

## **Institutional Innovations:**

### **Case Study in Homeowner Self-Governance**

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#### **[Abstract]**

**Given the governance problem posed by CPR, and facing the challenge of institutional obstacles to self-organization, condominium owners chose to create innovations to the traditional pattern of governance. In this paper, in accordance with the theoretical method of Elinor Ostrom's principles of institutional design, two typical cases: "Homeowner Representative Assembly System" and "Trusteeship of Property Management System" are compared, analyzed and evaluated. The inquiry derives the institutional incentive conditions for collective action by the specified groups and the requirements of common interest ownership without outside authorities or coercive force. It is shown that homeowner groups can solve the problem of supplying new institutions in ways that go beyond the assumptions of traditional theories of the collective action problem.**

**[Keywords] Homeowners, Common Pool Resource, self-governance institutions, innovation, collective action**

#### **Background of Homeowners Self-Governance**

**In China, the centralized regime has been in existence of a long tradition of history. In the early 1950s, the extreme case, there were only 44 civil organizations in national level, and less than 100 in 1965. Even these so called civil organizations were most of official established labor Unions, Communist Youth League, Women's federations, and the Association of Industry and**

Commerce and Association for Science and Technology, etc. (Yu Keping 2005)  
Since 1970s the starting of Reform and Opening policy, The civil society has been beginning of rehabilitation and civil organizations have emerged in China. As the same situations of requirements of rule of grassroots, Chinese Central Government Promulgated regulations to require the formations of Village Committee in rural area in 1987, Residential Committee in Urban Area 1989, and Homeowners Association(HOA), in Urban Condominium 1994.

However, after decades of development, HOAs show totally difference nature from the other organizations of grass roots. Village Committee and Residential Committee are actual branches of the Governmental authorities in grass-roots but HOA is still pure NGO, which give us Chinese scholars a good opportunity to observe such a classical sample of pure civil organization's development process: how Chinese HOAs' self-origination and self-governance are carrying out and developing under a background of political, economic and social conditions and environments:

A. NGOs are still tightly controlled by governments. For instance, citizens assembly, the organization's setup and designation of institutional rules must be exactly strictly in accordance with regulations and legal procedures in particularly in such a private governmental organization as HOA, which is often seen a trouble maker by most of local governmental officers. Homeowners must be struggling for organizing and registering HOA's with local government departments, developer, property management company, which in most ideal situation need one year for meeting official Statutory procedure and some even took many years but still end without result.

B. On the other hand, in grass roots of civil society, people lack of habit on working with neighbors voluntarily. So, people lack credibility and trust to community leaders and activists.

Therefore, due to this circumstance there are always debates and argument on Legitimacy and validity of any issues of institutional innovation in homeowner's self-governance. From a positive perspective, this situation also led to these issues into public domain: reported by media, discussed and researched by scholars, quoted by lawyers, paid closed attention by governmental officials, adopted by law-makers and controversy often involved by the public. However for scholars, HOA, as introduction above of being a pure sample of NGO, can be a typical case to measure the level of status quo and development of China's civil society. Furthermore, this observation also can be used as understanding whether emergency of order out from a combination of self-interested individuals or which people in CPR situation inevitably fall into dilemmas described by some influential models of the "tragedy of the commons". (Elinor Ostrom 1990)

Furthermore, we try to explore, such a grass-roots organization, a basic unit of human society in Chinese centralization of authority and very weak civil society tradition , while in the governance of their own affairs, whether it is essential to depend on the enforcement

authority in the external control from a failure or it is in accordance with their own wishes, relying on well-thought-out order and structure a rational collective choice to achieve good governance. Just as Ostroms question quoted from Hamilton “whether societies of men are really capable or not of establishing good government from reflection and choice, or whether they are forever destined to depend for their political constitutions on accident and force” (Vincent Ostrom 1987)

In this paper we try to exam two assumptions:

- A. What kind collective actions do they take to deal with the challenges?
- B. How effectives these actions' performance?

To answer these questions above, we have to understand the problems HOAs are facing to.

First, the Property Right Regime: condominium is based on a type of CPR situation as Elinor Ostrom defined. From the attributes of economic goods, it belongs to mixed goods. Each owner is entitled to exclusive ownership and use of the owner's unit. The common elements and an undivided interest in the common elements is appurtenant to each owner's unit. The common elements shall not be partitioned or divided, and which are non-rival consumption and non-exclusive consumption.

In a state of China's transition phase, rules to determine the legal ownership are often absent or vague. So HOAs are often in difficult situation in dealing with community public affairs such as in protecting and exercising their rights. How to build a system of property rights for adjusting and regulating the multilateral and complex relationship become China's civil law problems.

Second, System of Community Governance: There are always problem of governance. According to Olson's theory of collective action (Olson 1995), the most important factor he discussed was group size, and the conclusion was unless small size groups of limit member or there were coercion or some other special means, rational self-interest seeking individuals would not take action to achieve their common interests. The logic of collective action refers to the conflict between individual rationality and collective rationality, which demonstrates that common interest is not the sufficient condition for collective action. (Chen Youhong 2007)

HOAs in China are of big size groups, average in 1000 households, some even more than 5000 households in one residential complex. HOAs actually face huge challenge in dealing with their own business in self-organization and self-governance. Many arguments focus on the feasibility and reasonableness of the formation of such a system's organization and decision-making procedures regulated by law. As pure NGO, since governments don't use administrative authority and resource to setup HOA as they do for Village Committee and Residential Committee. Thus if the homeowners are unable to overcome the obstacles, and are unwilling to invest their own resources, HOAs could not successively establish their own organizations in a community. In Beijing the rate of HOA established is around 19% in all

residential complexes and about 20-30% in main cities as Guangzhou and Shenzhen. Also internal and external conflicts, disputes are arising from a large number.

Our survey in 138 Residential Complexes showed only 23% HOAs of them successfully liquidated assets of condominium, 48% HOAs grasped information of amount, deposit bank, etc. of their funds of maintain, no more than 35% HOAs have contacts with the Property Management Company(PMC)( the others were hired by the developers), so it is no surprising, there are 70% HOAs had Service Fee disputes for service fee with PMC and of them 40% was of serious disputes, and 74% had conflicts with security guards (which paid by HOA but belonged of PMC) and of them 30% of vehement conflicts, many causing violence. (Chen Youhong 2007)

The institutions of HOAs' self governance are a consequence of self-generated collective actions arises from the interaction of a decentralized, heterogeneous group of self-seeking agents with limited knowledge. In such a circumstance, we could review from our cases below to observe what collective choice the homeowners will choose in community, if not rely on the coercive power of external authority.

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## **II Analysis of Case One: The Trusteeship of Property Management Model**

This institutional arrangement of model is based on an idea of the important contribution of building social trust to social development. In Georg Simmel's term, Chinese urban area is in transition of "a society of acquaintances" to "a society of strangers". In this transformation process, the indifference is a normal phenomenon. This process requires members of the community through cooperation and consultation, to enhance the level of trust and then reach consensus and achieve good self- governance.

One of the designers Meng Xiansheng pointed out, without social public credibility and public trust, homeowners won't be able to build a well-organization, and thus, condominium's common property, common elements and public facilities would continue to be controlled by the developers and PMC. This consequences result unavoidable disputes and conflicts, because the nature of chasing profits by businessmen and pursuing for public interest of community public objectives by homeowners are running in the opposite directions. (Meng Xiansheng 2008)

The designers tried to re-build a legal relationship between parties of condominium and so as to balance the relationship between the role of firms' maximum profit and their social responsibility. Therefore in this system, it was assumed the trustee's legal obligations were loyal to the beneficiaries, to provide

real financial information, and self-prove its authenticity. Furthermore, the trustee were not only loyal to people, but also cautious in their honor. On the other hand, the legal relationship of Trusteeship system could be enforceable in the courts if problems or disputes happened. (Meng Xiansheng 2008)

In details, on the design of the Trusteeship of Property Management(TPM) model, it set the common part of condominium to be trust assets, so to establish a direct link between public affairs management and the interests of homeowners' property. Moreover, the subject matter of entrustment included the maintenance funds, the rights of control, management and administration of the common parts. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)

The designers defined the parties involving in condominium ownership to be clients, trustees, and beneficiaries:

The trustee could be legal or natural person, such as property management company or an property administrator. The whole of individual homeowner were beneficiaries.

Instead of HOAs, in this setup, individual homeowner was put on a most important position. First, individual homeowner was the client. Clients holded the right of decision – making by Majority Rule, and moreover, the individual member of the clients were empowered to claim for one's own right and could take legal action to sue to a court if infringed by trustee according to the principle of Trust Law. Which, the designer called it “Rat eats an elephant” mechanism. They addressed it could stimulate the homeowners to participate in the community public affairs and also could prevent from the problem of collective action. Furthermore, designers suggested the model could setup supervisors or monitors to audit the conditions and trustee's behavior accountable and keep the stability and transparent of the property management process. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)

Arguments about this model most focus on legal issues. The main points challenged were whether the business of "property management" could be a subject matter of entrustment? Jin Jingping asserted the right of administration of the common parts in Condominium is an integral part of business that belongs to the whole homeowners by China's Real Property. Thus, Jin said it was assumed that right could not be transferred separately from the real property. In contrast on a property of entrustment, she pointed out the attribute of difference between them is, a property of entrustment must be transferable, so the court could sale it by auction, if the trustee, natural person or an enterprises,

failure or go broke. Besides, Jin addressed, from the view of functions between trusteeship and real property management, there are also far different. The duty of trustee is to be entrusted on behalf of people, and maximize the interests of the beneficiaries, so trustee possess full rights of operation and management of property. Trustees engage in a great variety of legal nexus that cause changing of legal acts. But property management in condominium is engaged in more Day-to-day affairs and totally different from the former attribute. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)

Jin said although the designer wished by this way to solve the problems of homeowners' collective action and to made it possible for all beneficiaries eligible to participate in public affairs, decision-making and supervision. However, she was of the opinion that from the current judicial practice, an individual property owner tried to prosecute a company was not supported by the law so far. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)

Zhang Tianmin took a much more positive point of view towards this model. He firmly believed the designing principles of this Trusteeship Model did not contradict to any provision item of Chinese "Trust Law" and " Real Right Law ". However Zhang agreed that there were still some legislation works needed to do for solving legal issues due to the clients were individual homeowners, so there need build a system working for collective choices mechanism. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)

Although there were very different opinions among experts, it was symphonious that this model needs to distinguish two levels of of internal and external legal nexus which can not be confused:

A. should design rules on the internal legal nexus level for regulating the relationship among all homeowners;

B. should design rules on the external legal nexus level for regulating the relationship between manager of trustee and the whole homeowners. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)

Jing Jin-ping elaborated these two legal nexus between the two levels need to build two different systems. The internal system was construction based on community constitutional documents that required homeowners to clear rights and obligations between two levels of individual member and the group, which would form into a mechanism of collective decision-making. She claimed the right of individual legal action can not take the place of group supervisory system. Ren Chenguang emphasized the fundamental issue here was not the trust contract with the external managers but the institutional operational designing of homeowners.

**In sum, from a long-term point of view, theoretically common ground of comments about this model was it of great value. Zhang Tianmin explained there was similar legal system in international community, such as Quebec's Law, real property management was of trusteeship. In terms of the relationship between property managers and owners, Zhang Tianmin thought the current system provided by national "property management regulations", was not optimal, because the system needed HOAs having a well-founded professional client capacity but that was unpractical. Thus, the trusteeship model was a valuable strategic direction and worth to work for it. Moreover, he added, Chinese Trust Law defined very strict obligations of the professional competence, so that would push the trustees working for the best interests of the beneficiaries to manage the homeowners' property. (Beijing Real Estate Institute and Beijing municipal Construction Committee 2008)**

**Meng Xiansheng concluded this model of far-reaching significance by building the community on credibility, trust, cooperation in a development of self-organizing capacity, and to cultivate public spirit. He believed the system was trying to pursue a long-term effect of value orientation, beyond the question, the institutional arrangements would be beneficial to improve the integrity and trust of the society. (Meng Xiansheng )**

### **III Analysis of Case Two:**

#### **“Homeowner Representative Assembly System”**

**Compared with Trusteeship model system, this system is more focusing on internal governance structure of HOAs. Of which, Chinese National regulation "Property Management Regulations 2003" setup two-tier organization framework of HOA, and only describes a basic structure:**

- 1 . Homeowner Assembly: the whole owners, decision-maker**
- 2 . Homeowner Committee: an executing agency**

**In 2007, Chinese Real Property Law empower the ultimate rights of government of common part to individual owners and give them more legal space to create organizational structure in accordance with their community's condition and surround, so HOAs' institutional innovation have the legitimacy, and legally won't be challenged by external governmental authorities if only that creations are approved by majority votes. (Zhao Heng, Lin Yihai, 2007)**

**The designers and advocators claimed this system was prerequisite of social division and social development. In addition, they tried to introduce a mechanism of check and balance for condominium self-governance. In the residential complex of Shang-Di-Xi-Li this**

initiation was approved and described by constitutional documents of Shang-Di-Xi-Li Homeowners Convention, Shang-Di-Xi-Li Homeowners Rules of Procedure, and Election Procedure. This approved was proceeded by the rule of *double 2/3 votes* in accordance with the provisions of Chinese Real Property Law, (article 76: ... For making a decision on matters prescribed in Item (5) or (6) of the preceding paragraph, the consent of the 2/3 or more of the total owners with exclusive parts accounting for 2/3 or more of the total area of the building shall be obtained. For making a decision on any other issue prescribed in the preceding paragraph, the consent of half of the total owners with exclusive parts accounting for half of the total area of the building shall be obtained.)

Therefore, the designation of system developed the original two-fold structures of organization to a more complicated structure:

first, for the structure of organization: the collective of individuals-- Homeowner Representative assembly(HRA) -- the Board of Supervisors(BS)—Homeowner Committee(HOC).

Second, for the functions of organization:, the decision-making - - the executive - - the supervision.

By this institutional innovation, the designers built a decentralized decision-making and the mechanism of check and balance. The decentralized decision-making power was divided into two-tier system, The whole homeowners (HOA) referendum and Representative assembly.

The power system of check and balance divided functions of organization into three parts: decision-making part(HOA and HRA-- the executing agency of part (HOC)-- supervision of part (BS)

The designing principle of the organization could be summarized as follows:

1, The power was limited and authorized by constitutional documents, such as condominium convention, charter and bylaws that are made by majority rule. (Shang-Di-Xi-Li Convention 2007 )

2, A framework of Cooperation and Teamwork was formed by these structure of HRA, HOC, SB...

3, Structure of Hierarchical and decentralized decision-making. Exception of the issues must be voted by all owners prescribed by Real Right Law the institutional arrangement of this innovation through all owners “double 2/3 vote” by legal proceedings according the Real Right Law empowered:

A. HRA to decision issues of procedures, organization and personnel; Business or service in contracts that cost RMB 100,000 or more, and regarding to the proposal, investigation, audit, supervision and dismissal, internal conflict-resolving;

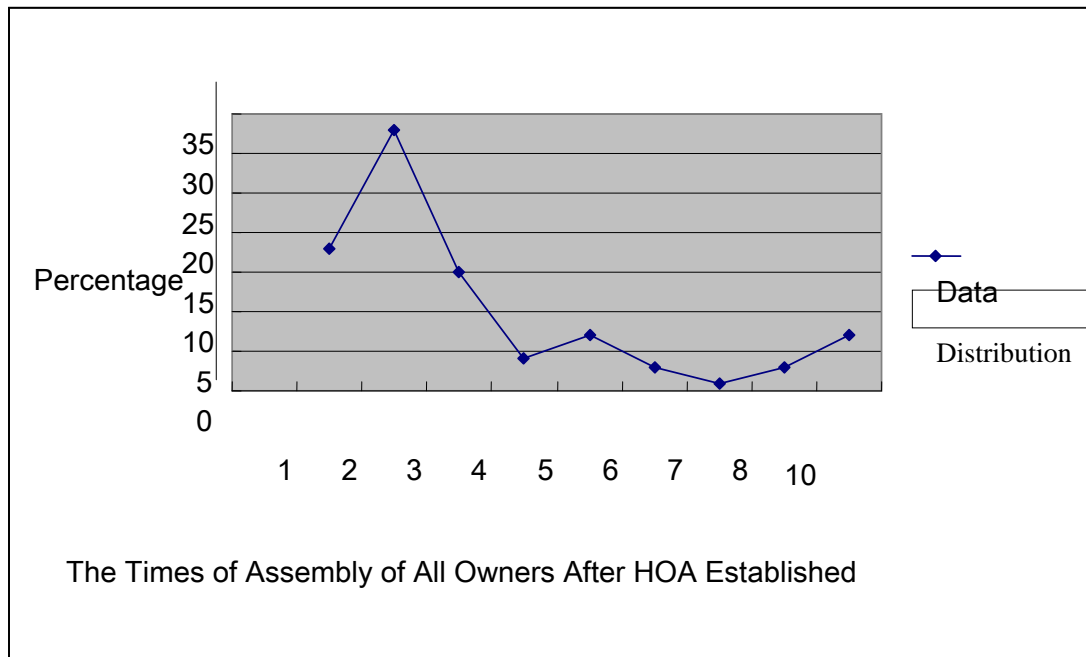
B. HOC to decision Day-to-day affairs.

C. Owners to decision to use the funds to rebuild their own building or any of its affiliated facilities involving in this building, and HOA in charge of assisting to this building owners’ vote proceeding.

#### 4 , The principle of legal remedies ((Shang-Di-Xi-Li Convention 2007 )

Homeowner committee, representative, managers and any staff in violation of relevant laws and regulations, in violation of this Convention and Procedures against the interests of homeowners, the owners have the right to exercise the power at any time in accordance with the procedure, homeowners can take actions by all legal means to protect and restore their rights. (Shang-Di-Xi-Li Convention 2007 )

No doubt discussion is the premise of decision-making. Discussion platform is the most remarkable and important institutional innovation in this system. There are no any article by Real Right Law or China Regulation Realty Management set any legal interpretation for how to make decision in a group of thousands decision-makers. But, in contrast, laws above-mentioned setup the most stringent conditions for homeowners' decision-making and action-taking. That makes homeowners almost unable to act if they wouldn't find a way out. In this case, the system makes HRA a channel of discussion, debate and question for condominium business. The Figure 1 below shows the frequency of homeowners' assembly after HOA establish and about 33% HOAs held 2-3 times assemblies. But HRA at the residential complex of Shang-Di-Xi-Li already held more than 20 meetings and discussed/decided by vote more than 60 issues.



As Zhao Heng pointed out that institutional arrangement built a platform in community where information communicating, ideas exchanging and proposals debating, so that all kinds of contradictions openly to the public and conflict could be resolving in early stage. The designers emphasized that the checks and balances designed not only for preventing from the abuse of power, but also for preventing fragmentation of the owners group because in reality there were so many at residential complexes homeowners were in serious split or rivalry. (Zhao Heng 2005)

In order to avoid the above situation, the mechanism of check and balance also designed some rules specifically as follows (Shang-Di-Xi-Li Convention 2007 ):

To HOA: through the delegation of authority and power to HRA and SB, the system limited and constrained the majority in the community;

To HRA: to HRA only had authority of decision-making, but no power of execution. Moreover, the rules forbid the representatives of HRA holding any other position else in HOC or SB, etc. in this organization;

To individual or collective homeowners: the setup tried to equilibrate the relationships among homeowners, and the relationships of homeowners with the branches of organization, HOC, HRA, SB, etc. so as to build a multi-ways to reduce the degree of practice difficulty for owners' collective actions, such as proposal, discussion, decision-making.

For instance, to put a proposal onto HOA, instead of the proportion of 20 percent members of HOA required by Real Right Law of the People's Republic of China , the lowest 5% of the owners member could make it through HRA. In addition, 10 percent of members can put a proposal onto HOA directly and independently, However, in order to prevent the organization paralyzed by frequent conflicts and rivalries, which widespread happened in residential community, if there are another 10 percent opposed for the same proposal, then the proposal will not be able to submit to HOA for vote. 20% of the owners, of course no any problem, can launch a proposal to vote. And on the discussion platform, HOC also has a place to defend itself and avoid the loss of credibility, which often come from some rumors due to a lack of trust to civil leaders in a tradition of weak civil society in China's long history. But most notable and shocking people rule was HRA may act on behalf of HOC if it collective resignation, which also often happened, until the new Committee elected. (Zhao Heng 2005)

By these rules mention above, the owners' opinions, especially with different views from the HOC could be submitted through another channel like HRA to publish to the community. At the same time, HRA also could hold a hearing on argument and debate, so that the controversy in the community was open to public for discussion. Zhao Heng, the director of HOC believed that such a system of innovation could supervise the execution of HOC. So "No man is a fit judge of his own cause in relation to the interests of others" (Vincent Ostrom 1987)

Arguments for the system of Homeowner's Representative Assembly, at present, lies mainly

on the rights and power that were belonged to the individual or whole homeowners(HOA) by law now transferred to HRA. Many questioned the real property rights have attributes of absolutely exclusiveness but the institutional arrangement of Shang-Di-Xi-Li residential complex gave broadly range of authorization to HRA, such as co- management of property interests, acting on behalf of the homeowners or HOC in so many way, and also, if necessary, have authority to empower some homeowners, lawyers and other citizens to prosecute and make the respondent on the court. (Liu Liu 2006 ) In this regard, one of designer Lin Yihai argued that property rights could be authorized to agents, such as to a lawyer on the business of housing trade, and could to a firm on the management of common part property, etc. So why not HRA, an organ of HOA?

From a pure legal point of view, Fang Shaokun and Wang Hongping addressed, by the legal proceeding, homeowners made rule for their own business of self-governance was in accordance with legitimacy of private law, because self-governance was a basis of the Statutory Principle of Property Rights. Based on this point of view, they asserted by Real Right Law there should be more open space provided for homeowners private governance. (Fang Shaokun and Wang Hongping 2005)

#### IV.Evaluation of principles designed and institutional performances

Respectively applied to the conditions and surrounds of inside and outside condominium, TPM and HRA are innovations for resolving the CPR problems of collective choices. I try to analyze and evaluate the two systems' institutional performance. By Eleanor Ostrom's set of eight design principles on the basis of CPR, robust CPR institutions need to be consistent with at least some standards of the following eight essential elements. (Elinor Ostrom 1990 )

Evaluation of principles designed and institutional performances		
Cites& Setup	Shang-Di-Xi-Li (Beijing, Haidian District) HRA	Lang-Qing-Yuan (Beijing, Xuanwu District) TPM
	(Institutional Performance)	(Institutional Performance)
Principles	Robust	Fragile
Clear boundaries & memberships	Yes	Yes
Congruence between appropriation and provision rules and local	Yes	Weak

<b>conditions</b>		
<b>Collective-choice arrangements(most individuals affected by the operational rules can participate in modifying the operational rules)</b>	<b>Yes</b>	<b>Not Relevant</b>
<b>Monitoring</b>	<b>Yes</b>	<b>Weak</b>
<b>Graduated sanctions</b>	<b>Yes</b>	<b>Weak</b>
<b>Conflict-resolution mechanisms</b>	<b>Yes</b>	<b>Yes</b>
<b>Minimal recognition of rights to organize</b>	<b>Yes</b>	<b>Yes</b>
<b>Nested enterprises</b>	<b>Yes</b>	<b>Not Relevant</b>

**Table1: Comparative Studies of Two Cases' Institutional Performances (Chen Youhong 2009)**

### **Conclusions**

Our study demonstrated the assumptions we proposed. Homeowners do have willingness and motivity to innovate institutional arrangements of self-governance and are really capable of establishing good government from reflection and choice. It approved what Elinor Ostrom had address, "Because the individuals involved gain a major part of their economic return from the CPRs, they are strongly motivated to try to solve common problems to enhance their own productivity over time." And it is also confirmed, HOAs self-governance system is well-designed of boundaries and membership, congruent rules, collective-choice arenas, conflict-resolution mechanisms. So it is no surprising, at least one of the case above could be evaluated "robust".

Some considering is arisen out for further reflection. The practice of HOAs self-governance in society of grass roots is of big group's collective action. What condition and surround make the big size group to escape the problem of collective action and to governance well in CPR? Condominium homeowner's practice in China gave a good sample to explore this question.

Condominium physical border is relatively closed and clear and the relationship of owners among the community are relatively stable. Institutional incentives are some different since Mixed-goods attribute of CPR, the calculation of profit and loss of personal values between individuals and group are also some divergence. Thus there need more-dimensional analysis

of the profit and loss account. The number of group operations / revenue sharing as an incentive factor in the calculation is not sufficient to explain the situation in this case. Especially when the residential complex under poor governance, property damage happened and intense conflicts occurred, the loss of a single owner is difficult to use the formula of ratio of group size to measure. For example, if there were no service of collecting of garbage, electronic power down, water supply and heat system stop, which situation in China now often happened when intense conflicts occurred between HOA and property management company, the owner of each family's loss will not reduce or increase because the group's size change. The reason people will take action in this situation may be directly related to their tolerance of degree and personal value.

Therefore, in China's civil society nowadays, instead of select to be the "free rider", there are a considerable number of homeowners choose to take actions and in charge of the cost of innovation for their own community and local society. Apparently to HOA leaders, self-identity and sense of honor are very important incentives. In addition, more importantly, by their practice and achievements in community, they have personally experienced of social changing through the nested institutional associated from bottom-up, which enlighten them a vision what they are striving for will have a great future in Chinese society transition.

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