THE HOA TIME BOMB

APACOLORADO State Conference, Telluride, 2017
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OUTLINE

The HOA Issue for Planners

The HOA Issue for HOAs

Potential Solutions

Discussion
Most Cities and Counties want:
- To keep taxes low
- To keep public operating costs low

To Do That, They
- Only accept dedication of infrastructure that meets their standards
- Set construction standards high enough that the infrastructure will last a long time before needing to be repaired or replaced
- Set minimum size standards for dedication parks and open space
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Builders Generally Want to:

- Complete the project successfully
- Earn a reasonable profit

To do That They:

- Try to reduce the risks of development by:
  - Reducing the costs of required infrastructure
  - Reducing the size of required open space
  - Taking on smaller projects (sometimes)
The Problem with Standards

- They tend to increase over time as engineers build in extra margins for safety (sometimes on top of earlier margins)
- They are often codified in national standards, which potential liability for approving improvements that do not meet or exceed them
- Beyond a point, lowering construction and size standards actually will result in increased repair and maintenance costs
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Infill Compounds the Issue

• They tend to be smaller projects with fewer houses and less traffic, especially projects defined for lower activity and occupancy:
  • Cottage housing
  • Co-housing
  • Senior housing

• They are sometimes on constrained or irregular sites where compliance with street, slope, open space, and drainage standards will be difficult
Approval of Lower Standards

- Requests for approval of infrastructure that does not meet city or county standards are often only approved with the conditions that:
  - The local government will not accept dedication of the infrastructure or open space; and
  - The builder must arrange for an entity other than the city or county to maintain and repair the infrastructure time.

- That means either:
  - A Special District or
  - A Homeowners Association
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• Special Districts:
  • Have more powers to raise money
  • Are harder to create because they require approval of the city or county
  • Have more legal requirements and are more expensive to operate than HOAs – particularly for small projects

• So -- many small project builders decide to create an HOA to be responsible for maintaining the undedicated infrastructure over time
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• HOAs:
  • Do not require city approval
  • Do not have general taxing powers
  • Usually rely on assessments and user-fees to pay for operations, amenities, and enforcement of any restrictive covenants

• Adding infrastructure maintenance and repair obligations often represents by far the largest potential HOA cost item

• Some of the largest infrastructure repair costs will not be apparent until the original infrastructure fails

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• HOAs for smaller projects generally do not have paid staff – they are run by volunteer residents of the project

• The smaller the project:
  • The harder it is to find volunteers to run it
  • The better each volunteer knows their neighbors
  • The harder it is to find the time, money, and motivation to enforce covenants and assessments against their neighbors
  • The fewer property owners there to cover large repair costs

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• When builders, cities, and counties require or allow small HOAs to be responsible for maintenance and repair of expensive infrastructure, it is fairly predictable that:
  • Enforcement of assessments may be weak
  • Funds will not be on hand to repair the infrastructure when needed

• That will lead to resident pressure on the city or county to take over and fix the infrastructure they refused to accept earlier

• That’s the Time Bomb

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Example 1 - The landscape maintenance

- Developer/planning department wants landscaping at entrance to, or bordering community
- Metro District won’t accept for maintenance
- County won’t accept for maintenance
- Developer creates an HOA

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• The burden of HOA governance
  • Formed as a separate Colorado nonprofit corporation
  • Requires election of Board of Directors
  • Owners within the community are members of the association
  • Association must obtain insurance – property, liability, directors’ and officers’, fidelity
  • Association elects to self-manage rather than hiring professional management company due to cost of professional management
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- Association hires landscape maintenance company and snow removal company
- Must comply with annual meeting and disclosure requirements of the Colorado Common Interest Ownership Act
- Conduct meetings (owners and Board)
- Adopt budget; allow owners to vote
- Levy and collect assessments
- Collect delinquent assessments
- File annual federal and state tax returns
- File state registrations
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• The inherent problems
  • Expenses of maintenance and snow removal total about $9/year/home
  • Administrative expenses total another $9/year/home
  • Total annual assessments are $18/year/home
  • Professional management would likely add another $40-$60/year/home to the assessment amount
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• Issues:
  • Owners move into community not understanding that there is an HOA, or why it exists
  • Getting owners to serve on Board of Directors
  • Getting owners to pay assessments
  • Enforcing obligation to pay assessments
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• Consequences of failure
  • No maintenance, upkeep or repairs to common areas
  • Failure to file tax returns
  • Failure to file annual reports with SOS and DORA

Association failure!
Example 2 – Incomplete development/formation of HOA

The failure of the developer to follow through

• Failure to annex lots into HOA
• Failure of developer to convey common areas to HOAs (or water rights, taps, etc.)
• Formation documents not appropriate to the community developed

What to do now?
Example 3 – The Condominium Dilemma

• Due to minimum lot sizes or other development/subdivision criteria and limitations, developer elects to develop residential project as condominiums

  • In-fill/re-development project (lot size will allow higher density, but subdivision code will not permit subdivision of lot)
  • Site condominiums
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- Development criteria requires mandatory employee housing/low income housing
  - Attendant caps on assessments
  - Limits on appreciation that can be realized by the owner/seller
  - Creates “us” vs. “them” mentality
  - Free-market unit owners bear an increasingly disproportionate share of common expense assessments
  - No incentive for restricted unit owners to pay anything more than the bare minimum to be able to continue living in unit
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- Reduces incentive of free-market owners to pay anything more than bare minimum to maintain their units and the common areas
- No incentive to fund reserves required to pay for major repair/replacement of common element components
- Value of condominium units suffers
POSSIBLE SOLUTIONS

From the Planners Side

1. Right-sizing Standards

• Cities and Counties can revisit infrastructure and open space standards to ensure that they are not excessive given the lower amounts of traffic and open space/amenity use to be expected in a small infill project.

• Infrastructure that meet those revised standards would be dedicated to and maintained by the city.

• This may be the price we pay for (or a key way to incentivize) infill development.

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POSSIBLE SOLUTIONS

From the Planners Side

2. Setting minimum size standards for HOAs required to maintain infrastructure

This may discourage infill development projects that require reduce infrastructure standards . . .

But may reduce the number of HOA failures to maintain and related calls for the local government to take over infrastructure it would not have approved.
POSSIBLE SOLUTIONS

From the HOA side

- Additional oversight by planning department?
- Require developers to do what they are supposed to do
- Read and understand the HOA/condominium formation documents
POSSIBLE SOLUTIONS

From the HOA side

• Understand the risks of creating small or limited purpose HOAs and condominiums
• Separate employee housing/low income housing from free market housing
• If employee housing/low income housing is part of the project, do not cap assessments on those units
• Clarity of responsibilities between housing types in master planned communities (even small communities, consisting of single-family, condo, townhouse)
QUESTIONS?