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Best Practices for Setting Homeowners Association Dues in the Presence of an Inclusionary Housing Policy

Introduction

Inclusionary housing programs commonly require that developers target a percentage of the units in a new condominium or homeownership development to families of more modest means, and then sell those units to income-qualified families at a below market-rate price. Inclusionary programs also typically require that the price-restricted units cost no more than 30% or 35% of the target buyer's total income.

Municipalities have the legal authority to set the initial sale and resale prices of the inclusionary units to ensure affordability, but are challenged by the added cost and unpredictability of Homeowners Association (HOA) dues. Many inclusionary housing programs encounter the problem of rising HOA dues, which undermine the affordability of below market-rate (BMR) homes. Particularly in high-priced markets, HOA dues can form a significant portion of the home cost for low-income residents.

HOA dues can also unexpectedly rise, for example, when operating expenses increase quickly or when wealthier homeowners are interested in adding luxury amenities. Typically, HOA increases are gradual, but sometimes HOAs charge large assessments for one-time expenses. However, even small changes can add up over time. The end result is that HOA dues may cause affordability to erode over time and may even cause a family who owns the inclusionary unit to fall into foreclosure.

While a number of best practices help protect low- and moderate-income homeowners, all of them present challenges. For example, under many of the solutions, market rate homeowners

subsidize the HOA dues of BMR residents. These solutions present challenges because, while this strategy may solve the affordability problem, it may foster animosity among a small group of residents who pay more than their neighbors for similar amenities. This can be a particular challenge when a community contains a large number of BMR residents (e.g., 20 percent), and the extra burden on market-rate homeowners is large. Of particular concern is if homeowners receive an unexpected assessment or increase in their HOA dues. They may be angry about the increase and look to blame others, such as BMR residents.

While there is no perfect solution to the affordability challenge of HOA dues, the best strategies involve:

- Setting an initial sales price which incorporates HOA dues,
- Requiring that HOA dues are lower for BMR residents, and
- Putting protections in place in case a BMR owner falls behind on dues.

The best practices below may be used as a menu from which to create a successful policy.

Note: Most states have complex rules governing Homeowners Associations that may preclude some of the options summarized below. It is important to consult with an attorney that knows the legal environment in your state before proceeding.

Best Practices

1. Calibrate Initial Sales Price for Expected HOA Fee Increases

It is important to calculate HOA dues into the initial sales price formula. Thus, monthly mortgage costs, insurance payments, HOA dues, and utilities should all together equal no more than 30 to 35 percent of a qualified owner's income. If HOA dues are expected to increase, the affordability calculations should also use projected HOA dues rather than current year HOA dues in the price calculation.

It is also advisable to have a cushion in the initial sales formula. With a cushion, if HOA dues increase more than expected, current owners of the BMR units can continue to afford their ownership costs. For example, a city can limit BMRs to households that make 80 percent of the area median income, but price the units so they are affordable to households that make 70 percent of the area median income.

2. Set Dues Based on Unit Value

HOA dues are usually charged one of three ways:

- Equal share – If there are 100 units, the total budget is divided by 100.
- Square footage – Units pay a *pro rata* share based on their size.
- Value – Units pay a *pro rata* share based on their value.

Charging the dues on the basis of value builds in an inherent discount for BMR units. While affordable homeowners still will be faced with a price increase under increasing HOA dues, the increase will be proportionally less compared to their market neighbors. This solution is appealing because it does not single out BMRs for special treatment, but there is still the potential for some animosity among homeowners.

Note: Some states specifically prevent HOA dues from being divided this way.

3. Require Lower Dues for BMR Residents

Some cities require that the dues for BMR residents be less than the dues for market-rate units. For example, Garfield County, Colorado has the following policy:

HOA dues for Affordable Housing Units shall be prorated as compared to HOA dues owed by market rate unit owners. HOA dues for Affordable Housing Units shall be prorated by either average Lot Size or average unit size in comparison to market rate lots and/or units, whichever results in the lower cost for the Affordable Housing Units, or by a formula proposed by the Applicant and approved by the GCHA and the BOCC. If prorated HOA dues are not possible, then the HOA dues for Affordable Housing Units shall be a maximum of 75% of the HOA dues owed by market rate unit owners.

Cities can also limit the increase of HOA dues for BMR residents. For example, cities could require that HOA dues for BMR residents may only rise two percent per year. While this potential solution is appealing, there are no known examples of this policy.

4. Adjust Dues Based on Access to Amenities or Actual Costs

If BMR units are expected to have lower costs, HOA dues can be structured to reflect this reality. If, for example, BMR units are duplexes, while market rate homes are single family homes, the costs (e.g., exterior maintenance, landscaping, etc.) for the BMRs may be lower.

While this solution seems fair, it may be hard to administer and require more record keeping for the HOA.

In some cases, there may be amenities that only apply to a small number of residents. For example, if an HOA maintains a lake, the dues associated with maintaining the lake could be charged just to those who have a view of the lake. If BMR units are less likely to use the amenity, their dues will be lower.

Another option is to limit the access of BMR residents to certain services. For example, if the HOA has a gym or pool, it could be restrict access to that amenity to only those residents in market-rate units and then lower the dues of BMR units. This solution, while potentially effective, highlights the differences between market-rate owners and BMR owners and may create a feeling that BMR owners are second-class citizens.

5. Create Separate HOAs for BMR Units

Larger developments with multiple HOAs can form a separate HOA for BMR residents so they have more control over their expenses. This is most practical if the BMR units are located in one area, rather than dispersed throughout the development, which is contrary to the policy of many cities.

6. Limit HOA Dues Based on Essential Items

It may be possible to differentiate between essential and luxury items when calculating HOA dues. If market-rate owners are interested in adding amenities—for example, a hot tub—the costs of those items can be excluded from the dues of BMR residents.

This approach is appealing because it balances the desires of market-rate residents with the needs of BMR owners. However, it is currently untested.

There are a number of challenges with this approach. It may be hard to differentiate between amenities that are essential and those that are optional. It is not clear who would make this determination, but it seems prone to disagreement unless objective standards can be used. Additionally, it would make budgeting more complicated for HOAs, some of which may lack accounting expertise.

7. Dedicate Funds to Reduce HOA Dues

A dedicated source of funding can help reduce HOA dues for BMR residents. For example, Chapel Hill, North Carolina charges a fee at resale for market-rate units and uses this fee to help reduce the dues of BMR units.

Rather than charging a fee to new market-rate homeowners, the public could also directly subsidize this fund. While most governments likely do not have the resources to buy down HOA dues on an ongoing basis, it is possible to have a loan fund to help BMR owners, as needed. If a BMR owner cannot afford the increase in HOA dues, a local government could lend the money to the homeowner and recoup the costs at resale, assuming there is enough money available at closing.

8. Advocate for State-Enabled Resident Protections

There are a number of strategies that states can take to protect residents, but they would typically require state-authorizing legislation. In 2009, California's legislature passed a bill offering some protection, but it was ultimately vetoed by the governor. Some potential state-level resident protections include:

- Require HOA boards of directors to offer payment plans for a duration of up to three years to BMR owners that cannot afford additional assessments;
- Prohibit HOAs from charging interest to BMR owners that are paying back additional fees through a payment plan;
- Prohibit HOAs from conducting lien enforcement procedures on any BMR owners during the period that the payment plan is in place;
- Require notice to cities before HOAs can pursue liens for BMRs; or
- Reserve a seat on the HOA board of directors for a resident of a BMR property.

9. Provide Homebuyer Education and Financial Planning Services to BMR Buyers

Homeowner education is crucially important. The homebuyer class that prospective BMR owners take should cover HOA dues explicitly. Homeowners should be knowledgeable so they can budget for unexpected increases. San Francisco has this warning on their paperwork: "Buyers should be aware of the fact that HOA dues can increase over time beyond the pace of inflation."

Conclusions: Ensuring Long-Term Affordability

Regardless of the method chosen, it is important to remember that HOAs have some autonomy in setting their dues. Consider this cautionary tale from Chicago, documented by the Center for Housing Policy:

Affordable buyers moved into a building, and the developer had promised that their condo fees would be calculated based on the price, rather than the square footage, of the unit. Once the units were sold and the developer was out of the picture, the newly formed condo association voted to change the monthly assessments calculation, so that the assessments were based on square footage rather than price. The affordable buyers were caught off guard – and many worry that they won't be able to afford the mortgage and the increased assessments. The condo association members, on the other hand, felt it was unfair that they should be subsidizing the affordable owners for a benefit that was received by the developer.

Since the methodology for assigning dues can change over time, if a city wants to ensure that its practices that protect BMR residents are permanent, it will need to specify those rules in the affordability agreements signed by the developer and the city and appropriately record them.

HOA dues must be considered to have a truly affordable inclusionary housing policy. In order to avoid eroding affordability due to increased HOA dues, communities should implement a strategy that includes: (1) appropriate initial sales prices which incorporate HOA dues, (2) a requirement that HOA dues are lower for BMR residents through one of the methods listed above, and (3) protections for BMR owners who fall behind on dues.