

Co-ordinating
neighbourhoods
– who should
plan?

PLANNING THROUGH RESIDENTIAL CLUBS: HOMEOWNERS' ASSOCIATIONS

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Private homeowners' associations now govern over 18% of the American population, enforcing contractual land-use restrictions and providing what would otherwise be municipal services. The rapid spread of these associations in new housing construction is explained by rising land costs, constraints on the ability of local governments to raise property taxes, and consumer preferences. Because these associations resemble club economies in significant respects, they provide an opportunity to test whether these private associations can provide services more efficiently than municipalities. Departures from the assumptions of the club economy model are noted, including the lack of options for consumer choice that undermine the consent-based rationale.

Introduction

It is common in urban studies to encounter the claim that the post-Second World War suburbanisation of the USA has been inadequately planned, particularly regarding provision of public goods and creation of externalities. The word *sprawl* has come to represent the land-use pattern allegedly responsible for these problems (Duany *et al.*, 2000). It is then argued that the situation can be improved through empowering centralised regional governments to control the real-estate development process (Dreier *et al.*, 2004).

Yet this argument is encountering a stiff response from those who emphasise that a great deal of planning takes place, unacknowledged by critics of 'sprawl', through the private sector and the local level, rather than through the public sector at the regional level. They call our attention to the rise of a new participant in the intergovernmental system that is by now heavily involved in land-use regulation, service provision and property maintenance across the nation: over the last half-century the institution of residential private government through condominium and homeowners' associations has emerged as a neighbourhood-level alternative to municipal regulation and service provision (McKenzie, 1994). These associations, it is claimed,

are a superior way of providing public goods (Beito *et al.*, 2002), and have the potential to replace the institution of municipal government, not only in new development, but in existing neighbourhoods (Nelson, 2005). It is argued that these developments promote more efficient land use through private planning at higher density and better use of open space; make for a stronger sense of local community; provide a wide range of services and amenities at a higher level of efficiency; and make high-quality housing affordable to the middle class in times of high land costs.

There is both an empirical and a normative side to this argument, and both must be considered in order to evaluate the costs and benefits of planning through homeowners' associations.

The rise of private neighbourhoods

The facts are quite remarkable, amounting to nothing short of a quiet revolution in the housing sector and its relationship with local government. Until the early 1960s, American homeowners typically had fee-simple ownership that was limited only by utility easements and municipal zoning and building codes.

This all began to change very quickly in the early 1960s. Since that time, there has been an astounding

increase in the number of privately governed housing developments, from fewer than 500 in 1964 to an estimated 274,000 in 2005. These developments house 54.6 million Americans, or nearly 18.5% of the nation's population (Community Associations Institute, 2005). There are no signs that this rapid rate of increase will slow. If anything, the reverse is true. In most rapidly growing parts of the nation, including the newer Sun Belt cities like Las Vegas and Henderson, Nevada, as well as areas undergoing redevelopment in large older cities like Chicago, Illinois, nearly all new housing is in such developments. A number of municipalities are accelerating the trend by mandating the creation of associations in new residential construction.

Homeowners' and condominium associations are typically not-for-profit corporations, chartered under state law, with the corporate purpose of providing a specified range of services to their members and enforcing private land-use restrictions. These associations are created by the real-estate developer at the time the property is subdivided into building lots. All purchasers become members automatically at the time they take delivery of the deed to their unit and may not leave the association except by selling the unit. The owners elect from among their number a group of volunteers who serve as a volunteer corporate board of directors and are thus a sort of private government for the development.

The deeds contain many limitations on the owners' use of their property, enforceable by the association, that are similar to but more restrictive than municipal zoning and building codes. These limits can include requirement of association approval for all modifications or additions to the original home design and landscaping; limits on the colour of houses, doors, drapes and even mailboxes; prohibitions on business use of property; occupancy limits; bans on posting of signs and mandates on property upkeep such as limits on the length of lawn grass and myriad other prohibitions and requirements that are similar to those imposed by municipal government but much more specific and numerous. Most significantly, homeowners' associations are not subject to constitutional limitations on government action, such as freedom of speech and due process of law, because they are viewed by the courts as private organisations. Consequently associations can, for example, ban display of political signs and flags and hold 'banana republic' elections, unless state laws are passed to protect owners against such practices.

The associations are initially controlled by the developer, but are turned over to owner control after the developer has completed selling the units. Thus, there is a democratic element to the regimes. However, developers typically impose super-majority requirements on the original restrictions so that they cannot be changed except by a two-thirds or

greater vote of all owners, which is extremely difficult to accomplish given the level of voter turnout. Thus, original restrictions are rarely done away with, regardless of majority dissatisfaction.

These deeds create a dual property ownership interest. The individual interest would be a 'home and yard', in the case of a detached single-family home in a homeowner association, or an airspace and the inner wall surface in a condominium. In either case the owner has the exclusive right to that interest, but it is inseparably coupled with a shared interest in the 'common area'. In a homeowner association that would typically include private streets, recreation facilities such as parks, lakes and golf courses, and in the case of a 'gated community' the common areas would include gates, fences, walls, guardhouses or other security features. In a condominium the common area is the entire building (less the unit air spaces), which is owned in common by all purchasers. A homeowners' association owns the common areas, while a condominium association manages it on behalf of the owners, although in practice this distinction is not usually important.

The range of services provided and functions undertaken by associations varies, but can include street lighting and maintenance; snow and leaf removal; lawn care; maintenance of storm water and sewer facilities; care of lakes and ponds; operation of restaurants, parks, swimming pools, parking facilities and golf courses; instituting litigation in the name of all owners; and buying and selling property. Ultimately, associations are empowered to do whatever is necessary for the preservation of the property entrusted to it, and for the overall quality of life in the development. They prepare budgets; determine the level of assessments levied on the owners to pay for maintaining the property; collect those assessments using, if necessary, the power of foreclosure on the owner's property; hold elections; maintain records; and conduct regular and special meetings. Associations have the responsibility of enforcing all the deed restrictions, which includes citing owners for infractions, holding hearings, and levying fines and other punishments. In short, associations operate a bit like business corporations to perform many of the functions of municipalities.

Why are homeowners' associations so prevalent in new housing?

Advocates of homeowners' associations prefer to attribute the phenomenal increase in their numbers to consumer preferences for this sort of housing. This argument has the rhetorical advantage of giving the institution the imprimatur of consumer sovereignty and thus putting it off-limits to criticism, but the argument on its own is nonetheless implausible in that it relies entirely on the demand side of the equation and entirely ignores the supply side.

In fact there are three incentives driving the rise of private communities.

On the supply side we find private real-estate developers and municipal governments, who must reach agreement with each other for any private community to be constructed. Developers plan, purchase land, obtain construction financing, build and sell. Municipalities have the power to grant or deny permission to go forward with these projects.

Developers have turned to this form of housing because it enables them to increase residential density while offering an attractive home and a full package of amenities. Increased density was forced on developers by land scarcity and resulting high land costs. It is no accident that this form of housing has exploded during a time of greatly increasing land costs that would undoubtedly have priced traditional single-family housing out of the reach of the American middle class in many markets, were any developers still trying to construct it. For example, it is simply impossible to offer the typical middle-class southern California homeowner a big plot with a swimming pool, as was done throughout much of the post-war housing boom, because the home would be prohibitively expensive. However, it is quite feasible to build 100 homes on small lots, create a common area with one swimming pool and a few small parks, put the whole thing under the governance of an association, and sell the homes at a price that many middle-class families can afford.

Municipalities might be expected to oppose private communities as potential competitors, but instead many have embraced it. That is because they receive a massive tax windfall through this form of privatisation. Residents of private communities pay a full share of property taxes to local government, in addition to paying assessments to their association for a range of services and facilities that would otherwise have to be provided by local governments. This 'double taxation', as it is called, allows municipalities to add new taxpayers who, because they are paying privately for many of their 'public' needs, do not impose as great a burden on the public treasury as traditional single-family homeowners. Thus there is less pressure for tax rates to be increased on all residents to pay for the services required by new developments. The so-called 'property tax revolt' that swept the USA in 1978 and the years that followed made it clear to local governments that tax increases would be met with massive public hostility. This understanding fuelled a shift in development practices by local governments in which land-use decisions were increasingly driven by fiscal considerations. Thus, many municipalities now prefer private communities as a solution to the confluence of development pressures and tax resistance.

The third incentive is, as association advocates claim, a preference among some consumers for this form of housing. They are willing to sacrifice some

level of freedom in order that their neighbours will be similarly restricted. It is difficult to determine how widespread this preference is, because many factors influence housing choice – price, location, architectural style, amenities, government school quality, crime rates, and many other matters – and precise comparisons by controlled experiment or statistical analysis are difficult to construct. Analysis of building industry and census data in California has shown that supply-side factors, including local government fiscal capacity and land costs, accounted for about two-thirds of the variation in the prevalence of private communities at the county level, so it is possible that consumer preferences explain most or all of the remaining third (McKenzie, 1998).

The case for owners' associations

The normative argument on behalf of residential private government has two bases, one grounded in political theory and the other in neoclassical political economy.

The political theory defence of associations is a quasi-communitarian argument. Proponents of owners' associations have long contended that these organisations are the modern equivalent of the New England town meeting, in the sense that they are an opportunity for direct participation by property owners in deciding which collective goods they want, how much to pay for them and what sort of rules they wish to live by. These are people, it is argued, who are dissatisfied with the remoteness, inaccessibility, inefficiency and social ills of urban and suburban municipalities, and who want a smaller scale of governance which affords more participation, greater control over taxation and spending, a higher degree of social control and an elevated sense of community.

This political theory argument is reinforced by neoclassical economics. Samuelson's (1954) famous statement about the difficulties of determining the optimal levels for provision of public goods found an answer in Tiebout's (1956) article on local public goods. Tiebout argued that if there were many communities offering various kinds and degrees of public goods at different costs, knowledgeable and mobile consumers could choose communities according to their own preferences, and thus establish optimal levels for those goods. Buchanan's (1965) article on club provision of public goods takes this further, because club economies can exclude non-payers and thus make public goods more like private goods. Club goods are also non-rivalrous among club members, at least up to the point where congestion occurs.

The similarities of the homeowners' association to club economies are striking. The rise of private communities now offers a real-world example of what looks to many observers like club economies that meet the conditions prescribed by the theorists.

The model and the reality

In the coming years, we can expect to see evaluations of the claims that owners' associations are a superior form of local democracy and that club economies are a more efficient way to provide local public goods and services. At present the issues continue to be hotly debated and it would be premature to state that they are resolved. However, some observations can be made with certainty.

Many, and perhaps most, associations are probably run reasonably well, given that they suffer from a lack of public or private institutional support and rely very heavily on untrained, uncompensated volunteers. However, the claim that associations have turned out to be models of local democracy and communitarian values is questionable in light of recent experience. To the contrary, the view that association governance is too often illiberal, incompetent and even corrupt is being given increasing credence by the press and by policy-makers. Reports of owners' associations acting in abusive fashion towards residents are now a staple of the mainstream press, including what appear to be senselessly restrictive actions, fiscal mismanagement, failure to follow proper corporate procedures and predatory foreclosures. Owners are beginning to form their own truly voluntary groups, outside of the mandatory membership associations. These groups are becoming involved in political action, mainly at the state level, to promote reforms. Consequently, there is now a clear trend towards much more assertive state regulation of owners' associations in a number of states, including California, Florida, Nevada and Arizona. Approaches vary, with state oversight commissions, legislative task forces and ombudsmen now being empowered to oversee the actions of association boards.

Yet, the picture is not entirely bleak. Increasing regulation, public education and informed consent requirements may offer improved consumer protection and thus safeguard this housing sector against failure of demand. This is a new institution that is still evolving and developing institutional support for volunteer directors. There is reason to believe that, over time, practices will evolve in a better direction. Indeed, there is even the danger that reactive over-regulation could make the job of volunteer director so onerous that people are reluctant to serve, or find the job simply impossible to perform correctly. To the extent that state legislatures require associations to operate like governments, these private organisations may lose the traits that make them potentially more efficient.

There are also divergences between the public-choice model and current practices. The consent-based rationale for owners' associations

is undermined by its own market success, which produces a striking lack of choice between association-controlled and non-association-controlled properties in many markets. Buyers of new housing are being forced into association membership, whether they want it or not. Moreover, the burgeoning practice of cities mandating such housing exacerbates that problem. This makes it difficult to attribute the spread of such housing to demand or to conclude that the resulting distribution of costs and services is the result of market forces. From a practical standpoint, mandates greatly increase the potential for conflict between association directors and owners who buy a house but do not accept the rationale on which association life is predicated.

Finally, it can also be expected that the years to come will bring demands for relief from the taxation-plus-assessments burden that owners' association residents bear. For example, association residents could be allowed to deduct some or all of their assessments from their local property tax bill. This would place associations more in direct competition with municipalities and remove the incentive municipalities currently have to promote them. Such a reform is a necessary prerequisite to comparing municipalities with associations in terms of efficiency of providing public goods, and more precisely testing the club economy rationales put forth by Tiebout and Buchanan.

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