by first lien foreclosure.[429] In addition, if more than 15% of a community's members are sixty days or more in arrears on their assessment obligation, GSE and FHA mortgage funds are unavailable with respect to every property in the CIC.[430]

Leasing prohibitions in CICs discourage lenders from foreclosing on defaulted mortgage loans secured by property in the community until a third party buyer can be found.[431] Lenders know that upon taking title at foreclosure, they will be obligated to pay costs associated with the property, including assessments.[432] Thus, if lenders are unable to rent CIC properties, foreclosure imposes an assessment obligation on the lender without providing any corresponding ability to generate

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possession." *Community Collateral Damage*, *supra* note 99, at 67 n.44 (citing John G. Sprankling, *An Environmental Critique of Adverse Possession*, 70 CORNELL L. REV. 816, 816 (1994)).

[426] *See id.* at 66–67; Yeebo, *supra* note 420.

[427] *Unbounded Servitudes*, *supra* note 28, at 485. "Owners in a CIC must pay for community assessments in addition to property taxes, homeowner insurance, and the various financing and upkeep costs associated with their particular property." *Id.* at 487 n.141.

[428] *See Community Collateral Damage*, *supra* note 99, at 56–57 (discussing the "tangible and permanent losses in value" in communities with unoccupied properties).

[429] *See id.* at 57, 76–80, 112–15; *see also* Boyack & Foster, *supra* note 145, at 246–59 (discussing different state approaches to bolster an association's ability to collect assessment arrearages).

[430] *See* 2012 Mortgagee Letter, *supra* note 294, at 7; *Community Collateral Damage*, *supra* note 99, at 84. "The underwriting guidelines recently changed from calculating delinquency based on thirty-day delinquency to a sixty-day delinquency, based on the current widespread problem of CIC assessment default." *Unbounded Servitudes*, *supra* note 28, at 490 n.163; *see also* FANNIE MAE, SELLING GUIDE: FANNIE MAE SINGLE FAMILY § B2-1.2-02 (2014), *available at* http://www.fanniemae.com/content/guide/sel041514.pdf.

[431] *See Community Collateral Damage*, *supra* note 99, at 113.

[432] *See id.*

revenue.[433] A few CICs attempted to alleviate this problem by specifically providing that REO properties could be rented short-term after foreclosure. The FHA, however, has reiterated that any such rentals will run afoul of its prohibition of short-term rentals in qualifying communities.[434] Thus, barriers to occupancy of vacant homes have the potential to impose economic costs on the entire community.[435]

No-lease covenants do not just limit owner financial options with respect to obtaining a stream of income from their property. In a more subtle way, they also reduce the sale price for the home. By precluding sales to investors, leasing restrictions operate to reduce the number of potential property purchasers.[436] Because real estate prices are particularly vulnerable to demand, cutting a segment of possible buyers out of the market will drive down the price for a home.[437] The effect may be minimal in a robust seller's market, but in a distressed housing market where buyers are scarce—say the 2009 condominium market in South Florida, or the 2010 luxury home market in California's "inland empire"—the effect is more pronounced.[438] Therefore, for multiple reasons, leasing restrictions can create an unjustifiable barrier to an owner's ability to access the trapped value of a CIC owner's real estate asset.

Leasing restrictions create an intangible cost for homeowners as well. These restrictions inhibit mobility and increase barriers to community exit for disgruntled members of a CIC. Transfer restrictions, including leasing limits, act as speed bumps on the property disposition off-ramp. This further impacts exit as a factor for legitimizing CIC governance.[439] The inability to lease may result in financial difficulty for an owner whose personal circumstances and work requirements mandate absence from her home for some period of time. For example, if a homeowner must relocate for a year for work, no-lease covenants in her

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[433] *See id.* at 113–14.

[434] *See* National Housing Act of 1934, 12 U.S.C. § 1731b (2012).

[435] *See Dean v. City of Winona* Amici Brief, *supra* note 38 at 13; *Unbounded Servitudes*, *supra* note 28, at 490.

[436] *See Unbounded Servitudes*, *supra* note 28, at 486–87.

[437] *See id.*

[438] *Id.*; *see also* Andrea J. Boyack, *Lessons in Price Stability from the U.S. Real Estate Market Collapse*, 2010 MICH. ST. L. REV. 925, 935–36 (2010) [hereinafter *Lessons in Price Stability*] (explaining the localized impact of the housing crisis).

[439] *See supra* notes 359–64 and accompanying text; *see also Unbounded Servitudes*, *supra* note 28, at 489–90.

community will force her to either maintain an empty home or sell a home she may wish to retain.

IV. THE INCONVENIENT TRUTH OF CIC NONOWNER EFFECTS

When courts speak of balancing costs and benefits of CIC covenant restrictions, they focus exclusively on costs and benefits to the community and its members. But CIC covenants impose costs on nonmembers and on the general public as well.[440] Covenants in communities may create costs and benefits for would-be residents of the community who may be excluded from the neighborhood because of covenant provisions. In addition, the broader effects of CIC covenants can affect local housing markets and society as a whole. Therefore, a full appreciation of costs of covenants must account for nonmember impacts as well as costs and benefits to the private community.[441]

A. The Would-Be Tenant

Even if the benefits of no-lease covenants to members of a private community outweigh the adverse impacts on the community and its members, this calculus fails to consider the costs that CIC covenant provisions may impose on nonmembers. When racial covenants were enforceable, courts balanced the cost and benefit of occupancy restrictions by looking exclusively at the effect within the community, asserting that because there were plenty of potential white buyers, prohibitions on minority race occupancy were not unduly costly to owners in the community.[442] From the perspective of community members, such restrictions were not considered unreasonably burdensome because there existed a sufficient market for the property outside of minority races. Their harm—a more limited market of potential transferees—was small.

From the perspective of a would-be resident, however, the impact of race-based occupancy restrictions was large and clearly unjustifiable.

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[440] *See* David J. Kennedy, *Residential Associations as State Actors: Regulating the Impact of Gated Communities on Nonmembers*, 105 YALE L.J. 761 (1995) (discussing the extent to which CICs can impose costs on nonmembers).

[441] *See id.* at 763 ("[c]ourts must move from the domain of the law of contracts and servitudes to grapple with the impact of residential communities on outsiders").

[442] *See* HARRY GRANT ATKINSON & L.E. FRAILEY, FUNDAMENTALS OF REAL ESTATE PRACTICES 428–29 (1946); ROBERT C. WEAVER, THE NEGRO GHETTO 231 (1948); MCKENZIE, *supra* note 107, at 60–68. This approach is identical to the approach many courts take in analyzing CIC leasing limits today.

African-Americans who wished to reside in a community burdened by a race-based occupancy restriction were completely barred from residing within that community. The impact could not be larger. The difference of perspective is key. Viewing racial occupancy restrictions from the perspective of the would-be transferor merely asks how the potential transferor is harmed by not being able to transfer possession to an African-American buyer. In contrast, viewing the covenants from the perspective of the would-be transferee asks how being excluded from the property harms the would-be resident. From the would-be transferee's perspective, the true harms of such covenants are apparent.

In *Shelley v. Kraemer*,[443] the Supreme Court found occupancy restrictions troubling because of their nonmember effect—both on would-be residents and on society as a whole.[444] Post-*Shelley* cases do not echo this concern and focus exclusively on covenants' effects on the parties who are bound by covenants rather than the effects on nonowners or on society at large.[445] This limited cost-benefit analysis fails to account for the very real cost externalities that CIC covenants impose.[446]

A complete analysis of costs of a no-lease provisions must recognize the dual effects of such restrictions: (1) an owner cannot rent out his home and (2) a would-be tenant cannot reside in the community. The plummeting homeownership rate in the U.S. translates into millions of former homeowners who are now renters—and these people need places to live.[447] The increase in renters and rising rental rates predict a possible rental housing crisis.[448] According to a study by the Joint Center for Housing Studies at Harvard University the number of "renter

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[443] 234 U.S. 1 (1948).

[444] *See id.* at 11–12.

[445] *See, e.g.*, Correll v. Early, 237 P.2d 1017 (Okla. 1951) (refusing to grant relief on the grounds that the restrictions represented a conspiracy to prevent minority buyers from residing in a neighborhood).

[446] *See* Kennedy, *supra* note 440, at 764 (explaining that community covenants have historically had an adverse effect on non-owners through "discrimination and exclusion of undesirables").

[447] *See* 2013 CENSUS BUREAU NEWS RELEASE, *supra* note 3; Gopal & Gittelsohn, *supra* note 3.

[448] *See* Richard Florida, *America's Looming Rental Crisis*, THE ATLANTIC CITY LAB, June 30, 2014, http://www.citylab.com/housing/2014/06/americas-looming-rental-crisis/373527/ (opining that "America is quickly heading toward a rental housing crisis" based on an analysis of Federal Reserve Economic Data (FRED) that shows steady increase of renters and rents).

households" increased by more than half a million in 2013.[449] The residential demand of former homeowners puts pressure on rental payment rates and drives down the vacancy rate for rental residences as well—rental vacancy has fallen from 10% to 7.5% in just four years.[450] With the post-housing crisis' tight credit standards, buying a home is less attainable today, also contributing to the increased demand for rental properties.[451] Due to the increasing number of renters, it is time to rethink the adverse effects that the widespread homeownership subsidies and owner occupancy promoting policies may have on people who do not own their homes.

CIC limitations on renting have two adverse impacts on nonmember renters. First, the inability to rent in certain CICs restricts the supply of rental housing in a community, which leads to increasing rental payment rates.[452] Renters are more "cost-burdened" than homeowners—spending a higher percentage of their income on housing.[453] Rental housing supply and costs are affected both in suburban areas, where homeowner association communities may mandate owner occupancy, and urban areas where housing costs are already relatively high.[454] Housing costs in revitalized urban areas are inflated further by the condominium conversion trend

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[449] *See* JOINT CTR. FOR HOUSING STUDIES AT HARVARD UNIV., THE STATE OF THE NATION'S HOUSING 2014, at 22 (2014), *available at* http://www.jchs.harvard.edu/research/state_nations_housing.

[450] *See* 2014 CENSUS BUREAU NEWS RELEASE, *supra* note 4, at 1. Reis.com, a real estate analytics firm, shows that apartment rental vacancy rates have dropped from 8% in 2009 to 4% in 2013. *See National Market Data*, REIS, https://www.reis.com/ (last visited Oct. 11, 2014). In 2011, Urban Land Institute predicted that "six million new renter households may be formed between 2008 and 2015, and supply has lagged demand in recent years." Strozier, *supra* note 16.

[451] *See* Valenza, *supra* note 8, at 247.

[452] *See* 2014 CENSUS BUREAU NEWS RELEASE, *supra* note 4, at 2 (showing that average rental payment rates have increased dramatically, from under $500 in 2001 to over $750 today); *Dean v. City of Winona* Amici Brief, *supra* note 38, at 12–15 (discussing how zoning restrictions on neighborhood rentals lead to higher rental prices and fewer rental choices). There is a single issue political party dedicated to reducing rental rates. *See* RENT IS TOO DAMN HIGH, http://www.rentistoodamnhigh.org (last visited Oct. 11, 2014). The party is called the Rent is Too Damn High Party and has put forth candidates for governor of New York in 2005, 2009, and 2010, as well as a candidate for the New York senate in 2010. *See id.* The party is also anticipating running a candidate in Washington, D.C. in 2014. *See id.*

[453] A majority of renters today pay more than 30% of their income on rent, and 28% of renters pay more than half of their income on rent. *See* JOINT CTR. FOR HOUSING STUDIES AT HARVARD UNIV., *supra* note 449, at 25; *see also* Florida, *supra* note 448.

[454] *See* 2014 CENSUS BUREAU NEWS RELEASE, *supra* note 4, at 3.

coupled with the practice of limiting the right to lease in condominiums.[455] Requiring nonmembers to pay more to rent a home is a clear and quantifiable cost externality that CIC no-lease covenants impose on nonmembers.

In addition, the inability to rent in certain CICs means that renters are barred from living in these neighborhoods. Many private communities are desirable places to live because there are good schools, enjoyable amenities, and safe common open space areas.[456] The majority of people who would prefer to rent single-family homes likely desire to live in CICs for the same reasons that buyers choose to reside in these communities. In some markets, single-family housing choices outside of CICs are quite limited and possibly in less preferable neighborhoods.[457] Condominiums may be better-situated and appointed than multi-family rental buildings. In terms of age and family size, single-family occupants are quite similar whether they rent or own their residence.[458] However, the people who are not owner occupants are forbidden to live in certain communities. The inability to live in a preferred neighborhood is a cost imposed upon people who finance their housing through rent paid to a landlord rather than mortgage loan payments made to a bank.[459]

B. Financial Recovery

Upholding CIC covenant restrictions on alienation supposedly fosters freedom of contract and, in the case of leasing restrictions, owner occupancy. But such alienation restraints also promote less defensible outcomes: (1) community homogeneity, (2) population immobility, and (3) economic stagnation. These wider societal and economic costs should

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[455] *See Condominium Conversion and its Impact on the Rental Market*, DUPRE & SCOTT, (July 21, 2007), http://www.duprescott.com/productsservices/articleinfo.cfm?ArticleId=311.

[456] *See* Edward J. Blakely & Mary Gail Snyder, *Divided We Fall: Gated and Wall Communities in the United States*, *in* ARCHITECTURE OF FEAR 85, 95 (Clare Jacobson, ed., 1997).

[457] *See* Sheryll Cashin, *Privatized Communities and the "Secession of the Successful": Democracy and Fairness Beyond the Gate*, 28 FORDHAM URB. L.J. 1675, 1678–79 (2001) (explaining how CICs contribute to income segregation by zip code and exacerbate income inequality in the United States). *See generally* EDWARD J. BLAKELY & MARY GAIL SNYDER, FORTRESS AMERICA: GATED COMMUNITIES IN THE UNITED STATES (1997) (indicating that homes outside of CIC may be of lesser quality).

[458] *See supra* notes 22–27 and accompanying text.

[459] *See Unbounded Servitudes*, *supra* note 28, at 477–78. For an explanation of the economic interest and investment of an owner based on down payment, see *Lessons in Price Stability*, *supra* note 438, at 948–49.

be weighed in the balance against the benefits that transfer restrictions provide.

"Limits on alienation by definition decrease the general economic gains of a free market."[460] Property kept out of commerce does not naturally become allocated to its highest valued use.[461] Disallowing leasing in certain communities skews the local market for rental housing by limiting and geographically concentrating rental options. Decreasing the supply of rental housing in a given local housing market will also drive up rental rates. Limits on rental use also lead to pricing difficulties with respect to real estate sale values.[462]

Although no-lease covenants promote owner occupancy in theory, if an owner cannot occupy her home, leasing restrictions may also lead to home vacancy.[463] Unoccupied homes are demonstrably costly to neighborhoods—decreasing property values, increasing crime, and making community upkeep difficult.[464] Leasing restrictions can disincentivize mortgage foreclosure, leading to foreclosure delay that not only can cause fiscal distress in CICs but, more broadly, retards the pace of economic recovery.[465] Housing market stability relies on free transfer to correctly price real estate and allocate real property to higher valuing, solvent, and attentive owners.[466]

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[460] *Unbounded Servitudes*, *supra* note 28, at 488.

[461] *See* Schnebly, *supra* note 404, at 64.

[462] Accurate pricing of real estate requires considering the rental stream. *See Lessons in Price Stability*, *supra* note 438, at 933–36.

[463] *See Unbounded Servitudes*, *supra* note 28, at 486.

[464] *See supra* notes 425–28 and accompanying text.

[465] *See supra* notes 431–32 and accompanying text.

[466] "Barriers to real estate transfer stymie market solutions to the wreckage of the housing crisis because they inhibit transfer of home possession to a resident party who can and will pay for home and community upkeep." *Unbounded Servitudes*, *supra* note 28, at 486. Barriers to leasing exacerbate the so-called "zombie mortgage" phenomenon—vacant houses and un-foreclosed defaulted mortgages—imposing documented community costs. *See* Michael S. Waldron, *CFPB Considering Action on Zombie Foreclosures*, 68 CONSUMER FIN. L.Q. REP. 49 (2014); Colin Robins, *Zombie Properties Continue to Linger Nationwide*, DS NEWS (June 26, 2014), http://dsnews.com/news/06-26-2014/zombie-properties-continue-linger-nationwide?utm_source=DSNews.com&utm_campaign=e3b76ebf1d-Your_Daily&utm_medium=email&utm_term=0_1924082bfe-e3b76ebf1d-175136497.

In addition, leasing limits can decrease workforce mobility, making it harder for laid-off workers to relocate for new jobs.[467] Increasing relocation flexibility can help solve job loss in depressed communities.[468] Promoting employment is a critical component of economic recovery.[469]

Homeownership and owner occupancy are important policies. Using rental prohibitions to achieve these goals may adversely impact other important public policies that are perhaps even more compelling. Many housing experts claim that rental housing affordability and availability is currently a more pressing public need.[470] At the very least, the importance of all policy goals, and the unintended consequences of promoting homeownership and owner occupancy at all costs should be re-assessed.

C. De Facto Housing Segregation

It may be that "[t]he very establishment of a residential association is fraught with potential for discrimination on the basis of race and class."[471] Historically, this theory was certainly true—and was specifically intended to be the case.[472] The 1938 FHA manual expressly promoted occupancy restrictions in community covenants, asserting that

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[467] *See* Martin Ricketts, *Mobility Barriers and Public Policy*, 10 CATO J. 211, 216–17 (1990); Plamen Nenov, *Regional Mismatch and Labor Reallocation in an Equilibrium Model of Migration* (2012), *available at* https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=SED2013&paper_id=565.

[468] *See* WORLDWIDE ERC, *Moving Expense Deduction: Promoting Worker Mobility, Enhancing our Nation's Global Competitiveness, Creating and Preserving Jobs*, http://www.worldwideerc.org/gov-relations/us-tax-legal-resources/Pages/Moving-Expense-Deduction.aspx (last visited Oct. 11, 2014); Nenov, *supra* note 467, at 41; Ricketts, *supra* note 467, at 216.

[469] The U.S. unemployment rate in 2013 was still depressed—7.6%, up more than 2% from before the financial crisis. *See Databases, Tables & Calculators*, BUREAU OF LABOR STATISTICS, http://data.bls.gov/timeseries/LNS14000000. A key policy goal of the government during the past five years has been job creation. *See* Christina Romer & Jared Bernstein, *The Job Impact of the American Recovery and Reinvestment Plan* (Jan. 9, 2009), *available at* http://www.illinoisworknet.com/NR/rdonlyres/6A8FF039-BEA1-47DC-A509-A781D1215B65/0/2BidenReportARRAJobImpact.pdf.

[470] *See, e.g.*, Nicholas J. Brunick & Patrick O'B. Maier, *Renewing the Land of Opportunity*, 19 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 161, 189 (2010).

[471] Kennedy, *supra* note 440, at 768. Kennedy points to several subtle ways that CICs encourage segregated housing, starting with the choice of community names—consider the many "Plantation" themed associations in Hilton Head, South Carolina. *Id.*

[472] *See id.*

"[i]f a neighborhood is to retain stability it is necessary that properties shall continue to be occupied by the same social and racial classes."[473]

When zoning could no longer achieve housing segregation by race,[474] community covenants proliferated to achieve these same purposes "privately" through servitude law.[475] A 1928 study of restrictive covenants in eighty-four "better class subdivisions" in various regions of the country found that thirty-nine of these covenant regimes specifically prohibited the sale or rental of homes to racial or ethnic minorities.[476] Many other developments provided that the developer must approve all buyers and renters in the community, a clause that implied de facto racial restriction.[477] Such restrictions proliferated for decades and remain on the record today.[478] This concerted practice of housing segregation persists on paper, even though such covenants were declared ineffective and, later, illegal.

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[473] 1938 FHA Manual, *supra* note 130; *see also* BROOKS & ROSE, *supra* note 114, at 91; WEAVER, *supra* note 442, at 211 (claiming that the FHA and financial institutions deliberately assisted property owners and developers in crafting racial housing covenants as a way to preserve property and social values).

[474] Zoning can still segregate housing by class in most states. *See* Kennedy, *supra* note 440, at 767; *see also supra* notes 30–35 and accompanying text. In New Jersey, three cases limit any municipality's ability to prohibit poorer residents from residing therein. *See* Hills Dev. Co. v. Twp. of Bernards, 510 A.2d 621, 655 (N.J. 1986) (pronouncing New Jersey Fair Housing Act constitutional and announcing court's withdrawal from issue); S. Burlington Cnty. NAACP v. Twp. of Mount Laurel, 456 A.2d 390, 450 (N.J. 1983) (striking down ordinance on ground that it did not provide for needs of low-income individuals); S. Burlington Cnty. NAACP v. Twp. of Mount Laurel, 336 A.2d 713, 725 (N.J. 1975) (requiring that municipality's land-use regulation take account of needs of low and moderate income individuals), *cert. denied*, 423 U.S. 808 (1975). These cases do not, however, prohibit a municipality from segregating by class within the jurisdiction.

[475] *See* BROOKS & ROSE, *supra* note 114, at 143–44.

[476] The covenant restrictions included: "Africans, Mongolians prohibited," "Caucasians only," "Negroes barred," "White race only," "Asiatics and Negroes barred," and "Mongolians and Africans barred." HELEN MONCHOW, THE USE OF DEED RESTRICTIONS IN SUBDIVISION DEVELOPMENT 46–50 (Richard T. Ely ed., 1928) (*quoted in* MCKENZIE, *supra* note 107, at 43).

[477] The Supreme Court struck down a zoning ordinance based on the conclusion that the ordinance was a fairly transparent proxy for outright racial exclusion. See Harmon v. Tyler, 273 U.S. 668, 668 (1927) (per curiam) (relying on the authority of Buchanan v. Warley, 245 U.S. 60, 82 (1917)). The zoning ordinance in question required "written consent for a majority of the persons of the opposite race inhabiting the 'community.'" Tyler v. Harmon, 104 So. 200, 200 (La. 1925)).

[478] *See* BROOKS & ROSE, *supra* note 114, at 98–105; WEAVER, *supra* note 442, at 231.

Whether by historical accident or deliberate design,[479] CIC occupancy today is predominantly white.[480] CICs that prohibit rental occupancy certainly, and even more obviously, perpetuate economic and racial housing segregation. The socio economic groups who tend to rent (young adults, middle-income individuals, single mothers, racial minorities, etc.) are effectively excluded from an increasing number of communities.[481] Housing segregation based on class, while not unconstitutional,[482] causes great harm to society.[483] Social separation of wealthier and more skilled residents from the less affluent and educated population creates a host of detrimental societal effects, from diminishing people's sense of civic responsibility to exacerbating income disparity and America's growing class divide.[484]

Housing segregation based on income, age, marital status, and gender is unfortunate, but housing segregation in its debilitating traditional sense—based on race—results from rental restrictions as well. CIC housing is already largely segregated by race,[485] and this segregation is exacerbated by limitations on leasing because the majority of minority races rent rather than own their home.[486] Therefore, keeping tenants out of neighborhoods often equates to keeping out racial minorities.[487]

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[479] Kennedy alleges that "local governments will collude with developers to create attractive residential associations even at the price of encouraging racial discrimination." Kennedy, *supra* note 440, at 769.

[480] *See id.*; *see also* Fennell, *supra* note 140, at 626.

[481] *See* Grassmick, *supra* note 112, at 211.

[482] *See* San Antonio Indep. Sch. Dist. v. Rodriguez, 411 U.S. 1, 16 (1973) (holding that Texas school financing scheme resulting in educational disparities between poor and wealthy districts did not violate Fourteenth Amendment).

[483] *See* Kennedy, *supra* note 440, at 777 ("The most harmful effect of the growth of residential associations may be the widening of the American class divide.").

[484] *See id.*; *see also* U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, RESIDENTIAL COMMUNITY ASSOCIATIONS: PRIVATE GOVERNMENTS IN THE INTERGOVERNMENTAL SYSTEM? 13–14 (1989); MCKENZIE, *supra* note 107, at 196; Robert B. Reich, *Secession of the Successful*, N.Y. Times, (Jan. 20, 1991), *available at* www.nytimes.com/1991/01/20/magazine/secession-of-the-successful.html.

[485] *See generally* BROOKS & ROSE, *supra* note 114 (discussing the history of racial segregation in CICs).

[486] *See supra* note 15 and accompanying text.

[487] *See* Villas West II of Willowridge Homeowners Ass'n v. McGlothin, 885 N.E.2d 1274, 1279 (Ind. 2008). *See also generally* BROOKS & ROSE, *supra* note 114 (discussing the history of racial segregation in CICs).

Even outside CICs, housing in the United States is still largely segregated, even though the Fair Housing Act[488] made overt acts of housing discrimination illegal in 1968.[489] Housing segregation was identified as one of the greatest threats facing American Society when the Fair Housing Act was passed.[490] During the 1960s, "the degree of segregation in residential housing was extraordinarily high, and discrimination in access to housing was rampant."[491] Furthermore, despite laws barring discriminatory lending, leasing, and realtor steering, the degree of segregation of housing has not significantly decreased since that time.[492] Housing segregation creates and perpetuates multiple social harms. For example, housing segregation leads to de facto school segregation because school districts are typically geographically defined.[493] When minority populations are barred from residing in better school districts, children of different races are afforded disparate educational opportunities.[494] Racial segregation in housing is a significant contributor to the income gap between minorities and whites and the

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[488] *See* Fair Housing Act of 1968, 42 U.S.C. §§ 3601-3619 (2006).

[489] *See id.*

[490] *See* REPORT OF THE NATIONAL ADVISORY COMMITTEE ON CIVIL DISORDERS 263 (1968) [hereinafter the KERNER COMMISSION REPORT]. The Fair Housing Act was passed in the wake of violent urban riots and the assassination of Dr. Martin Luther King Jr. *See* Oliveri, *supra* note 128, at 25–28 (discussing the social context in which the Act was drafted, debated, and passed).

[491] Oliveri, *supra* note 128, at 28; *see also* DOUGLAS S. MASSEY & NANCY H. DENTON, AMERICAN APARTHEID SEGREGATION AND THE MAKING OF THE UNDERCLASS 26–50 (1993); KERNER COMMISSION REPORT, *supra* note 490, at 259.

[492] *See* ARTHUR C. NELSON ET AL., THE LINK BETWEEN GROWTH MANAGEMENT AND HOUSING AFFORDABILITY: THE ACADEMIC EVIDENCE 34 (2002), *available at* http://www.brookings.edu/es/urban/publications/growthmang.pdf; Jonathan T. Rothwell, *Racial Enclaves and Density Zoning: The Institutionalized Segregation of Racial Minorities in the United States*, 13 AM. L. & ECON. REV. 290, 347–48 (2011); Kelly DeRango, *Discrimination and Segregation in Housing*, EMP'T RES. NEWSL., July 2001, *available at* http://research.upjohn.org/empl_research/vol8/iss3/1 (citing to and explaining the dissimilarity index, the standard measure of segregation in housing).

[493] *See* Brown v. Bd. of Educ. of Topeka, Kan., 98 F. Supp. 797, 798, *judgment reversed by* Brown v. Bd. of Educ. of Topeka, Kan., 349 U.S. 294, 301 (1955); Patrick Bayer, Fernando Ferreira, & Robert McMillan, *A Unified Framework for Measuring Preferences for Schools and Neighborhoods*, 115 J. OF ECON. POL. 588, 627–28 (2007).

[494] *See Brown*, 98 F. Supp. at 798; Bayer, Ferreira, & McMillan, *supra* note 493, at 627–28; Pat Rubio Goldsmith, *Learning Apart, Living Apart: How the Racial and Ethnic Segregation of 8 Schools and Colleges Perpetuates Residential Segregation*, 111 TCHRS. C. REC. 1605, 1606 (2010); Thomas J. Nechyba & Randall P. Walsh, *Urban Sprawl*, 18 J. OF ECON. PERSP. 193, 193 (2004).

relatively poor social outcomes of minorities.[495] One study "estimate[d] that a [single] standard deviation decline [in] black-white segregation would narrow the black-white gap in schooling (high school and college graduation rates), employment (labor force participation rates and earnings) and single parenthood by about one-third."[496] Other studies showed that racial segregation leads to increased infant and adult mortality rates and increased homicide.[497] Recently, the deadly and divisive effects of continuing racial segregation in communities was highlighted in the events surrounding the police killing of a black youth, Michael Brown in Ferguson, Missouri—a highly racially segregated community.[498] Civic participation and voter turnout is also diminished in segregated communities.[499] Housing segregation also inspires predatory lending and higher financial barriers to homeownership and wealth building.[500] Ultimately, housing segregation "perpetuat[es] a culture of division and domination."[501] Therefore, leasing restraints inhibit community diversity in a way that is harmful to society as a whole.[502]

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[495] *See* Kelly DeRango, *Black-White Segregation, Discrimination, and Home Ownership* (Upjohn Inst. for Emp't Research, Working Paper No. 01-71, 2001), *available at* http://research.upjohn.org/up_workingpapers/71.

[496] *Id.* at 3 (citing David M. Cutler & Edward L. Glaeser, *Are Ghettos Good or Bad?* 112 Q. J. OF ECON. 827, 846–47 (1997)).

[497] *See id.* at 3–4 (citing Chiquita A. Collins & David R. Williams, *Segregation and Mortality: The Deadly Effects of Racism?*, 14 SOC. F. 495 (1999); Thomas LaViest, *Segregation, Poverty, and Empowerment: Health Consequences for African-Americans*, 71 MILLBANK Q. 41 (1993)).

[498] For discussions of the role that racial segregation of housing played in the Ferguson tensions and conflicts, see RICHARD ROTHSTEIN, ECONOMIC POLICY INSTITUTE, THE MAKING OF FERGUSON: PUBLIC POLICIES AT THE ROOT OF ITS TROUBLES (2014), *available at* http://www.epi.org/publication/making-ferguson/.

[499] *See id.* at 4.

[500] *See Paying More for the American Dream*, *supra* note 19.

[501] Kennedy, *supra* note 440, at 768; *see also* MASSEY & DENTON, *supra* note 491, at 221–23 (1993) (calling continued de facto housing segregation by race "a fundamental cleavage in American society"); Richard Thompson Ford, *The Boundaries of Race: Political Geography in Legal Analysis*, 107 HARV. L. REV. 1843, 1847 (1994) (citing MASSEY & DENTON, *supra* note 491); *Government by the Nice, for the Nice*, ECONOMIST (London), July 25, 1992, at 26.

[502] *See* Michael C. Kim, *Involuntary Sale: Banishing an Owner from the Condominium Community*, 31 J. MARSHALL L. REV. 429, 430 (1998) (questioning whether such "insular and homogeneous communities [are] even possible in a multi-racial, multi-cultural society").

Engineered and persistent community homogeneity is socially unhealthy, creates a disparate impact in terms of housing availability and costs, leads to continuing racial stereotypes and tensions, and perpetuates housing patterns established during the heyday of race-based occupancy limits. Limiting and increasing the cost of housing options, particularly for vulnerable and protected segments of the population, and perpetuating de facto housing segregation, is too high of a price to pay for the amorphous gains of property values and neighborhood harmony that CIC leasing prohibitions purportedly create.

V. A BETTER APPROACH TO LEASING LIMIT LEGITIMACY

Covenant-based prohibitions on leasing for fee simple owners in a CIC create numerous costs: (1) to the property owner who cannot rent out the home, (2) to the community who is adversely impacted by unoccupied and financially distressed properties, (3) to the would-be tenant who cannot reside in the community, and (4) to the public in general that suffers decreased rental housing affordability and persistent, insidious housing segregation. On the other hand, asserted community benefits from leasing restrictions include better-maintained housing, community harmony, and financeability due to compliance with FHA and GSE underwriting mandates. Balancing these costs and benefits is difficult and typically, courts avoid undertaking a true reasonableness analysis.[503] But many of the asserted benefits arising from owner occupancy can be obtained through more defensible and more targeted community restrictions and requirements. Similarly, lender concerns, reflected in the FHA and GSE requirements, can also be addressed directly through community maintenance rules that focus on property use rather than property users.

A. Prohibiting Uses, Not Users

Courts agree that CIC covenants restricting leasing—particularly if created through amendment—should only be enforceable if they are reasonable.[504] The problem with merely asserting this standard of review

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[503] *See, e.g.*, Worthinglen Condo. v. Brown Unit Owners' Ass'n, 566 N.E.2d 1275, 1277–79 (Ohio Ct. App. 1989).

[504] The Restatement advocates for judicial invalidation of "unreasonable" restraints on alienation. RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 3.4 (2000). "A servitude that imposes a direct restraint on alienation of the burdened estate is invalid if the restraint is unreasonable." *Id.* "Reasonableness is determined by weighing the utility of the restraint against the injurious consequences of enforcing the restraint." *Id.*; *see also*

is that it is not really applied. Most courts seem unable to make an accurate cost-benefit analysis when it comes to leasing restrictive covenants. Values supported and costs imposed by restrictions on transfer are inherently difficult to quantify, and courts are ill equipped to factor in all the effects covenants will have on nonmembers and society as a whole. In lieu of balancing costs and benefits, most courts merely apply a good faith or rational basis type of review, upholding the restriction if a legitimate community goal can be identified.[505] But the mere existence of a community purpose for the restriction should not be enough to justify the restriction. Legitimate ends do not justify all means, particularly if less costly means exist to achieve the same result. Instead of attempting to undertake an elusive balancing test, courts—and communities—should consider whether the underlying goals that a no-lease covenant seeks to achieve can be obtained through less intrusive and less costly rules and covenants.[506] Under such an approach, no-lease covenants would be enforceable only if they indeed create community benefits that cannot be obtained in a less costly manner through direct regulation.[507]

It is asserted that a community benefits from owner occupancy because all community residents (1) will have a long-term outlook on community value, (2) will reside in the community for a significant time, (3) make—and pay for—community governance, and (4) share many demographic traits.[508] No-lease covenants also prevent renters from living in the community, and renter occupants allegedly cause community harm and drive down property values.[509] First, renters are

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Laguna Royale Owners Ass'n v. Darger, 174 Cal. Rptr. 136, 144-45 (Cal. Ct. App. 1981) (using rational relation form of reasonableness test); Iglehart v. Phillips, 383 So. 2d 610, 614 (Fla. 1980) (using similar test); Gale v. York Ctr. Cmty. Coop., Inc., 171 N.E.2d 30, 33 (Ill. 1960) (adopting a balancing test for restraints on alienation, comparing the utility of the restraint with the injurious consequences that will flow from its enforcement).

[505] *See, e.g.*, Hidden Harbour Estates, Inc., v. Norman, 309 So. 2d 180, 181–82 (Fla. Dist. Ct. App. 1975).

[506] The "least restrictive means" and "least intrusive means" tests are familiar judicial concepts, often used to sort out when government limits on individual rights are permitted. See *Unbounded Servitudes*, *supra* note 28, at 490 for a discussion of this test and how it could apply in the CIC context.

[507] *See id.*

[508] *See supra* notes 386–94 and accompanying text.

[509] When leasing restrictions are upheld, courts usually cite association claims that owner occupancy is vital to preserving "health, happiness, and peace of mind," as well as the oft-repeated assertion that owner occupancy promotes neighborhood property values.

thought to be more likely to break association rules and fail to respect or maintain common areas or the rental property. Second, because renters are more transient, rental occupancy leads to disruption through move ins and move outs.[510] Renters' short duration of residence also inhibits community involvement, neighbor relations, and community safety deriving from knowing neighborhood residents.[511] Third, rental occupancy is apt to make a community more diverse. Having different sorts of people allegedly may inhibit neighborhood friendships and create feelings of discomfort or disharmony in the community. In addition, neighborhood diversity has empirically been shown to decrease property prices by up to ten percent.[512]

Some of these factors are illegitimate and should be discounted as against public policy or, at the very least, easily overcome by competing social values. For example, it is unjustifiable to use no-lease covenants in order to preserve neighborhood homogeneity, even if people do desire to live in homogeneous communities. Clearly, there are significant social and moral harms from enforcing covenants in order to perpetuate housing segregation. It has been illegal to use covenants to achieve these ends since 1948.[513] With no-lease covenants, it is very easy to allege other purposes for the covenants and achieve these same discriminatory goals with impunity.

Most of the asserted purposes for no-lease covenants appear to be legitimate. Mandated owner occupancy may be one way to achieve these legitimate neighborhood benefits, but that does not make owner occupancy valuable as an end in itself. Instead, owner occupancy appears merely to be a tool to achieve these goals—a proxy for obtaining desired neighborhood behaviors and attitudes. The proxy is imperfect, however, and can be both under and over inclusive. An owner may intend to reside

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Apple II Condo. Ass'n v. Worth Bank & Trust Co., 659 N.E.2d 93, 98 (Ill. App. Ct. 1995) (citing Hidden Harbour Estates, Inc. v. Basso, 393 So. 2d 637, 640 (Fla. Dist. Ct. App. 1981)); *see also* Rawling, *supra* note 45, at 226–27 (stating that lease restrictions "likely improve the quality of life for owner-occupants within developments and may translate into higher property values" and calling leasing restrictions "a prophylactic measure").

[510] *See* Villas West II of Willowridge Homeowners Ass'n v. McGlothin, 885 N.E.2d 1274, 1279 (Ind. 2008).

[511] *See* CRB REPORT, *supra* note 375; Rawling, *supra* note 45, at 226.

[512] *See supra* note 402 and accompanying text.

[513] *See generally* Shelley v. Kraemer, 334 U.S. 1 (1948) (declaring that a court could not constitutionally enforce race-based occupancy restrictions in community covenants).

only a short time in a community and may eschew long-term preservation of community values and the establishment of neighbor relationships. Although some renters and nonresident owners may poorly maintain property, this is not necessarily always the case. Renters may have lengthy tenures, be friendly, and become involved community members. Therefore, prohibiting renter occupants is an inexact method for obtaining the widely touted benefits of community stability, value, and harmony. Many of the asserted benefits from owner occupancy can be obtained more directly through covenant restrictions that govern property use.

Although communities can seek to achieve goals such as well-maintained neighborhood property and well-behaved neighbors,[514] they should do so in a way that imposes the least costs. For example, one primary alleged benefit of avoiding renter occupancy is that it will lead to better-maintained homes.[515] This goal could be accomplished without prohibiting leases, by mandating a particular level of property care by the resident, the owner, or both.[516] If a community seeks to avoid inconsiderate resident behaviors, covenants and rules could directly proscribe these behaviors rather than preclude renter occupancy.[517] Even though renter residents are not voting members of a community, increased

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[514] Behavioral constraints, of course, should be limited to behaviors that actually do impose cost externalities. Several commentators have opined that CICs should not be allowed to pass rules controlling behaviors that are completely contained within a home and not causing any neighborhood cost externalities—regulatory restraint of completely private behavior generates public outrage. *See* DILGER, *supra* note 274, at 135–41; MCKENZIE, *supra* note 107, at 15–19; Gregory S. Alexander, *Freedom, Coercion, and the Law of Servitudes*, 73 CORNELL L. REV. 883, 895 (1988); Paula A. Franzese, *Does It Take A Village? Privatization, Patterns of Restrictiveness and the Demise of Community*, 47 VILL. L. REV. 553, 562 (2002); Brian L. Weakland, *Condominium Associations: Living Under the Due Process Shadow*, 13 PEPP. L. REV. 297, 299 (1986); Tim Vanderpool, *But Isn't This My Yard? Revolt Against Neighborhood Rules*, CHRISTIAN SCI. MONITOR (Aug. 18, 1999), http://www.csmonitor.com/1999/0818/p2s2.html; Laura Castro Trognitz, *"Yes, It's My Castle,"* 30 A.B.A. J., June 2000, at 30; *see also* Brower, *supra* note 174, at 204 (discussing the broad scope of CIC governing provisions, including behavior inside homes). There are, however, in-home behaviors that may generate cost externalities. One example is smoking. *See, e.g.*, Ezra, *supra* note 143.

[515] *See supra* note 391 and accompanying text.

[516] *See supra* notes 68–85 and accompanying text.

[517] *See generally* Franzese, *supra* note 514.

association control over and privity with such residents can be mandated as a condition of leasing.[518]

CIC covenants perform important functions. Primarily, they solve two problems endemic in community property—use incompatibilities and freeriding. It is useful and efficient to permit servitudes to privately address negative external impacts that the use of one parcel can impose upon other proximate parcels.[519] Rental occupancy is not a particular type of use that can legitimately be constrained, but adequate maintenance of property can be required. Rather than preclude rentals, CICs can appropriately address the behavior of renters and the quality of property maintenance—all of which are economically justifiable as within the scope of a community's concern because of cost externalities. Attempts by members of a community to control who their neighbors are—rather than reasonably govern what they do—are unjustifiable.[520]

Neighborhood covenants also address the economic problem of freeriding by mandating contribution by all owners who benefit from a common amenity.[521] Contribution can be through payment of dues or

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[518] For example, covenants could mandate lease forms, control of keys by the association, joint owner and tenant liability for rules violations, and assignment to the association of the right to receive rental payments when assessments are overdue. *See Community Collateral Damage*, *supra* note 99, at 122. Several states now provide by statute that an association can collect rents directly from a tenant when the owner has defaulted on her assessment payment obligation. *See, e.g.*, FLA. STAT. § 718.116(11)(a) (2011) (proving that associations can collect rent directly from a tenant when owner is delinquent); N.Y. REAL PROP. LAW § 1325(2) (2006) (providing that an association may obtain a receiver to collect rents when an owner is delinquent).

[519] Although the tort of nuisance can, theoretically, protect against negative externalities from one owner's land use, relying on nuisance law to prevent external harms is both cumbersome and unpredictable. *See* Rose, *supra* note 109, at 5. Prosser famously called the law of nuisance an "impenetrable jungle." W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 86, at 616 (5th ed.1984).

[520] *See Freedom of Contract Myth*, *supra* note 106, at 834.

[521] Neighborhood affirmative covenants, especially covenant obligations overseen by a neighborhood association, address the collective action and freeriding problems endemic in public amenity situations. *See Community Collateral Damages*, *supra* note 99, at 72–74. Most associations' governing documents explicitly provide for assessment funding of association obligations. *See* CONDOMINIUMS AND HOME OWNER ASS'NS PRACTICE, *supra* note 100, at 105. Required contribution to community maintenance means that CICs can enjoy better amenities at lower prices. *See Community Collateral Damages*, *supra* note 99, at 74; *Unbounded Servitudes*, *supra* note 28, at 456; *see also* Ellickson, *supra* note 157, at 1524–26 (discussing the equitable methods of assessments and distribution of costs amongst property owners); Treese et al., *supra* note 151, at 3–5

assessments used to maintain common property as well as through participation in CIC governance.[522] CIC assessment power ensures funding of common amenity upkeep, making it possible to have a well-maintained community park or swimming pool.[523] Interestingly, there is no participation requirement in CICs, even though the efficacy of community governance depends upon adequate community involvement and service.[524] This is, perhaps, one unarticulated justification for requiring owner occupancy, namely that owner residents are more likely and more inclined to participate in community governance. CICs—even fully owner occupied ones—are plagued with low levels of participation of volunteer board members to voting owners.[525] Perhaps, a better-tailored solution to low participation can be found. For example, along with a financial contribution requirement, a certain level of participation could be required of all CIC members, CIC residents, or both.

In areas with high tourism, leasing prohibitions have been implemented to keep residential property from being used as rental vacation homes and hotels.[526] This is a very different situation from typical residential communities enacting no-lease provisions. Tourist occupancy (use as a hotel) is not the same use as residential occupancy (use as a

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(noting that common upkeep also allows a community to take advantage of cost savings from economies of scale).

[522] Affirmative covenants established the legal obligation for property owners to pay their fair share, and owners associations created by the covenant declaration established an effective method to collectively maintain and pay for common space and amenities. *See Freedom of Contract Myth*, *supra* note 106, at 768. Furthermore, associations could place a lien on an owner's property and initiate enforcement actions if an owner failed to fulfill her obligations. *See id.* Governance in CICs is performed by volunteers—homeowners who serve in unpaid positions on the association's board and staff various committees. *See id.* at 789.

[523] Two early examples of covenant regimes to preserve a central park feature are Leicester Square in London and Gramercy Park in New York. *See Endangered Right to Transfer*, *supra* note 253, at 42 n.165. The viability of the servitude regime supporting maintenance obligations for Leicester Square was challenged (and upheld) in the early English case of Tulk v. Moxhay, (1848) 50 Eng. Rep. 571 (ch). For a discussion of the Gramercy Park covenant regime, see CLEVELAND ROGERS & REBECCA RANKIN, NEW YORK: THE WORLD'S CAPITAL CITY 253–59 (1948); *see also* Carol Rose, *The Comedy of the Commons: Custom, Commerce, and Inherently Public Property*, 53 U. CHI. L. REV. 711, 770 (1986).

[524] *See* Sterk, *supra* note 55; BARTON & SILVERMAN STUDY, *supra* note 310.

[525] *See generally* Sterk, *supra* note 55.

[526] *See, e.g.*, Seagate Condo. Ass'n v. Duffy, 330 So. 2d 484, 486 (Fla. Dist. Ct. App. 1976) (upholding a leasing restriction, in the context of "a tourist oriented community in South Florida").

home). Thus, precluding the former can be justified as a property use regulation.[527] A community need not rely on wholesale prohibitions of leasing to preclude hotel-type use of property. Prohibitions on short-term rentals (six months or less) curb these practices efficiently.[528]

B. Legitimate Lender Concerns

Many of the underlying benefits of owner occupancy can be achieved directly through contribution and maintenance requirements and behavioral controls. But as long as the GSEs and the FHA continue to require a certain level of owner occupancy in a community as a qualifying condition for financing, these requirements alone will justify rental restrictive covenants. In addition, as long as underwriting requirements are written to require a particular owner occupancy level, leasing restrictions will be the only way to achieve that end—there can be no less restrictive means.[529]

If the most compelling reason for the existence and enforceability of leasing prohibitions is GSE and FHA underwriting mandates, however, then leasing limits truly reflect not individual or community preferences, but rather deliberate public and quasi-governmental efforts to promote owner occupancy at the expense of would-be renters. This policy is unjustifiable as long as the legitimate security concerns of mortgage lenders can be adequately addressed in other, less intrusive ways. Lenders only benefit from neighborhood owner occupancy if the restriction translates into better neighborhood maintenance of their collateral and improved CIC fiscal health. Once again, rather than achieve these objectives by proxy, such concerns would be better reflected through underwriting requirements directly relating to a standard of upkeep and a measure of the community's finances.

If owner occupancy can be justified based on GSE and FHA preferences alone, then the property value increase resulting from lease restrictions is merely a self-fulfilling prophecy. It stands to reason that the GSEs and FHA mandatory owner occupancy rates protect against

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[527] *See, e.g., id.*

[528] GSE requirements of nonhotel use justify short-term leasing prohibitions. *See* FANNIE MAE, SELLING GUIDE: FANNIE MAE SINGLE FAMILY § B4-2.1-02 (2014), *available at* http://www.fanniemae.com/content/guide/SEL041514.pdf. These requirements are even more widespread than blanket prohibitions of leasing and are more justifiable because leasing for vacation purposes is quite different than leasing as a residence.

[529] It may be that government and GSE mandates alone justify CIC covenant limitations on an owner's right to lease. *See Unbounded Servitudes*, *supra* note 28.

falling property values, but it is this very mandate which guarantees that property values will decrease should owner occupancy decline. This sort of government meddling into market value and housing decisions often creates unforeseen consequences. By pursuing one policy objective—namely, owner occupancy—the FHA and GSEs may inadvertently sacrifice others, like neighborhood desegregation and housing affordability.

Legitimate lender concerns—like the legitimate concerns of a neighborhood—should be achieved in a way that is least costly and least intrusive with respect to individual freedoms. A least intrusive approach is particularly appropriate with respect to CIC leasing restraints because these restraints exist in large part because of state (municipal, federal, and quasi-governmental) action. An analysis of the enforceability of CIC covenants in general, and leasing prohibitions in particular, must take into consideration the ways in which such covenants diverge from typical contracts and the costs of occupancy restrictions on individuals, communities, and markets.[530] GSE and FHA policymakers should engage in the same analysis as well. At the very least, the GSEs and the FHA should recognize and acknowledge that their owner-occupancy mandates are not uncontroversial and costless promotions of universally accepted priorities. Instead, they should realize that these mandates come with costs and external impacts that may not be justified, particularly when other alternatives exist to protecting lender concerns.

VI. CONCLUSION

The content of CIC covenants is not necessarily a naked reflection of community preferences, but rather a reflection of government policies.[531] As such, freedom of contract and economic efficiency do not justify the enforcement of all covenant terms. Covenants that prohibit leasing in CICs are common and almost universally enforced.[532] But these covenants are troubling. Leasing prohibitions control who resides in property, not the property's use.[533] Restrictions on who can live in a

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[530] *See Freedom of Contract Myth*, *supra* note 106, at 823–35 (suggesting that homeowners should be required to more affirmatively manifest intent to be bound to CIC covenants apart from the mere purchase of real property and that there be more effective disclosure of community covenants; also concluding that CIC covenants should be limited to "legitimate subject matter"—that is, restrictions on use, not on a user).

[531] *See The Constitution and Private Government*, *supra* note 274, at 1112; *The Public Role*, *supra* note 152, at 879–80.

[532] *See supra* note 49 and accompanying text.

[533] *See supra* notes 334–35 and accompanying text.

community seem discriminatory and anachronistic, yet under the guise of rental restrictions, covenant-based housing segregation persists.[534]

CIC leasing restrictions may act as proxies in creating desired neighborhood attitudes and behaviors; however, they impose economic costs on individual owners and risk spillover financial distress in communities. In addition, no-lease covenants create adverse impacts for nonmembers of a community, particularly to renters who desire to reside in the community but are precluded from living there. Leasing prohibitions are problematic in terms of broader societal impacts as well. They are economically inefficient barriers to property transfer. They artificially raise rental rates and restrict housing access. And they perpetuate the already widespread and intransigent problem of racial segregation of housing.

Many asserted community benefits from no-lease covenants can be obtained through alternate, use-focused restrictions that would avoid many of the most objectionable effects of leasing prohibitions. Nevertheless, courts and communities will be unable to reconsider the efficacy, reasonableness, and wisdom of no-lease covenants until the FHA, Fannie Mae, and Freddie Mac change their underwriting standards to focus not on owner occupancy as an end in itself, but rather on legitimate lender concerns such as property maintenance and community fiscal health.

It is true that homeownership has been called "our national ideal," and for decades promoting owner occupancy has been an accepted way to encourage that goal.[535] But other important public concerns—including housing affordability and accessibility—are at risk when promoting owner occupancy discourages community rentals. The antiquated American Dream promoting homeownership and owner

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[534] Professor Winokur opined that "segregation of *uses* all too often corresponds—in motivation as well as in impact—to the widely desired segregation of *users* which our society collectively censures despite its popularity." Winokur, *supra* note 247, at 20–21 (emphasis added).

[535] "[H]omeownership is our national ideal, and we expect renters to strive for ownership." Kirsten David Adams, *Homeownership: American Dream or Illusion of Empowerment*, 60 S.C. L. REV. 573, 574–75 (2009) (referencing statements by Presidents Herbert Hoover, Franklin Delano Roosevelt, Calvin Coolidge, George W. Bush, & Bill Clinton to that effect); Segal & Sullivan, *supra* note 15 (referencing "a wide array of public policies" specifically aimed at growing homeownership, "includ[ing] favorable treatment of homeownership under the tax code, the creation of the thrift industry, the establishment of the Federal Housing Administration's (FHA) lending programs, and the chartering of government-sponsored enterprises to facilitate mortgage securitization").

occupancy at all costs needs to evolve in recognition of competing societal goals that present more compelling dreams for America today.