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The Journal of Sociology & Social Welfare

Volume 3
Issue 2 November

Article 9

November 1975

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Recommended Citation

Mittelbach, Frank G. and Ebin, Joe (1975) "Condominium Housing: Some Social and Economic Implications," *The Journal of Sociology & Social Welfare*: Vol. 3 : Iss. 2 , Article 9.

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CONDOMINIUM HOUSING: SOME SOCIAL AND ECONOMIC IMPLICATIONS

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The functioning of condominium communities and projects has received increased attention from housing analysts in many professions. As of 1973, there were an estimated 15,000 condominium and townhouse communities in the United States, a figure expanding approximately by 4,000 annually.¹

In this context, the proliferation of home owners associations in the communities or projects is of special interest due to their emerging role as a new form of residential government. This role manifests itself as both supplementary and in part complementary to the existing government framework. The collective provision and maintenance of selected services, including roads, utilities, lighting, refuse collection, recreational facilities and others, closely resemble and augment many services offered by cities and counties. The police power manifested as zoning and building controls in cities and counties translates itself into architectural and design control, and various property use, occupancy and related restrictions, in community associations. Much has been written on the methods of organizing these associations, but often discussion is couched in very practical terms without reference to underlying social and economic concepts which may influence effectiveness in meeting perceived problems. Generally, the goal here is to try and bridge this gap.

General Characteristics of Condominiums

Condominiums essentially involve fee simple ownership of a specified unit in a housing project and common ownership of certain ancillary spaces, facilities and services. The relationships are similar to a consumer cooperative (including cooperative housing) with the exception that the distinction between individual and common property is assumed to be more clearly defined in the condominium. In cooperative housing, for example, the residents own a share in the project with the right to occupy a designated unit, whereas in condominiums there is legal title to a specific unit which includes a proportionate share of the common area. While in cooperative housing all of the facilities are essentially under the control and management of a board of directors, in condominiums the control and management by the Home Owners Association (HOA) is primarily confined to common areas, but often affects private areas as well.

An important distinction between these two housing forms exists in their differing financial structuring. The condominium owner's liability is confined to the specific and individual financing arrangements for a designated unit and the proportionate share of the common area; to property taxes on the unit and share of the common area; and a share of the management and maintenance fees. The cooperative owners, however, are each, individually, liable (to the extent of their stock or share in the total property) for the collective functioning of the entire cooperative with comparatively little distinction made between private and common areas.

Physically a condominium project need not be different from other housing projects with primarily different forms of legal tenancy. The condominium

project could comprise a project of attached single family homes standing on their own (but perhaps relatively small) lots clustered together and surrounded by commonly owned open spaces, walkways and other facilities. Alternatively, many condominium projects are in multi-storied structures akin to apartment houses with individual ownership defined in three dimensions and common areas including primarily hallways, lobbies, garage space, etc. The fact that in the last few years many apartment projects have been converted to condominium ownership (and vice versa) suggests that physical attributes are not a critical factor in creating one or another form of tenancy. Such attributes may be present, however, if a project originally is designed for specific types of tenancy. Architects and developers, in designing a condominium project, probably would emphasize schemes which for legal, managerial and related reasons enhance the distinction between individual and common areas. In a typical rental project, this distinction is apparently of less consequence.

To place the condominium HOA in its proper context one can note that organizations reflective of common concerns may spring up in other types of tenancy. In multi-family rental housing we have seen in recent years the growth of tenant groups. However, these are essentially voluntary in character and attempt to constrain or influence the actions of what are perceived to be excessively powerful public and private landlords. Their orientation is toward improving the bargaining position of tenants via organized efforts.

Similarly in, let us say, areas with primarily owner-occupied single family homes, neighborhood associations are found. Indeed, common area questions will be of central interest to such groups including the development, management and maintenance of streets, parks, playgrounds, schools, etc. which usually are owned and operated by the public sector but not strictly for the benefit of residents in a neighborhood. Moreover, unless services and facilities are provided by special assessment districts, a club or similar organization and can be substantially internalized by residents, the benefits received from public facilities and services in areas of cities are not necessarily connected to the cost of producing them.

The point to be stressed is that the functions performed by HOAs in condominiums are not unique but are analagous to other community and neighborhood organizations. In principle, the HOAs are a form of governance--i.e., a local mini-government--of commonly owned areas in private housing developments where the benefits received by owners are reasonably closely tied to the costs of production and non-payees can be substantially excluded. As a working definition this may suffice, but as will be seen, the problem is considerably more complicated because of the blurring of individual and common areas and persistent difficulties in obtaining close relationships between costs incurred and benefits received. Moreover, the mini-government performs functions in addition to the local public sector in which a condominium project is located.

Individual condominium owners through membership in the HOA can influence the amount and quality of common area services in projects but only within the constraints of established contractual and other relationships and in juxtaposition to the goals and objectives of other owners and residents in projects. In terms of actions which influence the condominium owner-occupants' welfare, he or she is required to negotiate with others occupying the project in decision making surrounding common, and to some extent even private, area functions

and services. Potentially salient and perhaps transferable experiences are obtained not to mention possible efficiencies, but such experiences must be weighed against prospective uncertainties on the extent to which individual's interests are reflected in communal decision making and other possible negative outputs.

Condominium and townhouse owners are a heterogeneous group embracing all ages, according to one study. A 1973 sampling of 1,803 owners in primarily metropolitan Washington and Los Angeles showed 34% of the occupants to be of age 30 - 39, 29% of 20 - 29, 17% of age 40 - 49, 13% of age 50 - 59 and 8% over 60. The units were marketed from a low of under \$20,000 to nearly \$150,000 suggesting that the universe represents a broad spectrum of the existing housing demand and supply system.²

In light of the increasing role forecast for condominiums and townhouses in the future housing production of the United States, the HOA's considerable control over the property rights of its members, the expanded spectrum of users of this housing mode and the associated services offered our purpose is to provide conceptual foundations to anticipated and actual behavior in the "typical" HOA.

Organization of Condominiums

The introductory remarks serve as a backdrop for examining briefly the process in constituting a condominium project. This process generally begins with a builder and/or investor taking a series of distinct legal and financial steps as part of the building development of acquisition which eventually culminates in the transfer of titles to the new owners, including the common areas. Although our emphasis is on the HOA, which comes into full fledged operation when all or some designated percentage of the units have been sold, we should indicate this transfer is not always smooth and may be aborted, or revised, thus providing basis for tension not to mention financial consequences. Major departures from the "normal" case might include the following: (1) Not enough of the units are sold and, given certain restrictions, the project may then be transferred to rental status; (2) Only a portion of the units is sold and title transferred to purchasers, and the original builder or owner continues to exercise considerable influence on continuous management and operation through the HOA including disposition of the unsold units; (3) All units are sold to individual owners, but with time they do not occupy them but rent them out to others. Problems under (1) are outside of our concern here, but we shall introduce some consequences that flow from (2) and (3). At this point we merely wish to note that owner-occupancy and condominium housing are not necessarily synonymous. For the moment, however, we shall assume a nexus between the two and focus on the HOA.

The HOA is a necessary part of the condominium. Its board of directors and officers are initially appointed by the original builder/investor but eventually, as title is passed to the new owners, the board will be elected by them. The board and its officers operate within the constraints of (1) Federal, state and local laws and regulations which have been enacted, (2) Covenants, conditions and restrictions (CCGR) which are a matter of public record, and (3) By-laws and regulations surrounding occupancy and use as well as the duties

and functions of the board and the officers. In the long run all of these constraints may become variables, but holding constant for the moment federal, state and local laws, varying degrees and types of consensus are required to obtain major or minor changes. Major capital investments might call for 75 percent of the owners concurring, whereas a change in the by-laws pertaining to landscaping might require only a majority of the votes from members or the board. Certain decision making functions are within the purview of the board of directors and the officers. The board in many cases will also assume semi-judicial functions and arbitrate disputes between the owners as well as between owners and the association where property rights are unclear. Assume, for example, that a particular unit has experienced water damage (a fairly common occurrence) resulting from a failure in the plumbing system or negligence. This common maintenance problem may require determining the source of the problem (originating from a private or common area) as to who is to bear the costs and in what proportion. Such a determination may be made by the board, not to mention experts or by arbitration among those affected. However, the opportunity for legal action is always present.

Lack of clear distinction between common and private areas may lead to inequities and dissatisfaction. These, in turn, prompt the need for internal conflict resolution. The HOA's adaptability to internally arbitrate conflict resolutions and yet remain "cohesive" enough to function may in time determine condominium's ability to survive as a competing housing form.

Social and Economic Concepts in Condominium Housing

Two traditions are referred to here in the study of condominium home ownership and management. These traditions are not necessarily antithetical but they do start from different sets of assumptions. One of these might view condominiums as an extension of the housing cooperative which in turn represents a move away from the "technocratic caretaker model" to the "cooperative developmental model."³ In this view, the choices for housing residents might be between single family ownership housing, which is desirable but unattainable for prospective occupants for reasons of limited resources, and traditional rentership housing in apartments which is attainable but undesirable because the technocratic manager often "defines the problems and orders solutions according to the techniques he has mastered with minimal reference or no reference to those who are directly affected."⁴

Ideally, cooperative housing involving perhaps units of a type ordinarily offered in the rental market thus would produce a juncture between lower living costs, control over the management process and a departure from the "technocratic caretaker model." The condominium represents modification of cooperative housing with only common areas managed in concert by the occupants obtaining, hopefully, efficiency as well as social benefits. Some of the potential social benefits would be derived from the working methods which are more likely "personal, contractual and based on democratic organizational forms which stimulate trust and the development of personal and group resources."⁵ Moreover, an assumption is that certain goals would be met through cooperative housing including: decreased dependencies; increased economic, social and personal development and self-determination; dismantlement of paternalistic and oppressive structures; and so on.⁶ At least this is the contention. To be sure the assumptions concerning prospective social benefits might not hold in

every condominium housing environment, but certainly some of these benefits could be attainable if alternate housing delivery systems are irresponsive to consumers desires and tend to alienate them from society.

One may contrast the above optimistic expressions to the framework enunciated in economic analysis on collective action. This framework essentially assumes that consumers at the margin attempt to relate their own satisfaction to their costs incurred. In an acquisitive community where some goods are produced collectively, the consumption behavior of individuals or family units could produce distinct problems relative to an "optimal" level of group consumption. A crude illustration is provided by the situation where as an individual expands his consumption of certain goods and services, the costs of producing them are shifted to the community. In this case and in the absence of coercive action, consumption is expanded to the point where the marginal satisfaction derived from consuming an additional unit of the good or service is zero.⁷ A more realistic situation is exemplified where with increased consumption individuals bear some fraction of the costs of production but are able to shift the remainder to others. In this case, consumption increases to the point where the marginal satisfaction to the individual is equal to his marginal fractional costs.

An interesting example of interdependencies is provided by an actual condominium case where partly substitutable services were available individually as well as collectively. In the project two sources of heating were potentially available--individually metered heating from electric furnaces and commonly metered gas heating from fire places. The rational course of action for individual occupants was to obtain as much heating as possible from the commonly metered facility, for otherwise they might find themselves paying a fraction of other residents' heating costs from this source without receiving any benefits. This condition applied even though the commonly metered facility was less efficient and tended to drive up the cost of heating per unit for the whole complex. In other words, the rational course of action clearly conflicted with optimality criteria for the total condominium community. Assuming the problem is perceived to be significant, several approaches may be pursued to cope with a situation of this sort: (1) Selected individuals who value a common facility or service very highly may be induced to pay for it and still consider themselves to be better off even though some benefits are internalized by non-payees; (2) An attempt may be made to influence attitudes and behavior patterns, and this may be more or less effective depending on group cohesion and the possibility that alternative (3) will be voted in; (3) A system might be instituted to control individual or group rate of utilization of the common facility including the imposition of user charges or penalties when possible; and (4) The community may agree to eliminate or to individualize the common facility or service.

Alternatives (1) and (2) may be viable in dealing with a small closely knit group of individuals and family units who mutually support each other and where communication links are strong. Whenever the welfare of a group is defined by the participants to include people beyond the household or nuclear family, approaches under (2) are possible and usually this applies to small groups. Pertaining to condominiums we should note they usually do not comprise the ordinary voluntary association of people who have joined together to develop and manage housing in common. Quite the contrary, developers generally produce

the units and sell them individually without necessarily having reference to the prospective residents' affinity. Moreover, purchasers are probably motivated strongly by the opportunity for gaining access to the individual units and view common area management as an adjunct which, for the inexperienced at least, is assumed to be largely spelled out by the terms of the contract, requiring little personal effort on their part. Strong affinity among residents may evolve in time, but it is by no means a condition for their being associated initially. Therefore, attempts to persuade owners to work for the common good may be quite ineffective even in a small project where opportunities are present for internalizing common area benefits and externalizing costs.

Alternative (1) clearly has relevance only to small groups because the larger the group the higher would have to be the value attached to benefits by payees in relation to the non-paying beneficiaries. Moreover, resolution is complicated by the possibility that individuals or families do not reveal preferences. Simply put, by not revealing preference for a particular facility, an individual may induce others who reveal theirs to pay. Eventually, a realization that payees are producing significant benefits for non-payees would lead directly to consideration of approaches (3) and (4).

Various control devices (Alternative 3) may be instituted regarding common area facilities in condominium housing in order (a) to keep management and maintenance costs generally within reasonable bounds, (b) to avoid major inequities perceived to be associated with "free rider" problems involving disproportionately high utilization rates by some but with costs equally spread throughout the project and (c) because other alternatives are unworkable.

One of the persistent themes to which attention was drawn in our surveys of condominium projects was the very rapid increase in common area fees and charges from their initial level at the time of transfer to the HOA. In part these increases are attributable to general price level changes and the behavior of developers to underestimate such costs during the period of sale. However, the issue is more complex. Aside from another possibility, namely poor financial planning and budgeting by presumably lay management, the underlying collective relationships may also contribute to the pattern. Take the case of a project where, say, 40 percent of the residents have a strong preference for exterior common area maintenance, 40 percent for interior common area maintenance and 20 percent for both. In this case the possibility arises of high levels of maintenance in both exterior and interior areas being voted in although the majority would prefer lower expenditures in the aggregate. Alternatively, beginning with, say, a fixed budget, its division between exterior and interior maintenance may well be suboptimal from the standpoint of the majority. Other conditions could be specified pertaining to different preference functions for a mix of common area facilities and services, various voting blocks and the income of residents in relation to the costs of providing services. An increase in common area fees and charges is by no means inevitable. However, unless residents are very similar in their socio-economic characteristics and value orientation, individuals may have to compensate others to obtain a desired state and bargain with them or seek power by gaining representation on, say, the board of directors in moving them toward their goals. Moreover, and this probably applies more to small than large projects, residents' notions pertaining to resource conserving actions may be offset by inclinations to be agreeable as others express their desires for more

resource inputs. Thus, the price for realizing internal cohesion among residents might be an expansion of maintenance and management costs.

Even more dramatic are instances where a majority of residents or an otherwise powerful group with a fixed set of preferences induces the provision of a mix of services, facilities and maintenance which clearly is to their advantage. Others may be forced to consume services they do not want. Even if they do not consume them, they may still be required to pay. These conditions will not remain stable, for among the alternatives available to the losers is the sale of units, but at the expense of significant transfer costs, or to rent to others. Initially, the conditions result from poor information flows among new purchasers and lack of experience with condominiums and common area questions. Eventually, as more information is obtained and disseminated, formally or informally, and experiences accumulate on condominium housing, one might anticipate that potential purchasers would not only shop for units that in terms of lay-out, design, price and in other respects accord with household preferences, but which currently or prospectively include a mix of residents whose tastes for common area maintenance and management are very similar to the families searching. It might suggest that in time condominium communities and projects will become quite homogeneous in their character. However, given continued uncertainty surrounding the anticipated behavior of neighbors in projects, other alternatives are indicated. These alternatives include (1) greater demand for units in projects where common area facilities and services, including potential conflicts surrounding the, are kept to a minimum; (2) increased demand for units where the conditions and responsibilities surrounding common area facilities and services are spelled out in much greater detail than is currently the case in many new projects; or (3) not to purchase condominiums at all.

In view of the difficulty of forecasting resolutions of many common area questions well in advance (especially as the prospective mix of residents initially is uncertain and substantially under the control of developers), plus aforementioned problems surrounding "correct" pricing may occasion a search for other mechanisms in management. Suffice it to say that one finds in condominium housing a wide variety of rules and regulations in effect beyond those spelled out in the CCRs and the original by-laws. These rules or regulations pertain to utilization rates, they are of the "thou shalt" and "thou shalt not" type, and essentially express an exercise of the police power, including the institution of penalties. Since condominiums are in the nature of emergent communities the process in cases we have observed is quite incomplete. Moreover, variations in the physical environment, the mix of occupants and their values, and the types of common area facilities and services provided assure considerable diversity in these rules and regulations. An extensive review of these rules and regulations is beyond the scope here. However, we can indicate some major points of contention which have emerged.

In multi-story condominium projects, particularly where residents occupy different stories, conflict has arisen on the definition of what are common areas and determination of the source of problems, including payment of damages. Technical questions arise in the process. Is a failure in the plumbing system and associated damage to several units attributable to the individual or common areas? Assuming the failure is in the individual areas, where did it originate, and if several units are damaged, who is to pay? One of the specters

in addressing such questions is that legal action may be instituted by one or more parties concerned placing severe financial strains on individuals and the association. Therefore, many regulations reflect attempts to define property rights more precisely than was the case at the time projects were organized and they are designed to reduce the possibility of disputes including costly litigation.

In projects which include a mix of young and old, a difference of viewpoint on common area management often revolves around their varying goals. The young may be interested in the expansion or maintenance of amenities serving them and a general emphasis on expenditures that yield long-run benefits. The older generation obviously has a shorter-time horizon and is inclined to favor current expenditures which produce more immediate benefits. Intergenerational equity thus is often an issue particularly when older residents are faced with steady or declining income, in the face of general inflation, and the young comprise an upwardly mobile group.

These examples are merely indicative of the sorts of issues which have arisen and which have occasioned clarification in the forms of rules and regulations to resolve them. Many of these are framed on an ad hoc basis and deal with problems as they present themselves. So long as these rules attempt to define more precisely human and property rights and methods of conflict resolution they will contribute to smoother relationships among participants in the future. However, where these rules try to influence behavior but the penalties for non-compliance are small and the costs of enforcement are high their weaknesses will become apparent just as in the case of many codes of, say, chartered cities. Moreover, as the rules and regulations expand those who desire to dispose of their units in time may be faced with resistance in finding prospective purchasers who are interested not only in purchasing the units based on their intrinsic merits, but also express concern about various constraints reflected in ad hoc rules and regulations.

The Element of Project Size

From what has been said, we might expect a much closer approximation to an optimal level of common area services for all concerned in small versus large projects. The costs of decision making in small projects are lower and voluntary cooperation may be sought in arriving at common area solutions. However, these advantages must be contrasted to potential inefficiencies in the production of services in small projects. An assumed and much heralded benefit of condominiums was to be opportunity for access to common area amenities whose provision would be financially infeasible for individual consumers or even small projects.

One reason why small projects are more effective in resolving conflicts among participants thus has to do not only with size but also the relatively narrow range of services offered. At the same time, managerial inefficiencies in small projects often accumulate. Small projects usually rely on lay managers in addressing common area problems, whereas in large projects professionals may be called upon and their costs can be spread over many units. A further factor

is that since the resident selection process is unlikely to have any significant relationship to the professional skills purchasers possess, small projects often find themselves short of the talents required for management. We have observed small projects where the purchase of a unit by a lawyer, accountant or construction specialist is greeted with a sigh of relief.

Of course, more is at stake than merely project size for the price and quality of units would certainly influence the probability of attracting people with a particular set of desired management skills. Recognizing, however, that many of the desired skills are not necessarily formally acquired and can be developed large projects initially appear to have better potential in finding people able to manage. But ability to manage must be distinguished from willingness to participate in the process. Since members of the board of directors and officers in condominiums usually are not paid the incentives for participation in management alone are small unless the personal benefits from good management can be substantially internalized by those involved. In large projects, therefore, owners would be less willing to participate in management because the benefits of significant time and personal efforts are spread over many units. Given this condition the owners of units, even if they have appropriate skills, may incline toward being "free riders." However, since someone must manage the outcomes of these attitudes and behavior are quite predictable. Good management may be lacking or is purchased at a not insignificant cost from professionals. Another alternative is "side payments" to good lay managers perhaps in the form of political power within or outside the project area. However, we do not exclude the possibility of other forms of "side payments" some of which might come under the category of abuses.

In a number of projects we have seen attempts made to overcome the above problems by requirements that practically everyone in some sense participate in the management process. Complex committee structures are set up under the chairmanship of officers and others. But the sanctions for non-performance of committees are weak or non-existent. Therefore, committees do not eliminate the free rider problem but may only alleviate it.

Another potential source of condominium management problems which may be aggravated with time pertains to the renting of units in projects. This includes renting by developers of unsold units and by individual owners who for one reason or another do not occupy the units. Fundamentally, this is not a new phenomenon to the housing market exemplified by the fact that in the metropolitan areas of the United States close to one-fifth of the occupied housing inventory in one-unit structures (primarily single-family homes) is rented. Generally, the older the inventory of single-family homes in neighborhoods the larger is the share of units that are rented. One aspect of the problem concerns absentee landlords which in some cases might involve large numbers of people. Absentee owners often give their proxy votes to resident owners or officers. Thus, decision making may well be in the hands of a small group but renters, although they may be consulted, usually do not have voting power. Moreover, renters must deal with both the association and their landlords in obtaining resolutions to problems they perceive. Costs of decision making are raised in the process especially when boundary questions are involved. Equally important is the possibility that where only a few resident owners remain it may become quite difficult to find qualified people to serve on the board of directors. In some small projects this issue may present

itself rather early. Certainly, a scenario of many absentee condominium landlords negotiating among each other on management questions and simultaneously negotiating with tenants on common and individual area issues has within it the ingredients of severe tensions and conflicts.

Final Remarks

Condominium housing is still relatively new to the United States, but has represented increasing proportions particularly in the new housing market. Originally, condominium ownership was touted as a compromise between share cooperative housing and single-family home ownership and a viable alternative to renting. The distinction between individual and common areas in condominiums was introduced to reduce liability problems present in share cooperatives and to provide greater control and flexibility to purchasers. At the same time higher densities with homeownership were assumed to be realizable in condominiums as disproportionately rising building and land costs put single-family home ownership beyond the reach of large segments of the American public. Theoretically, many families who otherwise would rent now could have access to ownership housing. The issues of common area ownership, management, maintenance and services in condominiums were essentially seen as being within the realm of legal experts and social and economic theories of human behaviors did not seem to have any significant contributions to make toward projecting or understanding experiences. This assumption is in the process of revision.

Ideally, one might approach ownership and management of common areas in condominium housing as an opportunity for self-government at a relatively small scale offering, also the possibility for developing salient relationships among the participants and potential social benefits quite aside from assumed efficiencies in construction and management. In this model emerging problems might be considered as temporary distortions attributable to lack of experience with condominium housing and associated poor information flows.

Currently, a number of problems revolve around often unclear definitions of individual and property rights in condominiums; the costs of decision making in projects of various size; the "free rider" issue where selected groups attempt to internalize significant benefits from common area facilities without bearing an appropriate share of the costs; potential inefficiencies in consumption resulting from the collective provision of selected facilities and services; difficulties in arriving at consensus on common area questions which come to the fore as owners with different values and preferences (and no preknowledge of what these might be) are required to negotiate with each other; the meaning of sanctions for non-compliance with by-laws and regulations when these sanctions are often weak and unenforceable; and finally how to find and develop skilled people willing and able to manage within the project.

Despite the long tradition of condominium housing in other nations it may be considered as a social innovation introduced recently to the United States. As for most innovations there is a period of gestation and turmoil during the initial period followed perhaps by stability and equilibrium. Thus, some of the problems we have indicated will in part be resolved as market participants adapt the concept or in turn adapt to inherent problems. Other problems may be tackled via a process of social control and institutionalization. The complexities of relationships in condominiums suggest this housing form will be a likely target

for more public sector interference. Hearings before the U.S. Congress and concerns of public agencies might be indicative of prospective legislation. If this comes about and involves more than just clarification of rights and responsibilities the action space of participants will be further limited. Expanded social controls usually have a cost attached to them, however. Not the least of these costs is bureaucratization of condominium management and reduced interaction among participants outside of a formal and mechanistic framework. High decision costs implicit in collective goods questions and other costs may be further raised. An issue then arises about what the impact of increasing costs will be on prospective condominium developments and whether this form of housing will continue to be attractive or feasible for large numbers of people.

NOTES

1. Urban Land Institute, Community Associations Institute, Managing A Successful Community Association (Washington, D.C.: The Urban Land Institute, 1974), p. 2.
2. Carl Norcross, Townhouses and Condominiums: Residents Likes and Dislikes (Washington, D.C.: Urban Land Institute, 1973).
3. J.F.C. Turner and Robert Fichter, Freedom to Build (New York: The MacMillan Company, 1972), p. 194.
4. Ibid.
5. Ibid., p. 195.
6. Ibid.
7. An underlying assumption, of course, is that the satisfaction from increased consumption of one good or service increases at a decreasing rate and that the costs shifted to the community are the individual's incremental cost, an amount above the level of the average individual costs.