



WHITE PAPER

# The Impact of Community Associations on Residential Property Values:

## **A Review of the Literature**

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## EXECUTIVE SUMMARY

Despite the rapid expansion of community associations, relatively little is known about their impact on residential property values. The research put forth in this manuscript addresses this issue by examining the extant academic literature to determine how and when the activities of community associations are capitalized into housing prices. This paper should be helpful to the members of the Community Associations Institute as they are involved in crafting, implementing and managing community associations. To preserve their industry, they are likely interested in determining how this type of governance and organizational structure can be optimized in order to maximize residential property values.

Those who reject community associations may desire to change their stance as the majority of studies illustrate the positive relationship between residential property values and community associations. This positive relationship is based on the mitigation of negative externalities through constraints, neighborhood preservation, and enhanced efficiency. Negative results are seen when there are too many constraints, overprovision of services and fees, and where dog ownership is allowed. Modifying covenants, conditions & restrictions (CC&Rs) within aging associations, allowing different house designs, and considering the level of fees relative to the community association are recommended to lessen these negative results. As community associations continue to permeate the U.S. housing stock, further research on property valuation impacts is imperative. Specific recommendations include looking at specific covenants and their linkages to residential property values as well as the organization of these types of private governments to ensure efficient operations. This new knowledge will assist community association stakeholders in adopting the most appropriate CC&Rs and organizational structure.

## **Introduction**

The term community association refers to planned communities such as homeowners associations, condominium communities, and housing cooperatives. They are operationalized by administering CC&Rs and managing the provision of services to residents. CC&R administration can be through building and use restrictions. For example, a building covenant can restrict the color of a house while a use covenant can restrict renting out a house. Residential buyers who purchase within a community association are typically required to become a member of the association.

The first generation of property owners associations were created in order to maintain common areas and prohibit certain uses by way of deed restrictions in the 1850s (Miles, Netherton, Schmitz, 2015). While these entities were relatively uncommon only a few decades ago, they now outnumber municipal governments in the United States (Ellickson, 1982). As seen in Exhibit 1, the number of community associations operating in the country has grown 30-fold from 1970 to 2013 to include over 26.3 million housing units and 65.7 million residents. These figures represent approximately 24 percent of the U.S. housing stock and \$4.65 trillion in real property value (Treese, 2014).

Exhibit 1

*Community Association Growth (Treese, 2014)*

	1970	2013	Increase
Communities	10,000	328,500	3185%
Housing Units	701,000	26,300,000	3652%
Residents	2,100,000	65,700,000	3029%

Despite the proliferation of community associations, relatively little is known about their impact on residential property values. This impact is important because of the trend towards community associations and the potential significant impacts on property values. The research put forth in this paper addresses this issue by examining the extant academic literature to determine how and when the activities of community associations are capitalized into housing prices. This first section provides a background on community associations which provides a context for the paper. The next section will examine the value proposition by examining the state of existing knowledge. The following section will address the challenges involved in measuring the value added by community associations and the last section will discuss the important questions that need to be answered in the future.

**The Value Proposition of Community Associations**

Community associations have the potential to influence housing values based on the structure of their organization. This organization encompasses several components which can be linked to value. Hypothesized linkages include:

- The Mitigation of Negative Externalities through Constraints

- Service Provision and Neighborhood Preservation
- Enhanced Efficiency

### *The Mitigation of Negative Externalities through Constraints*

Overall governance within a community association is designed to place constraints on homeowners in order to decrease building and use risks. As community associations act somewhat as a private government, they can pass association rules which can place constraints within the community. These restrictive covenants have been shown to benefit homeowners limiting their exposure to negative externalities generated by nearby properties. This benefit tends to get capitalized into housing prices, with an observed price impact ranging from 2% to 17% in different market settings (Agan and Tabarrok, 2005; Hughes and Turnbull, 1996; Scheller, 2015a; Speyrer, 1989; Cheung, Cunningham and Meltzer, 2014; Meltzer and Cheung, 2014; LaCour-Little and Malpezzi, 2001; Rogers, 2006; Rogers, 2010; Groves and Rogers, 2011).

While the benefits of zoning and restrictive covenants include increased housing values within a community association (Speyrer, 1989), there are various other property valuation benefits to homeowners residing in and within close proximity to these types of associations. For example, positive price effects tend to be observed when evaluating spillover effects as a recent study has found an 8.5% premium for properties within 2 miles of an HOA (Meltzer and Cheung, 2014). This may be due to the restrictive covenants which ensure that the property within the community association be maintained to a certain level of quality. An example would be a covenant to ensure homes within a community association keep their lawn to a certain maximum height. These types of provisions can also protect the neighbors of a foreclosed home because negative local externalities such as high unkempt lawns can be avoided with various covenants. It has been shown that residential community associations lessen the negative impact of a foreclosed

home by approximately 3% and virtually eliminate any negative spillover effects to neighbors (Groves and Rogers, 2011). Furthermore, an increase in 30 day delinquencies decreases home values within community associations 1.5% less than homes outside community associations (Cheung, Cunningham, and Meltzer, 2014).

Specific restrictive covenants allow a community association to shape the character and image of their neighborhood. These specific restrictive covenants can also produce valuation benefits and detriments. Although the extant literature is sparse in coupling a specific covenant to the effect on property value, various types of restrictive covenants are found to impact housing values within a community association. Depending on the restrictive covenant of interest, price effects fluctuate from 5.64% to 19% (Cannaday, 1994; Groves, 2008).

One specific covenant of interest is the effect of home design variety on housing values. When forming a community association, there must be a decision made on the degree to which home designs can vary as there are potential property value consequences of designing a community with many of the same styled homes versus many varied designs. While limiting housing design variation can assist with mitigating negative externalities, over strict building restrictions can also negatively affect property valuations. For example, it has been shown that the most frequently occurring house style can experience an 8% decrease in value while the least frequently occurring housing style experiences can increase value approximately 19% (Groves, 2008).

Sometimes, building restrictions do not impact property values, but use restrictions influence housing prices (Rogers, 2006). Pet covenants are one such use restriction which can impact property value. Allowing cats can increase value by 5.64% (Cannaday, 1994). However, adding small dogs, even to a small pets only covenant, can decrease value by 5.72% (Cannaday,

1994). When large dogs are allowed per the covenant, housing values can decrease by 10.98% (Cannaday, 1994). As of 2012, 36.5% of households owned dogs and 30.4% of households owned cats (AVMA, 2015), illustrating that pet covenants could affect a substantial portion of the American population.

Although private contracts with restrictions lessen the housing consumption risk faced by all users within the subdivision, the value of deed restrictions decreases over time and over-restrictive covenants can negatively impact property values (Hughes and Turnbull, 1996; Dehring and Lind, 2007). For example, 10 year old neighborhoods based on restrictions were found to have a 6% housing value increase, but a 20 year old neighborhood was found to have only have a 2% housing value increase (Hughes and Turnbull, 1996). In years 25-27, deed restrictions actually had a negative impact on deed-restricted subdivisions (Rogers, 2010). Additionally, it has been shown that the premium of an HOA on housing values decreases over time at approximately .4%/year (Meltzer and Cheung, 2014). Furthermore, younger HOAs seem better shielded from negative price effects due to higher delinquency exposure rates (Cheung, Cunningham and Meltzer, 2014). In regards to excessive private land use controls, zoning must be taken into account to ensure that public zoning regulations coupled with private covenant regulations are not over burdensome to future homeowners. This burden can erase any positive property value impacts of community associations; or worse, generate a negative property value effect (Dehring and Lind, 2007).

#### *Service Provision and Neighborhood Preservation*

A principal component of community associations is the provision of services in order to preserve the neighborhood. Assessing fees allows for this provision of services. The hope is that these services will preserve the neighborhood and increase property values. It has been observed

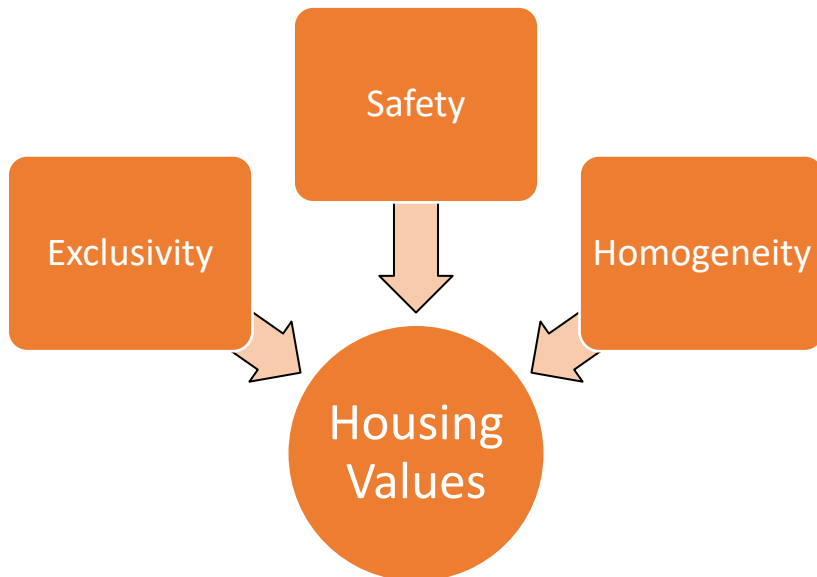
that these fees which provide services increase properties within HOAs 4.9% (Meltzer and Cheung, 2014).

Neighborhood preservation and increased property values can also be encouraged through gating. Gated communities have grown in popularity in the United States over the past decades. Popular reasons for gating a community include safety, homogeneity, and exclusivity. Security zone gated communities, which provide fences, gates, and security guards, provide safety in areas where residents fear crime; whether the crime is real or perceived (Blakely and Snyder, 1997). Security measures at gated lifestyle communities, such as golf and retirement communities, nurture homogeneity which send signals to the market about the kind of people that live in a neighborhood and what they value (Blakely and Snyder, 1997). Gate guards and security patrols in elite gated communities provide for protection of social and economic status (Blakely and Snyder, 1997). This homogeneity, superiority and security is safeguarded via the provision of private services and influences housing values as can be seen in Exhibit 2.



## Exhibit 2

### *Influence of Service Provision and Neighborhood Preservation on Housing Values*



Gating has been seen to increase property values 7%-24% within different regions in the United States (LaCour-Little and Malpezzi, 2001; LaCour-Little and Malpezzi, 2009). Even when there are no additional amenities within the gated community as compared to their ungated neighbors, a 6.07% price premium is observed (Bible and Hsieh, 2001). Private streets seem to add virtually no further value beyond the HOA (LaCour-Little and Malpezzi, 2001). Although an increased HOA size does not negate the premium of being located within an HOA, it has been observed that relatively larger HOAs command lower sale prices which may be due to their less exclusive or intimate nature (Meltzer and Cheung, 2014).

#### *Enhanced Efficiency*

Private arrangements, such as community associations, can be created to efficiently meet the specific needs of a relatively small group as opposed to the much more diverse needs of a municipality as a whole where public governments operate. These specific needs can be seen

through a hierarchy of needs lens (Scheller, 2015b). By addressing each hierarchy of need, contributions to property values are possible (Scheller, 2015b). As can be seen from Exhibit 3, addressing issues such as crime, aesthetics, neighborhood behavior monitoring, and professional management can lead to increased housing prices. When comparing homeowners associations to neighborhood associations, it has been seen that approximately 97% of HOA presidents agree or strongly agree that protection of property values is the main goal of the HOA versus only 70.5% of neighborhood association presidents (Scheller, 2015b). This shows that homeowners associations tend to operate more efficiently within the hierarchy than neighborhood associations. This could be due to their legal restrictive covenants which neighborhood associations typically do not implement.

### Exhibit 3

#### *Neighborhood Hierarchy of Needs (Scheller, 2015b)*



While community associations operate within the higher levels of the hierarchy in Exhibit 3, the efficiency of assessed fees should be evaluated to ensure appropriate fees are being charged for the appropriate amount of services. Services provided by community associations are supported through fee assessments. When administering services, it is important to strike a balance between the level of service provided and the associated fee level. If this is not the case, it could negatively impact property values. For example, the community association which responds to high demanders runs the risk of charging excessive fees and providing excessive services for the median resident (Langbein and Spotswood-Bright, 2004). In some cases, fees are too high which have reduced property values (Langbein and Spotswood-Bright, 2004). One way to mitigate this is professional management (Langbein and Spotswood-Bright, 2004).

### **The Challenges Involved in Measuring the Value Added by Community Associations**

Although it certainly is a worthy endeavor to attempt to measure the value added by community associations, there are concerns when performing this type of analysis. Firstly, knowledge on private governments is limited. As government services continue to become privatized on a regular basis, learning more can help us to understand the effect they can have on property values. Secondly, there is a lack of data. More time and energy is recommended to improve data availability to further the knowledge on the linkages between community associations and property values. Thirdly, this lack of data leads to a dearth of empirical studies. And much of the extant literature is geographic specific and does not take into account controlling variables such as neighborhood characteristics, number of bedrooms, and number of bathrooms. This can overstate results and make them less accurate. It is recommended that future studies control for more variables.

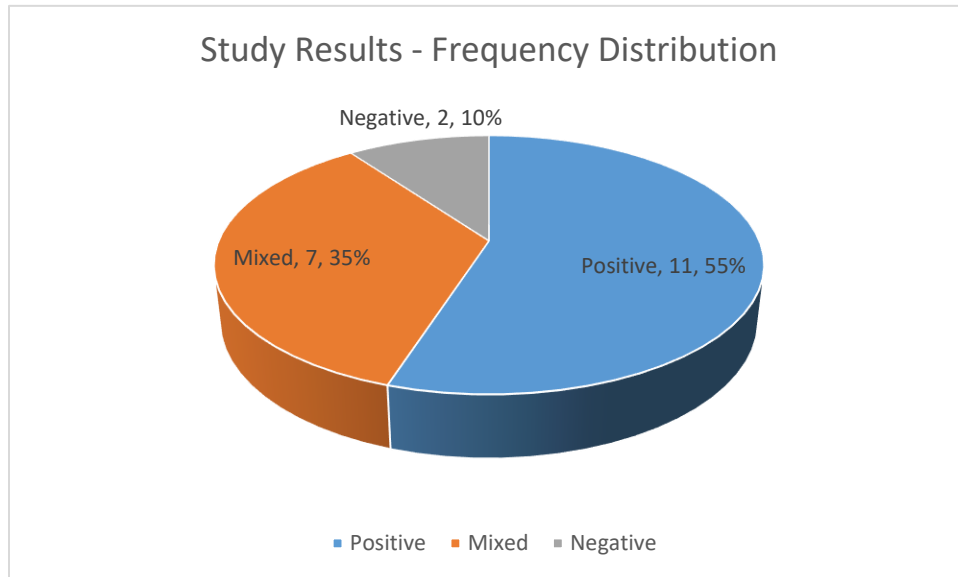
## **Conclusion**

The sheer organization of community associations influence housing values. The CC&Rs created by the community association assist in shaping the character and appearance of the respective neighborhood. These CC&Rs work to mitigate negative externalities, preserve the neighborhood, and boost efficiency which impact housing values.

Those who eschew community associations may want to reconsider their position in light of the potential property valuation benefits. Most studies reviewed in this paper indicate that community associations have a positive impact on housing values as illustrated in Exhibit 4 and Appendix A. Components which help reduce negative externalities seem to positively influence property valuations. Allowing cats and a variety of housing designs also seem to increase property values. Inciting exclusivity, safety, and homogeneity through gating likewise heightens housing prices. Furthermore, forming a community association may be a better organizational structure than a neighborhood association when the goal is to increase property values.

## Exhibit 4

### *Study Results – Frequency Distribution*



Supporters of community associations believe that being located within one increases property values (Groves, 2008). However, there are various components which can impede property values. Too many constraints, such as the lack of housing design variety and over burdensome public zoning regulations coupled with private covenant regulations, can hinder property values. Overprovision of services and fees and low efficiency of services can also hamper housing values. Dog ownership may also be a bone of contention for community associations as dogs have been shown to decrease property values.

To address these negative influences on property value, the following actions are recommended. As age seems to negatively affect the housing values within community associations, it may be important to modify CC&Rs within aging associations to keep pace with

modern preferences, features, and language. This may assist with the decrease in property premium over time. Also, allowing different house designs can assist in propping up property values. Furthermore, the level of fees relative to the community association should be kept in mind when trying to make this type of private government as efficient as possible.

As community associations become pervasive in the American landscape, further knowledge on property valuation impacts is imperative. Extant literature is sparse on this. Further specific covenants should be looked at to see how they impact property values within community associations. Linking a specific covenant to the effect on property value is crucial in producing more informed decision makers. Furthermore, the arrangement and actions of private governments need to be evaluated to ensure efficient operations. This new knowledge will assist community association stakeholders in adopting the most appropriate CC&Rs and organizational structure.

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## Appendix A

### Summary of Association Valuation Literature by Valuation Component

<b>Study</b>	<b>Valuation Component</b>	<b>Sample</b>	<b>Method Used</b>	<b>Result</b>	<b>Positive / Negative</b>
Agan and Tabarrok (2005)	Government constraint	Sales data from 5 zip codes in Prince William County, VA	Hedonic Regression	5.4% property value premium	Positive
Bible and Hsieh (2001)	Gated communities	284 sales within six different neighborhoods in same metropolitan area	Hedonic Regression	6.07% sale price increase	Positive
Cannaday (1994)	Pet covenants	13 condo complexes near downtown Chicago	Multiple Regression	Cats only increased value by 5.64%; small pets only, including dogs, decreased value by 5.72%; large pets, including dogs, decreased value by 10.98%	Mixed
Cheung, Cunningham, and Meltzer (2014)	Spillover effects of homeowner distress and foreclosures	316,267 arms' length sales in the state of Florida	Hedonic Regression	An increase in 30 day delinquencies decreases home values within HOAs 1.5% less than homes outside HOAs	Positive

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Dehring and Lind (2007)	Restrictive covenants coupled with zoning regulations	Vacant residential parcel sales from Southlake, Texas	Hedonic Regression	Covenanted land within the lower restricted zoning area did not affect value whereas covenanted land within the higher restricted zoning area sold for 21% less than non-covenanted land	Negative
Groves (2008)	Rules and regulations	124,878 single-family detached home sales in Saint Louis County, Missouri	Hedonic Regression	Most frequently occurring house style experiences an 8% decrease in value while least frequently occurring housing style experiences an increase in value of approximately 19%	Mixed

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Groves and Rogers (2011)	Covenant effectiveness on foreclosure and spillover effects	Property characteristics and sale prices for 90,532 observations in St. Louis County, Missouri	Hedonic Regression	Residential community associations lessen the negative impact of a foreclosed home by approximately 3% and virtually eliminate any negative spillover effects to neighbors	Positive
Hughes and Turnbull (1996)	Deed restrictions and neighborhood covenants	1,314 single-family detached house sales in Baton Rouge, LA	Hedonic Regression	6% housing value increase in 10 year old neighborhoods based on restrictions; 2% mean housing value increase in 20 year old neighborhoods	Positive
LaCour-Little and Malpezzi (2001)	Private and gated streets	381 sales in a well-established St. Louis, Missouri neighborhood	Hedonic Regression	HOA increases value by 17%; private streets do not add value while being gated increases value by an additional 9% (26% total)	Mixed

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LaCour-Little and Malpezzi (2009)	Gated streets	Gated subdivisions in La Habra Heights, CA, Chino Hills, CA, and Fullerton, CA	Hedonic Regression	7% to 24% premium	Positive
Langbein and Spotswood-Bright (2004)	Private government efficiency	195 units within six residential community associations in condominium communities in Alexandria, VA	Hedonic Regression	Fees are too high and are reducing property values, but professional management can help mitigate this somewhat	Negative
Meltzer and Cheung (2014)	Assessment of fees	583,133 single-family home observations	Hedonic Regression	Properties within HOAs sell for a 4.9% premium; Premium of HOA on housing values decreases over time at approximately .4%/year	Positive
Meltzer and Cheung (2014)	Spillover effects	583,133 single-family home observations	Hedonic Regression	8.5% premium found for properties within 2 miles of an HOA	Positive

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<b>Study</b>	<b>Valuation Component</b>	<b>Sample</b>	<b>Method Used</b>	<b>Result</b>	<b>Positive / Negative</b>
Rogers (2006)	Building and use restrictions	1,487 single-family home sales in Greeley, CO	Hedonic Regression	Building restrictions do not impact property values, but use restrictions increase prices	Mixed
Rogers (2006)	Restrictive covenants	1,487 single-family home sales in Greeley, CO	Hedonic Regression	3.1% premium on sale price with lender voting and 6.2% without	Positive
Rogers (2010)	Deed restrictions	Deed-restricted subdivisions in Wildwood, Missouri	Hedonic Regression	Deed restrictions have a positive marginal price impact between 4.5% and 6.5%, but this positive impact declines over time and becomes negative in years 25-27	Mixed
Rogers (2010)	Building and use restrictions	Deed-restricted subdivisions in Wildwood, Missouri	Hedonic Regression	Building restrictions do not impact property values, but use restrictions increase prices	Mixed

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Scheller (2015) a	Neighborhood governance	620 parcel sales in 2007 in Leon County, FL	Hedonic Regression	HOAs increase property values 13.3%; neighborhood associations do not effect property values	Mixed
Scheller (2015) b	Neighborhood governance	147 presidents of neighborhood and homeowners associations in Tallahassee, FL.	Mixed Methods	Approximately 97% of HOA presidents agree or strongly agree that protection of property values is the main goal of the HOA vs. only 70.5% of neighborhood association presidents	Positive
Speyrer (1989)	Zoning and restrictive covenants	230 sales of reasonably homogeneous houses within the Southwest Houston, TX area in 1978	Hedonic Regression	Approximately 7.1% premium for zoning restrictions and 8.7% premium for covenant restrictions	Positive