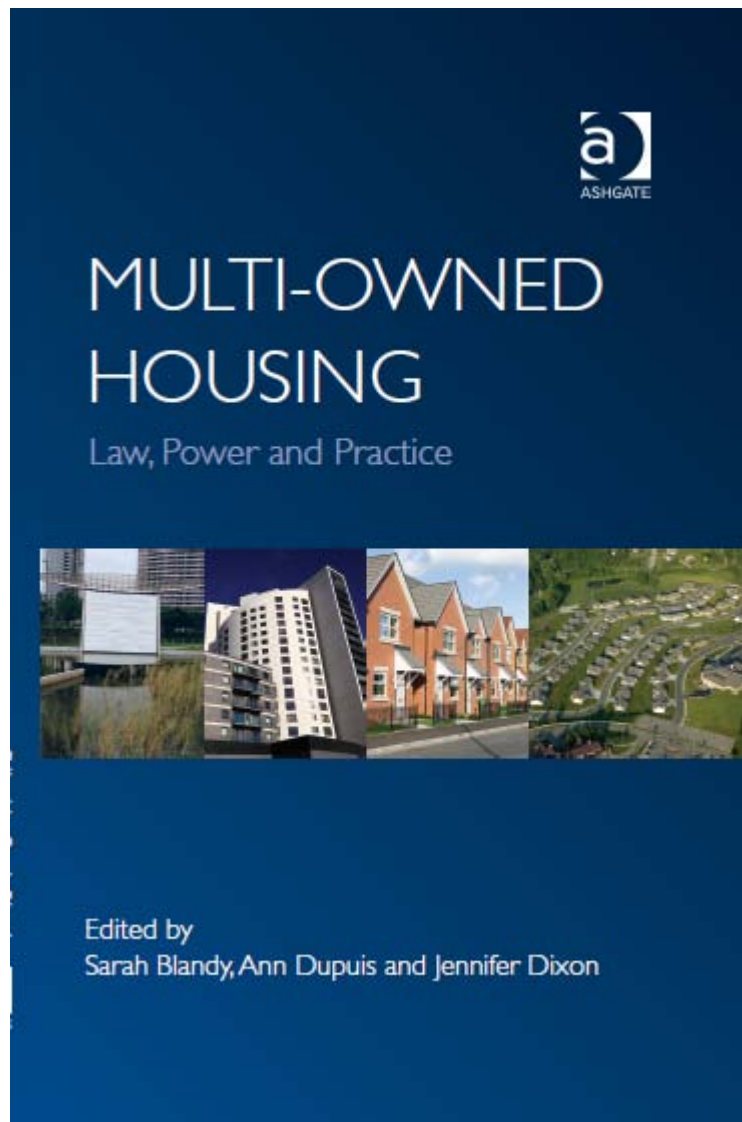


"The Maintenance of Residential Towers in Condominium Tenure: A Comparative Analysis of Two Extremes – Israel and Florida"

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## Chapter 5

### **The Maintenance of Residential Towers in Condominium Tenure: A Comparative Analysis of Two Extremes - Israel and Florida**

*Rachelle Alterman*

#### **Introduction**

This chapter addresses an increasing problem caused by the intersection of two major trends in urban living. The first is the steep worldwide increase in the number of residential towers, defined here as buildings of twenty storeys or more. Although no official data are available, some estimates indicate this trend (Council on Tall Buildings and Urban Habitat 2008). The second trend is the dramatic rise in condominium ownership and other forms of homeowners' associations. Not all the residents who belong to condominiums or other forms of homeowners' association live in residential towers, but the combination of these two trends harbors problems. A fast-rising proportion of the world's population is already or is expected to be living in this category of housing. An extremely challenging question concerning residential condominium towers has so far received very limited attention, namely: is there a sustainable legal-financial mechanism that can ensure their long-term maintenance so as to prevent their deterioration?

In addressing that question, the chapter focuses on two dichotomized types of condominium law, referred to here as 'simple' and 'enhanced'. The first type is represented by a Mediterranean country, Israel; the second by the US state of Florida. The main part of this chapter compares the degree of suitability of these two types of laws to tower housing. It concludes with a discussion of some public policy and legal instruments that may be required in order to bridge the gaps. The current financial crisis casts an additional shadow over the desirability, as a matter of public policy, of relying on tower condominiums as a mainstream part of the housing market.

#### **The Cost of Long-term Maintenance**

Contrary to conventional wisdom, tall buildings often entail *higher* rather than lower maintenance costs per unit despite the large number of owners; the taller, the more complex, although not quite in a linear relationship (for details see Alterman 2009). A further problem is related to the structural attributes of tower buildings, which operate like complex, closed machines that are not amenable to structural changes. Unlike regular buildings, in towers it will not be possible to grant additional development rights in the future as an incentive to finance the necessary updating costs. Tower buildings are less amenable to structural modifications, so there is a greater danger that their relative value will eventually diminish, causing them to lose their position in the housing market, and thus to deteriorate faster than smaller apartment buildings. In addition to current expenditures for routine maintenance, comparatively larger investments are required for periodic repair and replacement of expensive machinery,

large scale upgrading and renovation of the whole building and so on, than applies to regular buildings.

The problem of finding a mechanism for financing the long-term maintenance of tall buildings is complicated by the fact that the costs are not consistent over time. Four levels of maintenance may be distinguished schematically by the frequency of action required:

*Level 1 Ongoing maintenance:* day to day or weekly activities, such as cleaning of the foyer, staircases, elevators, gardening, security (where provided).

*Level 2 Preventative upkeep:* periodic upkeep needed every few years to prevent deterioration of structures and machines.

*Level 3 Periodic replacements:* Structures, machines and elevators, may need replacement approximately every decade, alongside external walls.

*Level 4 Renovation and updating:* after approximately 20 years even well-maintained the building will likely need renovation and upgrading to reflect higher housing standards in the marketplace, in order to prevent the otherwise natural process whereby the building would move down the ladder of housing quality, and price.

In terms of visibility, if Level 1 maintenance is neglected it quickly becomes obvious to the residents. In regular condominiums with a small number of owners, collection of funds for this level of maintenance should be less difficult than for the other levels because owners are able to see what their payment has financed close to the collection date, and the periodic payment is relatively small each time. For the other levels of maintenance, as the time periods grow longer, the connection between the date of collection of the maintenance fees and the maintenance activity becomes less direct. The visible benefits of Levels 2 and 3 maintenance activities are likely to be less obvious to the owners. By contrast, Level 4 maintenance refers to renovating the building as a whole, and is therefore likely to be highly visible. However, it is rarely undertaken and, in any case, is not usually budgeted for beforehand. In order to pay for maintenance activities of types Levels 2 to 4, a condominium should have a pool of financial resources over and above what is collected on a regular basis. As the time range expands, it becomes increasingly likely that many of the original owners will have moved out. An 'intergenerational' problem then arises, whereby upon sale, the current owners have an interest in passing on the onus of financing maintenance to the new purchasers.

The problem of financing maintenance is much more severe in tower buildings than low or middle-rise ones because they inevitably house a very large number of owners and are thus more susceptible to market failure than low-rise buildings. The costs also increase with the age of the building. Owners' willingness to pay higher one-off costs when the time comes is very susceptible to the 'free-rider syndrome' (Olson 1965). Where so many owners are involved, and where many apartments have changed hands, unwillingness to pay even relatively modest sums may well be anticipated.

### **Two Types of Condominium Law: Simple and Enhanced**

Condominium laws differ from country to country. For the purposes of this chapter, prototype laws have been chosen from two jurisdictions, in both of which the author has contextual knowledge and has conducted fieldwork. These two types of law have emerged from different housing traditions and socio-economic contexts, but share a similar definition of condominium property. However, they represent two sides of the spectrum (although not necessarily the extreme edges): the basic type of condominium law on one hand and the more sophisticated type on the other hand. The differences between these ‘simple’ and ‘enhanced’ condominium laws are most apparent when considering management and maintenance aspects.

Enhanced condominium laws prevalent in the USA and Canada are here exemplified by Florida. Although there are differences among legal provisions in the states in the USA and among the provinces in Canada, they have enough in common as a group to be labelled ‘enhanced’ condominium laws. In contrast, the condominium laws prevalent in the Mediterranean region and in some other parts of the world may be termed ‘simple’, and are here typified by the Israeli law. In Israel, condominium living encompasses a broad spectrum of households in urban areas, with housing units and apartment blocks varying greatly in economic value, size, the level of services provided, physical design, and levels of maintenance. Some are simply constructed and offer minimal services. Others offer luxury and prestige. A high proportion of all socio-economic groups apart from the very poorest owns condominium property. In Mediterranean countries, most of the existing stock of condominium buildings is not in towers but rather in ‘walk up’ buildings or in moderately high-rise buildings.

The laws and jurisdictions of Florida and Israel<sup>1</sup> are comparable because they are both democratic regimes and both belong to the same legal family: the common law tradition (Glendon, Carozza and Picker 2007: 23-49). More precisely, Israel is regarded as a mixed-system jurisdiction, with the influence of civil law being more apparent in less traditional areas such as the series of quasi-constitutional ‘Basic Laws’. Israeli property law dates back to legislation enacted during the British Mandate over Palestine 1921 - 1948, which drew heavily on English common law as exported to the colonies. Once the State of Israel was established in 1948, it adopted almost all the pre-existing legislation along with its common law foundations.

Although there are differences in gross domestic product per person between the USA and Israel (Florida’s is considerably higher), both jurisdictions belong to the group of advanced economies. The socio-economic differences between them in fact permit conclusions from this comparative study to be applied to a wider range of jurisdictions.

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<sup>1</sup> Note that the discussion here applies to Israel in its international borders. A different set of laws and practices applies to the occupied areas, both those areas held by Israel and those administered by the Palestinian Authority

### **The simple type of condominium law: the example of Israel**

As in many countries in the Mediterranean regions, the Israeli law was first enacted when most condominium buildings were middle-rise (2-5 floors), providing housing for many sections of the population. The prevalent building heights across Israeli cities until the late 1990s were three to five stories. Until the early 1990s, most high rise residential buildings reached only to eight to twelve stories. The steep leap in the height of residential towers developed in steps from the late 1990s onwards; first came towers of 20-plus floors, then 30-plus floors, and, more recently, even 40-plus floors have been gaining popularity. All but a few of these buildings are condominiums, with the few exceptions being institutional buildings that cater to special groups, such as the elderly, which are built either with government support or on a commercial basis. The same condominium law applies to all shapes and sizes of condominiums buildings. The question is, to what extent are the tower condominiums likely to be able to cope with the exacerbated market failures embedded in them?

#### *The Israeli law governing condominiums*

The 1969 Real Property Law establishes the basic rules of property rights as well as of condominium law. There is no other national legal mechanism that generally regulates maintenance in condominiums and in other forms of ownership of buildings. The 1965 Planning and Building Law, and its many subsequent incremental amendments, do not directly empower government to impose maintenance responsibilities on house owners, and nor do the laws that regulate construction quality and contracts between developers and residents. The Real Property Law 1969, which incorporated an earlier statute concerning condominiums dating back to British rule in the 1940s, sets out only two simple conditions to define a condominium: the building must have at least two separate units designed to serve for housing, business or the like; and the building must be registered with the State Registry of Condominiums. This legislation defines ‘common property’ in a way similar to condominium laws elsewhere, as comprising the ground areas, roofs, external walls, foundations, staircases outside private units, elevators, utility rooms and the like. The owner of each unit is assigned a non-specific part of the common property and any transaction in a unit also applies to the common property. The statute's criterion is that the proportion of common property is calculated according to the relative portion of each unit's floor area out of the cumulative floor areas. Under some conditions, the law permits a specific part of the common property, for example, the ground areas adjoining ground-floor units or parts of the roof directly above the top-floor unit, to be designated as attached to a particular unit.

Regarding cost sharing, all that the law specifies is that each unit owner must pay the due share of maintenance and management costs necessary for the ‘proper maintenance’ of the building. Proper maintenance is defined as activities necessary to keep the building in its original condition, plus any improvements made with time. The cost share is proportionate to the unit's floor area out of the total floor area, unless the

regulations adopted by the co-owners specify otherwise. The law devotes a single clause to authorizing the condominium to hire a professional maintenance corporation. The underlying assumption (and the practice, as discussed below) is that condominiums will be largely self-managed.

The Israeli law makes the management of condominium buildings as simple and easy as could be imagined. There is no obligation to form a separate legal entity such as a corporation or association; the law itself grants the elected representatives of the condominium legal authority to represent the condominium wherever necessary, for example to sign and enforce contracts for the necessary maintenance activities and to take legal action against unit owners who have defaulted in payment of maintenance fees. The elected representatives are also authorized to open a bank account in order to manage the money collected and to carry out the necessary expenditures for maintenance. However, they are unlikely to have legal authority to carry out ancillary economic activities such as purchasing real estate.

Rules of governance are set by default regulations, the Common Condominium Regulations, which are annexed to the Real Property Law 1969. These apply until or unless the owners in a specific condominium adopt a different set of regulations and register them with the State Registry of Condominiums. In practice, the majority of condominiums in Israel – which means the majority of households in the country – choose to remain with the default regulations. The Common Regulations specify that a general assembly of all unit owners must be convened at least once a year to set the maintenance fees and to elect a body of representatives of between one and five members for one year, irrespective of building size or number of units. The Regulations empower the general assembly to approve expenditures and make similar decisions ‘entailed by life as neighbours<sup>2</sup> in a condominium’. The representatives may convene more frequent meetings, and in fact must do so if a third of the owners so demand. One of the representatives should act as treasurer and must prepare six-monthly financial accounts to bring to the annual general assembly.

Most important is what the statute does *not* include. Unlike the ‘enhanced’ type of law, it does not oblige the condominium to establish a reserve fund for future maintenance expenditures (Levels 3 or 4). Indeed, the word ‘fund’ is not mentioned, though the condominium is fully empowered to create such a fund, whether on its own or by means of a management corporation. As discussed in the next part of this chapter, many condominium buildings encounter problems when they need to collect periodic lump sums for Levels 3 and 4 maintenance activities.

The Israeli law is also weak on enforcement powers. While the law obliges every unit owner to pay their share of the maintenance fees, whether for current or anticipated future costs, it does not grant the condominium special enforcement powers beyond those available as remedy in civil action for regular debts (see also Blandy,

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<sup>2</sup> The Hebrew term used is *ha-shhenut* which could be translated dryly as ‘living in proximity’ and, more emotively, as ‘neighbourliness’. There is no official English translation of these Regulations.

Chapter 2, for the similar provision relating to English commonholds). Neither the condominium entity nor a maintenance company has authority to place a lien on the privately owned unit as security for the maintenance fees owed. If, as frequently happens, a unit owner defaults in payments of the maintenance fees the condominium may submit a claim to an office of the State Inspector of Condominiums. This national statutory officer is empowered to hear both sides and request professional appraisals. Inspectors usually try to resolve conflicts in alternative ways but if necessary, they can also serve as a tribunal. Their judicial decisions have the powers of a magistrate court, with streamlined procedures. The Inspector's powers encompass the regular civil means of enforcement of civil contractual obligations. These do not usually include direct powers over real property unless other means have been exhausted, especially if the unit is the owners' residence.

The Knesset (Israeli Parliament) has revised the condominium legislation many times, but their amendments have focused on issues other than maintenance and upkeep. The basic structure and powers of condominium organizations, and the issue of collection of fees, have not been altered for decades. Concern for other urban and social issues have prompted the amendments, which each represent a particular need to update buildings on one specific issue. For example, Amendment 19 (1966) substituted a two-thirds majority for the unanimous consent of all unit owners which was previously required, before an elevator may be installed to update an older walk-up building. The growing social awareness of the Knesset is expressed, for example, in Amendments from 1987 and 2001. These empower apartment owners to alter the staircases and similar common property leading to a given apartment to make them accessible to disabled persons, without the consent of other condominium owners. Amendment 23 (2001) applies a similar rule to the introduction of solar energy heating and for disconnection from collective oil or gas heating.

These examples show that the Knesset's responses to these needs have all been ad hoc, and have each adopted the solution of providing for a special majority of owners to permit adaptations for newly emerging needs. To date, there has not been any attempt to establish a general rule requiring less than full consent of all owners before building renovation can take place. Nor has the Knesset revised the condominium legislation to address financial mechanisms for maintenance, the reserve fund, and the issue of enforcement. These issues will be further discussed in the concluding section of the chapter.

#### *Condominium Maintenance in Practice in Israel*

As may be expected, conflicts among condominium unit owners are not rare. However, in practice most are either resolved at the social level, without the Inspector's help, or are left unresolved. On this issue there are probably major differences both internationally, from one society to another, as well as within Israel's social mosaic. Although there is no empirical research to rely on, it is clear that in Israel, a highly urbanized condominium-based country, the capacity for self-resolution of conflicts in

condominium buildings is an extremely important resource with many wider implications for city life.

Where the Inspector does take enforcement action for default on condominium maintenance payments, he or she is likely to take social needs into consideration. This is because in Israeli society and law, housing is regarded as a primary need. Israeli courts are unlikely to approve an action that deprives people of their home (which in Israel usually means a condominium unit). The courts will not usually order that a unit is to be sold to pay the fees owed to the condominium, unless all other means have been exhausted and the unit is not the person's primary residence. The court may also view the value of the apartment unit and the very act of ordering its sale as highly disproportionate to the sum owed for maintenance. Therefore, Israeli courts rarely issue such an order except in very extreme situations.

Despite their modest enforcement powers, the hundreds of thousands of middle-rise condominiums in Israel have somehow been operating for decades in a tolerable way with regard to ongoing activities such as cleaning. The amount needed for Level 2 urgent maintenance works is also usually collected, sooner or later. At times, condominium owners put up with some free-riders, who do not pay their share, although not necessarily without any conflict. However, the deterioration of condominiums in lower income neighborhoods is becoming an insoluble problem. While Level 1 type maintenance is often carried out in these communities by the owners themselves, such buildings do encounter problems in raising money for any additional actions such as roof maintenance. There is no general public mechanism for investment in the maintenance of condominiums owned by low income households, except for occasional area-based government regeneration programmes.

The mechanism that compensates, somehow, for the weaknesses in legal mechanisms depends on the informal social norms that prevail in Israel and some other societies along the Mediterranean. Where the number of owners is not exceedingly high – say, up to 30 so that residents may know each other personally – the social expectation to pay one's share of the maintenance fees is the major mechanism which mitigates the free-riding phenomenon and unblocks some of the inhibitors to information flow. In these circumstances, free-riding cannot enjoy the social protection of anonymity.

However, where the number of owners is very large, such as in condominium towers, this social mechanism cannot operate. Furthermore, as explained above, the costs of long-term maintenance are much higher in towers than in middle-rise buildings. While the architecture of the middle-income towers may not be distinguishable from that of high-income towers, the location and socio-economic characteristics of the residents determine their future. Such towers are springing up not only in areas of high demand, but also in cities such as Beer Sheva, where there is no ostensible justification in terms of real estate prices or open space preservation.

In an attempt to find a solution to the management problem, an increasing number of new tower condominiums have recently hired the services of maintenance



companies. These companies were recently granted the same legal powers over defaulting individual owners as the condominium representatives. Field interviews conducted in 2005-6 with several leading companies showed that none has discovered a method to solve the free-rider conundrum (see Alterman 2009). When the condominium representatives compare offers by competing managers, they tend to select the least expensive package of services, rather than considering the proposals for long-term maintenance programmes. Most management companies do not even try to establish a fund to cover long-term expenses, probably because the chances of collecting the contributions from owners are small.

Where towers are designed for and sold to middle-income households, their quick deterioration seems inevitable. The real costs of long-term management (and even ongoing management) are high, relative to the paying capacity of such households which are usually also making high mortgage repayments on the same apartment. The extreme signs of decline may not be as strikingly visible on the exterior because current architectural design does not expose the external signs of deterioration, as buildings of the 1970s and 1980s do. However, the effects on property values caused by deterioration of elevators, staircases, or gardens are likely to be just as dramatic. The decline in the relative place held by such towers on the ladder of housing price and prestige may be quick to follow.

This scenario is ominous for Israeli cities, and for their counterparts in other countries with similar characteristics of condominium law and practice. Unlike mid-rise condominiums, towers are like sealed machines, making it difficult for future urban regeneration programs to offer additional development rights on the roofs or side wings of the towers as incentives to upgrade the buildings. And, of course, demolitions are so unfriendly to the social and physical environments!

#### *The Search for Surrogate Legal Mechanisms by Local Governments*

The shortcomings of the Israeli condominium law for managing tower condominiums has gradually become apparent to some Israeli planners, especially since the early 2000s and the sharp increase in numbers of tall residential buildings. In addition to the maintenance issues, developers and residents have occasionally also found it difficult to cope with the apportionment of special common facilities such as swimming pools, sports facilities, and concierge services. The law offers only one basis for allocation of common ownership and costs (by floor area), which sometimes seems inappropriate or unjust (see also Christudason, Chapter 6).

The main emerging concern about tower condominiums revolves around the issue of long-term maintenance. The author's research found that some individual local Planning and Building Commissions and local authorities around the country had already begun the search for legal mechanisms which might ensure that a newly approved residential tower would be well maintained. Some local governments had indeed foreseen the emerging problem, although, in general, they underestimated its magnitude. Most of the local planners looked for a solution along the same path as had

already emerged voluntarily in practice: the employment of maintenance corporations. The planners believed that if a legal mechanism could be found that would oblige condominium owners to contract with a management corporation, sustainable maintenance would ensue. Without any national legal platform to guide them, the local Planning Commission and other local government agencies began to experiment with alternative legal instruments.

Field research conducted in 2005-6 indicated that three different measures, which nonetheless all tend in the same direction, were being adopted or considered by some local governments in an uncoordinated experiment:

a) Condition inserted directly into the *building permit*, stipulating that the building may not receive a completion certificate (and so may not be transferred to the buyers) until the developer or the condominium representatives sign a contract with a management company;

b) Condition inserted into the *detailed plan* (equivalent to planning permission in the UK, and zoning or planning unit development in the US) stipulating that the developer or the condominium representatives must sign a contract with a management company;

c) Agreement made between the local Planning Commission, or the municipality, and the developer *outside* the statutory planning process (where it has discretion to do so). This agreement stipulates as an external condition that the developer must show a signed maintenance contract as above before the Planning Commission will exercise its powers and approve a plan and building permit.

All these solutions fall short of providing a sustainable solution to the problem. All orbit around the ‘panacea’ of a maintenance corporation, solving neither the free-rider problem in willingness to pay, nor the asymmetric information problem with respect to past and future costs. None of these three ideas tackles the problems of the expenditures needed in the future for maintenance Levels 3 or 4.

The first suggested remedy - relying on the building permit - is attractive to local governments because under Israeli law permitting development is almost totally within their control. At the permit stage, the developer is ‘ripe’ financially and eager to obtain the authorization to start building. Although this solution is the most flexible and can address potential problems with each new tower before it is too late, the building permit itself is a short-term, self-terminating certificate. Further, the legality of the condition itself is problematic, an issue discussed together with the next item.

The second instrument relies on a more permanent legal instrument – a statutory plan. However, approval of statutory plans for major projects takes years and cannot be ‘retrofitted’ to approved plans without great financial consequences to the municipalities. Thus, many tower projects would be able to escape the new proposed rules, if these were adopted. Furthermore, in current Israeli law there is some uncertainty about the legality of conditions of this type in statutory plans. There are no statutory guidelines specifically authorizing such a condition to be inserted, so this issue can only be resolved through case law.

The third instrument – an agreement outside the statutory instruments – is legally somewhat more robust since it is based on contract law. However, it may or may not be a better instrument for ensuring long-term maintenance. This depends on how enforceable such a contract would prove to be in the future. If the developer defaults, how will this affect the long-term maintenance of the condominium building? Furthermore, the legal status of developer agreements in the planning laws of most countries is often problematic. Unless they are specifically authorized by statute (and that is rare in comparative terms, and does not hold in Israel), their legality must be determined case by case (Alterman 1988, Alterman 1990). However, even if such a condition were to be legal, its wisdom is dubious.

Beyond the unresolved legal questions, all three instruments proposed by local governments are based on weak ground. Even if the contract that the developer is required to sign with a management company were to be ruled legal, the management company itself may not survive more than a few years. There is nothing in Israeli law to oblige maintenance corporations to stay in business or to protect the buildings they serve against the company's bankruptcy. The very fact that many local planning agencies around the country continue to fall for this illusion merely emphasizes the degree of their desperation to find some regulatory tool.

#### *Little Help from Central Government and the Knesset*

Local governments on their own cannot be expected to tackle a major national problem such as the one outlined here, at the scale encountered in Israel. The national government has not yet stepped in. There have, however, been two pre-legislative initiatives containing modest suggested steps in the right direction. In summer 2005 a then Member of the Knesset prepared a rough draft of a bill that would have revised the Law of Sales (Apartments) 1973, to oblige any developer of a condominium with over 40 units to state in the sales contract that the maintenance will be carried out by a management company, and to specify what services the company would be committed to undertake, and at what price. The bill would also have required each condominium regulation to insert an equivalent clause, but the draft bill did not go any further. This initiative is too rudimentary to be assessed, yet its grounding in the Law of Sales (Apartments) opens up an interesting possibility for future reform.

In 2008 there was a more serious attempt at legislative reform, this time from the then chair of the Knesset Finance Committee, M.K. Stas Misezhnikov (now Minister of Tourism). While this initiative also focuses on the management company concept, it anchors the obligation to contract with such a company in condominium law, rather than in sales law, which seems a more straightforward way of tackling the issue. It also begins to address the problem of how to oblige condominiums to establish a long-term fund. This more recent initiative is backed by a report prepared by the Knesset Research and Information Unit (2007).

However, both of these initiatives are still a long way from being submitted to the Knesset for enactment. The first legislative initiative outlined above makes the

important distinction between regular condominiums and those with large numbers of units, while the second is unclear on this point. This distinction makes good sense: too many regulatory and financial burdens should not be imposed on the vast majority of regular condominiums serving all population groups.

### **‘Enhanced’ Condominium Laws: the Example of Florida**

Among the US States Florida has been chosen as exemplar because, as the ultimate ‘sunbelt state’, it has attracted an especially high demand for condominium apartments for a relatively long time. In recent years, more and more Florida condominiums have taken the form of tower buildings. Many of these cater mostly to small households with no children, at upper-middle and upper income levels. Florida's condominium law falls among the ‘enhanced’ group, although there may very well be jurisdictions that have yet more stringent rules in order to reduce as far as possible the various free-rider tendencies amongst owners.

#### *Florida Law Governing Condominiums*

The Florida Condominium Statute 2008 is 92 single-spaced pages long – much longer than its Israeli counterpart – and is indeed much more sophisticated. It is clear that in the legislators' minds were not only the rudimentary objectives of establishing a special form of joint tenure and an organizational framework to operate it effectively. The intricate rules of governance indicate that the legislators also sought to curtail, or at least reduce, the major types of market failures inherent in condominiums.

The Florida condominium law requires that residents take positive action to form an association, as a Florida corporation for profit or not for profit. Unlike its Israeli counterpart, the Florida law empowers the condominium association to carry out real estate transactions including buying, leasing, and selling apartment units in the building. The Florida legislation tackles the issue of the inherent incentives for sellers to withhold information about prospective maintenance costs by obliging the initial developer to provide the buyer with a detailed calculation of the projected maintenance costs for the forthcoming years, prepared by qualified and regulated experts. All this information must be included along with the usual legal, structural, and mechanical information as part of the declarations that developers are required by law to provide to prospective buyers. The developer must supply the new owner with the initial bylaws of the condominium association, which must be read and signed by the buyers; new bylaws can later be adopted by the association. The entire package of information is usually scores of pages long and usually requires the help of a lawyer. The bylaws are overseen by a state authority.

It is clear that the Florida legislators, unlike their Israeli counterparts, sought to make a clear distinction between the ongoing maintenance tasks of Levels 1 and 2, and those that require larger periodic investments. In addition to quarterly estimates of income and expenditures, the Florida law obliges the condominium association to make a full estimate of future expenditures for the sort of repair actions that we have

classified as Levels 2 and 3. It specifies that the budget shall incorporate reserve accounts which:

include, but are not limited to, roof replacement, building painting, and pavement resurfacing, regardless of the amount of deferred maintenance expense or replacement cost, and for any other item for which the deferred maintenance expense or replacement cost exceeds \$10,000. (Section 718.112.1(f)2, Florida Condominium Statute 2008).

The state's regulatory authority must approve each condominium association's annual budget and estimates of future expenses. For capital expenditures, the Florida Act requires that the budget includes 'reserve accounts'. The rationale behind the legislation is clear: if money is not reserved in advance over a span of time, its collection in a lump sum is likely to encounter the free-rider syndrome in enhanced dosage. Yet at the same time, the statute authorizes a simple majority of the unit owners to waive the requirement to set up a reserve fund; thus the statute's ostensible wisdom in seeking to quell the free-rider effect regarding long-term expenses remains in part a paper tiger. The condominium association also has extensive authority to impose additional fees as needed and to enforce their collection, as discussed below. The legislation in Florida does not provide a default set of condominium regulations, but requires that each association set up its own bylaws (see McKenzie, Chapter 4, for the recent consumer protection measures which regulate these bylaws). The statute makes it mandatory for the association to assess each owner for *at least* the amount required in advance for payment of all of the anticipated *current* operating expenses and for all of the unpaid operating expenses *previously* incurred. This means that the condominium association is legally obliged to make assessments at a level that would prevent free-riders, but not necessarily for the full cost.

Perhaps the most important difference between the Florida and the Israeli laws lies in associations' powers of enforcement. The Florida statute specifically authorizes condominium associations to place a lien on each apartment unit and to sell it if necessary in order to secure the funds owed by the owners for the maintenance of the building. The associations are third in line of priority for securing their debt, after the local authority and the bank. The association's powers to claim the unpaid fees are extensive, including the powers to impose fines. In exercising most of these powers, the associations are independent; they do not need the authorization of a government agency nor a court order. Under normal circumstances when real estate prices are high, this linkage of the payment of maintenance fees to the apartment units themselves, which characterizes the 'enhanced' type of condominium laws, does provide an effective means of enforcement. It acts as a deterrent against failure to pay, since the owner is likely to lose a lot of money in the process of foreclosure, and at the same time provides adequate security to the condominium association's interests (for an alternative view of the foreclosure process, see McKenzie, Chapter 4). However, can the degree of deterrence withstand an economic crisis?

*Condominium Maintenance in Practice in Florida*

As in Israel, research was undertaken to investigate the extent to which the law indeed fulfills its objectives of preventing free-riders and other forms of market failure in maintenance. Interviews were held with several knowledgeable professionals in the Southern Florida area, including the president of the property management division of a leading property management group in Florida and his staff, a condominium developer, two lawyers who specialize in condominium transactions, and several real estate agents. The author also participated as an observer in the meetings of the condominium representatives of the building in the Miami area where she resided during 2006.

These expert informants were asked the degree to which, in their view, the statutory instruction to set up a reserve fund was in fact being observed; in other words, to what extent Florida condominium associations rely on the escape clause that leaves the establishment of a reserve fund to their discretion. The picture we obtained was mixed: the president of the maintenance company and his staff converged in their estimates that approximately 10 per cent of the condominiums entirely forego the establishment of a reserve fund. Our informants conjectured that these are largely condominiums with a majority of elderly households. At the same time, the interviewees estimated that only 40 per cent of the condominiums did set aside a reserve fund of adequate size for the full long-range needs of maintenance at Levels 3 and 4. It is debatable whether 40 per cent constitutes a reasonable degree of fulfillment of the law's objective, but there is no doubt that for the tower condominiums included in the other 60 per cent, this finding bodes bad news.

The research also found that there is a very high degree of professionalization of condominium management in Florida, with professionals from a variety of disciplines providing various specific services related to long-term maintenance. The legal requirement for each condominium association to prepare a forecast of its long-term maintenance expenditures, even if it decides not to set aside a reserve fund, has created the demand for such professionals. The fact that this task is overseen by government has further boosted this trend. Some of the professionals who must be consulted are specified in the statute; other specializations have evolved with time as market demand for better maintenance has become more sophisticated.

Even though the Florida statute does not require the engagement of a management corporation (unlike some of the surrogate solutions with which local authorities in Israel have been experimenting), a high proportion of high-rise condominiums in Florida do engage the services of such corporations. According to our interviewees, the competition in the marketplace among management companies does not revolve around the price of short-term maintenance services. This probably reflects the Florida requirement, absent in the Israeli statute, that each condominium association prepares and approves an annual long-term estimate of prospective maintenance costs. The performance of management corporations can thus be assessed against preset benchmarks that encompass preventive maintenance actions from Level 1 to Level 4. Another factor may be that some of the companies in Florida – unlike their Israeli

counterparts - have been on the scene for a long time. All these factors together contribute to reducing the asymmetric information failure in the market of tower condominiums, especially regarding maintenance operations of Levels 3 and 4, which are particularly complex and costly.

Finally, the enforcement issue is key to the capacity of any regulation to curtail the free-rider phenomenon. Our interviewees all testified that in Florida the condominium associations routinely exercise their powers against delinquent owners after about a month's grace. They do not (or at least did not, until the current economic crisis) hesitate to exercise liens and take possession of apartment units. If necessary, the association will offer the unit for sale, deduct the amount owed plus the legal and administrative costs and return the balance to the owner.

Now that both types of condominium laws have been analyzed, we come to the concluding sections, where we compare the two laws in order to glean out their broader implications for public policy. The Florida type of enhanced law appears to be the clear 'winner'. However, a closer, multi-faceted look reveals a mixed picture and some challenges for urban policymakers worldwide.

### **Comparative Analysis**

How well do the two types of condominium law – the simple and the enhanced types - perform as instruments to ensure sustainable, long-range maintenance of tower residential buildings? How well does each of them work to minimize free-riding among the condominium co-owners as well as asymmetric information between buyers and sellers? The conclusions are far from simple.

#### *The Capacity to Ensure Sustainable Maintenance*

Under normal economic circumstances, there is no doubt that the enhanced type of condominium law, as exemplified by Florida, is immensely more suited to tackling the long-term maintenance problems of tower condominiums than the simple type laws. It is clear that the Florida legislators methodically thought through the various types of market failure and attempted to address most of them by closing loopholes. But the legislators did not manage to close all the holes hermetically. They left the creation of a reserve fund and its level to the discretion of the condominium associations. Furthermore, even if such a fund is created, nothing in the law obliges the associations in the future to undertake actions beyond those that arise from Level 3 maintenance. Who will finance the costs of updating the building to the higher standards that are likely to hold in the future? Without such Level 4 upgrading, condominium towers are likely to lose their ranking on the housing ladder in terms of price and prestige.

Yet even these unequivocal advantages apparently hold only under economic circumstances in which real estate prices and the general economy are more or less stable in the long run. The 2008 sub-prime loans crisis and the ensuing financial 'meltdown' provide a rare laboratory to test the enhanced type of condominium laws. Both banks and condominium associations now own many apartments in condominiums. A January 2009 respondents' survey conducted by the Florida

Community Association reports estimates of dramatic increases in the number of foreclosures and, as a result, in non-payments of maintenance assessments (Community Association Leadership Lobby 2009). The survey indicates that the foreclosure crisis has resulted in postponements of major capital investments in upkeep or repair of buildings and other property, and that, in order to sustain their finances, many condominium associations are now finding it necessary to impose higher assessments on the non-delinquent owners.

Thousands of condominium owners are now offering their units for rent in order to pay the maintenance fees and avoid takeover by the condominium association. Other owners sell their units. A large percentage of renters and frequent turnover of owners tend to increase the prevalence of the intergenerational asymmetric information problem, and a large number of renters further increases the probability of free-riding compared with owner occupation. These trends inevitably imply a further plunge in the market price of the condominium units, and this, in turn, means that the new buyers may be a rung lower on the income ladder. Since the tendency to free-ride is also related to the capacity to pay, the decline in relative prices of the Florida condominium towers due to the economic crisis accelerates market failure. The situation is so grave in some parts of the USA, including Southern Florida, that a Miami Beach city commissioner has called it the 'condos' "death spiral" (Loney 2009). One may argue that the economic crisis accelerates the life trajectory of tower condominiums. It has made clear that even an enhanced condominium law such as Florida's cannot withstand the extraneous social and economic factors that a crisis of the current magnitude brings with it.

While the 'simple' type of condominiums laws takes a rather old-fashioned approach to maintenance issues, it has some advantage in time of crisis, being inherently more flexible than the enhanced type of laws. In a simple type jurisdiction, condominium owners are better able to meet the economic crisis because they do not have major overhead costs arising from the heavy regulation entailed by the Florida law. They are also free to change the maintenance fee level because they are not legally bound to a certain fee threshold as in Florida. Under the simple Israeli regime, owners are not legally bound to set aside money for future maintenance, and may therefore choose to reduce the fees during an economic crisis. While this is bad news for long-term maintenance in normal times, in a stressful period this flexibility may reduce the number of owners who would otherwise have to sell or rent out their unit in order to pay the maintenance fees. The ability to avoid an abnormally high turnover of condominium units may have significant economic value, and thus may provide a better interim solution than the Florida law. Crisis-driven decisions may not be very good for ensuring long-term maintenance, but their flexibility may balance out the weaknesses of the simple regulatory frameworks.



## **Conclusions and Policy Implications**

Whether or not to permit, or even encourage, tower condominiums is one of the most important urban policy questions facing decision-makers in cities and national governments around the world. Not enough policymakers are as yet aware of this question's importance, and this chapter's aim is to raise its profile. It has been shown that when it comes to condominium towers, rather than low or mid-rise condominium buildings, neither of the two types of law provides an adequate answer that ensures financing of long-term maintenance. While the enhanced type of laws offers a distinctly better legal framework when economic conditions are stable, they are less flexible when facing an economic crisis.

Given the higher maintenance cost in tall buildings, the higher probabilities for free-riding and the fact that essential investments increase with time, acceptable maintenance levels are less likely to continue over time in tower condominiums than in middle or low-rise condominiums. Once tall buildings deteriorate, they are difficult to rehabilitate and wasteful to replace, creating negative effects for the whole neighborhood.

### *\Policy Recommendations*

The major recommendation is that policymakers should regard all proposals for tower condominiums with suspicion. There should be extremely weighty public planning goals to justify their approval. For example, if the overriding urban goal is greater density, it is often possible to consider alternative urban design formats that achieve similar densities through middle-rise buildings. Calculations conducted by Alterman and Churchman (1998) show that mid-rise apartment buildings or moderately high-rise development can achieve adequately high densities and efficient use of scarce land resources. Towers do not necessarily achieve a more efficient use of land (see also Churchman 1999).

Unless there is public subsidy to finance maintenance for the long term, policymakers should approve condominium towers only in prime real estate locations where property values are initially high. Tower projects should be aimed only at upper income households. The probabilities of free-riding and foreclosures will be lower amongst wealthy residents than in towers oriented to middle or even upper middle income households.

If policymakers feel that condominium towers are nevertheless desirable, then the legal and financial mechanism that regulates their maintenance should be of the enhanced type. It should be mandatory to establish a full reserve fund adequate for Levels 1 to 4 of maintenance and renovation into the future. The range and extent of the reserve fund should be defined, and it should be directly monitored and regulated by a public body.

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