

# Proceedings of the 2009 Land Policy Conference



# MUNICIPAL REVENUES AND LAND POLICIES



Edited by Gregory K. Ingram and Yu-Hung Hong

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Emergency Appropriations	2,000 00	
Expenses	2,330,000 00	1,806,568 00
Reserved	15,810,815 00	1,770,170 00

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# Municipal Revenues and Land Policies

Edited by

*Gregory K. Ingram and Yu-Hung Hong*

 LINCOLN INSTITUTE  
OF LAND POLICY  
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## *Homeowners Associations and Their Impact on the Local Public Budget*

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Ron Cheung

In recent years, U.S. cities trying to provide public services for their residents have faced increasing fiscal and political pressures. One area of particular pressure has been in their ability to levy property taxes and control the revenue. Property tax is the most common, and often the most maligned, source of local revenue, and cities contend with voter-imposed tax limitations (now present in 43 states) and increasing centralization of fiscal authority by the state. The fiscal pressures become even more acute when revenue restrictions are combined with spending limitations.

Local authorities can pursue several avenues to contend with these pressures. Researchers have examined the impact of three main options: cutting expenditures, demanding more intergovernmental transfers from the state, and finding alternate sources of revenues such as charges and fees. Recent literature has been focusing on a fourth option that is growing in popularity: the private residential government.

Private governments are an innovation in local public finance and are blurring the distinction between public and private. In the residential setting, these private governments take the form of homeowners associations (HOAs), and they are found in planned developments (which include gated communities), condominiums, and cooperatives. While they vary dramatically in their scale and scope of functions, in general HOAs exist because local governments transfer public authority to private association boards by giving them government-like powers in service provision, taxation, and regulation enforcement. It is estimated that about 50 million Americans now live in residences governed by HOAs.

HOAs have characteristics of other forms of collective decision making. For instance, they are like a club in that their services are restricted to members, and



individuals who want the services pay to join. Some HOAs, particularly those in condominiums, mainly provide club goods. However, unlike a club, membership in an HOA is tied to housing choice. If a homeowner chooses to buy a house in a development that is governed by a homeowners association, membership is compulsory and automatic. This implies a similarity to local government, where citizenship (membership in the city) is also directly linked to locational choice.

The homeowners association also shares characteristics with private corporations and may thus be viewed as a manifestation of the privatization movement. Stabile notes that although homeowners associations are usually established as nonprofit corporations with elected governing boards, they “are a product made and sold by businesses for profit, . . . a corporation, a community, and a lifestyle” (2000, 5). The objective of the association is to maximize the welfare of its members, whether by providing excellent public services or by maintaining high property values. However, sometimes the objectives of the homeowners and the objectives of the governing board do not match precisely, leading to well-publicized instances of homeowners claiming they are harassed by their association’s stringent rules and regulations.<sup>1</sup>

Finally, the homeowners association shares many characteristics with local governments. It can tax homeowners for membership dues and can enforce payment through civil law. The board has the power to impose conditions and regulations not only on allowable architecture and landscaping, but sometimes also on acceptable behavior. The characteristic most reminiscent of local government is that the association may provide goods and services similar to those provided by a city. However, these services are meant to supplement the existing provision by the municipal government, as most associations are located within city boundaries. The overlapping provision of services occurs most frequently in planned developments rather than in condominiums and co-ops. As these private governments coexist and interact with traditional local governments, their influence on local budgets will become stronger. This presents researchers with a rich area for study.

A theoretical literature has provided a framework for thinking about the impacts of HOAs on local budgets. In this chapter, however, the emphasis is on providing a critical review of empirical findings. To quantify the scope of these developments, the chapter presents some statistics from a database on California’s 30,000-plus HOAs. California’s rapid residential development provides strong incentives for the formation of HOAs, making it an ideal state in which to examine their impact on local public finance.<sup>2</sup>

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1. Readers interested in examples of conflict between HOAs and their members may reference Evan McKenzie’s blog, “The Privatopia Papers,” at <http://privatopia.blogspot.com> and the American Homeowners Resource Center at <http://www.ahrc.com/new/index.php/src/news>.

2. California is not the only part of the country with substantial numbers of residents in HOAs. Nevertheless, HOAs are most rapidly growing in the Sunbelt states. According to the 2007 American Housing Survey, 9.3 percent of surveyed homeowners in the western region (which

The main question is how the rise of the HOA has affected the local public sector. The chapter posits that HOAs have an impact on local expenditures, on local revenues, and on the local tax base. The effects may vary widely because HOAs can take very different forms. Most of the analysis in this chapter focuses on the effect of HOAs in planned developments, where services tend to overlap with those provided by cities: security, parks and recreation, sanitation, and so on.

The first section of the chapter outlines a more detailed definition and exposition of HOAs. Then, some data on HOAs in California are presented to illustrate the scope of the phenomenon. To address the first empirical question, older results and newer evidence show that HOAs, in parallel with other innovations in private government, alter the level and distribution of local public services. The revenue side is then examined, arguing that HOAs are associated with cities' increasing reliance on fees and charges and decreasing reliance on broad-based taxes. Finally, by examining a case study of a municipal secession campaign championed by HOAs, the expenditure and taxation results are reconciled to look at the relationship between HOAs and the residential tax base.

## *A Primer on HOAs*

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### WHAT ARE HOAS?

A homeowners association is a body found in certain housing developments that manages property owned in common and charges fees for its services.<sup>3</sup> It also establishes and enforces covenants and restrictions governing land use. Homeowners who buy property in the housing development must become members of the association, and they elect the governing members of the association, who are generally also homeowners in the development serving without pay.

It has been common to refer to a homeowners association as an example of a private government in which an organization of private individuals is empowered by public authority to act as a government in service provision, taxation, and enforcement (Foldvary 2006; Helsley and Strange 1998; McKenzie 1994). Helsley and Strange (1998) have outlined a typology of private government characteristics, and it can be argued that HOAs satisfy them well. It is also useful to distinguish this type of institution from other forms of collective decision making.

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includes California) paid fees to an HOA, while 11 percent of homeowners in the southern region paid fees (U.S. Census Bureau 2008). The median monthly fees are fairly similar (\$47 in the West and \$33 in the South), so it is likely that a typical California HOA is comparable in scale and scope to an HOA in, say, Florida, Virginia, or Arizona.

3. Homeowners associations are also sometimes known as community associations (CAs). Terms that encompass the governing association and the member households are common interest development (CID) and common interest community (CIC). This chapter uses these terms interchangeably.

First, membership in the private government should be voluntary, appealing to the free mobility assumption common to multi-community local public good models based on Tiebout (1956). However, *voluntary* refers to the fact that a person who does not want to be a member of the HOA must not purchase a home in the development. Based on the oft-quoted statistic that half of all new housing in the United States includes membership in a homeowners association (Nelson 2005, 28), it may be more and more difficult for prospective homeowners, especially those seeking entry-level homes, to opt out of membership.

Second, it must be possible to exclude the consumption of the supplementary services to nonmembers of the private government. An extreme example is the gated community, which, for the most part, denies even access to its streets to nonresidents. Less extreme examples are the recreational facilities and landscaping provided by most planned communities and condominiums. Many local public goods, it should be noted, also exhibit exclusivity because of their limited geographic nature.

Third, private governments provide services that supplement publicly provided ones. Mallett (1993) notes that private governments initially arose because the public sector was perceived to be unresponsive to consumers' demands for recreational and leisure facilities. Blakely and Snyder (1997) point to the "fortress mentality" in explaining homeowners' demands for gated access and round-the-clock patrols to supplement public policing. Supplementarity is a key feature in analysis because it implies that members do not remove themselves entirely from the city, but private actions will interact with public ones.

Fourth, private governments are self-financing. Most HOAs fund themselves by monthly or yearly membership assessments. The Community Associations Institute (2009) reports an average monthly assessment of \$180.<sup>4</sup> In the larger planned communities, these assessments could result in a total that is nearly as large as the municipality's budget.<sup>5</sup> The budget of an HOA is also supplemented by fines collected from homeowners who contravene regulations.

Finally, a private government possesses the scope for strategic interaction with the public sector. If public good provision is viewed as a game between the HOA and the municipality, it is important to treat both players as strategic actors. In contrast, in many traditional models with public-private choice (Epple and Romano 1996; Gouveia 1997), consumers can purchase as much or as little

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4. This figure is about four times larger than the median homeowners association fee reported in the Census Bureau's American Housing Survey (AHS). However, these figures may be reconciled by noting that (1) the AHS considers only fees to an HOA in a planned development, whereas the CAI average also considers condominium fees, which in general are higher; and (2) the CAI mean may be much larger than the AHS median due to the number of associations providing very high levels of services (for example, retirement communities).

5. Le Goix (2006) notes several examples of "minimal cities" in California, where nearly every resident is a member of a planned community, and where municipal incorporation was pursued only as a means of obtaining local control of land use and providing basic infrastructure.

of the public service as they want from the private provider in the event the public provider is unsatisfactory. This effectively renders the private provider's role as passive. HOAs have a much more active role, choosing and selling their collectively provided services to homeowners.

These characteristics imply that homeowners associations are similar, but not identical, to other methods of collective decision making. The growing influence of this institution has generated fierce debate about their impact on the local public budget. Supporters argue that they fill the gaps left by underfunded and inefficient local governments. They claim that private governments reflect the self-help attitude of their members, who pay for and receive local services that would otherwise not be provided. Proponents also contend that transferring some responsibility to private associations may free up public resources to be used elsewhere, so that everyone, even nonmembers, can benefit.

On the other hand, critics of private governments claim that HOAs erode support for public institutions. Those who join can bypass the public system: homeowners who fear crime do not have to vote for tax dollars to attack the root of the problem; they can build a gate to keep the criminals out. Opponents maintain that the erosion of public support, reflected at the ballot box, leads to further deterioration of municipal services and reductions in local revenues. Nonmembers experience a reduction in public service levels and may be worse off. At the extreme, homeowners associations may contribute to sentiments of secession and withdrawal from the public sector.

#### WHAT DO THEY DO?

The primary responsibility of homeowners associations is to provide public services for members. These vary substantially from development to development, and they can be as simple or as lavish as the developer likes. The most basic is the provision and routine upkeep of common hallways and thoroughfares. Nelson reports on a survey that finds that over half of the HOAs in planned developments nationwide engage in infrastructure-related services: garbage collection, street cleaning, and street lighting (2005, 74). Common recreational facilities are widespread in larger developments: according to one survey, 76 percent of medium-sized HOAs in planned developments have swimming pools, and 45 percent have tennis courts (Treese 1993, 20). Additional security is popular, ranging from patrols to gates. Access may also be restricted through the construction of private streets.

Apart from providing services, homeowners associations also enact and enforce land use regulations. These are summarized as the association's covenants, conditions, and restrictions (CC&Rs). Their goal is to limit the negative externalities neighbors' actions may impose; as Stabile states, "by joining a [community association], members have implicitly agreed to a private contract to eliminate the social costs of neighborhood effects in a prescribed way" (2000, 22). The CC&Rs maintain order in the community by providing homeowners with a way to resolve disputes among neighbors and to maintain property values. The regu-

lations may also be used to further petty arguments among neighbors or to maintain board control of homeowner behavior (Glasze 2006).

#### WHAT DROVE THEIR POPULARITY?

The rise of the homeowners association as a key feature of many present-day housing developments, especially planned developments, can be attributed to several factors. The first is suburbanization. Housing developers took advantage of cheap land on the outskirts of cities and recognized the cost-efficiency and marketability of large-scale communities. Techniques included reducing lot sizes and providing community facilities (Roland 1998). As a result, developers were able to market communities suited to middle-income households looking for affordable housing with ample amenities.

A second factor is the growing heterogeneity in the demand for public services. A city government that acts in the interest of the median voter is unlikely to please all residents equally; Bogart states that “the advantages of private associations are their efficient decision making and the responsiveness of the ‘government’ to local concerns” (1998, 228). Relative to a city, the small size of homeowners associations means that it is easier to agree on a service level. Because the associations contract for services directly, they may be able to find the most cost-effective ways to provide the services (Stabile 2000). Heterogeneity also contributes to insecurity, and this has made gated communities and extra security particularly attractive (Glasze 2006).

A final factor lies in the ongoing conflict between voters and local government. With 30 years’ worth of tax limitations and spending cuts, local governments have been dealing with greater fiscal pressure. This has often meant reductions in public service, which makes housing developments with privately provided public services even more attractive. In addition, cities have made the formation of HOAs easier because developers have often promised to place infrastructure on behalf of the city (Cheung 2008a; McKenzie 1994, 179).

These factors imply that the growth of homeowners associations in housing development is driven primarily by new construction, and this implies a potentially even greater impact on the local public budget. Most new construction is in suburban towns,<sup>6</sup> whose newness precludes an established inner core with well-developed infrastructure. McKenzie (2006) notes that some localities rely so heavily on private communities to provide basic public services that they have, in essence, shifted the balance of power from the city to the developer.<sup>7</sup> These factors have made the private government a major player in urban governance.

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6. According to Barton and Silverman (1994), the percentage of new housing incorporating an HOA in suburbs can be as high as 80 percent.

7. McKenzie states that developers “argue that much of the new infrastructure that will be needed is to be privately constructed, owned and maintained, and that many of the services that the new residents need will be paid for by their HOA assessments. . . . This argument has become so persuasive that some local governments in Nevada, Arizona and other states have

Because of their private nature, accurate data on the number and nature of homeowners associations are limited. According to the 2002 U.S. Census of Governments, there are 87,849 units of local governments in the United States. These include county governments, general-purpose local governments, special purpose districts, and school districts. The Community Associations Institute (CAI 2009) estimates that in 2002 there were 231,000 residential private governments.<sup>8</sup> Not one of these private governments is counted by the Census of Governments. If some of the services HOAs provide are similar to public services provided by municipalities, this implies that a large proportion of the GDP devoted to public goods and services has gone unrecognized.

### *Descriptive Statistics: California HOAs* —————

A persistent obstacle to empirical research on HOAs is a lack of reliable data. Detailed public data are practically nonexistent. Because HOAs are private associations of homeowners, they are not required to report budgets or statistics, notwithstanding the government-like nature of their activities. Most states regulate these associations loosely and do not in general maintain a registry of HOAs within their borders. (Nevada seems to be a notable exception, with a registry created in 1998.)

Much empirical analysis, then, either uses survey data to ascertain which homes in a particular area fall within an HOA (for instance, Groves 2008; LaCour-Little and Malpezzi 2001; McKenzie 1994) or uses private-sector data sources. This chapter uses the latter: a database of all the homeowners associations in California as of 2003 obtained from the accounting firm of Levy and Company in Oakland. This database, called HOA-Info, is a comprehensive listing that includes the type of association (condominium, cooperative, planned development, etc.), the size category of the association, the address of the HOA president (from which is inferred the location of the HOA), the date of incorporation, and several other variables. The statewide coverage allows for comprehensive analysis, and the location and the incorporation dates of the associations allow a panel of HOAs to be backed out at any desired geographic level. This data set has been used in several empirical analyses of private government (Cheung 2008a, 2008b; Gordon 2003, 2004).

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adopted it as and their own and are actually requiring that new development be in HOAs” (2006, 20).

8. The reliability of this figure should be assessed as it comes from a trade organization of HOA managers. There is little known about the exact number of HOAs nationwide, but the following back-of-the-envelope calculation suggests that the CAI figure is not exaggerated: the comprehensive data set from California described in the next section shows about 33,000 HOAs in the state as of 2003. California housing units comprise about 11 percent of the total housing units in the country, and so if the rate of HOA membership is similar in other states, there should be about 300,000 HOAs in the United States. This number is overinflated because HOAs are substantially less prevalent in the Midwest and the Northeast.

### NUMBER AND TYPE OF HOAS

The first question is how many HOAs there are. Nationwide as of 2009, the Community Associations Institute, the umbrella trade association that represents HOAs, estimates that there are 300,800 associations. Gathering this number is a data challenge for several reasons. First, most states do not have legal requirements for annual information reporting. More detailed information is known because most HOAs are incorporated for liability reasons, and incorporation records are maintained. Second, states use different language and different definitions to regulate HOAs, which causes inconsistency in summarizing and reporting.<sup>9</sup> To obtain its estimate of HOAs nationwide, the CAI primarily uses the American Housing Survey, which has recently begun asking respondents if they paid homeowners association fees.

Figure 12.1 shows the number of HOAs in California by type and by year of incorporation. HOAs of any type were rare in the state through the middle of the 1970s. Their popularity shot up dramatically in the late 1970s. Several factors for this surge have been proposed, including economies of scale in the housing construction industry and demand for housing from the population shift to the Sunbelt states. Cheung (2008a) proposes that the stringency of Proposition 13 spurred local governments to pursue private governments as a way to offload the responsibility of providing local services. After the spike in the late 1970s, the number of incorporations remained high through the 1980s. Since 1990 the number of new incorporations has slowed.

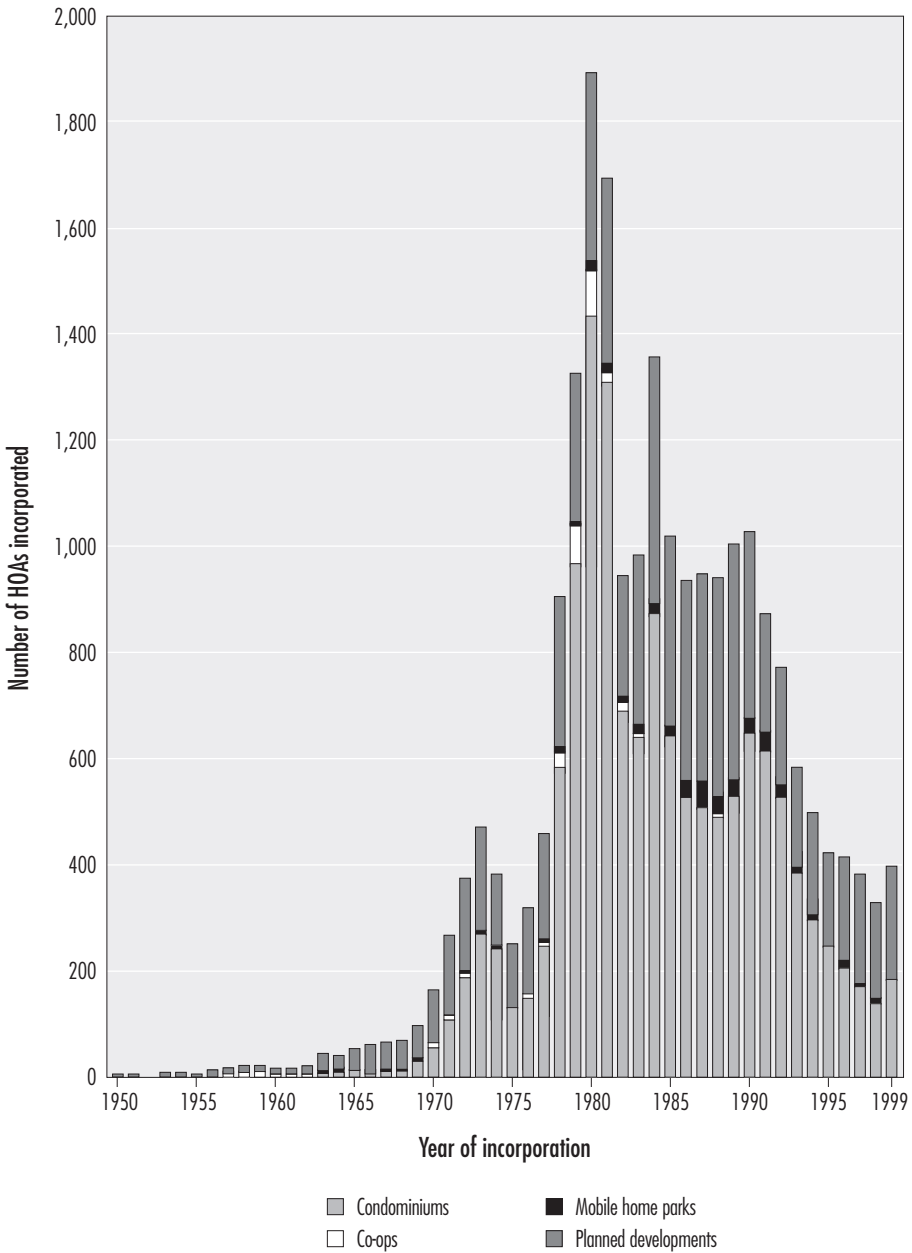
Legally, a homeowners association is found in developments in which homeowners have separate interests in their own units and an undivided interest in common with other owners. HOAs can exist in practically any organization of homes, but there are three primary types. Condominiums make up the largest subset of HOAs, accounting for about half of the HOAs in the state. A condominium is a set of units attached to each other in a complex. Homeowners own the units that they occupy, and each homeowner is a tenant in common ownership of the common property, which includes common hallways. In recent years, many apartment buildings have been converted into condominiums because, in rising housing markets, it has often been more profitable for building owners to sell the units than to rent them out. Conversion generally entails the creation of a homeowners association. The HOA in condominiums is primarily responsible for providing maintenance and infrastructure services, as well as some recreational amenities.

In cooperatives, homeowners do not own their units, but they own a share of the legal entity that owns all the units and the common areas. Many of the first homeowners associations were cooperatives, and their popularity was greatest in New York City in the decades after World War II (Nelson 2005, 29). They are not common in newer housing developments.

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9. For instance, Florida statutes provide for an ombudsman for condominiums, but not for planned developments. California law places both condominiums and planned developments under the rubric of CIDs (common interest developments).

**Figure 12.1**  
HOAs in California by Type and Incorporation Year



Source: Levy and Company (2003).



Finally, the type of development that has generally attracted the most attention is the planned development (PD). It usually consists of detached or semi-detached houses, although larger developments may also include multifamily housing. The homeowner owns the house and the lot under it. For newer developments, the developer designs the entire community, including common property and infrastructure. Gated communities are planned developments, although not all planned developments have gates.

**SIZE**

The size of an association—that is, the number of housing units in it—is correlated with the types of services it can provide to its members. What is the variation in the sizes of HOAs across different types of associations? Has this variation changed over time? Table 12.1 summarizes the California HOA data by different sizes as of 1980 and 2003.<sup>10</sup>

Looking at all HOAs in 2003, smaller associations account for almost two-thirds of all associations in the state. The size distribution of planned developments is more skewed toward larger sizes than that of condominiums. In 2003 only about 12 percent of the very large HOAs were condominiums; the majority were planned developments.

**Table 12.1**  
HOAs by Size and by Type, 1980 and 2003

Size	1980			2003		
	All HOAs	Condos	PDs	All HOAs	Condos	PDs
Small (2–50 units)	3,979 (53)	2,264 (63)	826 (35)	18,562 (65)	10,976 (75)	4,223 (47)
Medium (51–150 units)	2,225 (30)	923 (26)	855 (37)	6,261 (22)	2,469 (17)	2,819 (31)
Large (151–500 units)	1,048 (14)	368 (10)	470 (20)	2,978 (10)	1,114 (8)	1,414 (16)
Very large (more than 500 units)	270 (4)	29 (1)	186 (8)	773 (3)	90 (1)	502 (6)
Total	7,522	3,584	2,337	28,574	14,649	8,958

Note: Percentage of total is in parentheses.  
Source: Levy and Company (2003).

10. A dozen size groupings defined by the data provider have been combined into fewer categories by the author.

Comparing the percentages from 1980 to 2003, it seems that recent years have witnessed more formation of smaller associations. This is reflective of a decline in the popularity of very large-scale communities. However, it is unclear whether this change is driven by diseconomies of scale in private government provision, by the lack of developable land on which to build very large communities, or by some other factor.

Although the greatest number of associations falls into the small category, a better measure of the impact of associations is based on the number of housing units in them. In table 12.2, the numbers of housing units of each type and of each size are presented.<sup>11</sup> A different picture emerges from the distribution: although the large and very large HOAs make a smaller proportion of associations, together they have more than half of the association-governed housing units in the state.

### SCOPE: BUDGETS AND TYPES OF SERVICES

What do HOAs provide? As the working assumption behind private governments is that they represent a substitute for local government services, knowing how much HOAs spend and what they spend on is crucial. Budget information is arguably the most difficult data to obtain. Private associations generally are not required to file yearly budgets with governmental agencies.<sup>12</sup> It is difficult enough to obtain statistics on the annual budgets of HOAs, let alone a breakdown by categories of spending undertaken.

The HOA-Info database does provide some information on overall budgets obtained by voluntary reports by the associations during the data collection process. Table 12.3 provides some summary statistics. Two issues affect the quality of the data: (1) only one-third of the HOAs in the data set reported budget numbers; and (2) the numbers are for 2003 only. Thus, if an association engaged in substantial capital improvements in 2003, the reported number overstates current expenditures.

Data quality aside, the table shows wide variance in budgets. The most common association budget is under \$25,000 for condominiums, planned developments, and all HOAs together. However, more PD budgets than condo budgets are at higher values, with 8 percent of the PD budgets in the sample in excess of \$500,000, compared to 6 percent of condominiums.

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11. These housing unit numbers are imputed by taking the median number of units in the narrow size grouping that each association belongs to, and then summing up over all the associations. For more details on the imputation method and a justification for its accuracy, see Cheung (2008b).

12. Future studies may uncover additional possibilities for systematic data. For instance, as of 1998 Nevada has required an annual filing of every common interest community in its registry. The filing includes limited information on the amount of the assessment paid by each housing unit, from which the annual budget may be inferred.

**Table 12.2**  
HOA Units by Size and by Type, 1980 and 2003

Size	1980			2003		
	All HOAs	Condos	PDs	All HOAs	Condos	PDs
Small (2–50 units in HOA)	85,352 (11)	44,163 (18)	21,772 (6)	325,233 (14)	169,373 (22)	95,717 (8)
Medium (51–150 units in HOA)	204,738 (25)	83,537 (34)	80,253 (20)	581,355 (24)	228,609 (30)	263,135 (22)
Large (151–500 units in HOA)	282,849 (35)	97,734 (39)	129,185 (33)	797,139 (33)	291,207 (38)	386,232 (33)
Very large (more than 500 units in HOA)	232,194 (29)	23,017 (9)	161,387 (41)	679,335 (29)	74,058 (10)	439,627 (37)
<b>Total</b>	<b>805,132</b>	<b>248,450</b>	<b>392,596</b>	<b>2,383,062</b>	<b>763,247</b>	<b>1,184,710</b>

Note: Percentage of total is in parentheses.  
Source: Levy and Company (2003).

**Table 12.3**  
Summary of 2003 Budgets of HOAs with Reported Data

Budget for 2005	All HOAs		Condos		PDs	
	Count	Percentage	Count	Percentage	Count	Percentage
Less than \$25,000	4,286	31	2,322	37	1,448	25
\$25,000–\$50,000	2,565	18	1,214	19	1,010	17
\$50,000–\$75,000	1,437	10	604	10	660	11
\$75,000–\$100,000	939	7	366	6	454	8
\$100,000–\$200,000	1,942	14	774	12	975	17
\$200,000–\$300,000	885	6	350	6	455	8
\$300,000–\$400,000	502	4	228	4	220	4
\$400,000–\$500,000	294	2	124	2	124	2
Greater than \$500,000	1,034	7	352	6	470	8
Total	13,884	100	6,334	100	5,816	100

Source: Levy and Company (2003).

### *HOA Impacts on Local Expenditures*

A defining feature of an HOA is its provision of public services that supplement municipal government services. How does this private provision affect the pattern of expenditures in cities?

The theoretical model of private government by Helsley and Strange (1998) treats public and private government services as perfect substitutes in consumption; as a result, private and public government spending are strategic substitutes. A public government, knowing that a private government exists to supplement services to some residents, provides less of the public service in equilibrium. The upshot is that city residents who do not belong to an HOA receive less of the public service, while members receive more. Helsley and Strange refer to this result as “strategic downloading.”

The strategic downloading hypothesis bolsters popular claims that private government institutions are usurping authority previously held by local governments. Roland (1998) and Johnston and Johnston-Dodds (2002) conclude that HOAs’ governance structures resemble both business enterprises and municipal governments. Like directors in a corporation, HOA board directors are not personally liable for any damages the association may incur. But like municipal governments, they can enact enforceable regulations and laws, and the association can be compensated for breach of these regulations. McKenzie argues that such broad powers mean that common interest developments “currently engage in many activities that would be prohibited if they were viewed by the courts as the equiva-

lent of local governments” (1994, 154). The transfer of public authority to private governments may lead to a deterioration in the public system. With private provision of many public services, local communities may no longer feel compelled to spend: Roland (1998) notes that the city of Fremont, California, has stopped building city pools and requires HOAs in new planned developments to provide their own. McKenzie (2006) echoes this, stating that some towns in fast-growing Arizona and Nevada require new residential development to be in HOAs.

A lack of data has meant that little empirical work has been done to uncover systematic effects of HOAs on local expenditures. Cheung (2008b) provides one of the first by using the California HOA database, but the theoretical framework leaves ambiguous the response of public expenditures to private government. It is possible that the two governments are strategic complements to each other. This may arise, for instance, if there are positive spillovers from one government to the other. It could also arise in specific budget categories if the presence of private governments causes a substantial reallocation across city budgets. For example, in a city with many residents living in gated communities because of fear of crime, taxpayers may demand more police spending even as their willingness to fund other public services decreases.

Cheung combines the California data with municipal government spending data from the U.S. Census Bureau’s annual Survey of Governments. He forms a 30-year panel (from 1970 to 1999) of 110 California cities<sup>13</sup> and estimates the following equation:

$$\ln g_{it}^{pub} = \beta g_{it}^{priv} + \delta X_{it} + d_i + d_t + d_r + \varepsilon_{it},$$

where  $i$  indexes cities,  $r$  indexes region (defined as the metropolitan area), and  $t$  indexes years. The dependent variable  $g_{it}^{pub}$  is the local public expenditure per capita measured nine different ways: total expenditures; police; fire; roads; solid waste disposal; parks and recreation; libraries; government administration; and housing and community development. The key explanatory variable,  $g_{it}^{priv}$ , measures the level of private government activity in the city as the number of planned development units per capita. The analysis focuses on planned developments as they are more likely than condominiums to provide services most like those of a local government; restricting the definition of HOA to planned developments is common in other empirical analyses (for instance, Gordon 2003). PD units are chosen as an imperfect measure of private government prevalence in the city, as private government spending data are not available. A set of control variables, mainly from the U.S. Census, is included to account for socio-demographic and

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13. Cheung restricts the sample to the 110 cities that have reported local spending data for every year from 1970 to 1999. This allows for a greater panel length and thus more within-city variation, but it will bias the sample to older cities. In the later part of the analysis, robustness of the sample is checked by increasing the sample size to all the cities in the state and using only Census of Governments years ending in 2 and 7.

economic differences. Finally, the estimation includes three sets of fixed effects: individual city fixed effects, year fixed effects, and MSA-year (region-specific, time-varying) fixed effects.

Because it is likely that trends in public expenditures could themselves affect private government activity, the equation above is estimated with two-stage least squares. The level of private government in a city is instrumented with (1) the private government level lagged 15 and lagged 20 years ago; and (2) the land area of the city.<sup>14</sup>

Table 12.4 shows some of the key empirical results. For brevity, only the coefficient on the private government variable, PD units per capita, is reported. Column 1 reproduces the main result. In the first row, the estimated coefficient on PD units is negative, suggesting a significant negative interaction effect consistent with downloading. Elasticities of public expenditure with respect to private government suggest that for a city with the mean of 0.02 PD units per capita, the elasticity is  $-0.151$  ( $-7.548 \times 0.02$ ). Hence, a 10 percent increase in the number of planned development units, which is nearly the average one-year rate of increase in this variable in the sample, would decrease total expenditures by 1.51 percent. Thus, cities cut back on spending in response to private government presence, but the effect is rather small.

A clear follow-up to the question above is whether PDs have an effect on local service quality. The California data, unfortunately, do not report how large individual HOA budgets are or how they are spent. However, two indirect ways can provide clues about whether specific categories of public spending respond differently and whether public expenditures per nonmember change.

Cheung runs specifications with a set of dependent variables representing eight subcategories of local expenditure; the results are reported in the bottom eight rows of column 1. The results are consistent with the paradigm of a “minimal city” (Miller 1981), where the homeowners associations take care of day-to-day current expenditure and the public entity is responsible for providing infrastructure. There is a substantial negative effect of PD growth on parks and recreation,

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14. For identification, the lagged HOA value assumes there is an underlying factor about a city such that cities with fast rates of growth in HOA membership in the past are likely to have fast rates of growth today. This could, say, be institutional where a city is more inclined toward residential growth. It is necessary that private government decisions in the past do not influence directly current local expenditures. It is reasonable to assume that, although there is presumably persistence in local public expenditures, it is unlikely to be as long as the 15- or 20-year lags used as instruments.

The second instrument is land area changes. Such changes (generally annexations) are, first off, correlated with residential development. Cities that rapidly annex are cities that both have the ability to develop (they are not hemmed in on all sides by other jurisdictions) and have the desire to develop (as many annexation petitions are developer-driven in California). Increased developable land is strongly responsible for the growth in planned developments, which require large tracts. Thus, the instrument is correlated with private government growth. In addition, the instrument is argued to satisfy the exclusion restriction because land area changes are usually small annual changes, which should not result in large shocks to per capita expenditures.

**Table 12.4**  
2SLS Regression Results on Local Expenditures

Dependent Variable	(1) Expenditures Measured per Housing Unit	(2) Expenditures Measured per Housing Unit	(3) Expenditures Measured per Nonmember Housing Unit
All expenditures	-7.548** (2.376)		-3.027 (2.131)
Current expenditures		-4.789*** (0.628)	
Capital expenditures		-0.947 (0.828)	
Police	-2.098*** (0.691)		-2.083 (1.412)
Highways and roads	-0.124 (0.563)		0.754 (1.118)
Fire	-0.786** (0.311)		-0.561 (0.647)
Parks and recreation	-1.228*** (0.611)		-2.998** (1.331)
Solid waste disposal	-1.583*** (0.487)		-3.158 (1.130)
Libraries	-0.194 (0.260)		-0.220 (0.712)
Housing and community development	-1.448** (0.959)		-2.852 (2.209)
Government administration	-0.459 (0.639)		0.375 (1.319)

Each row represents a 2SLS specification with a different expenditure category as the dependent variable. Each cell represents a different regression, with the only reported coefficient being the one on per capita PD units. Figures in parentheses are robust standard errors, clustered at the city level. All specifications include year dummies, region-time dummies, and additional covariates. \*  $p < .10$ ; \*\*  $p < .05$ ; \*\*\*  $p < .01$ .

Source: Column 1: Cheung (2008b).

garbage collection, and public safety (fire and police) spending, but there is no effect on roads and government administration. Thus, public services for which private government can easily provide a substitute are cut, but public services that have more common-access or public good aspects remain unaffected. This dichotomy can be made even clearer by splitting up the expenditures into current spending and capital spending, as defined by the annual Survey of Governments. These regressions are presented in column 2. As expected, current spending is downloaded by public governments, while capital spending is not.

The differences between various expenditure categories provide a way to examine the efficiency mechanism further. If the services that the public and the private governments provide are true private goods, the private government's provision simply displaces the public government's provision. The negative downloading result should therefore not be surprising. However, if the only motivation for public-sector downloading is to transfer provision responsibility to efficient providers, public expenditure per nonmember should not be affected by the prevalence of private government. In other words, the coefficient on private government membership should be statistically insignificant if the dependent

variable is public expenditure per nonmember. The dependent variables for the regressions in column 3 are real expenditures, divided by the number of housing units that are not planned development units.<sup>15</sup>

The IV regressions show that public downloading is still present for only one category of spending, parks and recreation. This indicates that something beyond an efficiency motive drives the strategic downloading in this category. Given that recreational facilities are among the most visible of local services, voters in planned developments may be less inclined to support public spending on facilities that they know are destined for nonmembers. Nonmembers experience a decrease in government expenditure that goes beyond simple displacement of private provision for public provision; however, as parks spending is only a small component of local spending, the welfare losses are likely to be small.

### *HOA Impacts on Local Revenues*

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On the other side of the municipal budget is revenue. While most local communities in the United States are required to balance their budgets every year, this does not automatically imply that the impacts of HOAs on revenues directly mirror those on expenditures. Just as HOAs in planned developments have been found to have differential impacts on different categories of local expenditure, different sources of revenue may respond differently. There has been relatively little in the way of studies of revenue impacts, but there are reasons to examine this side of the coin. Hoene (2004) argues that when faced with fiscal pressure, cities may respond differently on the revenue side than on the expenditure side. In particular, he argues that the revenue structure is more dramatically altered in California than expenditures, with a lesser emphasis on property taxes and a greater emphasis on charges and user fees. Theoretically, Henderson (1994) adds that developer-dominated or profit-maximizing communities such as those found in HOAs generally prefer fees or charges to taxes.

Cities can turn to a wide array of fiscal tools when their traditional sources of revenue dry up, including permit fees, impact fees, and assessments by extra-governmental entities (such as Mello-Roos districts in California). As Cheung (2008a) argues, as cities scramble to find alternative ways to fund public services, private government could represent an attractive option. He presents evidence that cities that were more relatively constrained by Proposition 13 in 1978 were those more likely to experience higher growth in HOA incorporations.<sup>16</sup> The constraint that a city faced may have been based on the demand side, as measured by the level of crime before Proposition 13; cities with high crime rates stood to be

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15. It is not possible to know the population that does not live in PDs, so the number of non-PD housing units is used instead to stand for nonmembers.

16. The term *HOA* is used to encompass HOAs in planned developments, condominiums, and cooperatives. The question is whether Proposition 13 encouraged cities to turn to private government of any form. However, the results are qualitatively similar if the definition is restricted to planned developments only.



hurt the most by diminished property tax revenues. But interestingly, cities can also be differentiated based on their property tax position relative to other cities in the county. Because Proposition 13 in effect transferred property tax rate-setting ability from the cities to the county, a tax revenue sharing rule was instituted to dictate how funds would be doled out. Cheung argues that cities that benefited least from the rule (somewhat perversely, cities that had had the lowest property taxes prior to Proposition 13) would face the greatest tax constraint, and he shows that they had the highest growth in HOAs.

While these prior studies examined how the revenue structure may influence the popularity of HOAs, what about the other direction? Through which channel will the impact of private governments on local revenues act? The answers may lie in property values and the ballot box. The explicit goal of many associations is a shared interest in increasing property values (Blakely and Snyder 1997, 72). Homeowners who belong to private governments may be loath to support taxes based on the appreciation of their homes. Le Goix claims that a driving factor in the popularity of planned developments is “the need to retain the property tax dollars within the limits of a municipality” (2006, 83). In addition, by introducing a private government directly competing with the public sector, voters in planned developments may demand tax policies that restrain local government growth, in the manner of the Leviathan hypothesis. Roland adds that as PDs provide more and more of the similar services the cities used to provide, members “then vote down taxes needed by local governments to provide services to the broader community” (1998, 19). This may be amplified by the perception that property tax revenues will simply be redistributed to spending programs outside the development. These factors suggest that cities with growing numbers of private governments should see decreases in tax revenue, or at least slowdowns in revenue increases.

While fundamentally it may be unsurprising that revenues should decrease with HOAs (with evidence, after all, showing that public expenditures have decreased), a more interesting question is whether the way in which revenue is collected has changed. The HOA movement can be argued to be another step toward the fiscalization of local government: the need to find new sources of revenue to replace those lost by constraints on the property tax (Chapman 2008). These tools are used to circumvent property tax limitations, which are in force in most states. Chapman cites more than a dozen, including community facility districts (also known as Mello-Roos districts in California), impact fees, general obligation bonds, and tax increment financing. Their common mentality is pay-for-use, which has been documented as a shift away from a reliance on property tax toward fees and charges. The pay-for-use thinking pervades the political opinions of some planned development members, who argue vociferously against “double taxation.” Anderson (1996) notes that homeowners association lobbies have been particularly vocal in demanding reimbursement for public services that they provide for themselves. In a way, the shift to fee-based revenue generation serves to decouple the property-appreciation benefits of HOA membership from additional property tax burdens. Despite McKenzie’s argument that HOA

members should not be permitted to escape property tax liability and that “public services are not provided on a pay-as-you-go basis” (1994, 166), current methods used by cities to generate revenue demonstrate that local governments are operating with those goals in mind. A second empirical observation that should be expected, then, is that cities with high rates of HOA growth would experience more marked shifts toward fee-based revenue sources.

### *Do HOAs Have an Effect on Local Revenues?* \_\_\_\_\_

To test the hypotheses that HOAs both reduce the level of revenues and shift the revenue mix toward fees, the fixed effects IV strategy employed in Cheung (2008b) may also be employed. The definition of HOA is restricted to those in planned developments only. For the same panel of 110 cities used in the expenditure analysis, a set of new dependent variables is defined:

- Revenue level variables (in logs in 1997 dollars):
  - Total own-source revenues<sup>17</sup> per capita (OWNREV)
  - Property taxes per capita (PROPTAX)
  - Charges and miscellaneous revenues (fees) per capita (CHARGES)
- Revenue share variables:
  - Property tax share, which is property taxes divided by own revenues (SHR\_PROP)
  - Charges and fees share, which is charges and fees revenues divided by own-source revenues (SHR\_CHAR)

Table 12.5 provides summary statistics for the revenue variables. The upper part of the table provides summaries of the variables for 1970 only, for 1999 only, and for the entire 30-year panel. The three tax-level variables show that real per capita tax revenues have actually increased on average, despite stringent tax and expenditure limitations. At the beginning of the panel, property tax revenues and charges revenues were roughly the same, but this diverged substantially. By the last year in the sample, charges per capita were double the property tax revenue per capita. This is consistent with a clear shift in the source of own shares from property taxes to charges. As for private governments, the average number of planned development units per capita increased more than four times in 30 years.

The lower part of the table further highlights differences between cities with different private government prevalence. The 110 cities are sorted into quintiles based on their 1970 and 1999 PD levels, and the revenue share variables are summarized for the lowest and the highest quintile cities in columns 4 through 7. The revenue shares of both low PD and high PD cities shifted from taxes to charges

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17. A substantial portion of city revenues comes from state grants. Grants are generally subject to less volatility, and it is unlikely that HOA membership has much impact on their size or timing. Therefore, own-source revenues are the appropriate dependent variable.

**Table 12.5**  
Summary Statistics of Revenue Variables

All Cities	(1)	(2)	(3)
	1970 only	1999 only	1970-1999
PD units per capita (PDUNITS)	0.007 (0.020)	0.030 (0.037)	0.020 (0.031)
OWNREV	0.370 (0.181)	0.695 (0.316)	0.545 (0.279)
PROPTAX	0.111 (0.078)	0.144 (0.097)	0.128 (0.088)
CHARGES	0.109 (0.082)	0.309 (0.184)	0.217 (0.160)
SHR_PROP	0.257 (0.114)	0.159 (0.072)	0.198 (0.09)
SHR_CHAR	0.244 (0.108)	0.349 (0.112)	0.313 (0.119)

Top / Bottom Quintiles	(4)	(5)	(6)	(7)	(8)	(9)
	Low PD <sup>a</sup>	High PD <sup>a</sup>	Low PD <sup>a</sup>	High PD <sup>a</sup>	Low $\Delta$ PD <sup>b</sup>	High $\Delta$ PD <sup>b</sup>
PD units p.c.	0 (0)	0.034 (0.035)	0.002 (0.001)	0.087 (0.049)	0.006 (0.015)	0.054 (0.050)
SHR_PROP	0.232 (0.110)	0.298 (0.129)	0.163 (0.074)	0.141 (0.064)	0.202 (0.106)	0.176 (0.081)
SHR_CHAR	0.238 (0.097)	0.285 (0.147)	0.345 (0.137)	0.369 (0.097)	0.319 (0.107)	0.331 (0.118)

Sample: 110 cities over 30 years. All values are means, with standard deviations in parentheses.

<sup>a</sup> Cities are grouped into quintiles according to the level of planned development units per capita in either 1970 or 1999. Low PD cities are in the first quintile; high PD cities are in the fifth.

<sup>b</sup> Cities are grouped into quintiles according to their absolute change in planned development units per capita between 1970 and 1999. Low (High)  $\Delta$ PD cities are in the first (fifth) quintile.

between 1970 and 1999, but this shift is more dramatic for the high PD cities. The average high PD city had property tax revenues that were 30 percent of own-source revenues in 1970, but this fell to 14 percent in 1999. On the other hand, the average low PD city went from a 23 percent share to a 16 percent share, a much smaller shift. This difference is also observed if the 110 cities are shifted on their growth in PDs from 1970 to 1999. Cities that experienced the fastest growth in PDs have lower reliance on property taxes and higher reliance on charges, suggesting a link between planned developments and the pattern of local revenues.

Utilizing the same econometric framework as the last section, the equation was estimated using the new dependent variables on revenue. A similar set of instrumental variables for PD units, demographic controls, city fixed effects, year fixed effects, and MSA-year fixed effects are included. The 2SLS regression results are presented in table 12.6.

Before addressing the key private government variable, it is useful to see how the demographic controls perform. The ethnicity and race variables suggest that cities with increasing shares of Asians and Hispanics have lower property tax revenues as well as lower shares of revenues from property taxes. This may reflect the lower home ownership rates of minorities, which lead to lower property tax bases. Higher median incomes lead to high tax revenues, which is consistent with a greater demand for public goods. However, many of the other control variables are insignificant, which may be due to the inclusion of the city fixed effects: the demographic makeup of the city is unlikely to have greatly changed over the study period.

Turning to the private government variable, the first three columns suggest that planned developments exert a significant negative impact on tax levels.<sup>18</sup> Column 1 demonstrates that even controlling for year and region-year effects, it seems that cities with fast growth in planned development units exhibit faster declines in total revenues. For instance, a city with a mean PD units per capita value of 0.02 has calculated elasticity of own tax revenues with respect to private government of  $-0.17$  ( $-8.102 \times 0.02$ ). This is a small but nontrivial effect. Looking at the breakdown of revenues into property tax and charges, it is unsurprising that the magnitudes of both estimated coefficients are smaller than the estimates for total revenues. Interestingly, the coefficient on charges is negative, which is consistent with the argument that looking at levels of taxes is simply gauging residents' perception of local government. As private governments become more prevalent, there may be less willingness to support increasing revenue from any source.

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18. If the instruments are not used, the OLS specifications show only a (weakly) significant effect on total revenues. As a diagnostic, a Hansen overidentification test was performed for each of the 2SLS specifications. The P-value in every case indicates that the exclusion restriction is met for the set of instruments. In addition, the first stage F statistic (12.5 for the level regressions) also suggests that weak instruments are not a concern.

**Table 12.6**  
2SLS Regression Results — Revenue Variables

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	OWNREV	PROPTAX	CHARGES	SHR_PROP	SHR_CHAR	OWNREV per Nonmember	PROPTAX per Nonmember	CHARGES per Nonmember
PDUNITS	-8.102*** (2.401)	-1.681*** (0.495)	-2.319*** (0.568)	-0.408 (0.558)	2.590*** (0.992)	2.604*** (0.961)	0.569 (0.984)	4.854*** (0.915)
Percent black	-0.106 (0.242)	-0.088 (0.077)	0.005 (0.073)	-0.010 (0.081)	-0.065 (0.196)	-0.151 (0.486)	-0.158 (0.272)	-0.157 (0.455)
Percent Asian	0.129 (0.094)	-0.030 (0.043)	0.044 (0.031)	-0.068* (0.088)	0.055 (0.065)	0.233 (0.200)	0.039 (0.144)	0.173 (0.171)
Percent Hispanic	-0.190 (0.198)	-0.111** (0.056)	0.038 (0.056)	-0.159*** (0.056)	0.178* (0.099)	0.514*** (0.127)	0.300*** (0.086)	0.435*** (0.118)
Percent college	-0.367 (0.441)	-0.412** (0.176)	-0.044 (0.174)	-0.605*** (0.184)	0.379 (0.357)	1.216*** (0.337)	0.199 (0.224)	1.648*** (0.336)
Percent owner-occupied	0.929*** (0.332)	0.150 (0.112)	0.107 (0.091)	-0.048 (0.122)	0.022 (0.178)	0.664** (0.276)	0.234 (0.171)	0.459 (0.327)
Median income	0.004 (0.003)	0.003*** (0.001)	0.002*** (0.001)	0.002*** (0.001)	-0.002 (0.001)	0.0002 (0.003)	0.003* (0.006)	-0.004 (0.003)
Population density	-0.021 (0.009)	-0.003 (0.002)	-0.009*** (0.003)	0.004 (0.003)	0.005 (0.004)	0.022*** (0.008)	0.019*** (0.006)	0.013** (0.007)

Sample = 110 cities over 30 years. Only selected covariates are reported. All specifications include city, year, and MSA-year fixed effects. Robust standard errors, clustered at the city level, are in parentheses.

\* p < .10; \*\* p < .05; \*\*\* p < .01.

Columns 4 and 5 report the 2SLS results from the share specifications. The effect of HOAs on the property tax share of total own-source revenue is statistically insignificant. However, the coefficient on the charges share of revenue is now positive and significant, but it is small. The elasticity of the charges share with respect to PDUNITS, calculated at the mean PDUNITS, is 0.05. An interesting observation is that the coefficient on CHARGES is roughly the same magnitude as SHR\_CHAR, indicating that the drop in the level of charges is balanced with a proportionate increase in the local budget sourced from charges.

A contributing reason why HOAs still generate so much debate is that they have controversial impacts on residents who are not members. Again, it is possible to get a sense of the welfare implications of the revenue shift by looking at planned developments' impact on the tax revenues collected per nonmember household. Columns 6 through 8 of the table replace the tax-level variables with ones where the denominator is not population, but rather nonmember housing units. Column 6 shows that own-source revenues per nonmember actually increase with the prevalence of private government. If private government members are effectively withdrawing from the local public sector by their own service provision, it is reasonable to expect that tax revenues on nonmembers would have to increase. Consistent with the idea that cities with private governments are reluctant to use broad-based property taxes to make up these revenues, columns 7 and 8 show that charges, not property taxes, per nonmember are increasing. Putting the revenue and the expenditure results together, the analysis suggests that private governments are contributing to a local budget where services that can be privately provided are cut loose from the public realm, while the remaining services are funded increasingly by fees and charges. Private governments seem to be contributing a fragmented urban patchwork consisting of pockets of high-service, high-fee neighborhoods coexisting with the low-service, low-tax city. Whether this type of structure can persist requires examining the impact of HOA prevalence on the tax base.

### *HOA Impacts on the Local Tax Base* —————

The impacts of HOAs on local spending and taxes fundamentally depend on the tax base. The tax base is not a stable entity, and its response to HOAs can take many forms. It may be broadened: cities find new sources of revenue, such as impact fees to offset the increased cost of new infrastructure. The base may be altered: tax burdens may be shifted toward commercial and industrial property as the power to levy residential property taxes dwindles. However, the growing political power of the HOA suggests that we may expect to see a shrinking of the tax base. This shrinking can be summarized by Robert Reich's famous phrase "the secession of the successful."

In a 1991 article, U.S. Secretary of Labor Robert Reich argued that "This secession of the successful in America has been unplanned and undeclared. . . . The well-off have always lived and worked in their own sections of town. But in recent years they have seceded into their own towns, with tax bases supporting

their own schools and roads and recreation centers. Some even have moved into their own gated communities and residential compounds. . . . We are witnessing a retreat from . . . the very idea of shared aspiration and common responsibility. And as the successful secede, they ask with an ever louder voice why they should care about the rest” (Reich 1991, 16).

While Reich was presumably referring to a metaphorical withdrawal of the successful from shared public responsibility, it is crucial to consider whether practical withdrawal has occurred. A long literature has argued that HOAs, gated communities particularly, have contributed to an increase in social segregation (Blakely and Snyder 1997). Whether motivated by fear of crime, desire for exclusion, or dissatisfaction with inadequate public services, the growth of private governments has allowed households to sort themselves across neighborhoods of varying public good and taxation within the same municipality. However, the perception of double taxation and duplication of government may lead to drastic disengagement from the political structure, as argued by authors such as McKenzie (1994) and Nelson (2005). The result may lie at various places along a spectrum. On one end, HOA members enact policies or vote for councilors who lower expenditures or taxes (such as what happens in the last two sections). In the middle, members demand concessions from the city to end “unfair” double taxation; for instance, New Jersey homeowners associations were successful in getting the state to mandate local governments to reimburse associations for some of the common services they provide (Nelson 2005, 76). Finally, the most extreme result would be political secession, a change that would completely remove the tax base from the municipality. As associations make it easier for residents to assume responsibility for providing public services, have they rendered the public sector redundant?

### *Case Study: The Secession of the San Fernando Valley* —————

To shed some light on the impact of HOAs on the local budget by directly affecting the local tax base, the rest of the chapter presents a detailed case study of two secession referenda. Elements of this case study are drawn from Cheung and Helsley (2009). Did HOA membership and HOA actions contribute to support for withdrawal from the public sector?

The 5 November 2002 general election in Los Angeles featured two hotly debated questions on the local ballot: the reorganization of the San Fernando Valley and Hollywood as cities. Measure F asked voters whether the San Fernando Valley should be detached from Los Angeles and incorporated as a new general law city. Measure H asked the same question about Hollywood. The questions explicitly stated the appropriations limit of the two new cities and the compensation due to the city of Los Angeles for the detachment.

Of the two secession questions, the San Fernando Valley measure was by far the most hotly debated. A San Fernando Valley municipality, if created, would have been 211 square miles and would have contained about 1.3 million residents, making it the sixth largest municipality in the country. Examining the

history of the San Fernando Valley gives some clues about the connection between HOAs and the sentiment for secession. The Valley had been a source of some discontent for many decades before measure F went on the ballot. It had voted to join Los Angeles in 1915 to obtain access to water, and it was not long before some resident and business groups complained about high taxes and lack of adequate representation. However, no formal election to secede had taken place until 2002. Hogen-Esch (2001) notes that the most direct predecessor to the secession referendum was the Valley Voters Organized Toward Empowerment (Valley VOTE) movement, organized in 1996 by Valley business groups. Valley VOTE eventually was able to get 200,000 residents of Los Angeles to sign a petition to place measure F on the 2002 ballot. It is notable to this analysis that Valley VOTE had new allies in the secession movement: 17 homeowners associations publicly backed it. The motivations that drove the Valley's HOAs to support secession can be broken into three broad categories:

1. Unfair taxation and double taxation. The most common complaint of Valley VOTE was that residents of the Valley paid more taxes to the city than they were receiving back in services. However, the Valley had a larger share of suburban single-family homes than the rest of the city, so the property tax liability was higher. HOAs in the Valley rallied behind the Valley VOTE viewpoint and added double taxation to the argument.
2. Dissatisfaction with local policies. The perception that residents in the Valley were disproportionately taxed went hand in hand with the view that the policies of the city of Los Angeles were not good for residents of the Valley. A primary objective of HOAs is to defend residents from outside threats to the quality of life. The growth measures of the city of Los Angeles, which include high-density low-income housing, were perceived as threats by the San Fernando secessionists. As a much more homogeneous area in terms of both income and ethnicity, the Valley also was a source of opposition to redistribution policies practiced by the city.
3. Desire for greater political voice. As HOAs are governed by volunteer homeowners serving on the association board, many residents already had experience dealing with formalized political processes. Association boards already have mechanisms for readily disseminating information to resident members, whether by newsletters or Web sites. This level of individual-homeowner organization gives HOAs an edge in lobbying ability, and as Hogen-Esch (2001) argues, movements such as the San Fernando secession demonstrate that homeowners associations have asserted their power increasingly in local politics. Purcell (1997) notes that this is a consequence of their quasi-governmental nature: "Affluent homeowners associations already enjoy considerable informal sway over neighborhood decisions, but they seek a formalization of this power" (696).

The Hollywood secession, on the other hand, received less debate. A similar secession group, Hollywood VOTE, was organized, but it had less historical



claim to secession. Also, while the Valley is clearly geographically distinct from the rest of the city, Hollywood is located in the center of Los Angeles. These conditions led many to believe that the Hollywood measure was headed for certain failure.

In order to pass, the secession had to be approved both by a majority of the residents of the proposed seceded municipality itself and by a majority of the residents of the entire city of Los Angeles. Even Valley VOTE admitted that gaining the support of non-Valley voters would be difficult. After a heated electoral campaign, both the San Fernando Valley and the Hollywood secessions were defeated, but in different manners.<sup>19</sup> The Valley measure passed in the Valley with 51 percent of the vote, but failed because the city at large only voted 33 percent in favor of the secession. In Hollywood, both the Hollywood precincts and the entire city voted down the measure, with 31 percent and 29 percent in favor, respectively. Breaking the results down into precincts, it is clear that the two referenda had different bases of support. For the Valley secession measure, roughly half of the Valley's precincts reported a majority of yes votes, while outside the Valley only one precinct supported secession. This is consistent with secession's being popular in the Valley but not outside it. On the other hand, none of the 93 precincts in the proposed Hollywood municipality had a majority of yes votes.

Was membership in private government a contributing factor in the Valley's support of secession? A simple correlation analysis can be performed using the HOA-Info database. The address of the president of each planned development in Los Angeles is used to geocode the development; this is then overlaid with a precinct map to determine which precinct each PD lies in. The correlation between the percentage of votes in favor of the San Fernando Valley secession in the precinct and the binary variable indicating whether a PD is present in the precinct is 0.14. This positive correlation is suggestive of some role of PDs in the secession movement, although it is by no means causal or substantial. It is possible that the choice to belong to a planned development is correlated with characteristics that would have supported secession anyway.<sup>20</sup> Further analysis of the support for secession would suggest an econometric framework that would also account for selection into planned developments.

## Conclusions

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As homeowners associations become more prevalent, their interaction with the local public budget becomes more evident. The empirical literature on HOAs

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19. *Los Angeles Times* polls showed 46 percent citywide support (weak and strong support combined) for the San Fernando Valley secession in March 2002 and 30 percent citywide support in June 2002. In the October 2002 poll, there was 23 percent citywide support, but 57 percent San Fernando Valley support (*Los Angeles Times* 2002).

20. This view is explored by Gordon (2003), who looks at whether membership in a PD increases voter turnout. After controlling for characteristics that determine selection into a PD, she finds no causal effect on turnout.

has demonstrated that the scope and scale of private governments has led to changes in the traditional local government that may be seen in both the scale and the structure of the public budget. First, by supplanting some of the roles previously taken by the public sector, private government growth is associated with a decrease in both public expenditures and revenues. Second, private governments have been associated with a realignment of public expenditure away from services that can be readily provided by HOAs, such as recreation and garbage collection. For services that remain in the public realm, the method of revenue collection has also changed, moving away from broad-based property taxes and toward charges and use fees. The impacts suggest that HOA members may be able to effect a de facto withdrawal from the public sector by removing their support for broad-based expenditures and taxation. As the San Fernando Valley referendum experience has demonstrated, this withdrawal can be reflected in actual sentiment for secession. The concentration of political will and the increasing heterogeneity between HOA members and nonmembers serve to fuel these actions.

As the empirical research on the budgetary impacts of HOAs is still young, there are many potential questions to be addressed in future work. What are the short-run and long-run welfare effects of HOA growth; in particular, what is the impact on nonmembers? How do residential private governments coexist and interact with other forms of private service delivery, such as business improvement districts and private-public partnerships? How can the benefits of HOA membership be accounted for in property tax assessment? With better data on the number and nature of homeowners associations on the horizon in different states, the public impact of this innovation in service provision can be better understood.

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