

Chapter 2

Differences and Similarities Between Contractual Communities, and Reasons for Their Success

Abstract In this chapter we will focus principally on the differences and similarities between contractual communities; special attention will be given to their similarities, as this will enable us to shed further light on the phenomenon of contractual communities, and lay the basis for the arguments and proposals tabled in the ensuing chapters. We will also outline the reasons for the success of this type of communities, and put forward some conjectures about their future.

Keywords Voluntariness · Benefit principle · Land rent · Leadership · Security · Technological innovations

2.1 Differences and Similarities

2.1.1 Differences

At this point in our argument it is worth pinpointing some of the differences and similarities between the various forms of contractual communities discussed here, first dealing briefly with the differences in this paragraph, and exploring the similarities more extensively in the next. The key differences between the contractual communities under study are basically two, and concern the *ownership regime* and *system of decision-making*.

As for the *ownership regime*, in the case of the proprietary community the ownership of the land is undivided, and in the hands of a single owner, both for the individual lots and for the areas used for common activities; in the case of the homeowners association, the ownership of the land is instead divided up among individuals, and only certain areas are jointly owned and used for shared activities.

As for the *decision-making setup*, they differ in one fundamental way: in the case of the proprietary community the “collective” decisions are entrusted to a single owner that manages the real estate according to the rent agreement; in the case of the homeowners association, the “collective” decisions are entrusted to an elected body of association members, whose task is to implement the association’s founding principles.

2.1.2 Similarities

There are at least five basic features shared by the contractual communities under study: (1) recognised boundaries; (2) the importance of the institutional aspect; (3) the voluntary adherence; (4) the principle of contribution in terms of benefit; (5) the function of land rent; (6) the special role of leadership.

Recognised boundaries

The first feature in common is the fact that contractual communities are strictly tied to an identifiable territory, namely, a tract of land with distinct contours (whether or not these are physically present). In other words, the identification of a specific portion of space is an indispensable factor for all the various possible forms of contractual community. If its boundaries were not clearly defined, then the rights and duties of the community (and its members) regarding the use of that space would remain unclear.¹

The importance of the institutional aspect

The second feature in common is not only the element of “design”, but also—and chiefly—the relevance of the “juridical and institutional” aspect. This means that what counts is not simply the physical and architectural unity of the ensemble of buildings and spaces, but above all the institutional basis on which they depend. The crucial point is that both proprietary communities and homeowners associations are primarily “institutional bodies”, over and above the physical arrangements. Clearly, in such cases the mechanisms of *private law* represent the basic tools for creating the institutional entities in question.² As Boudreaux and

¹ The scale and physical shape of the said enclave are not preconceived factors, as each one’s nature is instead determined by the needs of the context, adjusting accordingly to the evolving demands of the local use and management of the relative goods and services. As already pointed out repeatedly, this constituting feature of the community’s being anchored to the specific context, gives rise to a broad variety of spatial configurations for settlements of the kind under discussion here, ranging from a compound of separate buildings, to an urban neighbourhood, or a full-fledged community of town size.

² To distinguish the type of issues involved in *private* and *public* law, the first is said to concern the interrelations (e.g., the exchange of goods) among citizens; whereas the second covers the interrelations between the state and the citizens as a whole [with specific reference to land use issue, see Needham (2006)].

Holcombe (2002, p. 289) write, the great variety in private contractual governments is easily understandable:

Different people prefer different types of government just like they prefer different types of homes, cars, music, or food. But there are many local governments already in existence, so the question arises as to why contractual governments might be desirable The answer lies not in the goods and services contractual governments provide, but in the rules they follow to produce those goods and services.

In this perspective, “the contractual government’s creator, then, is actually producing and selling constitutional rules” (p. 304).

As aptly pointed out by Nelson (2005), the recent boom of homeowners associations in America can be seen as a grandiose exploration of “local constitutionalism”. In reference to homeowners associations, Lee and Webster (2006, p. 28) note how the boom seems to indicate a “convergent process of institutional discovery” under way; in particular, “neighbourhood government is being re-invented in the US as a response to state failure, limits on local taxation and the demand for greater choice and greater local control”.³ Similarly, and in reference to the growing phenomenon of proprietary communities, MacCallum (2003, p. 15) observes that “the unexpected result logically implied by this real estate trend is nothing less than the qualitative transformation of government”. In short, contractual communities are an engine of institutional reform (Brunetta 2006, 2008).

An important aspect that should be stressed here—and which appears even more evident in the present case—is that the land and the relative buildings are not merely a “physical fact”, and what is leased or sold is by no means a mere “material thing”.

On the one hand, a given parcel of land is not important solely for its inherent physical features, but mainly for its location—not in the static sense of geographical place, but as regards its dynamic position within a broader network of external effects of a both positive and negative nature.

By the same token, what is sold or rented out is not strictly a “thing” as such (i.e., a piece of land and/or a building), but effectively a certain type of “social jurisdiction” on a thing (i.e., on a piece of land and/or building). The market transactions are therefore not simply material transactions, but socio-juridical ones: exchange is “wholly social, denoting a change in human relationships; it is behind all physical processes, a matter of title and jurisdiction over physical things” (Heath 1957, p. 99). To put it yet another way, the right to use a given piece of real estate does not so much entitle a relationship over a thing, as involved a relationship between a plurality of individuals in relation to the use of a thing (Baron 2006, p. 1425; Needham 2006, p. 32).

³ See also Deng et al. (2007, p. 195): “Private communities, in various forms, compete in the search for new urban institutions”. And Chen (2011, p. 5): “HOA (Homeowners association) is a kind of institutional innovation by developers, which demonstrates... that there are institutional alternatives in neighbourhood management”.

Voluntary adherence

The third similarity concerns the principle of voluntary adherence on the part of the lessees or association members. In the case of proprietary communities and homeowners associations one can effectively speak of communities based on free contract choices (Fennell 2004).⁴ As pointed out by Foldvary (2006, p. 23), private forms of governance are distinct from their public counterparts—based on the notion of sovereignty—because they pivot on “explicit voluntary contracts among persons of equal legal standing”.⁵ Voluntary contracts are positive-sum contracts: in this case each party is gaining value; otherwise, the parties would not enter the agreement (Foldvary 2009).

Ellickson (1982, p. 1520) also suggests that the main difference between “cities” (as public entities) and contractual communities like “homeowners associations” is “the sometimes involuntary nature of membership in a city, versus the perfectly voluntary nature of membership in a homeowners association”. In brief, “public entities have involuntary members when they are first formed... By contrast, membership in a private organization is wholly voluntary” (p. 1523).

Obviously, what is *strictu sensu* voluntary here is the entrance and adherence to the contractual agreement; once the agreement is accepted, the terms and conditions became mandatory.

Given that the rules of cohabitation are automatically adhered to at the moment of purchase or leasing a property in a given place, basically the adherence to the “social contract” is automatically unanimous. In this sense it is not necessary to resort to a *hypothetical social contract*—as instead one must for political sovereignty—which the individuals would supposedly underwrite if they had been in an “original position” (Rawls 1971), or resort to an *implicit social contract*, which assumes that individuals accept it for the mere reason of not leaving the place in which certain laws obtain (Locke 1690). In fact, in the case of contractual communities, the contract is a *real social contract*—it is to all effects accepted and expressly undersigned by all concerned. Nelson (2005, p. 91) observes that this

⁴ The generative principles of the contractual communities combine the condition of freedom and voluntary action: two elements that call into play reconsidering some basic ethical values such as autonomy and responsibility (Goodman 1967; Ward 1973; Sennett 1992).

⁵ Contracts present the following qualities. First, contracts “are concerned with the distribution of responsibilities and obligations. They place responsibility on people and/or organisations to comply with their own voluntary agreements. As such, they facilitate ‘responsibilisation’ within civil society”. Second, contracts “entail a degree of reciprocity or mutuality. Responsibilisation is not merely one-way”. Third, contracts “assume a ‘sense of choice’. ... The more people believe that they have choice in ... an agreement, the more they are likely to adhere to its logic. In this sense, contracting is ‘reflexive’ as it seeks to achieve the collaboration and cooperation of those subject to the regulation, favouring self-regulation”. Fourth, contracts “presuppose a conscious awareness of a future and a desire to control the uncertainty of the future by regulating its excesses”. Fifth, contracts “provoke active rather than merely passive responsibility” (Crawford 2003, pp. 489–490).

case is “one of the few instances in the real world where all the governed have actually given their consent on the dotted line”.⁶

Contribution on the basis of benefit

The fourth similarity concerns the special meaning that the “levy” assumes in contractual communities. In the case of proprietary communities and homeowners associations, the quotas paid by the lessees and the members differ in some respects from the traditional levies paid to the local public bodies.

First, quotas are paid on the basis of a voluntary agreement. The principle of contribution is intrinsic to the voluntary agreement, and is linked to a levy that the lessees pay to the single owner (in the case of a proprietary community), and a fee that the association members pay to the board (in the case of the homeowners association). To put it another way, there is no coercive form of taxation to finance services for the common enjoyment, as the necessary quota is already included in the freely accepted contract.

Second, the quotas have been established in direct ratio to the benefits expected in return; in other words, those who pay are entitled to a corresponding benefit of exactly the type they have paid for. In economic science this is known as the “benefit principle” (Musgrave and Musgrave 1976). In this case the “levies” are conceived as “costs”, with consequent advantages in terms of allocative efficiency.

Third, the quotas are established once and for all beforehand in the original contract, and cannot be arbitrarily modified with legislative “innovations” (updates): in the case of proprietary communities, the levy and its possible revisions are stipulated in the rental contract; in the case of homeowners associations, the membership quota and the way it is calculated and updated are both fixed in the declaration of covenants, conditions and restrictions.

Fourth, levies tend to come *after* any upgrading carried out on the property, rather than *before* (as instead usually happens with local public administrations).

The positive role of land rent

The fifth similarity concerns the positive utilisation of certain aspects of the phenomenon of “land rent”. It is particularly interesting to note that the influence of some actions and interventions on the land is, in the case of both the proprietary communities and the homeowners associations, the very thing that allows contractual solutions to the complex issues of coexistence be found. In other words, the fact that the properties “incorporate” an increase in value owing to the

⁶ See also Ellickson (1982, p. 1526): “The initial members of a homeowners association, by their voluntary acts of joining, unanimously consent to the provisions in the associations’ original governing documents. ... This unanimous ratification elevates those documents to the legal status of a private ‘constitution’. The original documents ... are a true social contract. The feature of unanimous ratification distinguishes these documents from and gives them greater legal robustness than non-unanimously adopted public constitutions”.

enhancement of infrastructure and supply of services, is what allows for a “voluntary exchange” to this end. The increases in value of the land due to certain enhancements are, in this case, not a *problem*, but the *condition* that makes it possible to guarantee the collective services, accruing and sharing out indirectly the advantages among all the members of a contractual community.

To sum up: “The ownership of sufficient territory so that the rent generated by the goods can be collected enables the owners to eliminate free-riders and determine the profit-maximising level of collective goods to provide” (Foldvary 1994, p. 41). In other words:

When a private agency owns the territory (estate) serviced by a territorial collective good, it can simultaneously provide the good and collect the rent generated by it, satisfying the conditions of simultaneity, benefit and voluntarism. ... Consensual rent collection is an economic equivalent of government land-value taxation, except that the equilibrating agents operate by a market rather than a political process (Foldvary 1994, p. 42).

It is therefore clear that, in the case of the contractual communities, the land rent should not be seen merely as a form of exploitation by owners who benefit passively, but instead becomes a component of a more articulated active operation for the enhancement of the territory.⁷

The function of private leadership

The sixth similarity concerns the particular role of leadership performed, in one case, by the single owner and, in the other, by the board of the association. What is interesting to point out is that, in both these specific cases, the agent acting out the role of leadership has a more clearly defined field in which to act compared to traditional public bodies, but also a more vested interest in the success of its actions.

First, the agent operating the leadership cannot alter his or her range of action, and is closely bound to complying with private law and with forms of mandates that are explicitly geared to a specific end; in other words, the agent cannot alter the private originating declaration from which he or she takes its role—as instead public authorities do with increasing disregard. Should some contravention occurs, the private leadership can be dragged before the court by any one of the lessees or association members. About the role of the single owner in a proprietary community, MacCallum (1970, p. 88) observes: “In comparison with that of a sovereign official, the role of an owner is clearly defined. His obligations towards his tenants are detailed in the lease agreements negotiated with each”.

Second, in many cases the leadership has a more direct interest in the success of his actions: paradoxically, the private dimension within which he performs his duties increases the responsibility of the decision-maker. The very programming of the duties to perform—complying with a specific schedule, a budget, and the auditing of the results, etc.—is in many cases more accurate and transparent than

⁷ We will return to this issue in [Chap. 6](#).

what takes place with the public authorities in corresponding operations. In short, in certain situations the incentives to toe the line are more transparent and direct for private leadership than in public administration.⁸

In pointing this out, it is not opportune to generalise indiscriminately beyond the forms of organisation under study here, nor should we conceal the drawbacks and failings that inevitably befall *any kind* of leadership; that said, we must not underestimate certain decisive structural features that connote the performance of leadership in certain specific private areas and which manage to forge particularly close links between authority, responsibility, and efficacy.

As we shall see further on (Chap. 4), this is not a call for the end of the public body, but simple to radically re-examine its role, and not expect it to perform beyond its means.

2.2 Plural Motives for the Emergence of Contractual Communities

As explained earlier, contractual communities are spreading, and have recently been gaining ground in the United States in particular. Taking for granted the fact that this expansion come about if (and where) a favourable legal framework prevails, and if (and where) the local administrations are not opposed to such schemes,⁹ we will now take a look at the question of *demand* and *supply*.

2.2.1 Questions of Demand

From the point of view of demand, our conviction is as follows: in their attempt to account for the emergence of certain phenomena, the usual “single-cause psychosociological explanations” prove to be completely inadequate, because they tend

⁸ Worth noting are the results of a national survey in the US conducted by Zogby International in 2009 on behalf of the Community Associations Institute. While the survey covered several types of community associations (homeowners associations, condominiums, housing cooperatives), the results are indicative for the arguments under discussion here. To the question: “Do you think the members of your elected governing board strive to serve the best interests of the community as a whole?”, 44% responded “Absolutely”, and 45% “For the most part”. Source: Community Associations Institute (www.caionline.org).

⁹ In the United States various local administrations have welcomed the fact that certain companies or associations opted to take on the direct management of infrastructure and services, thereby considerably easing the tight local budgets (McKenzie, 1998). Elsewhere, for example in some countries across Europe (e.g., Italy), one can see – at least for the time being – a stronger aversion of public administrations toward such contractual communities as homeowners associations.

to reduce the “consumers” of certain forms of contractual communities to a single, univocal psychological type, driven by crude and antisocial impulses. The reality instead is that many individuals are doing nothing more than exercising their liberty to willingly enter contractual communities in their quest for good-quality living environments, for services that address their needs, for greater guarantee of an increase in value of their real estate investment, and for more direct forms of involvement in the running and care of their neighbourhood, and so forth. Factors of this kind are combined variously (Glasze et al. 2006a). The concern for personal safety and security, which many writers continue to see as the primary obsession of people choosing private residential communities, is therefore only one of the elements of a more complex whole of motives, and furthermore not always the purchaser’s and tenant’s priority.¹⁰

As observed by Glasze et al. (2006b, p. 2) in their *Introduction* to a book that brings together varied research into the phenomenon of residential contractual communities all around the world: “security is only one service that residents want and in both conventional and private neighbourhoods it is generally packaged up with other services. Locational choice is made on the basis of subjective evaluation of bundles of civic goods”. The same point is endorsed in the book’s *Conclusion*:

Contrary to much of the media coverage about secured communities, security seems to be only one motivation for moving into this form of neighbourhood. It is often not as important as the desire to secure the supply, more generally, of a bundle of rights including the rights to goods and services and freedom from risk of all kinds (Webster and Glasze 2006, p. 232).

Generally speaking, the question of safety and security is more layered (Kilburn and Shrum 1998) than some rather simplistic readings continue to obtain; and many assumptions that have come to be accepted without question should be critically revised.¹¹

¹⁰ We quote here the results of the national survey carried out in the United States by Zogby International (2009) (covering homeowners associations, condominiums, and housing cooperatives). As for “the best aspects of living in an association”, the replies are as follows: 23% “Neighbourhood attractiveness”; 22% “Less maintenance for individual homeowners”; 13% “Community safety”; 11% “Property values”. Source: Community Associations Institute (www.caionline.org).

¹¹ It is interesting to recall here some data covering the situation in the US taken from the recent American Housing Survey (United States Census Bureau 2009). Some 90.66% ticked the option “satisfactory police protection”; and only 6.57% ticked “unsatisfactory police protection” (The remainder gave no answer.). As for the question “serious crime in past 12 months” in your neighbourhood, 80.6% responded “no”; 17.26% responded in the affirmative. These data seem to indicate both that crime is not perceived as a constant and pervasive threat, and that people are quite satisfied with the protection offered by the police force. See Appendix, Tables 7 and 8, for details.

2.2.2 Questions Regarding Supply

On the supply side, it goes without saying that real estate developers and market agents tend to prioritise and favour forms of settlements in which lessees or owners are willing to make a larger investment. For their part, developers have contributed and will continue to contribute and/or administer certain types of goods and services in a way that guarantees them significant economic returns. This is not so much because [as claimed by McKenzie (2005, 2006) and Winokur (1994)] the physical conformation of certain contractual communities—usually with a dense layout and ample collective spaces—allow for particular savings in their construction, as for the fact that contractual communities are distinctive “institutional subjects” that guarantee certainty and quality over time, and are therefore appealing to the market.

It is interesting to note here that developers are likewise taking greater account of environmental issues and sustainability—also when creating settlements that are specifically intended for contractual community management—given the growing interest in the public and market in these issues. In addition to the better-known cases (for example what took place at the island of Hilton Head in the United States¹²), there is a growing occurrence of contractual communities that make proper care for the environment one of their main priorities.¹³

¹² The development was got under way by two construction partners, Charles Fraser and Fred Hack. From the outset Fraser and Hack failed to agree on the development project: but the two decided to go ahead—separately—with two different projects. Hack constructed traditional buildings without an overall scheme, and sold them piecemeal as they became read. Whereas Fraser conceived a unitary settlement and functional community of residents, envisaging forms of specific safeguard for the island’s ecosystem, applying rigid covenants that bound owners to the upkeep of the original project over time. In this way he began to realise the settlement of Sea Pines, which would become one of the most cited examples for the combination of residential development and environmental protection. Fraser’s approach was so successful in economic terms that his former partner was forced to recant and copy the former’s scheme—the same applied to many of the other islands and coastal sites in the area. In such cases, the developers went far beyond their legal obligations in terms of respect and protection of the environment. As Rinehart and Pompe write (1997, p. 555), commenting the case of Hilton Head: “By not building as close to the ocean as possible and by protecting shoreline vegetation, property values for the community are enhanced. Although developers find protecting such environmental resources costly, they will voluntarily engage in such activity when they expect to receive private net gains”. And: “Private developers are making significant efforts to protect environmental resources that add to the net collective value of the community. These efforts are simply profit-maximising behaviour by developers responding to property owners’ growing demands to protect the environment and preserve the natural landscape” (p. 557).

¹³ Examples worth citing in the United States include: Ross Bridge (Alabama), Civano (Arizona), DC Ranch (Arizona), Desert Highlands (Arizona), Talking Rock Ranch (Arizona), Portola Valley Ranch (California), Village Homes (California), Sea Ranch (California), Bonita Bay (Florida), Tupelo Plantation (Florida), The Peninsula at Golden Isles (Georgia), Huntsman Spring (Idaho), River Rim Ranch (Idaho), Prairie Crossing (Illinois), Coffee Creek Center (Indiana), Radisson Community Association (New York), Mountain Park Home Owners Association (Oregon), Eagle Rock Reserve (Montana), Great Brook Preserve (Maine), The

2.3 The Role of Technological Innovation in Fostering Possible Further Development of the Contractual Communities

As we near our conclusions, a considerable aspect worth highlighting is that instances of contractual community may undergo a surge as a result of certain forms of technical advances that can significantly alter the supply of certain types of services.

Generally speaking, it is worth noting that very often political and economic theory assumed technology as a given (Foldvary and Klein 2003b). Part of the justification for attributing a decisive role to the state in so many fields is tied to the habit of considering certain forms of technology as fixed elements of our world. In truth, many technical advances under way actually favour the freeing up of various sectors. As Foldvary and Klein (2003b, p. 1) observe, the technological advancement under way tend to favour the case for free-enterprise action; it reduces the relevance of market-failures arguments and the case for public intervention:

Most market-failures arguments boil down to claims about invisible-hand mechanisms being obstructed by some kind of transactions costs. If technology trims transaction costs – by making it easy to charge users, define and enforce property rights, exit and utilise substitutes, gather information, gain assurance of quality and safety, enter and compete in markets – the invisible hand works better.

This aspect is particularly important for our discussion of contractual communities, as they are in a position to exploit these technological advances as a means of securing certain basic resources for themselves. In this way they eliminate the need to link up to (and depend upon) the statutory supplier network.

A case in point is the opportunity of improving solar energy transformation for domestic use; another opportunity is to create independent water processing and recycling plants—in particular, closed-circuit systems (Foldvary and Klein 2003a). To get such innovations off the ground would clearly require radically rethinking the traditional methods of supplying services, and would entail creating the conditions for significant alterations to administration and social organisation.

(Footnote 13 continued)

Branches at East Fork (North Carolina), Crescent Communities on Lake James (North Carolina), Balsam Mountain Preserve (North Carolina), Cliffside of Hickory Nut Falls (North Carolina), Creston (North Carolina), Firefly Mountain (North Carolina), French Broad River Crossing (North Carolina), Hickory Nut Forest (North Carolina), Highlands Pass (North Carolina), Mount Wilderness (North Carolina), Palmetto Creek (North Carolina), The Cove at Flat Gap (North Carolina), Cedar Creek Falls Retreat (North Carolina), The Legacy at Jordan Lake (North Carolina), The Preserve at Little Pine (North Carolina), Sunalei Preserve (North Carolina), Dewees Island (South Carolina), Seabrook Island Property Owners Association (South Carolina), Haig Point Club (South Carolina), Daufuskie Resort (South Carolina), Spring Island (South Carolina), Kiawah Island (South Carolina), The Ponds (South Carolina), Woodland Valley (South Carolina), Thunder Pointe (Tennessee), Homestead Preserve (Virginia), Preserve at Hunters Lake (Wisconsin).

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