<u>Condominium and Resort Rental Management Agreements: Lessons Learned</u>

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For those of you who are involved in the small but growing niche of the real estate market called condo/hotels, I have some thoughts on interpretation and problem resolution in Rental Management Agreements. For those of you who work with hotels and mixed use projects, but not condo/hotels specifically, you may still pick up some good ideas from this discussion, because, as we know, the basic real estate issues of ownership, right of possession, clear title, income and foreclosure, are present in each of our deals, but the meat is just chopped and diced in a different way for the different type of project.

A. <u>Background.</u> How a condo-hotel is set up.

B. <u>The Rental Management Agreement.</u> The basic document which controls the rights and responsibilities between a unit owner and the manager of the rental program.

C. <u>The Turn of the Economy.</u> Many of these transactions were set up in better economic times; how does the downturn in the economy affect the assumptions in these deals.

D. <u>The Unit Owner's Dilemma.</u> Unit Owners purchased for their own use, for rental, or appreciation?

E. <u>The Hotel Manager's Response to Changing Economic Times.</u> Hotel operators in general and condo/hotel managers in particular, have tried new options to manage better and secure more guest nights.

F. <u>Comments on Specific RMA Provisions; Lessons Learned.</u>

   i. <u>Parties and Combined Agreements.</u> Make sure rights and responsibilities are combined in one document.

   ii. <u>Resort Costs.</u> How are general resort costs allocated.

   iii. <u>Easements.</u> Make sure each entity has easements for all the rights they need to operate together.

   iv. <u>Unit Foreclosure</u>. How does the Operator react? What should the lender do to preserve as much value of the unit as possible?

   v. <u>Unit Owner Foreclosure Part II.</u> Who owns the Headboard?

   vi. <u>Ownership Transfer Timing.</u> Accepting bookings, rights of possession, income rights, voting rights.

vii. Can the Bank Vote the Unit's Share? Obligations of Notice in By-Laws, Declarations.

viii. RMA Survival of Foreclosure. Can the Operator continue to rent the unit?

ix. Rental Rotation Obligations. How to coordinate bookings with foreclosure.

x. Municipal Notices. For municipal law purposes, is a unit a "property" that needs to be notified for municipal changes?

xi. Notice Part II. Should the RMA have a Power of Attorney provision?

xii. Property Tax Assessment Challenge. Does the RMA operator or the Association have the right to challenge the property taxes for the benefit of all unit owners?

xiii. Rate Setting. Setting rack rates has become much more complicated.

xiv. "Travel Agency Fees". Cost of securing that guest room night is more expensive.

xv. Who owns the reserve for repairs? Can it be reached by Unit Owner's Bank?

xvi. Personal Property foreclosure. The increased cost of replacement personal property when not purchased in bulk.

xvii. Extra services. Joint repair contract for appliances, extended warranties.

xviii. Portals and non-paper notices

xix. Quorums. Harder to get quorum for meetings and alternatives.

xx. Utilities are Changing. Maybe land lines no longer needed; guests changing expectations.

xxi. Operators' Duties to Foreclosing Banks. Who has right to possession under State law.

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Timesharing Scams - Resale Promises and Transfer Company Dreams

ABA RPTE Spring Symposia
April 28, 2011

Joseph Lubinski
Timeshare and Interval Uses Committee

“Timeshare”

- Many types of “timeshare” products
  - “True” timeshare (weeks)
  - Fractional interests
  - Private Residence Clubs
- The issues to be discussed relate principally to “true” timeshare interests in which the owner owns or has a right to use a week (or several weeks)

Introduction to Resales

- The timeshare resale market
  - Initial sales prices
  - Resale prices
  - Sales volume
- History of timeshare resale companies

Introduction to Resales (cont.)

- If neither timeshare resales nor resale companies is a new phenomenon, why all the attention?
  - Downturn in the economy
  - Financial realities of timeshare ownership
  - Popular media attention
  - Consumer alerts from the BBB and state attorneys general
  - Willingness of ARDA to attempt to address

Resale Concepts to be Discussed

- Principal resale activities that can result in abuses and fraud
  - Advance fees
  - Guaranteed sales
  - Transfers to shell entities

Advance Fees

- Fee charged, prior to sale, for services provided by resale company
- Not illegal, nor necessarily inappropriate
- Abuse arises where the seller receives nothing for having paid the fee

Transfer Scams

- Postcard Solicitations
- “Ready to Close” (just need to fund closing costs)
- Transfers to a shell

Effects on Interest Owners/Sellers

- Upfront loss of fees
- Continued ownership of interest and obligation to pay assessments
- Liability for fraudulent behavior

Effects on Associations

- Loss of assessment revenue
- Loss of ability to enforce remedies for collection of assessments
- Higher costs to other owners
- Investigation costs
- Bearer of bad news

Remedies

- Consumer awareness
- Association vigilance
- ARDA model act
- Fraudulent transfers
- Attorney general enforcement
- Possible FTC involvement

Additional Resources and Source Material

- Timesharing and Interval Uses Committee

  http://apps.americanbar.org/dch/committee.cfm?com=RP273000

- Media Coverage
  - MSNBC
  - Miami Herald

- ARDA Model Act

  http://dev.arda.org/uploadedFiles/ARDA/Government_Affairs/State_Legislative_Committee/ARDA%20Model%20Resale%20Act%20Ver15-Adopted.pdf

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RPPT SPRING SYMPOSIUM

HOT TOPICS 2011

COMMON INTEREST AND DEVELOPMENT COMMITTEE

WHAT IS THE UPROAR OVER PRIVATE TRANSFER FEE COVENANTS?

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WHAT IS THE UPROAR OVER PRIVATE TRANSFER FEE COVENANTS?

OVERVIEW

What is a Transfer Fee Covenant?

- A covenant that imposes a fee that is analogous to a real estate transfer tax but that is payable to a private party rather than a governmental agency.

Three Categories

- Covenants that require payment to HOAs or similar organizations
- Covenants that require payment to Charitable or "Quasi-Public" Organization
- Covenants that require payment to third party (Developer)

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Run with the Land?

- Payments to HOAs or similar organizations – the benefit and burden “touch and concern” the subject land
- Payments to Charitable or “Quasi-Public” Organizations – with a bit of stretch, the benefit and burden “touch and concern” subject land
- Payments to Developer – Just “Gross”

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Touch and Concern

- Traditional Covenant Enforcement
  – Both the benefit and the burden of the covenant touch and concern the subject land
- Common Interest Development Covenant Enforcement
  – Cultural, environmental, educational, charitable, recreational, conservation or other similar activities benefitting the real property affected by the burdensome provision or the community of which the property is a part
- And if none of the above:
  – If Benefit is personal (“in gross”), then the burden will not run with land

“Illegal, Unconstitutional or Violation of Public Policy”

- Violation of Public Policy if the servitude is:
  - Arbitrary, spiteful or capricious, an unreasonable restraint on alienation;
  - Unreasonably burdensome of a fundamental constitutional right;
  - Imposes an unreasonable restraint on alienation;
  - Imposes an unreasonable restraint on trade or competition; or
  - Unconscionable

Freehold's "Freehold" on Private Transfer Fees

- 1% Transfer Fee or "Capital Recovery Fee"
- Development Costs Equitably Shared
- Transfer Fees are Not Hidden
- Transfer Fees are an Important Financing Tool
- Freehold touts 99-year transfer fee covenants upon land in 45 states on projects valuing in excess of $600 billion!
- Possible securitization

State Action – Legislatures Join in Uproar

- Numerous states have enacted legislation that prohibits transfer fee covenants that require fees to be paid to a developer or third party
- ALTA and NAR have prepared a Model Statute
- States with legislation that tracks the Model Statute:
  - Florida, Missouri, Arizona, Delaware, Hawaii, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, Mississippi, North Carolina, Ohio, Oregon and Utah

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California Does Its Own Thing

- Disclosure: California's legislation requires substantial disclosures with respect to for-profit private transfer fees

Federal Action In 2010

- Federal Housing Finance Agency Guidance
  - August 2010 publication promulgated guidance on private transfer fee covenants to Fannie Mae and Freddie Mac
  - Guidance indicated that Fannie and Freddie should not deal in mortgages on properties encumbered by private transfer fee covenants
  - Private transfer fee covenants appear "adverse to liquidity, affordability, and stability in the housing finance market and to financially safe and sound investments"
  - Guidance extends to mortgages and securities held by Banks as investments or as collateral for advances and to mortgages and securities held or guaranteed by the Enterprises

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4,210 COMMENTS LATER….

- Increased Costs to Homeowners
- No distinction between “public” private and “private” private
  - Beneficial Transfer Fees v. Non-beneficial Transfer Fees
  - Beneficial Transfer Fees Should be Permitted
  - Freehold’s view: all private transfer fees (including the securitization of such fees) should be permitted
- Looking backwards and forwards: Retroactive compliance = Nightmare
  - Compliance issues
  - Unmarketable title
  - Economic hardship to consumers (no purchase or refinancing available)

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FHFA's Response

- "Touched and Concerned" (Narrow Focus):
  - Rule proposes to except from the Rule private transfer fees that are paid to HOAs or similar associations and to tax-exempt non-profit organizations, where the fees are used for the direct benefit of the encumbered properties
- "Look to the Future" (Prospective):
  - Rule proposes that it will apply to private transfer fee covenants created after the publication date of the proposed rule

Defined Terms

- "Paid to HOAs"
- "Direct Benefit"
- "Of the Encumbered Property"

APPLAUSE?

- Pros of New Rule
- Cons of New Rule

Other Federal Action in 2010

- HR 6260
  - Congresswoman Maxine Waters sponsored a new bill in the House or Representatives in September 2010 that proposes to amend RESPA to allow transfer fees in certain situations
- HR 6332
  - Congressman Phil Gingrey sponsored a new bill in the House of Representatives entitled “Homebuyer Enhanced Fee Disclosure Act of 2010” that required a separate notice of disclosure to be filed of record when a document containing a transfer fee is recorded against real property

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In Closing…..

- Issues Left Open
- What's Next?

For Your Reading Pleasure….

(Information included in the Materials)

- February 1, 2011 Rule on Private Transfer Fee Covenants (FHFA 12 CFR Part 1228)
- August 16, 2010 Proposed Guidance on Private Transfer Fee Covenants (75 FR 49932)
- Joint Editorial Board for Uniform Real Property Acts Comments on Proposed Guidance re: Private Transfer Fee Covenants (October 12, 2010)
- Freehold Capital Partners Comments on Proposed Guidance re: Private Transfer Fee Covenants (October 13, 2010)
- Joint Letter from Hospitality and Commercial Real Estate Transactions on Proposed Guidance re: Private Transfer Fee Covenants (October 15, 2010)
- “Private Transfer Fee Covenants: Cleaning Up the Mess”, R. Wilson Freyermuth

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FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1228

RIN 2590-AA41

Fannie Mae, Freddie Mac and the Federal Home Loan Banks Restrictions on the Acquisition of, or Taking Security Interests In, Mortgages on Properties Encumbered by Certain Private Transfer Fee Covenants and Related Securities

AGENCY: Federal Housing Finance Agency.

ACTION: Notice of proposed rulemaking; request for comment.

SUMMARY: The Federal Housing Finance Agency ("FHFA") published on August 16, 2010, proposed guidance on private transfer fee covenants that would apply to the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, the "Enterprises"), and to the Federal Home Loan Banks ("Banks") (the Enterprises and Banks are collectively referred to as "regulated entities"), 75 FR 49932 (Aug. 16, 2010). FHFA received several thousand comments on the proposed guidance and has decided to address the subject by regulation rather than through guidance.

This proposed rule would restrict the regulated entities from dealing in mortgages on properties encumbered by certain types of private transfer fee covenants and in certain related securities. Such covenants are adverse to the liquidity and stability of the housing finance market, and to financial safety and soundness. The proposed rule would apply this restriction to mortgages on properties encumbered by certain types of private transfer

fee covenants; to securities backed by such mortgages; and to securities backed by any income stream from such covenants. The proposed rule would restrict the Banks from purchasing such mortgages or securities as investments or taking them as collateral for advances or for other purposes, and the Enterprises from purchasing such mortgages either to hold as whole loans or for securitization. This proposed rule would except private transfer fees paid to homeowner associations, condominiums, cooperatives, and certain tax-exempt organizations that use the private transfer fees to provide a direct benefit to the owners of the encumbered real property. With limited exceptions, the rule would apply only prospectively to private transfer fee covenants created on or after the date of publication of the proposed rule. Regulated entities are required to comply with the final rule within 120 days after the date of its publication in the Federal Register.

DATES: Written comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit your comments, identified by regulatory identification number (RIN) 2590-AA41, by any of the following methods:

- E-mail: Comments to Alfred M. Pollard, General Counsel, may be sent by e-mail to RegComments@fhfa.gov. Please include "RIN 2590-AA41" in the subject line of the message.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by e-mail to FHFA at RegComments@fhfa.gov to ensure timely receipt by FHFA. Please include "RIN 2590-AA41" in the subject line of the message.

- U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA41, Federal Housing Finance Agency, 1700 G Street, NW., Washington, DC 20552.
- Hand Delivered/Courier: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA41, Federal Housing Finance Agency, 1700 G Street, NW., Washington, DC 20552. The package should be logged at the Guard's Desk, First Floor, on business days between 9 a.m. to 5 p.m.

FOR FURTHER INFORMATION CONTACT: For issues regarding this proposed rule, contact Christopher T. Curtis, Senior Deputy General Counsel, (202) 414-8947, christopher.curtis@fhfa.gov; David Pearl, Executive Advisor, Office of the Deputy Director for Enterprise Regulation, (202-414-3821), david.pearl@fhfa.gov; Christina Muradian, Senior Financial Analyst, Office of Examinations Policy and Strategic Planning, (202-408-2584), christina.muradian@fhfa.gov; or Prasant Sar, Policy Analyst, Office of Policy Analysis & Research, (202-343-1327), prasant.sar@fhfa.gov. (None of these telephone numbers is a toll-free number); Federal Housing Finance Agency, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Comments

FHFA invites comment on all aspects of the proposed rule and will take all comments into consideration before issuing a final rule. Copies of all comments will be posted without change, including any personal information you provide, such as your name and address, on the FHFA Internet Website at http://www.fhfa.gov. In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m. at the Federal Housing Finance Agency, 1700 G Street, NW., Washington, DC 20552. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 414-6924.

II. Background

Establishment of FHFA

FHFA is an independent agency of the Federal government and was established by the Housing and Economic Recovery Act of 2008 ("HERA"), Public Law 110-289, 122 Stat. 2654, to regulate and oversee the regulated entities.[1] HERA amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 et seq.) ("Safety and Soundness Act") and the Federal Home Loan Bank Act (12 U.S.C. 1421 through 1449) ("Bank Act") to enhance the authorities and responsibilities of the new agency. FHFA's regulatory mission is to ensure, among other things, that each of the regulated entities "operates in a safe and sound manner" and that their "operations and activities . . . foster liquid, efficient, competitive, and resilient national housing finance markets." (12 U.S.C. 4513(a)(1)(B).)

III. Discussion of the Federal Housing Finance Agency's Proposed Guidance

FHFA issued a proposed guidance on private transfer fees for comment on August 16, 2010 (75 FR 49932) and requested public comments during a 60-day public comment period that ended on October 15, 2010.

[1] See Division A, titled the ''Federal Housing Finance Regulatory Reform Act of 2008,'' Title I, section 1101 of HERA.

FHFA's proposed guidance stated that the Enterprises should not purchase or invest in mortgages on properties encumbered by private transfer fee covenants or securities backed by such mortgages, as such investments would be unsafe and unsound and contrary to the public missions of the Enterprises and the Banks. Likewise, the proposed guidance stated that the Banks should not purchase or invest in such mortgages or securities or hold them as collateral for advances.

As described in the guidance, private transfer fee covenants may be attached to real property by the owner or another private party – frequently, the property developer – and provide for a transfer fee to be paid to an identified third party – such as the developer or its trustee – upon each resale of the property. The fee typically is stated as a fixed amount or as a percentage, such as one percent of the property's sales price, and often exists for a period of ninety-nine (99) years.

The proposed guidance noted that a number of states have either enacted, or are in the process of enacting, legislation to regulate private transfer fee covenants. In California, private transfer fee covenants are permitted, provided that they are properly recorded and contain certain disclosures.[2] Other states, such as Minnesota,[3] Delaware,[4] North Carolina[5] and Hawaii,[6] prohibit private transfer fee covenants that require payment to private third parties (e.g., for-profit companies), but permit these covenants when the fees are paid to homeowners' associations, condominiums, cooperatives, and similar organizations that use the fees to directly benefit the properties encumbered by the covenants.

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[2] Cal. Civ. Code §§ 1098 and 1098.5 (2010).
[3] Minn. Stat. §§ 513.73 to 513.76 (2010).
[4] Del. Code Ann. Tit. 25, § 319 (2010).
[5] N.C. Gen. Stat. §§ 39A-1 to 39A-3 (2010).
[6] H.B. 2288, 25th Leg., 1st Sess. (Haw. 2010).

Legislation was introduced in the 111th U.S. Congress – H.R. 6260, "Homeowner Equity Protection Act of 2010" and H.R. 6332, "Homebuyer Enhanced Fee Disclosure Act of 2010" – to address the issue of private transfer fee covenants.

H.R. 6260 would have banned private transfer fees, with exceptions such as those payable to homeowners' associations. H.R. 6332 would have permitted them, subject to notice and recordation requirements.

In response to questions at congressional hearings, FHFA expressed concerns that private transfer fees may be used to fund purely private continuous streams of income for select market participants either directly or through securitized investment vehicles, and may not benefit homeowners or the properties involved.

FHFA also expressed concerns about the adequacy of disclosure of these private transfer fee covenants which, in turn, may impede the transferability of property and affect its overall marketability. This can impact the valuation and marketability of the encumbered property. Consumers may also be unaware that a fee applies even if the resale price of their home drops below the original purchase price.

IV. Public Comments on the Proposed Guidance

A. Overview of Public Comments

FHFA received over 4,210 comment letters from a broad spectrum of individuals and organizations, including the Community Associations Institute; American Land Title Association ("ALTA"); National Association of Realtors; Freehold Capital; American College of Real Estate Lawyers; Institute of Real Estate Management; Coalition to Stop Wall Street Home Resale Fees; Sierra Club; numerous state and regional real estate agent associations; real estate companies; numerous homeowners', cooperative, and condominium associations, and individuals living within such associations; community associations and other nonprofit organizations; conservation funds and land trusts and foundations; housing and conservation boards; state housing and community development agencies; state natural resources agencies; developers; builders; appraisers; accountants; title companies; several Banks; members of the U.S. House of Representatives; State Governors; law firms (writing on their own behalf and on behalf of their clients); and other individuals and organizations who wrote to express a wide range of views on private transfer fee covenants.

Comments generally fell into five categories: (1) commenters advocating a complete ban on private transfer fees; (2) commenters advocating for private transfer fees for condominiums, cooperatives, and homeowners associations; (3) commenters advocating for private transfer fees for section 501(c)(3) or (c)(4) nonprofit associations that provide activities that directly benefit the encumbered property; (4) commenters advocating for private transfer fees for general welfare purposes, even if they do not directly benefit the encumbered property; and (5) commenters who supported the payment of such fees to for-profit entities and also supported the securitization and sale of transfer-fee income streams to investors.

B. Discussion of Public Comments

1. Private Transfer Fees Are Adverse to the Market and Homeowners

Commenters supporting a complete ban on private transfer fee covenants included many local real estate agent associations and private citizens. The real estate agent associations generally argued that the fees increase the cost of homeownership, generating revenue for developers or investors while providing no benefits to homebuyers over time.

Further, these commenters stated that there are few binding requirements for fee disclosures to homebuyers and to homeowners and that disclosure of fees at the time of closing adds undesirable complexity to real estate transactions. The commenters argued that the fees do not correlate with any tangible benefit received by the homebuyer and place an inappropriate burden on the transfer of property.

Several individuals submitted comment letters indicating private transfer fees were a "scam" against homeowners, robbing them of their equity. Many asserted that the U.S. Department of Housing and Urban Development's ("HUD's") General Counsel had opined that private transfer fees violate HUD's regulations that prohibit legal restrictions on conveyance and require lenders to convey clear and marketable title.[7]

The American Land Title Association (ALTA) raised concerns about private transfer fees, commenting that there is little uniform regulation over their use, with some states prohibiting their use, while others allow such fees with adequate notice and disclosure. ALTA also noted that courts and state legislatures generally do not favor restrictions on the ability of owners to sell real property. The association stated that private transfer fees could be viewed by courts and state legislatures as impairing the marketability and transferability of real property, and as an unreasonable restraint on

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[7] See Letter from Margaret E. Burns, Director, Office of Single Family Program Development, to Vicki Cox Golder, President, National Association of Realtors, April 14, 2010: "HUD agrees that this fee unnecessarily increases the cost of homeownership, and in most cases the homebuyer is unaware of its existence. Our General Counsel has confirmed that private transfer fees would clearly violate HUD's regulations at 24 CFR 203.41, which prohibit 'legal restrictions on conveyance,' defined to include limits on the amount of sales proceeds retainable by the seller."

alienation of property – regardless of the duration of the covenants or the amount of the transfer fees.

2. Private Transfer Fees for Homeowners' Associations, Condominiums, Cooperatives and Similar Associations Should Be Permitted

Many homeowners' associations, condominiums, and cooperatives with properties subject to private transfer fee covenants commented that the final guidance should be crafted to allow private transfer fees to these associations.

These commenters maintained that private transfer fees fund the capital reserves of their buildings or communities and help to fund critical and necessary capital improvements, upgrades and major repairs. They noted that these improvements increase property values, result in lower regular association dues and create more desirable communities. The commenters asserted that restrictions on these private transfer fees would affect the overall affordability of units by causing owners to raise building reserves through special assessments, through higher monthly fees or by a reduction in services, or by a combination of the alternatives.

Several of the Federal Home Loan Banks commenting agreed that private transfer fee covenants can serve a beneficial purpose when those fees are used for capital improvements and repairs. Several of these commenters stated that buildings that have incorporated a private transfer fee will benefit significantly over those that rely on maintenance from tenant shareholders or rental from commercial units. They also asserted that private transfer fees provide a stable reserve fund by insulating owners from large and immediate costs associated with longer term repair projects.

Other commenters argued that homeowner association private transfer fees are fully disclosed and are at most two or three months of dues or a flat fee from as low as $500.

3. Private Transfer Fees for Section 501(c)(3) and (c)(4) Nonprofits Should Be Permitted

Many commenters proposed that FHFA except from the final guidance transfer fees paid to nonprofit corporations with tax-exempt status under Internal Revenue Code ("Code") sections 501(c)(3), 501(c)(4) or 528 where the fees are targeted to social welfare purposes, environmental purposes, civic betterment and social improvements or to "sustain the real estate infrastructure."[8] These commenters asserted that certain not-for-profit organizations play important roles by supporting the creation and maintenance of community enhancements such as open space, environmental conservation and preservation, affordable housing and transit improvements. Several individuals, associations and nonprofit organizations described their own experiences with private transfer fees and how these fees have provided them with both direct and indirect benefits by improving their communities and their quality-of-life.

For example, one nonprofit organization stated that the private transfer fees it collects are disclosed on the good-faith estimate and argued that the fees support "land preservation, agriculture, energy efficiency, green building, walkability, high density building, arts and culture, and community living" for the residents of the community with which the organization is associated.

[8] Section 501(c)(3) of the Code provides tax exemption for charitable organizations. Section 501(c)(4) of the Code provides tax exemption for civic leagues, social welfare organizations, and homeowners' associations, among others. Section 528 of the Code provides tax exemption for certain homeowner associations.

A number of commenters urged FHFA to except from the final guidance government agencies and other government entities that partner with nonprofits and collect private transfer fees to grow and maintain the affordable housing stock. Other commenters not only shared these views, but also supported the use of private transfer fees in city and state redevelopment efforts, arguing that these efforts were adversely affected by the economic downturn and the resulting reductions in Federal, state and municipal funding.

Some commenters argued that private transfer fees should be allowed for 501(c)(3) nonprofits that collect the fees and then acquire open-space land in the immediate area of a project. Other commenters extended this argument to environmental mitigation, the preservation of sustainable building programs, the protection of wildlife habitats, and the funding for workforce housing programs. These commenters uniformly argued that private transfer fees in this context were a community benefit.[9]

Some commenters supported uses for private transfer fees that fund community organizations such as cultural centers or parks and community centers. These commenters argued that private transfer fee arrangements are sometimes created when developers build community centers and then transfer ownership of the center to a 501(c)(3) organization that uses the private transfer fees to fund its mission by providing and maintaining community services to the homeowner and community. They maintained that these practices make the homeowner's home more valuable because of the services.

4. All Private Transfer Fees, Including the Securitization of the Transfer Fees, Should Be Permitted

[9] Several commenters said that private transfer fees improve the lifestyle of residents, and the surrounding community, by funding yard sales, potluck dinners, concerts, baseball games located at a stadium five miles away from the development and by promoting land conservation and wildlife habitats.

A number of commenters, including some developers and builders, opposed FHFA's proposed guidance on private transfer fee covenants. These commenters contended that private transfer fees confer the same benefits, and raise the same objections, whether viewed in the context of homeowner associations, apartment cooperatives, nonprofit entities or private for-profit groups.

In addition, these commenters advocated for private transfer fees benefitting developers and related parties. One promoter referred to this type of private transfer fee as "capital recovery fees," implying that the fees recover part of the developer's investment in a given project—an amount in addition to the sales price of the houses in the development.

Proponents of developer transfer fees argued that they lower the cost of construction and development. Under this model, a security would be created, backed by the future stream of transfer-fee payments by future buyers of a house. The value of the security, which would only be realized by the developer at the time of its original investment if the security were sold, is argued to offset up-front infrastructure costs, which would otherwise be captured in initial house sale prices.

In this manner, proponents claim private transfer fees spread development costs over all those who benefit; that is, for the next 99 years, subsequent purchasers of the developers' homes would absorb these costs by paying transfer fees to the developer or any other holder of the related security. On the premise that the present value of the transfer-fee revenue stream supplements the sale price of the developer's new houses, proponents claim that private transfer fees can reduce the developer's negative equity in some developments which have suffered declines in value, thereby assisting in restarting failed development projects and creating jobs.

In response to FHFA's expressed concerns about lack of transparency of private transfer fee covenants, transfer-fee advocates indicate that they support state legislative and regulatory efforts, and private initiatives, to ensure disclosure that is meaningful to future home buyers.

5. Level of Fees

In the proposed guidance, FHFA expressed concern that the typical private transfer fee of one percent was neither minimal nor reasonable, and that the fees were likely not related to the value rendered by the property owner or community. Further, there is an issue of whether the fees are limited to one percent or may be raised by individual developers or securitization firms. In response to this concern, FHFA received a few comments stating that the marketplace does not consider the proportion of the fee relative to the purpose for which it is collected and, therefore, FHFA should not consider the level of the fee. Some commenters also argued that asking the regulated entities to ensure fees were proportional with rendered value would increase costs, including accounting and legal costs.

6. Compliance

Each of the nine Banks that submitted comment letters expressed concern about their ability to comply with the final guidance, which would ask them to ensure that mortgage loans on properties with private transfer fees, and securities backed by such mortgage loans, are not purchased or accepted as collateral. The Banks expressed concerns about their ability to access underlying loan documentation, especially in cases in which they take a blanket lien on member assets, and about the availability of information on the presence of private transfer fee covenants.

Some of the Banks suggested that they could inform their members that such loans may not be pledged as collateral, require enhanced member certifications, and conduct reasonable assessments of loans during on-site reviews.

7. Prospective Application

Several commenters raised concerns about retroactively applying the final guidance to previously originated loans because, they argued, attempts to discover the presence of private transfer fee covenants would pose significant operational challenges. These commenters argued that compliance under most circumstances would be, at best, difficult and, at worst, impossible, because of the added operational complexity it would require on real estate title searches.

Some commenters objected that a retroactive application of the final guidance would effectively render current loans with private transfer fees unmarketable, which would affect both current owners and prospective homebuyers. These commenters argued that retroactivity of the final guidance would impose economic hardship to consumers who should not be subject to rules of which they were unaware at the time of their original purchase.

Similarly, another commenter argued that the final guidance would effectively prohibit sellers from selling their homes, because lending institutions would not finance such purchases for fear these loans would be ineligible for secondary market execution.

Other commenters recommended that the final guidance be applied prospectively, with an effective date of 120 days from the date of issuance. They argued that market participants would require some time to make any necessary operational changes. One Bank requested that members be allowed to pledge loans as collateral if those loans were already acquired by its members prior to the issuance of the final guidance. Another Bank proposed that member institutions be allowed to provide an indemnification to the Bank for a breach, thus avoiding a put-back of the asset.

Another Bank commented that, since the Enterprises could be expected to comply with the final guidance prospectively, Enterprise mortgage-backed securities ("MBS") should be exempt from any investment or collateral prohibitions contained in the final guidance.

C. FHFA Response to Public Comments in the Proposed Rule

After reviewing comments on the proposed guidance, FHFA has decided to publish a proposed rule for comment, with a number of changes to the substance of the former proposed guidance. While FHFA's proposed guidance advised the Enterprises and the Banks not to purchase, or accept as collateral for advances mortgages on property subject to any private transfer fee covenants, FHFA has determined to propose a rule with a narrower focus. FHFA's responses to the comments it received, and the changes included in this proposed rule, are described below. In summary, the principal differences between the proposed guidance and the proposed rule are:

- FHFA proposes to except from the rule private transfer fees that are paid to homeowners' associations and similar associations, and to tax-exempt non-profit organizations, where the fees are used for the direct benefit of the encumbered properties.

- FHFA proposes to make the rule prospective in effect, so that it applies to private transfer fee covenants created after the publication date of this proposed rule.
- FHFA allows an implementation period of 120 days for the regulated entities. The regulated entities may use reasonable means to achieve compliance with this rule.

1. Definitions

FHFA is including a number of definitions in the proposed rule to clarify terms, and to identify the scope of the proposed rule's coverage. These definitions include, among others: "adjacent or contiguous property"; "covered association"; "direct benefit"; and "private transfer fee covenant." FHFA requests comment on the content of these definitions, because of the role they play in establishing the scope of the rule's restrictions. For example, the rule would permit the regulated entities to do business in encumbered mortgages when the private transfer fees are paid to a "covered association" and provide a "direct benefit" to the encumbered properties; definitions, therefore, are of significance to market participants. In sum, "covered associations" are defined as homeowners' and similar associations, and tax-exempt non-profit organizations; "direct benefit" is generally defined to include maintenance, improvements, and amenities benefiting the encumbered properties or adjacent properties.

2. Private Transfer Fees Generally

In considering the scope of this proposed rule, FHFA took into account the many public comments received on the August 16, 2010 proposed guidance. One set of commenters stated: "Consumers are essentially forced to pay for the right to sell their property." If the fee is not paid, it results in a lien on the property impairing its marketability. This implicates the public policy against restraints on alienation as well as the mission of government-sponsored enterprises to foster "liquid, efficient, competitive, and resilient national housing markets."[10]

Because it is difficult to value the burden of a private transfer fee, it is also difficult to value the property that it encumbers and hence the value of that property as collateral for the mortgage loans that the Banks accept as collateral, and that the regulated entities buy, or that back the mortgage-backed securities that the Enterprises guarantee. This is a safety and soundness concern, and is a substantial motivation for FHFA to take action in the form of this rulemaking. In FHFA's view, the purposes for which private transfer fees are imposed are unrelated to the transfer of the property. The transfer is simply an opportunity for the beneficiary of the fee to collect it, imposing a "toll gate" that must be passed before the transfer may occur. While the purposes asserted for these fees – construction of community improvements, upkeep of community amenities, etc. – are more logically built into the purchase price of the house (in the case of initial construction) or regularly recurring fees (in the case of upkeep) and using the property transfer as the vehicle for collecting the fee may constitute a restraint on alienation, nevertheless, FHFA believes that certain fees may benefit properties. Fees enhancing the value of collateral backing loans would not be inconsistent with safety and soundness goals.

3. Transfer Fees Paid to Homeowners' Associations and Similar Organizations

FHFA proposes to exclude homeowners' and other similar organizations from the proposed rule in certain instances. First, FHFA acknowledges comments received on the

[10] Safety and Soundness Act section 1313(a)(1)(B)(ii).

proposed guidance from homeowner associations and their members, as well as from residents of New York co-operatives who feared that the "flip taxes" on their stock interests – analogous to transfer fees on typical real-estate transactions – would be adversely affected. These comments, mostly favorable though not unanimously so, and the longstanding existence and ubiquity of the transfer fees described, suggest that these fees are expected by and are familiar to many homeowner association members and are well understood in banking and mortgage markets.

Private transfer fees assessed by homeowners' and other covered organizations may be viewed as a means by which members of the organizations avoid paying the costs of their amenities out of current income, instead paying those costs out of the equity in their houses when they sell. While owners will then have less sales proceeds with which to buy their next house or to use for other purposes, this has been an accepted means of paying for the maintenance, infrastructure and amenities at these associations.

Further, transfer fees paid to associations contribute to the value of the burdened property through the amenities and maintenance that they fund, and hence do not pose the same valuation risk as do fees that fund other activities that do not provide a direct benefit to the burdened property.

Also FHFA is excepting from the proposed rule private transfer fees that are paid to nonprofit organizations that are tax-exempt under section 501(c)(3) or (c)(4) of the Code and provide direct benefits to the encumbered property. Private transfer fees paid to such nonprofits are comparable to those paid to a homeowners' association and should be similarly excepted from the proposed rule.

Accordingly, FHFA is excepting from the restrictions of the proposed rule private transfer fees paid to homeowners', condominium, cooperative and similar associations, and to certain tax-exempt organizations under section 501(c)(3) or (c)(4).

4. Private Transfer Fees Paid to Non-profit Organizations That Do Not Provide a Direct Benefit to the Encumbered Property.

Some commenters described payments to non-profit organizations whose relation to the burdened properties was difficult to characterize, e.g., to grow and maintain the affordable housing stock, to support city and state redevelopment efforts or for environmental preservation.

These private transfer fees do not appear to provide exclusive support of cultural, educational, recreational, maintenance or environmental activities providing a "direct benefit" for the encumbered real property. Although the activities themselves may be meritorious, it appears that these private transfer fees provide a benefit to the general community rather than specifically to the community that is burdened by the private transfer fee covenants, and hence are not dedicated to enhancing the value of the residential housing collateral that is central to the underwriting of mortgage loans purchased and accepted by the regulated entities. Because these fees pose the valuation and other issues related to private transfer fees, without providing benefits that are directly focused on the burdened properties, FHFA declines to except them from the restrictions of the proposed rule.

Traditional real-estate law requires that, to be binding, a covenant running with the land must benefit the land that it burdens. Whether these more general charitable uses meet that test is an open question, which casts doubt on the validity of the covenants and hence creates a possible source of challenge in sales transactions. This is only one reason FHFA regards such private transfer fees, as well as those paid to developers and to unrelated parties, discussed below, as creating a safety and soundness risk for FHFA-regulated entities.[11]

5. Developers, Builders, and Related Parties

Private transfer fees paid to developers or other third parties also would be subject to the restrictions described in this proposed rule. Though asserted to be collected for the purpose of funding infrastructure investments, there is no assurance that they actually are. They are simply another source of return to the developer: a way for a developer to extract additional value from its real estate portfolio. There is no relationship between the transfer fee and the actual costs of the developer.

Proponents of private transfer fees payable to developers and their related parties commented that the fees would enable developers to proceed with developments that would otherwise be uneconomical. No evidence has been presented that this would be the case. The argument appears to depend on the proposition that the future income stream from the fee covenants could be securitized and the securities sold to realize immediate revenue for the developer. To FHFA's knowledge, no such securities have ever been issued, so FHFA regards the argument as speculative.

Further, the argument appears to be based on the assumption that the sales prices of the encumbered properties, when sold by the developer, would be discounted by less than the value of the transfer-fee-backed securities that would be sold. No evidence has

[11] Several states have passed laws to restrict the use of private transfer fees, often permitting the use of such fees only where they are used for the benefit of the encumbered property. *See* Ariz. Rev. Stat. § 33-442 (Arizona); Cal. Civ. Code § 1098.5 (California); Del. Code tit. 25, § 319 (Delaware); Fla. Stat. Ann. § 689.28 (Florida); Haw. Rev. Stat. § 501(Hawaii); 765 I.L.C.S. 155/10 (Illinois); Iowa Code § 558.48 (Iowa); Kan. Stat. Ann. § 58-3822 (Kansas); La. Rev. Stat. Ann. § 9:3131 to 3136 (Louisiana)); Md. Code, Real Prop. Law § 10-708 (Maryland); Minn. Stat. § 513.73 (Minnesota); Gen. Laws Miss. 2010 Ch. 348 (Mississippi); Mo. Rev. Stat. § 442.558 (Missouri); N.J. Stat. Ann. 46:3-28 to 46:3-33 (New Jersey); N.C. Gen. Stat. § 39A (North Carolina); Ohio Rev. Code Ann. § 5301.057 (Ohio); 2009 Oregon Laws Ch. 298 (Oregon), Texas Prop. Code Ann. § 5.017(b) (Texas); Utah Code § 57-1-46 (Utah).

been presented that this would be the case. There has been no demonstration of how purchasers should calculate the discount from the purchase price that would be necessary to offset the effect of the covenant, or that if the purchasers did make such a calculation accurately that there would be any remaining benefit to the developer from this scheme.

FHFA invites comment on these issues.

6. Compliance

FHFA found persuasive the Banks' comments regarding the challenges in identifying mortgages on properties with private transfer fee covenants and securities backed by such mortgage loans. The issues of inconsistent disclosure, and access to loan files for individual loans covered by a blanket lien or for loans underlying securities, have merit.

Acceptable compliance with the final rule may be achieved through the Banks' quality control review process or through the Banks' collateral review process, coupled with appropriate direction to their members, as well as robust representations, warranties, or certifications. The Enterprises would be expected to use similar compliance tools such as appropriate provisions in seller-servicer guides, representations and warranties, and quality-control processes.

FHFA does not expect that the Banks must use such compliance tools with respect to Enterprise securities. Enterprise securities issued prospectively – should comply with the provisions of the final rule.

7. Prospective application

To avoid market uncertainties such as those suggested in the comment letters, the final rule will apply only to transfer fees created after the date of publication of the proposed rule, and to securities issued after that date backed by revenue from private transfer fees regardless of when the covenants were created. Regulated entities are required to comply with the final rule within 120 days after its publication.

8. Level of fees

While FHFA expressed concern in the proposed guidance regarding the level of private transfer fees, no specific request to consider or evaluate the proportion of the private transfer fee relative to its purpose was included in the proposed guidance. This proposed rule remains consistent with the proposed guidance on that point. FHFA is not requesting that the regulated entities consider or evaluate the level of private transfer fees. Comments received on this issue during the public comment period reinforced FHFA's concern about the relation between the fees and the value provided to the homeowners. This, in turn, reinforced FHFA's decision to issue the proposed rule to cover all private transfer fees other than those paid to homeowners' and similar associations, and to tax-exempt nonprofits under sections 501(c)(3) or (c)(4) of the Code, that provide a direct benefit to the encumbered property. Comments on the appropriate level of fees are welcome, but FHFA has not addressed that subject at this time.

9. State laws

As noted above, a number of states have enacted legislation restricting or otherwise regulating private transfer fees. FHFA has included a section in the proposed rule to clarify that the rule does not affect such legislation.

V. Paperwork Reduction Act

The proposed rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 et seq.). Therefore, FHFA has not submitted any information to the Office of Management and Budget for review.

VI. Regulatory Flexibility Act

The proposed rule applies only to the regulated entities, which do not come within the meaning of small entities as defined in the Regulatory Flexibility Act (See 5 U.S.C. 601(6)). Therefore, in accordance with section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), FHFA certifies that this proposed rule, if promulgated as a final rule, will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 1228

Asset-backed securities, Builders, Condominium associations, Cooperative associations, Developers, Federal Home Loan Banks, Government-sponsored enterprises, Homeowners' associations, Housing, Mortgages, Mortgage-backed securities, Nonprofit organizations, Private transfer fees.

Authority and Issuance

For the reasons stated in the preamble, and under the authority of 12 U.S.C. 4526, the Federal Housing Finance Agency proposes to amend Chapter XII of Title 12 of the Code of Federal Regulations by adding a new part 1228 to subchapter B to read as follows:

PART 1228—RESTRICTIONS ON THE ACQUISITION OF, OR TAKING SECURITY INTERESTS IN, MORTGAGES ON PROPERTIES ENCUMBERED BY CERTAIN PRIVATE TRANSFER FEE COVENANTS AND RELATED SECURITIES

Sec.
1228.1 Definitions.
1228.2 Restrictions.

1228.3 Prospective application and effective date.
1228.4 State restrictions unaffected.

Authority: 12 U.S.C. 4513(a)(1)(B) and 12 U.S.C. 4526(a).

§ 1228.1 Definitions.

As used in this part,

Adjacent or contiguous property means property that borders or lies in close proximity to the property that is encumbered by a private transfer fee covenant or to other similarly encumbered properties located in the same community and owned by members of the same covered association, provided that in no event shall a property greater than one thousand (1000) yards from the encumbered property be considered adjacent or contiguous.

Covered association means a nonprofit, mandatory membership organization comprising owners of homes, condominiums, cooperatives, manufactured homes or any interest in real property, created pursuant to a declaration, covenant or other applicable law, or an organization described in section 501(c)(3) or (c)(4) of the Internal Revenue Code.

Direct benefit means that the proceeds of a private transfer fee are used exclusively to support maintenance and improvements to encumbered properties as well as cultural, educational, charitable, recreational, environmental, conservation or other similar activities that benefit exclusively the real property encumbered by the private transfer fee covenants. Such benefit must flow to the encumbered property or the community comprising the encumbered properties and their common areas or to adjacent or contiguous property. A private transfer fee covenant will be deemed to provide a direct benefit when members of the general public may use the facilities funded by the transfer fees in the burdened community and adjacent or contiguous property only upon payment of a fee, except that de minimis usage may be provided free of charge for use by a charitable or other not-for-profit group.

Enterprises means, collectively, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Excepted transfer fee covenant means a covenant to pay a private transfer fee to a covered association that is used exclusively for the direct benefit of the real property encumbered by the private transfer fee covenants.

Federal Home Loan Banks or Banks mean the Federal Home Loan Banks established under section 12 of the Federal Home Loan Bank Act (12 U.S.C. 1432).

Private transfer fee means a transfer fee, including a charge or payment, imposed by a covenant, restriction or other similar document and required to be paid in connection with or as a result of a transfer of title to real estate. A private transfer fee excludes fees, charges, or payments, or other obligations–

(1) imposed by a court judgment, order or decree;

(2) imposed by or are payable to the Federal government or a State or local government;

(3) arising out of a mechanic's lien; or

(4) arising from an option to purchase or for waiver of the right to purchase the encumbered real property.

Private transfer fee covenant means a covenant that–

(1) purports to run with the land or to bind current owners of, and successors in title to, such real property; and

(2) obligates a transferee or transferor of all or part of the property to pay a private transfer fee upon transfer of an interest in all or part of the property, or in consideration for permitting such transfer.

Regulated entities means the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal Home Loan Banks.

Transfer means with respect to real property, the sale, gift, grant, conveyance, assignment, inheritance or other transfer of an interest in the real property.

§ 1228.2 Restrictions.

The regulated entities shall not purchase or invest in any mortgages on properties encumbered by private transfer fee covenants, securities backed by such mortgages or securities backed by the income stream from such covenants, unless such covenants are excepted transfer fee covenants. The Banks shall not accept such mortgages or securities as collateral, unless such covenants are excepted transfer fee covenants.

§ 1228.3 Prospective application and effective date.

This part shall apply only to mortgages on properties encumbered by private transfer fee covenants created on or after [INSERT DATE OF PUBLICATION OF THE PROPOSED RULE], and to securities backed by such mortgages, and to securities issued after that date backed by revenue from private transfer fees regardless of when the covenants were created. The regulated entities shall comply with this part not later than 120 days following the date of publication of the final rule in the Federal Register.

§ 1228.4 State restrictions unaffected.

This part does not affect state restrictions or requirements with respect to private transfer fee covenants, such as with respect to disclosures or duration.

Edward J. DeMarco
Edward J. DeMarco,
Acting Director, Federal Housing Finance Agency.

1-28-2011
Date

CALENDAR OF REPORTING DATES FOR ILLINOIS SPECIAL ELECTION

Report	Close of books[1]	Reg./cert. and overnight mailing deadline	Filing deadline
Pre-General	10/13/10	10/18/10	10/21/10
Post-General	11/22/10	12/02/10	12/02/10
Year-End	12/31/10	01/31/11	01/31/11

Dated: August 10, 2010.

On behalf of the Commission,

Cynthia L. Bauerly,

Vice Chair, Federal Election Commission.

[FR Doc. 2010–20229 Filed 8–13–10; 8:45 am]

BILLING CODE 6715–01–P

FEDERAL HOUSING FINANCE AGENCY

[No. 2010–N–11]

Private Transfer Fee Covenants

AGENCY: Federal Housing Finance Agency.

ACTION: Notice of proposed guidance; request for comments.

SUMMARY: The Federal Housing Finance Agency (FHFA) is proposing to issue a Guidance, "Guidance on Private Transfer Fee Covenants," to the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises), and the Federal Home Loan Banks (the Banks) that the entities it regulates should not deal in mortgages on properties encumbered by private transfer fee covenants. Such covenants appear adverse to liquidity, affordability and stability in the housing finance market and to financially safe and sound investments. This proposed Guidance would extend to mortgages and securities held by the Banks as investments or as collateral for advances and to mortgages and securities held or guaranteed by the Enterprises.

DATES: Interested persons may submit comments on or before October 15, 2010.

Comments: Submit comments to FHFA using any one of the following methods:

- *E-mail: regcomments@fhfa.gov.* Please include "Guidance on Private Transfer Fee Covenants, (No. 2010–N–11)" in the subject line of the message.
- *Mail/Hand Delivery:* Alfred M. Pollard, General Counsel, Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552, Attention: Public Comments "Guidance on Private Transfer Fee Covenants, (No. 2010–N–11)".
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

FOR FURTHER INFORMATION CONTACT: Peggy K. Balsawer, Assistant General Counsel, (202) 343–1529 (not a toll-free number), Federal Housing Finance Agency, Office of General Counsel, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. The telephone number for the Telecommunications Device for the Deaf is (800) 877–8339.

SUPPLEMENTARY INFORMATION:

I. Comments

FHFA invites comment on all aspects of the proposed guidance, including comments on which actions by FHFA would be most appropriate to address the concerns posed by private transfer fees. The comment period will end on October 15, 2010. Copies of all comments will be posted on FHFA's Internet Web site at *http://www.fhfa.gov.* In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, Fourth Floor, 1700 G Street, NW., Washington, DC 20552. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 414–6924.

II. Background

Establishment of FHFA

FHFA is an independent agency of the Federal Government and was established by the Housing and Economic Recovery Act of 2008 (HERA), Public Law 110–289, 122 Stat. 2654 to regulate and oversee the Enterprises and the Banks (collectively, the regulated entities). HERA amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 *et seq.*) (Safety and Soundness Act) and the Federal Home Loan Bank Act (12 U.S.C. 1421 through 1449) to enhance the authorities and responsibilities of the new agency. FHFA's regulatory mission is to ensure, among other things, that each of the regulated entities "operates in a safe and sound manner" and that their "operations and activities * * * foster liquid, efficient, competitive, and resilient national housing finance markets." (12 U.S.C. 4513(a)(1)(B).)

III. Federal Housing Finance Agency Guidance

A private transfer fee covenant is attached to real property by the owner or another private party, frequently, the property developer, and provides for a transfer fee to be paid to an identified third party (such as the developer or its trustee) upon each resale of the property. The fee typically is stated as a percentage, such as one percent of the property's sales price and often survives for a period of ninety-nine (99) years.

FHFA has expressed concerns about private transfer fees in congressional testimony and in other public statements. FHFA is publishing this Notice in order to receive public comment on this proposed draft Guidance.

Promoters of private transfer fees and their possible securitization argue that such fees are beneficial when used to fund project developments or to enhance community investments through homeowners associations or through affordable housing groups, environmental groups, or other charitable organizations.

FHFA is concerned that such fees are used to fund purely private continuous streams of income for select market participants either directly or through securitized investment vehicles. Further, it is unclear that the fees, even if dedicated to homeowners associations, are proportional or related to the purposes for which the fees were to be collected. FHFA's draft Guidance is based on the view that investments in mortgages on properties with private transfer fee covenants and securities designed to generate income from the fees are not acceptable for the regulated entities. FHFA's draft Guidance does not distinguish between private transfer fee covenants which purport to render a benefit to the affected property and

[1] The reporting period always begins the day after the closing date of the last report filed. If the committee is new and has not previously filed a report, the first report must cover all activity that occurred before the committee registered as a political committee with the Commission up through the close of books for the first report due.

those which accrue value only to unrelated third parties.

Encumbering housing transactions with fees that may not be properly disclosed and that may limit the alienation of property means that such fees may impede the marketability and the valuation of properties and adversely affect the liquidity of securities backed by mortgages so encumbered. FHFA is concerned that such consequences will have a particularly detrimental effect on still fragile housing markets. FHFA's position is also influenced by considerations of consumer protection where disclosures may be insufficient and add costs not fully understood by consumers.

FHFA recognizes that there is a range of actions it can take, including to require the regulated entities to report on the extent of their exposure to private transfer fee covenant investments, change seller/servicer guides to identify restrictions on the purchase of encumbered mortgages, create and enforce additional representations and warranties against encumbered mortgages, or to prohibit the purchase or investment in the mortgages or the revenue generated by the fees.

FHFA's draft Guidance directs that the Enterprises should not purchase or invest in mortgages encumbered by private transfer fee covenants or securities backed by private transfer fee revenue, as such investments would be unsafe and unsound practices and contrary to the public missions of the Enterprises and the Banks. Likewise, the draft Guidance would direct that the Banks should not purchase or invest in such mortgages or securities or hold such mortgages as collateral for advances.

IV. Proposed Guidance

The proposed draft Guidance follows:

Federal Housing Finance Agency

Guidance on Private Transfer Fee Covenants

Issuance Date: August XX, 2010

I. Introduction

The Federal Housing Finance Agency (FHFA) is an independent agency of the Federal Government and was established by the Housing and Economic Recovery Act of 2008 (HERA), Public Law 110–289, 122 Stat. 2654 (2008) to regulate and oversee the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Enterprises), and the Federal Home Loan Banks (collectively, the Banks). HERA amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 *et seq.*) and the Federal Home Loan Bank Act (12 U.S.C. 1421 through 1449) to enhance the authorities and responsibilities of the new agency.

The respective federal charters of the Enterprises reflect their public mission to "provide stability in the secondary market for residential mortgages," "respond appropriately to the private capital market," "provide ongoing assistance to the secondary market for residential mortgages * * *," and "promote access to mortgage credit throughout the Nation * * *" (*see* section 301 of the Fannie Mae Charter Act and section 301(b) of the Freddie Mac Corporation Act.) FHFA's regulatory mission is to ensure, among other things, that each regulated entity it supervises "operates in a safe and sound manner" and that their "operations and activities * * * foster liquid, efficient, competitive, and resilient national housing finance markets." (12 U.S.C. 4513(a)(1)(B)).

II. Private Transfer Fees

A private transfer fee covenant is attached to real property by the owner or another private party (frequently, the property developer) and requires a transfer fee payment to an identified third party, such as the property developer or its trustee, a homeowners association, an affordable housing group or another community or non-profit organization, upon each resale of the property. The fee typically is stated as a percentage (*e.g.*, 1 percent) of the property's sales price and often survives for a period of ninety-nine (99) years.

Some states have legislated against private transfer fee covenants in all circumstances. Other states permit them only when they benefit a homeowners association or community organization or when they have been adequately disclosed. Still other states have no position on such covenants.

Proponents of private transfer fees argue that these fees have positive effects when the proceeds offset initial infrastructure improvements or to fund new improvements to existing communities. Further, they argue that payments at the time of a resale are intended to reimburse the developers or investors for their initial outlays. At the same time, opponents argue that these community goals can be achieved through more transparent and equitably distributed assessments on all commonly affected property owners. Many covenants are not intended for purely community purposes and, instead, create purely private continuous streams of income for select market participants either directly or through securitized investment vehicles.

III. FHFA Guidance to the Enterprises and the Banks

FHFA has found that the typical one percent fee at the time of resale is neither a minimal nor a reasonable amount; further, such fees may be in excess of one percent. Such fees increase by a meaningful amount the seller's and potentially the buyer's burden at the time of a property sale. Expanded use of private transfer fee covenants poses serious risks to the stability and liquidity of the housing finance markets.

Further, FHFA has concerns that private transfer fee covenants, regardless of their purposes, may:

- Increase the costs of homeownership, thereby hampering the affordability of housing and reducing liquidity in both primary and secondary mortgage markets;
- Limit property transfers or render them legally uncertain, thereby deterring a liquid and efficient housing market;
- Detract from the stability of the secondary mortgage market, particularly if such fees will be securitized;
- Expose lenders, title companies and secondary market participants to risks from unknown potential liens and title defects;
- Contribute to reduced transparency for consumers because they often are not disclosed by sellers and are difficult to discover through customary title searches, particularly by successive purchasers;
- Represent dramatic, last-minute, non-financeable out-of-pocket costs for consumers and can deprive subsequent homeowners of equity value; and,
- Complicate residential real estate transactions and introduce confusion and uncertainty for home buyers.

The risks and uncertainties for the housing finance market that are represented by the use of private transfer fee covenants are not counterbalanced by sufficient positive effects. To the extent that private transfer fee covenants benefit unrelated third parties, one cannot claim that a service or value is rendered to the relevant property owner or community. Even where such fees are payable to a homeowners association, unlike more typical annual assessments they are likely to be unrelated to the value rendered, and at times may apply even if the property's value has significantly diminished since the time the covenant was imposed.

FHFA regards such purchases as inconsistent with the Enterprises' public missions to promote liquid, efficient and stable housing finance markets. FHFA does not consider mortgages encumbered by private transfer fee covenants to be prudent or safe or sound investments for the Enterprises or the Banks. Consequently, Fannie Mae and Freddie Mac should not purchase or invest in any mortgages encumbered by private transfer fee covenants or securities backed by such mortgages. The Banks should not purchase or invest in such mortgages or securities or hold them as collateral for advances.

Dated: August 10, 2010.

Stephen Cross,

Deputy Director of the Division of Federal Home Loan Bank Regulation, by Delegation, Federal Housing Finance Agency.

[FR Doc. 2010–20108 Filed 8–13–10; 8:45 am]

BILLING CODE 8070–01–P

FEDERAL RESERVE SYSTEM

Change in Bank Control Notices; Acquisition of Shares of Bank or Bank Holding Companies

The notificants listed below have applied under the Change in Bank Control Act (12 U.S.C. 1817(j)) and § 225.41 of the Board's Regulation Y (12 CFR 225.41) to acquire a bank or bank holding company. The factors that are considered in acting on the notices are set forth in paragraph 7 of the Act (12 U.S.C. 1817(j)(7)).

The notices are available for immediate inspection at the Federal Reserve Bank indicated. The notices also will be available for inspection at the office of the Board of Governors. Interested persons may express their views in writing to the Reserve Bank indicated for that notice or to the offices of the Board of Governors. Comments must be received not later than August 31, 2010.

A. Federal Reserve Bank of Cleveland (Nadine Wallman, Vice President) 1455 East Sixth Street, Cleveland, Ohio 44101–2566:

1. WVS Financial Corp. Employee Stock Ownerhsip Plan, and Jonathan D. Hoover, sole trustee, both of Pittsburgh, Pennsylvania; to retain and acquire additional voting shares of WVS Financial Corp., and thereby indirectly retain and acquire additional voting shares of West View Savings Bank, both of Pittsburgh, Pennsylvania.

Board of Governors of the Federal Reserve System, August 11, 2010.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 2010–20157 Filed 8–13–10; 8:45 am]

BILLING CODE 6210–01–S

DEPARTMENT OF HEALTH AND HUMAN SERVICES

[Document Identifier: OS–0990–New; 60-day Notice]

Notice of Request for Public Comments

AGENCY: Office of the National Coordinator for Health Information Technology (ONC), Office of the Secretary, Department of Health and Human Services.

Agency Information Collection Request: 60–Day Public Comment Request

In compliance with the requirement of section 3506(c)(2)(A) of the Paperwork Reduction Act of 1995, the Office of the Secretary (OS), Department of Health and Human Services, is publishing the following summary of a proposed information collection request for public comment. Interested persons are invited to send comments regarding this burden estimate or any other aspect of this collection of information, including any of the following subjects: (1) The necessity and utility of the proposed information collection for the proper performance of the agency's functions; (2) the accuracy of the estimated burden; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) the use of automated collection techniques or other forms of information technology to minimize the information collection burden.

To obtain copies of the supporting statement and any related forms for the proposed paperwork collections referenced above, e-mail your request, including your address, phone number, OMB number, and OS document identifier, to *Sherette.funncoleman@hhs.gov*, or call the Reports Clearance Office at (202) 690–6162. Written comments and recommendations for the proposed information collections must be directed to the OS Paperwork Clearance Officer at the above e-mail address within 60 days.

Proposed Information Collection: ONC Temporary Certification Program's Application, Reporting and Records Requirements—OMB No. 0990–NEW-Office of the National Coordinator for Health Information Technology.

Abstract: The Office of the National Coordinator for Health Information Technology (ONC) received emergency approval from OMB under section 3507(j) of the Paperwork Reduction Act (PRA) for this collection of information on June 14, 2010 (OMB No. 0990–0358). This emergency approval expires on December 31, 2010. Accordingly, ONC seeks public comment and OMB's approval for this collection of information under section 3504(h) of the PRA.

In a notice of proposed rulemaking implementing section 3001(c)(5) of the Public Health Service Act, ONC proposed to establish two certification programs, a temporary certification program and a permanent certification program. On June 24, 2010, a final rule was published that established the temporary certification program ("Establishment of the Temporary Certification Program for Health Information Technology," 75 FR 36158) (Temporary Certification Program final rule).

The temporary certification program, which is anticipated to sunset on December 31, 2011, requires: applicants that wish to become ONC–Authorized Testing and Certification Bodies (ONC–ATCBs) to respond to and submit an application; collection and reporting requirements for ONC–ATCBs, and requirements for ONC–ATCBs to retain records of tests and certifications and disclose the final results of all completed tests and certifications (*i.e.*, provide copies of all completed tests and certifications) to ONC at the conclusion of testing and certification activities under the temporary certification program.

Estimated Annualized Burden Hours

APPLICATION FOR ONC–ATCB STATUS UNDER THE TEMPORARY CERTIFICATION PROGRAM

Type of respondent	Form name	Number of respondents	Number of responses per respondent	Burden hours per response	Total burden hours
Conformant Applicant	ONC–ATCB Application	3	1	4.5	13.5

JOINT EDITORIAL BOARD
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UNIFORM REAL PROPERTY ACTS

October 12, 2010

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, DC 20552

Re: Public Comments "Guidance on Private Transfer Fee Covenants" [No. 2010-N-11]

Dear Mr. Pollard:

On behalf of the Joint Editorial Board for Uniform Real Property Acts (JEBURPA), we are submitting these comments on the FHFA's proposed guidance No. 2020-N-11 on Private Transfer Fee Covenants.

The JEBURPA is comprised of representatives from the American Bar Association Real Property, Trust and Estate Law Section, the Uniform Law Commission (ULC), and the American College of Real Estate Lawyers, as well as liaisons from the American College of Mortgage Attorneys and the Community Associations Institute. The JEBURPA members — all distinguished real estate practitioners and/or teachers of real estate law — advise the ULC regarding prospective uniform law projects relating to real estate, and seek to promote law reform by encouraging states to adopt existing uniform and model real estate laws. We emphasize, however, that the comments in this letter represent solely the views of the individual members of JEBURPA and have not been considered or approved by the ULC or the other constituent organizations of JEBURPA.

Over the past three years, the JEBURPA has been engaged in detailed study of transfer fee covenants. This study prompted the JEBURPA to prepare a formal position paper, issued in April 2010, which recommended that all state legislatures enact statutes declaring private transfer fee covenants to be unenforceable. A copy of this position paper is attached to these comments as Exhibit A.

In addition, members of the JEBURPA have consulted with representatives of the American Land Title Association (ALTA) and the National Association of Realtors (NAR) in the preparation of a model state statute. Since 2007, these collaborative efforts have produced legislation banning private transfer fees in 17 states, and we expect significant new enactments in the 2010-2011 and 2011-2012 legislative sessions.

The JEBURPA's position paper, and all of the recent state legislation, is directed at covenants imposing "non-beneficial" or purely ***private*** transfer fees — *i.e.*, transfer fees payable to the developer or other third parties with the recipient(s) having no ongoing obligation to use or apply the fees for the benefit of the land affected by the covenant or the common interest community in which the land is located. If the FHFA's proposed guidance had been limited ***solely*** to these private transfer fee covenants, JEBURPA would have had no substantial concerns with the proposed guidance. We find no policy justification for purely private transfer fee covenants and little support for them among any interest groups, other than those financially benefitted by such covenants.

Our major concern, however, is that the proposed guidance "does not distinguish between private transfer fee covenants which purport to render a benefit to the affected property and those which accrue value only to unrelated third parties." 75 Fed. Reg. 49932-33. The proposed guidance would direct Fannie Mae and Freddie Mac not to purchase any mortgage loan where the mortgage secures land that is subject to a transfer fee covenant — even if that fee is payable to an owners' association and its use is devoted to purposes which directly benefit the owners of the affected land, such as maintenance of, improvements to, or replacements of community facilities.

In this respect, the proposed guidance is demonstrably overbroad when compared to the existing legal status of covenants imposing transfer fees for the benefit of owners' associations. Existing law is clear — if a covenant imposes a financial obligation on a landowner, but the funds generated by that covenant would provide a benefit to the affected land or other land, the covenant "touches and concerns" the land and thus the covenant is enforceable against the owners of affected land and their successors. *See, e.g., Neponsit Property Owners' Ass'n, Inc. v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938) (annual lot assessment covenant "touches and concerns" land); *Mayerson v. 3701 Tenants Corp.*, 123 Misc.2d 235, 473 N.Y.S.2d 123 (1984) (upholding covenant imposing 7.5% transfer fee upon resales of cooperative units); *Jamil v. Southridge Co-op. Sec. No. 4 Inc.*, 102 Misc.2d 404, 425 N.Y.S.2d 905 (1979) (upholding covenant imposing flat $2,000 transfer fee upon resales of cooperative units); Restatement (Third) of Property — Servitudes § 3.5.[1]

Likewise, the proposed guidance would direct Fannie Mae and Freddie Mac not to purchase any mortgage loan where the mortgage secures land that is subject to a transfer fee covenant for which the fees support various forms of charitable endeavors such as affordable housing, historic preservation, or environmental protection. Again, the proposed guidance would be overbroad when compared to the existing legal status of such covenants, many of which are enforceable under state law (either because they have been found to "touch and concern" the affected land or because of enabling state legislation).

The JEBURPA members appreciate that the question of whether an association should generate revenues from transfer fees as opposed to periodic lot assessments — or whether endeavors such as affordable housing or environmental protection should be financed using transfer fee covenants — is a political question on which persons hold differing views. In offering these comments, the JEBURPA does not express a position on the relative merits of using transfer fee covenants. Rather, our substantial concerns

[1]The comments to Restatement § 3.5 explicitly validate a covenant that imposes a transfer fee payable for financing the activities of an owners' association. Illustration 5 states: "The declaration for a condominium development requires payment of a transfer fee to the property-owners association on each transfer of a unit by sale or lease. The amount of the fee is set by the governing board of the association and the funds are used for operating expenses of the association. There is a rational justification for the servitude."

regarding the proposed guidance focus instead on the consequences that homeowners will likely face if the guidance should bar Fannie Mae and Freddie Mac from purchasing any mortgage on real estate that is subject to a transfer fee covenant. In this regard, the JEBURPA has three substantial concerns. First, the retroactive nature of the proposed guidance would have unwarranted negative consequences upon many existing homeowners whose titles are subject to transfer fee covenants. Second, because the proposed guidance includes transfer fee covenants that are enforceable under state law, implementation of the guidance could hinder the recovery of markets for residential real estate development. Finally, the proposed guidance could result in additional compliance costs to mortgage lenders that could result in higher transaction costs for all homeowners seeking mortgage financing. Each concern is addressed briefly below.

The Retroactive Application of the Proposed Guidance. JEBURPA believes that FHFA's proposed guidance, as drafted, will create significant title and financing problems for all homes currently subject to a transfer fee covenant. Under the proposed guidance, any homeowner whose title is now subject to a transfer fee covenant — whether it is a non-beneficial, purely private transfer fee covenant or is instead payable to an owners' association or to an entity for a charitable purpose — will be unable to refinance their existing mortgage. Further, a homeowner whose title is subject to a transfer fee covenant likely will be unable to sell her home, because the proposed guidance would prevent most would-be buyers from obtaining the financing needed to complete the purchase. In effect, the proposed guidance would, if it became effective in its current form, render hundreds of thousands of land titles immediately unmarketable.[2] This would have devastating personal economic consequences for the current owners of those properties — who, of course, had nothing to do with the original decision to impose the transfer fee covenant. Further, the inability of homeowners to sell their affected properties would exacerbate an already wrenching economic downturn in the national housing market.

While the JEBURPA would like to discourage the imposition and enforcement of non-beneficial and purely private transfer fee covenants (*i.e.*, those that do not provide ongoing or future benefit to the affected land), we believe that sound policy requires that the proposed guidance be narrowly tailored to avoid dramatic financial consequences on innocent homeowners. If the FHFA is going to issue any guidance on this subject, JEBURPA believes that such guidance should be issued only on a prospective basis. Regardless of whether any guidance ultimately issued by FHFA applies to transfer fee covenants broadly or only to non-beneficial and purely private ones, FHFA should limit the applicability of the

[2] In the case of transfer fee covenants on land within common interest communities, some commentators have suggested that residents can solve this marketability problem by having the association's residents vote to amend the covenant regime to remove the transfer fee covenant. Unfortunately, this solution is not feasible in many circumstances. Amendments to a community's declaration of covenants frequently require unanimous consent, unless either the declaration itself or applicable state law provides for modification by majority or supermajority vote. In communities whose documents require unanimous or substantial supermajority consent, obtaining the necessary consent will be practically impossible. In other communities, modification is impossible because of commitments the association will have made to municipalities or to third parties. For example, municipalities have sometimes conditioned development approvals upon the developer's imposition of transfer fee covenants payable to environmental or conservation entities (to be used to mitigate the environmental impacts of the development). Likewise, in some master planned communities, the owners' associations have pledged transfer fee income to lenders to secure the funds needed to build community facilities.

guidance to parcels of land for which a transfer fee covenant is first recorded on the land records after the effective date of the guidance.

The Proposed Guidance Creates a "Mismatch" with Respect to Existing State Laws. As drafted, the proposed guidance would prohibit Fannie Mae and Freddie Mac from purchasing mortgages on land subject to transfer fee covenants that are ***currently enforceable under state real estate law***, and that common interest community developers and municipal planners view as legitimate land planning tools. While this would not inherently justify the purchase of mortgages that are, in the words of the guidance, "adverse to liquidity, affordability and stability in the housing finance market and to financially safe and sound investments," developers and community associations have made longstanding and widespread use of transfer fee covenants to fund the construction, financing, and/or maintenance of community services and facilities — and we are aware of no empirical evidence to suggest that this practice has compromised the operation of the secondary market or threatened the solvency of home mortgage lenders.

The JEBURPA does appreciate that if the FHFA should choose to make its guidance parallel either to existing state statutes — or even to more restrictive statutes that FHFA might itself urge upon the states — the nation's real estate community would enjoy the considerable benefits of a single body of regulatory law on this subject. Stated differently, the nation's real estate community would function with greater efficiency — which we believe to be a public good — if whatever forms of transfer fee covenants were permitted under state law were simultaneously viewed as acceptable under the FHFA guidance. In suggesting this approach, JEBURPA does not intend that FHFA should surrender its regulatory authority in these matters to the states. Indeed, there have been many instances in the history of secondary market underwriting where the underwriting standards of the secondary market imposed significant constraints on state statutes and essentially forced state adoption of secondary market expectations.

Rather, what JEBURPA suggests is that before FHFA acts unilaterally to adopt underwriting standards that may radically affect the nation's housing market, it should first confer with other stakeholders in the national real estate community to identify those aspects of transfer fee covenants that pose the greatest threat to the fiscal soundness of the secondary market (and that simultaneously can most readily be constrained by statute). While development of a broad consensus in these circumstances might well require some delay in the implementation date of FHFA's guidance, it would most likely result in state adoption of more uniform state statutes that would meet with far broader public acceptance and far less disruption of the nation's mortgage industry.

New Guidance Should Not Impose Increased Closing Costs for Borrowers. JEBURPA urges FHFA, as it considers adoption of any new guidance, to take into account whether the costs to mortgage lenders of compliance with the guidance would likely produce higher transaction costs for all borrowers. To satisfy the standards required by the proposed guidance, mortgage lenders will be obliged to make additional representations and warranties to secondary market purchasers. In this case, an originating lender is likely to insist upon a title insurance endorsement affirmatively insuring that the mortgaged real estate is not subject to a subordinate transfer fee covenant — an endorsement not currently being offered by major title insurers. It may be that such an endorsement will be made available and that, as with many endorsements, it will be offered at no additional premium. On the other hand, JEBURPA is concerned that if an additional premium is assessed, that premium will be passed on to the borrower, resulting in increased closing costs for a home purchase. As with any additional costs in this economic environment, such an outcome will be viewed negatively by the general public and by their elected representatives at both the federal and state levels.

Conclusion. State law has traditionally defined the rights and obligations associated with landownership. State legislatures have begun to address the problems created by non-beneficial private transfer fee covenants, and now 17 states have banned their enforcement, with more enactments anticipated during the next two state legislative sessions. Notably, nearly all of these state statutes carve out an exception for transfer fee covenants that impose a fee payable to an owners' association to fund the provision of services or the maintenance of facilities that benefit the common interest community residents. Many of these statutes also carve out an exception for covenants that fund the provision of affordable housing, historic preservation, environmental protection, or other charitable purposes.

If FHFA is to issue any guidance to Fannie Mae and Freddie Mac regarding the purchase of loans secured by mortgages on land affected by transfer fee covenants, we encourage FHFA to tailor that guidance carefully with this existing state law landscape in mind. Because it does not do so, the proposed guidance risks not only disrupting the financial operations of untold numbers of common interest communities that have traditionally levied transfer fees, but also rendering unmarketable the titles of many innocent owners of single family homes or units in common interest communities whose current chains of title contain a transfer fee covenant of any type.

Respectfully submitted,

R. Wilson Freyermuth Executive Director, JEBURPA	William R. Breetz, Jr. Co-Chair, JEBURPA	Barry B. Nekritz Co-Chair, JEBURPA

Attachment (JEB Position Paper)

JOINT EDITORIAL BOARD
FOR UNIFORM REAL PROPERTY ACTS

Position Paper on Transfer Fee Covenants
April 2010

Introduction. With increasing frequency, developers are imposing private transfer fee covenants upon real estate. These covenants, which purport to run with title to the land (either perpetually or for a defined term), typically require that a fee be paid to the developer upon each subsequent transfer of the affected land. Under the traditional common law rules governing the enforcement of covenants, a transfer fee covenant payable to the developer would not run with the land to bind successors. However, following the promulgation of the Restatement (Third) of Property — Servitudes (the "Restatement"), developers have begun to impose transfer fee covenants upon land under development on the theory that such covenants do not create unreasonable restraints on alienation.

As this position paper explains, the Joint Editorial Board for Uniform Real Property Acts (JEBURPA) is of the view that transfer fee covenants payable to a developer serve no useful purpose in land development and thus create an unreasonable restraint on the alienability of land. In recognition of this concern, legislatures in eight states have enacted statutory prohibitions on the enforcement of private transfer fee covenants since 2008. The American Land Title Association and the National Association of Realtors have proposed model legislation (a copy appears in the Appendix to this position paper), for which introductions are anticipated during 2010-2011. The JEBURPA recommends that state legislatures enact a statutory prohibition on private transfer fee covenants similar to the model legislation in the Appendix.

What Is a Transfer Fee Covenant? A transfer fee covenant purports to impose a fee that is analogous to a real estate transfer tax but that is payable to a private party (typically, the real estate developer) rather than a governmental entity. For example, suppose that the developer of Sea View (Developer), a proposed common interest development, imposes a recorded covenant upon all lots within the development. This covenant requires that upon any resale of an affected lot within Sea View during the term of the covenant, a fee equal to one percent (1%) of the sale price must be paid to Developer. Upon Developer's initial sale of an affected lot to Buyer #1, no transfer fee arises. However, when Buyer #1 sells the affected lot four years later to Buyer #2 at a price of $250,000, the terms of the covenant (assuming the covenant is enforceable) would entitle Developer to collect a $2,500 transfer fee. Likewise, when Buyer #2 sells the affected lot 10 years later to Buyer #3 for a price of $350,000, Developer could collect a $3,500 transfer fee. Furthermore, the documents creating a transfer fee covenant often provide that any transfer fees that have accrued but remain unpaid constitute a lien against the affected real estate.

Why Would Developer Impose a Transfer Fee Covenant? Economics would predict that a buyer of land affected by a transfer fee covenant will factor that covenant into the price to be paid for the land. For example, suppose Developer is considering imposing a 1% transfer fee covenant on units in Sea View. If the units were unrestricted, a buyer may be willing to pay $400,000 to acquire a unit (assume this is the fair market value of a comparable unrestricted unit). If the units are subject to a 1% transfer fee, however, a buyer might insist upon discounting the price for the unit by at least 1% (to $396,000 or less) to account for the future impact of the 1% transfer fee. After all, when the buyer goes to resell the unit, the buyer's purchaser will be subject to the 1% transfer fee upon the next resale, and thus should insist upon a comparable discount. Theoretically, then, the burden of the transfer fee covenant — if it runs with the land to bind future owners — should reduce the value of the affected land as compared to comparable unrestricted land.

By imposing a transfer fee covenant, Developer thus forfeits a higher initial lot sale price in exchange for the right to collect a stream of future transfer fee payments. In a perfectly efficient market, the consequences of this trade-off would be irrelevant — the discount on Developer's initial sale would precisely equal the expected value of the future transfer fees. Regardless, however, Developer might still prefer to impose the transfer fee covenant as a marketing device. Because the transfer fee covenant would be expected to lower the sale price of the Developer's inventory, the covenant may assist Developer in marketing its unsold inventory, particularly as contrasted with comparable unrestricted units.

Transfer Fee Covenants and the "Touch and Concern" Test. Under the traditional common law rules, the burden of a covenant did not run to bind a successor to the original covenantor unless ***both the benefit and the burden*** of the covenant "touched and concerned" land. While the precise meaning of "touch and concern" has never been transparent, the standard was understood to protect against the creation and enforcement of covenants that could unreasonably restrain the alienability of land.

Historically, American courts have struggled in applying the "touch and concern" test to evaluate affirmative covenants to pay money. Both the benefit and the burden of an affirmative covenant to pay money can "touch and concern" land. A good example is the typical lot assessment covenant in a common interest development. Such a covenant imposes an assessment on each lot, payable to an owners' association, to fund the operation of the association and the maintenance of common facilities. These assessments provide for the maintenance of services and amenities that benefit community residents directly (e.g., access to pools, parks, etc., and in some cases even insurance and maintenance of the residents' own dwellings) and/or indirectly (e.g., higher property values due to the presence of valued amenities). Since the landmark case of *Neponsit Property Owners' Ass'n, Inc. v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938), courts have held that both the burden and benefit of a lot assessment covenant "touch and concern" land such that a lot assessment covenant binds successor owners of that land.

This result makes good sense doctrinally. While a lot assessment covenant theoretically creates an indirect restraint on alienation of the affected land (those unwilling to pay the assessment will not agree to purchase the land), its practical impact on alienability is negligible. Many purchasers sufficiently value the common amenities to the point that they would willingly accept the assessment in exchange for access to and preservation of the common amenities. As a result, the lot assessment covenant constitutes a reasonable (and enforceable) restraint.

The typical transfer fee covenant, however, is payable to the ***developer***, not to an owners' association. By the time the developer attempts to collect a transfer fee (at the time of a future transfer), it is likely that the developer will have completed the sale of all affected lots and will no longer have any legal interest (other than by the transfer fee covenant) in the community. As a result, the benefit of the transfer fee covenant is personal to the developer; in the language of the common law, the benefit is "in gross." Under the weight of judicial authority, if the benefit of a covenant was in gross, the burden of that covenant did not run to bind successors to the original covenantor. *See, e.g., Garland v. Rosenshein*, 649 N.E.2d 75 (Mass. 1995); *Bremmeyer Excavating, Inc. v. McKenna*, 44 Wash. App. 267, 721 P.2d 567 (1986); *Caullett v. Stanley Stilwell & Sons, Inc.*, 67 N.J. Super. 111, 170 A.2d 52 (1961).

This aspect of the "touch and concern" standard essentially established a prophylactic rule against the running of covenants that created purely personal benefits. In other words, it did not matter whether the enforcement of a covenant in gross ***actually*** constituted an unreasonable restraint on alienation. Instead, courts viewed the ***potential*** burden on alienability posed by covenants in gross as warranting a *per se* rule prohibiting their enforcement against successors, regardless of the actual harm posed by any particular "personal" covenant. Under this traditional view, a developer would not be able to enforce a transfer fee covenant against subsequent owners of the lot.

The Restatement of Servitudes. Over the past decade, the status of the "touch and concern" standard has been called into question following the American Law Institute's promulgation of the Restatement of Servitudes. The Restatement purports to abandon the "touch and concern" standard, instead substituting standards under which a covenant purporting to affect title to land is enforceable against successors unless the covenant is "arbitrary, spiteful, capricious" [Restatement § 3.1(1)], imposes an "unreasonable restraint on alienation" [§ 3.1(3)], imposes an "unreasonable restraint on trade or competition" [§ 3.1(4)], or is "unconscionable." [§ 3.1(5)] Where a covenant imposes only an indirect restraint on alienation, the Restatement suggests that the covenant does not create an unreasonable restraint on alienation unless it "lacks a rational justification." [§ 3.5(2)] Professor Susan French, the Restatement's Reporter, has argued that application of the Restatement standards should generally produce the same result that courts would have reached under the "touch and concern" test — but with greater transparency, because a court that refused to enforce a covenant would have to articulate the specific concern justifying nonenforcement (rather than masking its conclusion behind the opaque "touch and concern" label).

With respect to most covenants, Professor French may be correct, but this is uncertain with respect to transfer fee covenants. Under the prophylactic "if the benefit is in gross, the burden won't run" rule, a developer had little incentive to attempt to create a covenant imposing a transfer fee payable to the developer (rather than payable to owners' association to finance and/or maintain common amenities). However, the Restatement creates an incentive for developers to impose such covenants, because it purports to permit enforcement of a covenant for which the developer can proffer a "rational justification." The dominant marketer of transfer fee covenants is Austin, TX-based Freehold Capital Partners (formerly known as Freehold Licensing and hereafter referred to as "Freehold"), which markets a comprehensive transfer fee document (the "freehold license") to developers and encourages developers to place it on land under development.[1] Freehold's

[1]As part of its study of transfer fee covenants, the JEBURPA invited Freehold to make a presentation to the board on its transfer fee covenant documentation. A representative of Freehold made such a presentation to the JEBURPA at its December 2008 meeting.

promotional materials (available online at www.freeholdlicensing.com), demonstrate how Freehold uses the language and rhetoric of the Restatement to make a case for the enforcement of a transfer fee covenant. Freehold argues:

- A 1% transfer fee covenant will have no practical effect on the alienability of land — only upon the price at which any transfer will take place — because each buyer of land affected by a transfer fee covenant will reduce its offer price to account for the impact of the covenant upon resale. Thus, the covenant does not create an unreasonable restraint on alienation and should be enforceable as long as it has a rational justification.
- A 1% transfer fee covenant has a rational justification because it creates arguable benefits for both the developer and the initial buyer. It benefits the developer by allowing it to retain the transfer fee rights, which it can either sell immediately or hold to collect as fees come due upon future resales. The value of the transfer fee stream permits the developer to discount the sale price of its lots, thereby facilitating the developer's ability to market the lots (particularly as contrasted with otherwise comparable unrestricted land). In turn, the buyer is benefited because it obtains the land at a discount from the price that the land would have commanded if unrestricted. This discount reduces the buyer's acquisition cost (enabling the buyer to obtain land at a nominally lower investment), and should also reduce the buyer's transaction and carrying costs. For example, if the buyer obtains the land for a lower price, the buyer can borrow less to finance the purchase, thereby reducing its interest costs. Likewise, with a lower acquisition price, the buyer's title insurance premiums would be marginally reduced. Further, the reduction in land's value occasioned by the transfer fee covenant should also marginally reduce the buyer's real estate tax obligations during the period of the buyer's ownership. Finally, when the buyer later resells the land, the cost of a brokerage commission should be slightly reduced (as the transfer fee covenant should produce a discounted sale price vis-a-vis a comparable unrestricted parcel).

Based upon the commentary to Restatement § 3.5, courts may well be reluctant to invalidate a transfer fee covenant as lacking a rational justification, because the freedom-of-contract rhetoric in the Restatement's commentary is sweeping:

> Many economic arrangements for spreading the purchase price of property over time and for allocating risk and sharing profit from property development can be attacked as indirect restraints on alienation. If such arrangements are not unconscionable and do not otherwise violate public policy, there is usually no reason to deny the parties freedom of contract. The parties are usually in a better position than judges to decide the economic trade-offs that will enable a transaction to go forward and enhance their overall value. The fact that the value that may be realized from a parcel of land that is part of a larger arrangement has been reduced does not justify legal intervention to nullify part or all of the agreed-on arrangement.

In the period following the Restatement's promulgation, the imposition of transfer fee covenants has accelerated. As of December 2009, Freehold has (in conjunction with developers and homebuilders) imposed 99-year transfer fee covenants upon land in 45 states with an estimated total improved value of $488 billion. Further, Freehold's promotional materials argue that the Restatement supports its view that a transfer fee covenant based upon the Freehold model constitutes a reasonable and enforceable restraint on alienation.

Transfer Fees and Land Policy. For a number of reasons discussed below, the creation and attempted enforcement of transfer fee covenants constitutes unsound public policy and should be discouraged.

Buyers cannot accurately price the impact of a transfer fee covenant. Freehold defends transfer fee covenants by arguing that as long as the covenant is recorded, the buyer can readily discover the transfer fee covenant, fully understand and evaluate its implications, and adjust the offer price accurately to account for the covenant's financial impact. However, even intelligent buyers that know of the transfer fee covenant are unlikely to be able to "price" its effect with precision. There are simply too many variables for the typical buyer to assess.

One such variable is the buyer's holding period (i.e., how long before the buyer will resell the land and incur the transfer fee?). Assume that X is looking to buy a home that is subject to a 1% transfer fee covenant, and that the unrestricted fair market value of a comparable home would be $250,000. If X expects she will sell the house in 2 years, she can readily appreciate the need to discount the offer price to account for the fact that she expects to incur a transfer fee of approximately $2,500 or more in the near future. By contrast, if X thinks she will live in the house for 40 years (e.g., until X retires or dies), she may tend to disregard a future transfer fee, concluding that its effect in present dollars is *de minimis*. Because a buyer typically has imperfect information about the buyer's likely holding period, the buyer may have a difficult time judging how much to discount the offer price.

Second, the amount of the buyer's future transfer fee obligation is a function of the land's value at a ***future*** date. As a result, a buyer's ability to "price" the appropriate discount in present-day dollars is a function of both (a) the expected future appreciation in the land's value and (b) the appropriate "discount" rate (to convert the expected future transfer fee obligation into present dollars). But there is little empirical evidence to suggest that the typical buyer can make an informed or reliable judgment about future rates of appreciation or an appropriate discount rate.

Third, developers market transfer fee covenants as having beneficial effects for buyers (by lowering the buyer's acquisition cost, transaction costs, and carrying costs). But some of the transaction costs savings are sufficiently *de minimis* that buyers are likely to ignore them in the context of a land purchase. For example, in Missouri, the difference in title insurance premium cost for a $250,000 policy versus a $245,000 policy would be only $4. Further, while Freehold argues that buyers will enjoy reduced carrying costs, real estate price negotiations take place in a context in which buyers lack a defined reference point from which they can accurately calculate the appropriate reductions. It is correct to say that ***if*** a transfer fee covenant enables X to pay $2,500 less to acquire the land — and thus allows X to borrow $2,000 less to finance the purchase — X will save approximately $100-120 per year in interest costs during its first year (declining thereafter as the principal balance amortizes). But X cannot be certain that she is saving $100-120 per year in interest costs ***unless she also knows she is paying $2,500 less to acquire the land due to the presence of the covenant***. This determination is not possible in the context of real estate price negotiation, unless the developer is offering the buyer a choice to purchase the land at either a "restricted" price (subject to the covenant) or an "unrestricted" price (not subject to the covenant). But because developers typically impose transfer fee covenants on a "take it or leave it" basis in the context of common interest development, developers are not presenting buyers with a "covenant or no covenant" choice. Further, because land is relatively unique, there is no identical "unrestricted" parcel that the buyer can use as a baseline to calculate the incremental "burden" and "benefit" of the covenant. Without this baseline, the buyer lacks the ability to evaluate fully the financial impact of the covenant and thus to price the land accurately to account for its presence.

As a result, one would expect buyers to underestimate the impact of the covenant and thus not to discount their offer prices sufficiently to account for the covenant's impact. In fact, Freehold's promotional materials demonstrate that transfer fee covenants present an arbitrage opportunity for developers. Freehold argues that the presence of a 1% transfer fee covenant would typically result in an offer price that is reduced by 1-2% percent. At the same time, Freehold asserts that the present value of the future income stream from transfer fee covenants is at least 4-5% of the final improved value of the property. If buyers were truly informed and sufficiently sophisticated to price the impact of the covenant accurately, no such gap should be present. Essentially, the transfer fee covenant allows a developer to exploit the inability of buyers to price the impact of the covenant with precision.

Enforcing transfer fees could result in "stacking" of transfer fees. Suppose that the initial buyer of land subject to a transfer fee covenant decides to impose an additional transfer fee covenant on the land, payable to the initial buyer on all future transfers. If enforceable, this would permit the initial buyer to collect future fees that would offset the initial buyer's liability for the transfer fee payable to the developer. If a single transfer fee covenant in favor of the developer is enforceable — i.e., if it were reasonable for the developer to effectively finance a portion of the initial buyer's acquisition cost through the imposition of a transfer fee covenant — there would appear to be no reason why the initial buyer could not do the same thing. This could lead to the "stacking" of transfer fees, with each buyer in the chain creating an additional transfer fee covenant. With each additional transfer fee covenant imposed, the market value of the parcel should be further reduced, and the burden upon that parcel's alienability is further magnified.[2]

Transfer fee covenants unreasonably hinder the alienability of land by complicating future land transactions. In addition to creating an additional fee payable at closing, a transfer fee covenant will impede future land transactions by imposing additional transaction costs. Because the developer may have sold the right to collect future transfer fees, the seller may incur additional expense to

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[2]Freehold's transfer fee covenant documentation, by its terms, purports to prohibit the stacking of multiple transfer fees on the same property. However, nothing would prevent a developer from creating a transfer fee covenant using a document that did not prohibit the creation of additional transfer fees. Furthermore, there is an implicit contradiction in Freehold's position. If (as Freehold argues) its private transfer fee covenant is reasonable, why would a second (or third) transfer fee covenant be unreasonable, and why wouldn't Freehold's prohibition on "stacking" of transfer fees constitute an unreasonable restraint upon the initial buyer's right to alienate the property on the buyer's terms?

locate and pay the person entitled to payment of the transfer fee,[3] and the fee may have to be escrowed if that person cannot be found. The seller and the buyer will incur additional cost negotiating between themselves regarding responsibility for the payment, and the seller may incur additional costs in determining whether disclosure of the covenant is required in the purchase contract and, if so, ensuring that proper disclosure has been made. The buyer may incur additional time and expense negotiating with the title insurer over the form of the exception which the insurer will undoubtedly take for the transfer fee covenant. Unless the transfer fee covenant by its terms subordinates the developer's lien for transfer fees to the lien of future mortgage loans, the buyer may incur greater expense in obtaining financing if the buyer's mortgage lender insists upon obtaining subordination of the transfer fee covenant lien.

Transfer fee covenants reduce the tax base for the benefit of private parties. Finally, it is important to acknowledge that any financial benefit that a transfer fee covenant accords to a developer comes at the expense of the public as a whole. If a transfer fee covenant is enforceable, its imposition should reduce the value of the affected land, thereby creating an artificial reduction in the community's ad valorem tax base. Incremental sums that would have gone to the local community to fund public education, infrastructure, and community services instead are diverted to private parties. Sound public policy should not permit private action (outside the community's democratic processes) to create an artificial diversion of a portion of the tax base for private benefit.

Recent Legislative Activity. In recognition of the negative impacts of transfer fee covenants, ten states have recently enacted legislation that specifically address transfer fee covenants.

Total bans. Legislatures in Florida (2007), Missouri (2008), Kansas (2009), Oregon (2009), Arizona (2010), Iowa (2010), Maryland (2010), and Utah (2010) have enacted statutes that ban the use of transfer fee covenants payable to a developer. Fla. Stat. Ann. § 689.28; Mo. Rev. Stat. § 442.558; Or. Rev. Stat. § 93.269 (2009); Kan. Stat. § 58-3821 (2009); Ariz. Rev. Stat. § 33-442 (2010); Iowa Code § 558.48 (2010); Md. Real Prop. Code Ann. § 10-708 (2010); Utah Code Ann. § 57-1-46 (2010). Notably, the Florida legislation embraces the traditional view that a covenant creating a purely personal benefit does not run with the land:

> The Legislature finds and declares that the public policy of this state favors the marketability of real property and the transferability of interests in real property free of title defects or unreasonable restraints on alienation. The Legislature further finds and declares that transfer fee covenants violate this public policy by impairing the marketability and transferability of real property and by constituting an unreasonable restraint on alienation regardless of the duration of such covenants or the amount of such transfer fees, and do not run with the title to the property or bind subsequent owners of the property under common law or equitable principles. [Fla. Stat. Ann. § 689.28(1)]

[3]Freehold's transfer fee covenant documentation establishes a "trustee" to whom the transfer fee is payable, with the trustee thereafter remitting paid fees to the person entitled to collect the fees. This model would reduce some of the potential transaction cost, but nothing compels a developer to use the Freehold model to create a private transfer fee covenant.

In these states, transfer fee covenants imposed after the effective dates of the relevant statutes are void. By their terms, these statutes do not apply to transfer fee covenants imposed before their respective effective dates, leaving the enforceability of such covenants an open question.

Texas. In 2007, the Texas legislature adopted a transfer fee statute that applies only to covenants on "residential real property." Texas Property Code § 5.017(b) provides in pertinent part:

> A deed restriction or other covenant running with the land applicable to the conveyance of residential real property that requires a transferee of residential real property or the transferee's heirs, successors, or assigns to pay a declarant or other person imposing the deed restriction or covenant on the property or a third party designated by a transferor of the property a fee in connection with a future transfer of the property is prohibited.

Freehold argues that its transfer fee covenant is enforceable under this statute because the terms of its covenant obligate the ***seller*** to pay the fee, not the buyer. This argument seems dubious for two reasons. First, Freehold's interpretation is inconsistent with a literal reading of the statute. If X contracts to buy from Y land that is subject to a 1% transfer fee covenant, X may not be liable for the 1% fee that accrues upon the Y-to-X transfer, but the covenant does impose upon X the obligation to pay "a fee in connection with a ***future*** transfer of the property" (i.e., X's future resale). Second, if X fails to pay the fee, the unpaid fee would become a lien against the land that would prevent X from delivering clear title to a subsequent purchaser without paying the prior fee. Thus, it seems more plausible to interpret the Texas statute as a prohibition upon transfer fee covenants. Nevertheless, it appears that developers using the Freehold model continue to impose transfer fee covenants upon residential land in Texas.

California. By contrast, the California legislature has chosen to validate transfer fee covenants, subject to explicit disclosure requirements. In California, a transfer fee covenant is enforceable against successors as long as the person imposing the fee records a document indicating "Payment of Transfer Fee Required" in the chain of title to the real estate. Cal. Civ. Code § 1098.5. This document must contain certain mandated information, including: (I) a clear statement of the amount or percentage of the fee; (ii) if the real estate is residential, "actual dollar-cost examples of the fee" for a home priced at $250,000, $500,000, and $750,000; (iii) the expiration date of the transfer fee covenant, if any; (iv) the purpose for which the funds from the fee will be used; and (v) the name of the entity to which the fee must be paid (along with specific contact information).

Conclusion and a Model Statutory Solution. Under the traditional common law approach, a covenant imposing a transfer fee payable to the developer was unenforceable because the benefit of such a covenant did not "touch and concern land." The Restatement of Servitudes purported to reject this prophylactic rule in favor of a more nuanced standard under which a covenant that indirectly restrains alienation is enforceable so long as the restraint has a rational basis and is not unreasonable. Of course, the Restatement does not become the common law of any particular state solely by virtue of its promulgation. Whether courts will actually enforce transfer fee covenants depends upon (a) whether an individual state's courts will adopt the Restatement's purported abolition of the "touch and concern" rule and (b) if so, whether a court concludes that the covenant in question meets the enforceability standards expressed in the Restatement. Developers have exploited this uncertainty by imposing transfer fee covenants upon new land development with greater frequency, thereby greatly increasing the uncertainty of title to land affected by such covenants. Therefore, to promote clarity in land titles and efficiency in land transfer, the Joint Editorial Board for Uniform Real Property Acts (JEBURPA) is of the unanimous opinion that state legislatures should enact statutes imposing a ban upon the enforcement of transfer fee covenants imposing fees payable to the developer (e.g., a transfer fee covenant based upon the Freehold model).

A suggested model statute appears in the Appendix to this paper. Section 1(b) expresses model state legislative findings that transfer fee covenants violate public policy by creating an unreasonable impediment to the alienability of land, regardless of the duration of the covenant or the amount of the transfer fee. Section 1(c) would prospectively invalidate any transfer fee covenant recorded after the statute's effective date — making such a covenant unenforceable against the real property or any subsequent owner of the property. Section 1(c) also would invalidate any lien to the extent that it purports to secure the payment of a transfer fee. While the model statute would not apply to transfer fee covenants recorded prior to the statute's effective date, Section 1(d) does provide that the statute should not be interpreted to validate such covenants. In a state adopting this model statute, a court facing a challenge to a pre-existing transfer fee covenant should evaluate its enforceability against successors based upon the common law of covenants and servitudes (and, in our view, ought to conclude that such a covenant does not run with the land to bind successors).

The model statute does recognize that a covenant might impose a transfer fee that is payable to an owners' association for the purpose of financing association operations and/or maintenance of common amenities. These covenants (e.g., the "flip tax" that is commonly included in housing cooperative documentation) would typically have satisfied the common law's "touch and concern" test, and thus Section 1(a) of the statute excludes such covenants from the definition of a "transfer fee covenant."

* * * * * * * *

Members of the JEBURPA stand willing to assist state legislative efforts to adopt a statute prohibiting the enforcement of private transfer fee covenants. For further information, please contact any of the following:

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The JEBURPA is comprised of representatives from the American Bar Association's Real Property, Trust and Estate Law Section, the American College of Real Estate Lawyers, and the Uniform Law Commission, as well as liaison members from the American College of Mortgage Attorneys and the Community Associations Institute. The JEBURPA advises the Uniform Law Commission as to prospective uniform law projects relating to real estate, and seeks to promote law reform by encouraging states to adopt existing uniform and model real estate laws.

Disclaimer: This Position Paper reflects the views of the members of the JEBURPA. It has not been approved by, and thus does not reflect the official position of, either the Uniform Law Commission or the American College of Real Estate Lawyers.

APPENDIX
PROPOSED MODEL STATE LEGISLATION ON TRANSFER FEE COVENANTS

SECTION 1. Prohibition on Transfer Fee Covenants.

(a) As used in this section:

(1) "Association" means a nonprofit, mandatory membership organization comprised of owners of homes, condominiums, cooperatives, manufactured homes, or any interest in real property, created pursuant to a declaration, covenant, or other applicable law.

(2) "Transfer" means the sale, gift, conveyance, assignment, inheritance, or other transfer of an interest in real property located in this State.

(3) "Transfer fee" means a fee or charge imposed by a transfer fee covenant, but shall not include any tax, assessment, fee or charge imposed by a governmental authority pursuant to applicable laws, ordinances, or regulations.

(4) "Transfer fee covenant" means a provision in a document, whether recorded or not and however denominated, which purports to bind successors in title to specified real property located in this State, and which obligates the transferee or transferor of all or part of the property to pay a fee or charge to a third person upon transfer of an interest in all or part of the property, or in consideration for permitting any such transfer. The term "transfer fee covenant" shall not include:

(A) any provision of a purchase contract, option, mortgage, security agreement, real property listing agreement, or other agreement which obligates one party to the agreement to pay the other, as full or partial consideration for the agreement or for a waiver of rights under the agreement, an amount determined by the agreement, if that amount:

(I) is payable on a one-time basis only upon the next transfer of an interest in the specified real property and, once paid, shall not bind successors in title to the property;

(ii) constitutes a loan assumption or similar fee charged by a lender holding a lien on the property; or

(iii) constitutes a fee or commission paid to a licensed real estate broker for brokerage services rendered in connection with the transfer of the property for which the fee or commission is paid;

(B) any provision in a deed, memorandum, or other document recorded for the purpose of providing record notice of an agreement described in subsection (a)(4)(A);

(C) any provision of a document requiring payment of a fee or charge to an association to be used exclusively for purposes authorized in the document, as long as no portion of the fee is required to be passed through to a third party designated or identifiable by description in the document or another document referenced therein; or

(D) any provision of a document requiring payment of a fee or charge to an organization described in Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code, to be used exclusively to support cultural, educational, charitable, recreational, environmental, conservation, or other similar activities benefiting the real property affected by the provision or the larger community of which the property is a part.

(b) The Legislature makes the following findings:

(1) The public policy of this State favors the transferability of interests in real property free from unreasonable restraints on alienation and covenants or servitudes that do not touch and concern the property.

(2) A transfer fee covenant violates this public policy by impairing the marketability of title to the affected real property and constitutes an unreasonable restraint on alienation, regardless of the duration of the covenant or the amount of the transfer fee set forth in the covenant.

(c) A transfer fee covenant recorded after the effective date of this section, or any lien to the extent that it purports to secure the payment of a transfer fee, is not binding on or enforceable against the affected real property or any subsequent owner, purchaser, or mortgagee of any interest in the property.

(d) The limitation of paragraph (c) to transfer fee covenants recorded after the effective date of this section does not imply that a transfer fee covenant recorded prior to the effective date of this section is valid.

FREEHOLD CAPITAL PARTNERS
900 Third Avenue | Fifth Floor | New York, NY | 10022

October 13, 2010

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, D.C. 20552

Re: Notice of Proposed Guidance — No. 2010-N-11, Private Transfer Fee Covenants

Dear Mr. Pollard:

We are writing to you today on behalf of our approximately 6,000 developer-clients who utilize a type of private transfer fee (PTF) known as a *capital recovery fee*. In doing so we join the 1,777 respondents to date (representing 96.21% of the 1,925 respondents) who have urged the FHFA to reject the Proposed Guidance. In support of this request we comment as follows:

SYNOPSIS

The FHFA's Proposed Guidance questions whether or not private transfer fees burden homeowners, inhibit the orderly functioning of the real estate market, and adversely impact government sponsored enterprises (GSE). We believe that the evidence clearly demonstrates that the answers to these questions is emphatically, "No".

Opposition to PTFs centers around the inaccurate notions that, among other things, the (1) covenants make transferring the encumbered properties difficult; (2) parties to a real estate transaction are not even aware of the covenant running with the property; (3) fee recipients are making money on the backs of homeowners; and (4) fees are new and potentially as dangerous as the financial products that caused the housing meltdown. All of these contentions, however, are simply wrong.

PTFs have been around for decades, and currently cover an estimated 12 million homes. Even with this widespread usage, transactions have proceeded smoothly, with no evidence that PTFs have adversely affected these transactions. This lack of evidence of actual harm strongly suggests that the Proposed Guidance is unnecessary.

Realtors looking to preserve commissions, and title agencies looking to eliminate the potential for claims that cut into profits, lead the opposition to PTFs. While we understand that they are in business to make money, the financial interests of these industries cannot be placed above good public policy. Both groups' attacks are not only self-serving, but they lack any basis in reality, and should not be used as a basis for cutting off the important funding that PTFs provide for non-profits, homeowner associations, master planned communities and development projects nationwide.

Opponents of PTFs have argued that PTFs somehow increase the risk to the safety and soundness of the GSEs and that the fee provides no benefit to consumers. This contention is illogical, and demonstrates a fundamentally flawed understanding of the purpose of the fee and the benefits it provides. The reality is that capital recovery fees are one of the few fees that actually provide consumers with a benefit commensurate with the amount of the fee. Capital recovery fees lower home ownership costs by spreading development costs over time among those who benefit from the infrastructure. In addition, by selling off the future income stream that arises from PTFs, negative equity is reduced, development loans are paid down, failed projects are restarted, and, importantly, jobs are created.

Unlike the absence of a negative impact from the use of PTFs over the past several decades, adopting the Proposed Guidance will have an immediate and devastating impact. The Proposed Guidance will suppress the value of the estimated 12 million homes currently encumbered with a PTF and the owners of these homes will be left scrambling for buyers willing and able to obtain a non-conforming loan, which in today's market may mean no buyers at all. Considering that millions of homes have been bought and sold with a PTF, the evidence is not merely suggestive – it is overwhelming: private transfer fees pose no threat to GSEs or the real estate market, but the Proposed Guidance does.

I.

OVERVIEW OF CAPITAL RECOVERY FEES

The debate surrounding capital recovery fees has been dominated by misperceptions and inaccuracies. To properly evaluate the fees' utility, these misperceptions and inaccuracies must be addressed:

A. Development Costs are Equitably Shared

Streets, utilities and similar capital improvements make up a significant portion of the expenses associated with development of a modern master-planned community. Traditionally, 100% of these embedded development costs have been absorbed by initial buyers coming into the community, who, as a result of embedded development costs, experience a higher purchase price, higher transaction costs and higher carrying costs. Currently, developers use capital recovery fees to spread the significant development costs incurred in connection with modern master-planned communities. ***As such, the fees clearly represent neither a windfall to the developer nor a "private source of income to unrelated third parties" with no corresponding benefit to the land.***[1]

By equitably spreading infrastructure costs that would otherwise be absorbed entirely by the initial buyer, a capital recovery fee reduces the sales price of the home, making it more affordable. As Julie Snyder, Policy Director for non-profit Housing California stated during the California debate over transfer fees, ***"Reconveyance financing ... helps keep home prices low by spreading costs over all beneficiaries of a project."*** The California Building Industry observed ***"You can't put all of the costs on home buyers and still sell at an affordable price."***[2]

[1] Clearly streets, utilities, etc., provide ongoing benefits to the homeowners that use them. From a public policy perspective, there seems little rationale for drawing a distinction between a fee used solely for ongoing maintenance and one which pays for the underlying infrastructure itself. Both clearly benefit the land and the homeowner.
[2] Source: Builders, Realtors Square Off on Transfer Fees. May 16, 2007. Inman News.

B. Capital Recovery Fees Are Not Hidden

Reports that the fees are hidden are patently false. In reality, a capital recovery fee is created when the developer files a *Declaration of Covenant* in the public records, and all parties are made fully aware of the fee through the title commitment, *which is the same method used to disclose encumbrances such as HOA dues, assessments and other rights and obligations that bind the property.* The entity entitled to the fee wants their money and common sense suggests that a hidden fee will not be paid, particularly if unveiled at the eleventh hour. Freehold supports full, clear and early disclosure of PTFs and requires nothing less of those with whom we work. An important example of this is our recent agreement with Fidelity National Title Group (which includes Fidelity Title, Chicago Title, Alamo Title, Lawyers Title and Commonwealth Title), to obtain a separate signed disclosure for all transactions. In addition, several states have separate disclosure requirements.

C. Capital Recovery Fees Are An Important Financing Tool

The fee has been referred to as a "**Development Bond**" because the future revenue expected from the fee can be sold off to investors.[3] A typical capital recovery fee is generally 1% of the sales price, paid by the seller, for a term of 99 years.[4] ***When developers sell off this future income stream, they generate much-needed liquidity that they can use to reduce bank debt, reduce or eliminate negative equity, and restart failed projects - creating jobs.*** This interrupts the cycle of declining property values that leads to foreclosures, which in turn leads to further declines in property values and additional foreclosures. In sharp contrast, when failed projects are restarted, homeownership is made more affordable, loans are paid down, and jobs are created. This leads to a positive ripple effect that spreads throughout the entire community, interrupting the downward spiral the real estate sector finds itself in today.

[3] This process is similar to toll bonds being used to fund toll roads. Similar "development bonds" designed to reimburse infrastructure and development costs include PIDs, MUDs and Mello-Roos, all of which have been routinely sold with no meaningful defaults.

[4] This translates into 8-10 sales (8-10%) paid out over the 99-year term. Source: Statistical Information Office, U.S. Census Bureau, Washington, D.C.; Geographical Mobility by Tenure: 1987-2006.

To understand how a capital recovery fee can reverse the downward spiral, consider the following:

> A developer borrowed money from a community bank to finance a master planned subdivision. He installed streets, utilities and other infrastructure, using the money borrowed from the bank. When the housing market crashed, the project's value plummeted before a single home could be finished and sold. As a result, the project stalled and workers were laid off. The bank, stuck with an impaired loan, now has to set aside additional reserves, reducing the amount of money it can lend to Main Street. The developer is unable to find funding on commercially reasonable terms since (1) virtually all banks now have the same problem (and thus have no money to lend to the real estate sector) and (2) regulatory requirements have reduced the amount of real estate loans a bank can have outstanding (as a percentage of capital).
>
> Overcoming this lack of capital, the developer utilizes a private sector solution by deciding to finance the infrastructure costs in a different way - with capital recovery fees. The developer imposes a capital recovery fee on the property and sells the long-term revenue stream for an immediate capital injection that is used to repay the bank.[5]
>
> The bank resolves a troubled loan, freeing up capital that it can lend to other small businesses. The developer restarts the project now that the "negative equity" has been cured. Construction crews, electricians, surveyors, and other workers are hired, and can now pay their own bills. Demand for construction materials also increases. Homeowners buying into the development get a lower price up front, and save on transaction costs and interest expenses. 5% of the income stream over 99 years goes to non-profits operating within the community, providing important funding for clean air, clean water, open space, affordable housing and more.
>
> ***All of this is accomplished at zero taxpayer expense.***

[5] The developer must pay the bank, because the bank's lien is superior to the capital recovery fee covenant.

Capital recovery fees will not solve all of our current real estate, lending and jobs issues. But given their potential to aid in economic recovery and job creation, and to resolve troubled real estate loans, while making homeownership more affordable, we should think long and hard before destroying one of the few solutions actually providing relief in this environment, particularly in the complete absence of any evidence of harm.

II.

SPECIFIC RESPONSE TO THE PROPOSED GUIDANCE

The following address specific concerns identified by FHFA in the Proposed Guidance.

1. … "PRIVATE TRANSFER FEE COVENANTS MAY INCREASE THE COSTS OF HOMEOWNERSHIP, THEREBY HAMPERING THE AFFORDABILITY OF HOUSING AND REDUCING LIQUIDITY IN BOTH PRIMARY AND SECONDARY MORTGAGE MARKETS"…

When you spread infrastructure costs across the life of the property, there is an immediate and continuing *savings* for homebuyers, because the price of the home is lower than it otherwise would be without the fee. When homebuyers pay less up front, they enjoy lower closing costs and pay less interest, which creates significant savings over the life of the average loan.

Studies have examined Mello-Roos and similar financing vehicles that reimburse infrastructure costs, as well as taxes and fees and the impact on consumers, and the evidence is clear: *The market adjusts the price of the home to reflect the existence of the fee.* Studies include:

- Residential Property Tax Capitalization by A. Quang Do (Dep. Of Fin. – Univ. of San Diego) and C.F. Sirmans (Center for Real Estate and Urban Economic Studies – Univ. of Ct.), which concluded that homebuyers will in fact discount the purchase price of a home encumbered by a fee.[6]

- The Economics of Private Transfer Fees by Ph.D. land economist Dr. Tom McPeak, which concluded, "This assumption [that that the seller will lower the sales price] is

[6] Exhibit A (http://www.coalitiontopreservecommunityfunding.org/studies/quang_study.pdf)

well-founded because economic theory suggests that buyers armed with the facts will not pay the same for a home with a transfer fee as they will pay for the same home without a transfer fee."[7]

- A Bill Analysis prepared for the California Senate Transportation and Housing Committee, which concluded:

  > Another fee that the market will adjust to. Private transfer fees are one more line item on the escrow instructions. To the extent that the existence of such a fee impacts the value of the property, as long as the fee is fully disclosed the market will adjust to the fee. A homebuyer who knows that she must pay such a fee upon subsequent resale will pay the developer less for the home than for a comparable property. Likewise, future buyers will pay less to the seller.[8]

- William Fischel, Professor of Economics at Dartmouth College and author of Municipal Corporations, Homeowners and the Benefit View of Property Tax (2000), commenting on the premise that home prices will adjust to reflect all encumbrances and that home buyers can "vote with their feet," remarked, *"I have found that, once I explain the basic idea, most people say, of course, how could anyone think otherwise?"*[9]

We agree with Professor Fischel – *how could anyone think otherwise*? Even if there was evidence that a capital recovery fee increased the cost of homeownership (which we maintain does not exist), the value that developers create through the many significant capital improvements that benefit homeowners for generations to come, more than justifies the fee. In sharp contrast, one

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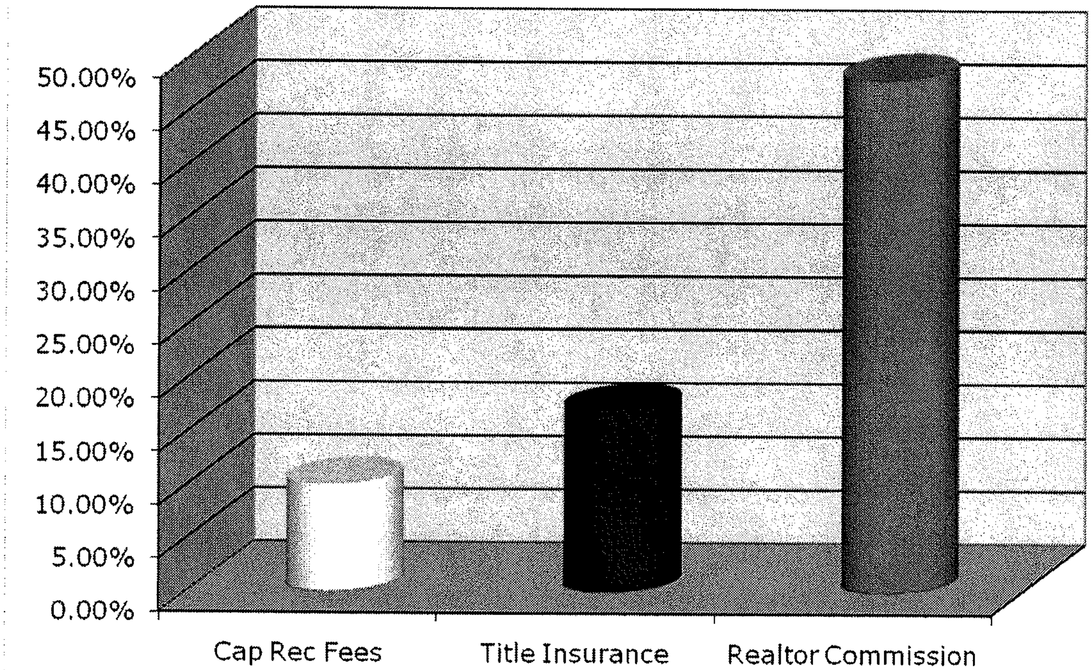
[7] Exhibit B.
[8] http://info.sen.ca.gov/pub/07-08/bill/sen/sb_0651-0700/sb_670_cfa_20070413_131835_sen_comm.html at ¶4.
[9] School Finance at p.6 (http://www.lincolninst.edu/subcenters/property-valuation-and-taxation-library/dl/fischel.pdf) See also p. 13 for discussion with approval of Quang study.

need look no further than the typical real estate commission and title insurance fee to find evidence of significantly more egregious fees which provide significantly less corresponding benefit to the homeowner. As such, it seems difficult to imagine the impetus for singling out a fee charged by the one group that invests the <u>most</u> in the project – in terms of time, money <u>and</u> creativity - *developers*.



COMPARISON OF CAPITAL RECOVERY FEES TO OTHER REAL ESTATE FEES OVER THE LIFE OF THE TYPICAL TRANSFER FEE INSTRUMENT (99 YEARS)

Adopting the Proposed Guidance would create the very harm it seeks to avoid *(hampering affordability and reducing liquidity).* If adopted, the owners of the millions of properties with transfer fees will find themselves with property that is restricted to non-conforming loans, which will cause an immediate drop in the value of their property.

2. …"PRIVATE TRANSFER FEE COVENANTS MAY LIMIT PROPERTY TRANSFERS OR RENDER THEM LEGALLY UNCERTAIN, THEREBY DETERRING A LIQUID AND EFFICIENT HOUSING MARKET"…

An estimated 12 million properties are already encumbered with transfer fees, and have been bought and sold for decades without rendering property transfers legally uncertain. As such, the overwhelming (indeed, indisputable) evidence is that private transfer fees do not interfere with property transfers.

The New York Bar Association, in FHFA comment 1076, agreed, writing: *"New York's transfer fees are not hidden and do not create any 'legal uncertainty' at any time during the sale process."* Other comments have mirrored the exact same finding. It is instructive to note that <u>all</u> transfer fees, including New York's widely-used condo and co-op "flip tax," HOA transfer fees, non-profit transfer fees, *and capital recovery fees*, are all created by the exact same means – a covenant filed in the public records. ***Since there is no such thing as a transfer fee that is imposed by any means <u>other</u> than a covenant filed in the real property records, the inescapable conclusion is that either <u>all</u> transfer fees are disclosed – or <u>none</u> are disclosed.***

For decades, Fannie Mae and Freddie Mac have routinely and repeatedly financed properties with private transfer fees, with no reported adverse impact. In sharp contrast, Fannie and Freddie (and taxpayers) have suffered billions in losses from acceding to the demands of the National Association of Realtors and the American Land Title Association (the two primary proponents of the Proposed Guidance) who repeatedly demanded lax lending standards and development of subprime loans in pursuit of higher profits.[10] *We understand why these two special interest groups want to be involved in the debate over how best to finance infrastructure and resolve the current crises – and why they urge policy-makers to protect their profits by banning this useful financing tool - but what we cannot understand is why they think that this is good public policy, or why their positions appear to have gained so much traction..*

3. …"THE FEE MAY DETRACT FROM THE STABILITY OF THE SECONDARY MORTGAGE MARKET, PARTICULARLY IF SUCH FEES WILL BE SECURITIZED"…

A capital recovery fee is not imposed in connection with a foreclosure and, therefore, has no impact on a foreclosing GSE. The fee is paid once, at closing, at which time the lender receives a

[10] For example, in 2003, the president of the National Association of Realtors, Cathy Whatley, testified before Congress in support of <u>subprime lending</u>, stating, ***"We support the development of such a [subprime] product, which would expand home purchase opportunities for more borrowers."*** What she clearly meant was, subprime loans will expand commissions for Realtors. http://banking.senate.gov/03_06hrg/061203/whatley.pdf @ *page 13*

title policy. By definition the fee cannot arise again until the next transfer of title, *at which time the lender is paid off.* Out of the billions in mortgage losses suffered by GSEs, no reported instance of a loss has been attributed to a private transfer fee.

It also is difficult to visualize a scenario where securitization of transfer fee income would have a negative impact on the stability of the secondary mortgage markets. Securitization simply dictates where the fee ends up. It does not change the risk profile to the lender.

4. … "PRIVATE TRANSFER FEE COVENANTS MAY EXPOSE LENDERS, TITLE COMPANIES AND SECONDARY MARKET PARTICIPANTS TO RISKS FROM UNKNOWN POTENTIAL LIENS AND TITLE DEFECTS"…

As a condition to acquiring a mortgage, both *lenders* and *secondary market participants* require a title policy. Thus "lenders" and "secondary market participants" have no exposure from a private transfer fee. ***This leaves the title insurance industry as the beneficiary of the proposed guidance.***

Freehold has entered into an agreement with Fidelity National Title, parent company of Fidelity Title, Chicago Title, Commonwealth Title, Alamo Title, Lawyers Title and Ticor Title. The Fidelity family of insurers covers an estimated 60% of the U.S. title insurance market. The stated purpose of the agreement is to establish *"a procedure by which property subject to a [Freehold] Covenant can be insured without undue risk to either property."* The agreement further provides that Fidelity (1) *"will not refuse to issue a Title Policy or close a transaction based solely on the existence of the [Freehold] Covenant"* and (2) will disclose the Covenant in a separate document, which the proposed insured will be required to sign. The agreement addresses concerns for title insurers, and Fidelity's suggested adjustments to Freehold's instrument and payment process have been made, thereby benefitting all title companies nationwide.

Private transfer fee covenants are not particularly unique or complicated, and they are fully transparent and traceable. Further, given the very nature of their business, title companies are readily equipped to indentify any encumbrances of record – a service for which they are typically paid a substantial fee. While title companies could conceivably face claims that might arise from their own negligence in failing to discover a transfer fee covenant, those risks are no greater than the risks routinely assumed in connection with standard liens, judgments, assessments, homeowner association dues, and similar title commitment encumbrances. In addition, there is a complete absence of evidence of title claims having arisen from the existing pool of over 12 million properties with transfer fees.

What makes the title industry's opposition to a financing mechanism that can help homeowners, developers and lenders alike particularly self-serving is that title companies already enjoy monopolistic protections that allow them to pay out less than 5% of premium dollars in claims,[11] and 100% of those payments arise from the title company's own negligence. This industry hardly needs additional protection.

5. ... "PRIVATE TRANSFER FEE COVENANTS MAY CONTRIBUTE TO REDUCED TRANSPARENCY FOR CONSUMERS BECAUSE THEY OFTEN ARE NOT DISCLOSED BY SELLERS AND ARE DIFFICULT TO DISCOVER THROUGH CUSTOMARY TITLE SEARCHES, PARTICULARLY BY SUCCESSIVE PURCHASERS"...

The following describes the process by which a capital recovery fee is created and disclosed.

A. <u>The Process</u>.

A developer creates a capital recovery fee by filing a "Declaration of Covenant" in the real property records. This process provides <u>notice</u> to all prospective buyers, and is <u>identical</u> to the long-standing process for assessing and disclosing homeowner association restrictions, dues and transfer fees. Unlike HOA dues and transfer fees, which can often be found inside lengthy HOA documents, a capital recovery fee covenant is virtually always filed as a separate stand-alone instrument, prominently styled, in bold 14-point font at the top of the very first page:[12]

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[11] See Eaton, Prof. David. **<u>The American Title Insurance Industry: How a Cartel Fleeces the American Consumer</u>**. NYU Press, 2007.

[12] Exhibit C.

NOTICE: THIS DOCUMENT MAY REQUIRE PAYMENT OF A FEE IN CONNECTION WITH A TRANSFER OF TITLE

When a buyer and a seller enter into a purchase agreement, the contract is receipted with the closing agent (typically a title company). **The title company then sends a title commitment to the buyer, where the transfer fee is disclosed.**

B. Right to Terminate

Virtually every earnest money contract allows the buyer to review the title commitment. *The buyer then has a period of time to withdraw from the transaction, without penalty.*

C. Additional Disclosure is Always Desirable

Although millions of transfer fee transactions are processed annually *with no evidence of inadequate disclosure or consumer harm*, additional disclosure is always welcome. A party imposing the fee will always want to take every reasonable step possible to ensure that the fee is easily discoverable by the title company. After all, if the fee is hidden, who will pay it, and who will buy it?

As discussed above, Freehold Capital Partners entered into a written agreement with Fidelity National Title Group (parent company of Fidelity Title, Commonwealth Title, Alamo Title, Chicago Title, Lawyers Title and Ticor Title, which together cover an estimated 60% of the U.S. title insurance market) which requires these title insurers to obtain a separate disclosure, signed by the buyer and seller.

D. The California Model

After extensive public debate and analysis, California rejected a proposed ban on private transfer fees, instead opting for a disclosure statute (Cal. Civil Code 1098.5). As a result of this new law not only is disclosure required, but the standard real estate contracts were revised:

- The standard Seller Property Questionnaire now requires disclosure of a transfer fee by the Seller and a buyer has the opportunity to terminate without penalty after review of this form.[13]

- The California Residential Purchase Agreement now includes a provision for a private transfer fee.[14]

E. Marketable Title Act

The title industry has suggested that the 99-year term of common transfer fee instruments presents challenges. However, this argument is a red herring:

1. In most states an abstract of the private transfer fee covenant must be re-filed within the period designated by the applicable states' **Marketable Record Title Act**, typically no more than 30 years, thus ensuring that the title reviewer does not have to search back for an unreasonable period of time.[15]

2. In today's modern information age, when a document is filed in the real property records it is indexed in a title plant, and will remain there until such time as the expiration date specified within the database (e.g. 99 years) has elapsed. The modern title plant tracks dates with virtually flawless precision.

F. Fee is Not Hidden in Complex Documents

Both Homeowner Associations and developers assess transfer fees through a covenant. In other words, the mechanism is exactly the same, except that a capital recovery fee document is a separate stand-alone document, whereas HOA covenants include a myriad of rules, regulations and fees. ***If a capital recovery fee is "hidden" then HOA transfer fees are even more hidden.***

As reiterated throughout our response, over 12 million homes have a transfer fee, and none of the concerns contemplated in the Proposed Guidance have materialized. More particularly, there is

[13] Exhibit D.
[14] Exhibit E.
[15] Generally, these laws limit the duration of an encumbrance to a period of years.

no basis for asserting that private transfer fees are *"often not disclosed"* or that they are *"difficult to discover*". If the encumbrance is in the public records, it is neither more difficult nor less difficult than any other routine encumbrance of record. Nonetheless, to the extent concerns linger (despite overwhelming evidence that the concerns are unwarranted) additional disclosure lays the concerns to rest.

6. ... "PRIVATE TRANSFER FEE COVENANTS MAY REPRESENT DRAMATIC, LAST-MINUTE, NON-FINANCEABLE OUT-OF-POCKET COSTS FOR CONSUMERS AND CAN DEPRIVE SUBSEQUENT HOMEOWNERS OF EQUITY VALUE"...

Capital recovery fees are typically paid <u>by the seller</u>. As such, it is not an *out of pocket cost* – it is a reduction in proceeds at the time of future sale. In addition, the fee is neither *dramatic* nor *last minute*, since the seller knows <u>years in advance</u> that the fee will be due at the time of sale.

Homeowners are not *deprived of equity* because they pay less for the home upfront. As shown in the studies cited above, it is undisputed that the market will adjust the price of the home to reflect the existence of the future fee obligation.

7. ... "PRIVATE TRANSFER FEE COVENANTS MAY COMPLICATE RESIDENTIAL REAL ESTATE TRANSACTIONS AND INTRODUCE CONFUSION AND UNCERTAINTY FOR HOME BUYERS".

There is no evidence that private transfer fees have either complicated residential real estate transactions or introduced confusion and uncertainty into the process for the homebuyer. In fact, the evidence is <u>overwhelmingly</u> to the contrary and it strains credulity, and flies in the face of the evidence, to suggest that there has been any confusion over what is one of the simplest of fees to calculate.

8. ... "THE RISKS AND UNCERTAINTIES FOR THE HOUSING FINANCE MARKET THAT ARE REPRESENTED BY THE USE OF PRIVATE TRANSFER FEE COVENANTS ARE NOT COUNTERBALANCED BY SUFFICIENT POSITIVE EFFECTS."

Again, opponents of PTFs have made bold assertions regarding *risks and uncertainties* for the housing finance market, but they have not offered any evidence to support their contentions. In fact, the evidence that does exist suggests a complete absence of risks and uncertainties: millions of homes across the country have been sold for decades with a transfer fee in place.

The counterbalancing positive effects resulting from the use of capital recovery fees are significant. The fee:

- Spreads infrastructure costs, thus making homeownership more affordable.
- Provides a source of financing that can reduce project indebtedness, eliminate negative equity, restart failed projects and create jobs.
- Provides important funding for non-profits, including funding for clean air, clean water, the environment, open space and more.
- Is paid by a seller who willingly assumed the obligation.

9. … "TO THE EXTENT THAT PRIVATE TRANSFER FEE COVENANTS BENEFIT UNRELATED THIRD PARTIES, ONE CANNOT CLAIM THAT A SERVICE OR VALUE IS RENDERED TO THE RELEVANT PROPERTY OWNER OR COMMUNITY"…

This is a fallacious argument that the special interest groups have pushed to protect their profits. They are not only wrong, but this argument seems misplaced in the context of guidance designed to address systemic risks to GSEs and the housing market.

Nonetheless, the "concern" does not apply to capital recovery fees. ***One cannot credibly argue that a developer is an "unrelated third party" who renders no value to the property owner or the community.*** Developers create master planned communities, investing millions of dollars in the process. Homeowners who live in the community clearly benefit from improvements that will last for generations to come – roads, wastewater lines, curbs, etc. It cannot be argued that these homeowners do not benefit: they pay less up front for the home and they use the infrastructure regardless of the ultimate disposition of the fee.[16]

The argument that investors who provide the funding are somehow "*unrelated third parties who provide no benefit* is analogous to saying that paying toll road proceeds over to investors who bought the bonds that paid for the roads provides no benefit to the drivers. ***The fact that a developer creates the funding stream, and then sells the future income to investors, does nothing to alter the fact that the fee was assessed as a way to pay for the improvements that the homeowners will be using and benefitting from for decades to come.***

In addition to the upfront savings afforded the homeowner,[17] a capital recovery fee allocates 5% of the gross income to non-profits operating within the community from which the fee was derived. A strong charitable presence builds strong property values, thus clearly rendering yet another service to the *"relevant property owner or community."* This private income stream will generate billions of dollars for non-profits, clean air, clean water, open space and other uses within the community from which the fee originates.

Certain HOAs and non-profits have asked for an exemption for their fees, while expressing a willingness to carve everyone else out. In reality, the harm suggested by the FHFA's Proposed Guidance either exists or it doesn't exist. ***If the harm exists, it is not mitigated one iota based on the ultimate use of the fee. If the harm does not exist, then the Proposed Guidance is unnecessary.***

While their desire to stay out of the line of fire is understandable, there is little rational basis for banning fees payable for infrastructure while preserving fees to charities and HOAs. Such an approach would not only ignore the tremendous benefits developers provide in creating and

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[16] Even if the homeowner did not pay less up front, there seems little public policy justification for dictating how much a developer can charge for the benefits provided by developing a master planned community. If the total charges are not commensurate with the value provided, buyers will take their business elsewhere.

[17] From an economic perspective, if the homeowner receives a discount upfront, and if the amount the homeowner pays for the home is satisfactory to the homeowner, then it is difficult to identify a legitimate public policy issue that isn't resolved through disclosure such as that contemplated in H.R. 6332 (111th Congress).

developing common interest communities, but it would acknowledge that a property right can exist while simultaneously restricting ownership of this valuable property right to certain special classes.

10. … "EVEN WHERE SUCH FEES ARE PAYABLE TO A HOMEOWNERS ASSOCIATION, UNLIKE MORE TYPICAL ANNUAL ASSESSMENTS THEY ARE LIKELY TO BE UNRELATED TO THE VALUE RENDERED, AND AT TIMES MAY APPLY EVEN IF THE PROPERTY'S VALUE HAS SIGNIFICANTLY DIMINISHED SINCE THE TIME THE COVENANT WAS IMPOSED"…

It is true that a seller exiting a subdivision, and paying a transfer fee, will not benefit from that fee. However, this does not mean that the seller did not benefit. The economic reality is that the "value rendered" was acceptable to the seller at the time of purchase. In other words, the homeowner paid a purchase price that reflected the obligation to pay the future fee. *This holds true regardless of whether the fee is paid to an HOA or as a capital recovery fee.* It seems inappropriate for FHFA to try and renegotiate the economics of a transaction that was acceptable to the parties. Should FHFA set the sales price as well, dictate the amount of the HOA dues, or mandate any of the other economic realities of the transaction?

As to the fee being payable even if the value of the property drops significantly, clearly the fee drops pro-rata. The owner paid less up front, and thus received the benefit of a discounted price based upon the future fee obligation, which presumably contemplated a higher sales price. It can hardly be argued that having to pay a lower fee than bargained for, after having received a discount up front, is harmful to the buyer.

III.
CONCLUSION

Opponents of PTFs have offered conclusory and unsupported statements and passed them off as fact. The reality is that despite millions of home transactions with PTFs, there is not a scintilla of evidence that a private transfer fee causes any of the harm contemplated in the Proposed Guidance. In fact, the existence of millions of problem-free transactions over the past few decades is the strongest of all possible evidence that the guidance is unwarranted, and indeed could disrupt markets if adopted.

Some supporters of PTFs, clearly concerned that they will lose their own funding source, have urged FHFA to limit the guidance to a prohibition on fees imposed *"solely to benefit unrelated third parties, and where there is no corresponding benefit to the land."* Although understandable, there is no rational basis for carving out particular transfer fees through the Proposed Guidance, for two reasons:

- First, *a transfer fee either impairs real property transactions and threatens GSEs, or it doesn't.* The purpose of the fee is irrelevant.
- Second, despite the complete absence of any evidence that such a fee is actually being imposed, if such were to occur the courts would remove the encumbrance.

There also is the practical issue of how to decide whether or not a transfer fee benefits the land. This is a fact-based inquiry that would need to be undertaken on a property-specific basis.

PTFs are not the Wall Street enrichment fees that the special interest groups, looking to preserve their own profits, would have you believe. PTFs have been around for decades and, assertions to the contrary notwithstanding:

- the fee is fully disclosed;
- it is voluntarily paid;
- the market reflects the existence of the encumbrance;
- the appraisal reflects the encumbrance;[18]
- the lender receives a title policy; and
- the fee has been around for decades – with millions of homes, bought, sold and financed, *with no resulting harm.*

[18] The appraisal is based upon (1) encumbrances of record and (2) comparable sales – which means the other homes in the neighborhood, *which have the same fee.*

The only beneficiaries of the Proposed Guidance are the title industry (and their request is that policy-makers protect them from claims arising from their own negligence) and Realtors (concerned that sellers will ask the realtor to absorb the fee). Analysis of the comments reveals that 96.21% of respondents oppose the Proposed Guidance, and, if the Realtor "form letter" is treated as a single response, **opposition to the Proposed Guidance rises to 98.89%**.[19]

The reality is that PTFs represent a fair and equitable way to fund homeowner associations, generate long-term sustainable income for non-profits, spread infrastructure costs, and provide capital to pay down development loans, restart stalled projects and put Americans to work.

In summary, we urge the FHFA to not adopt the Proposed Guidance.

Sincerely,

J.B. Alderman, CEO

[19] Calculated through comment 1,925.

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Exhibit A

RESIDENTIAL PROPERTY TAX CAPITALIZATION: DISCOUNT RATE EVIDENCE FROM CALIFORNIA

A. QUANG DO* & C. F. SIRMANS**

Abstract *- In spite of the voluminous literature on property tax capitalization, this paper is the first to derive a discount rate empirically. The paper uses an unique data set from a Mello–Roos Community Facility District (CFD), where taxes are expected to be totally capitalized into property values. Using a standard hedonic pricing model, the results show that buyers of homes within the CFD capitalize taxes into the prices of purchased properties at a discount rate of around four percent.*

INTRODUCTION

The empirical literature on the effects of property taxes on housing values finds that taxes are capitalized to some degree. The degree of capitalization, to a large extent, depends upon the rate used to discount the tax payments' stream. Past studies have assumed the discount rate to be between three percent and six percent. These studies include Oates (1969), Pollakowski (1973), Church (1974), King (1977), Reinhard (1981), Dusansky, Ingber, and Karatjas (1981), Richardson and Thalheimer (1981), Ihlanfelt and Jackson (1982), Lea (1982), Goodman (1983), and Yinger *et al.* (1988). Because the discount rate plays an important role in determining the degree of capitalization, it is imperative that we estimate the correct discount rate.

As pointed out by Yinger *et al.* (1988), previous studies estimating the housing pricing equation used either actual tax payments or a tax dummy variable. Hence, a discount rate was assumed in order to derive the degree of capitalization. The major problem with the literature has been an inability to accurately estimate the degree of tax capitalization, because these previous studies had to assume a value for the discount rate and test for the degree of capitalization based on that assumption. This problem is largely due to the fact that the discount rate and the degree of capitalization cannot be separately estimated. It is unavoidable, because the degree of capitalization represents the amount of discount relative to the present value of

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the property tax, all else equal. Therefore, either the discount rate or the degree of capitalization must be known or assumed.

Unlike previous studies, this paper uses a unique data set in which buyers are expected to fully capitalize taxes into housing values. This allows us to empirically determine the discount rate used by individuals to capitalize taxes into housing prices. Because there exists a discrepancy in the discount rate assumed in the previous literature, this paper takes an important step in resolving the issue. The housing transaction data are collected from a Mello–Roos Community Facilities District (CFD)[1] in San Diego county, where new homeowners are levied special taxes for the expansion of schools to accommodate the expected increase in the numbers of students that will move into the new development. Because the schools benefit homeowners in the CFD as well as in the surrounding area, the special taxes should thus be 100 percent capitalized into the purchased prices allowing us to empirically derive the implied discount rate. The 100 percent capitalization is further plausible by the fact that the amount of housing in the CFD is fixed by virtue of the buildable land and the approval of the plat map by the city planning commission. In addition, the CFD area from which part of the sample was drawn is considerably small and only consists of new subdivisions within a developed area. In addition, we are reasonably confident that average home buyer characteristics are constant from one area to the next.

The remainder of this paper is organized as follows. The next section presents the various aspects of the Mello–Roos Community Facilities Act as it relates to financing public infrastructure. Section 3 of the paper presents a theory on Mello–Roos tax capitalization. Section 4 provides a brief discussion of the data, the empirical methodology, and results of the paper. Finally, section 5 concludes the paper.

MELLO–ROOS INFRASTRUCTURE FINANCING

California's well-known Proposition 13 severely restricted local governments' ability to raise taxes for financing public infrastructure. This restriction, together with a significant reduction in federal grants, has hampered many California cities' efforts to construct much needed infrastructure to support their expanding populations. The passage of the Mello–Roos Community Facility Act of 1982, which took effect in the beginning of 1983, was aimed at partially solving the infrastructure financing problems in newly developed areas. The Act allows the establishment of a Community Facility District, where public service facilities can be financed by tax-exempt Mello–Roos bonds. In addition to school districts, other community projects allowed under the Act include the following: police protection including criminal justice facilities (*i.e.*, detention facilities, prisons, and juvenile halls); fire stations including ambulance and paramedic facilities; recreation facilities such as parks and community recreational centers; construction and maintenance of public roads and traffic light systems; public libraries; storm sewers and water mains; and other governmental facilities.

Since the Act became law in 1983, more than $3.2 billion in bonds have been issued to finance various public projects in the state of California (California Debt Advisory Board, 1991). The most common beneficiaries of Mello–Roos have been various school districts, primarily the K–12 facilities. As of March 1992, 302 Mello–Roos bonds have been issued, with the majority of these special tax bonds for projects located in Riverside, San Bernadino, and Orange coun-

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ties. Of these $3.2 billion, nearly half are issued by cities (46 percent), 23 percent are by counties, and 20 percent are by school districts. The remaining are from public finance authorities (three percent), special districts (five percent), and redevelopment agencies (three percent). As of December 1991, a total of 226 Mello–Roos community facilities districts have been formed and more are expected.

The additional public facilities are needed to accommodate population growth due to the influx of new homeowners. These new residences are required to pay for these facilities by way of Mello–Roos special assessments.[2] To meet the principal and interest payments on the bond, homeowners in the CFDs are levied an additional amount on their total monthly mortgage payments. The amount of extra taxes is fixed according to the resolution establishing the CFD and for the duration of the bond term of maturity, which, according to the Act, must be 40 years or less.

MELLO–ROOS TAX CAPITALIZATION AND DISCOUNT RATES

The degree of property tax capitalization depends on the amount of taxes, the benefits from the taxes, and the discount rate. Previous studies have been unable to accurately estimate the degree of tax capitalization, because these studies must assume a value for the discount rate and test for the degree of capitalization based on that assumption. This problem cannot be avoided, largely due to the fact that the discount rate and the degree of capitalization cannot be separately estimated. Therefore, either the discount rate or the degree of capitalization must be known or assumed. In our sample, the impact of Mello–Roos payments on house prices is unique in that the marginal benefits are the same for both those paying and not paying the taxes. The special assessments are for the expansion and construction of a middle school and a high school to be utilized by all residences in the newly developed as well as the surrounding established area. Because there are no differences in the marginal benefits of paying the special taxes, it is expected that these taxes are fully capitalized into selling prices. A 100 percent capitalization implies that the selling price is reduced by the same amount as the present value of the taxes over the term of payments. For example, suppose house A and house B are both located within the same jurisdiction and are assumed to be similar in every aspect except the monthly payments for the Mello–Roos taxes. Further, assume that the additional tax on house A is $1 per month for 25 years and is discounted at three percent, all else equal; house A would sell for $210.88 less than house B. The amount of capitalization depends upon the discount rate. The before-tax present value of the Mello–Roos payment stream is

$$\text{MELLOROOS} = \{[(1 + i)^n - 1]/[i * (1 + i)^n]\}[\text{payment}]$$

where

payment = the Mello–Roos payment;
i = the discount rate; and
n = the duration of Mello–Roos payments.

The present value of the taxes is inversely related to the discount rate. A higher rate will result in a smaller discount in selling price. For an increase in discount rate from three percent to five percent, a $1 monthly Mello–Roos tax payment for 25 years will reduce the discount by $39.82. Therefore, the choice of discount rate is important, because the estimated degree of tax capitalization depends on the rate. Overstat-

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ing the discount rate will lead to an overestimate of the degree of capitalization and *vice versa.*

DATA DESCRIPTION

The data were collected between March 1991 and April 1992 from a district located in the southwestern part of California's San Diego County, where property values remained relatively constant over the period. Only single-family detached residential dwellings are included in the data set. The total sample is comprised of 645 sold homes, with 289 coming from the area surrounding the CFD and 356 lying within the CFD. The out-of-CFD data are from the San Diego Board of Realtors' Multiple Listing Service (MLS). The remaining in-Mello–Roos CFD observations are obtained from the developer. The data contain the following information about each sold property: physical characteristics of the houses such as total square feet of the home, the age of the property, whether or not the property has a fireplace and/or garage, and lot size. Because we are reasonably certain that the areas from which the observations are collected are uniform with respect to incomes, population densities, and major public facilities, neighborhood variables are not included here.

The amounts of Mello–Roos assessments, which are based on the square footage of a house, are also collected for all sold homes within the CFD area. In addition, selling price, date of sale, and the property address are also collected for each home in the sample.

Descriptive statistics pertaining to the total sample are presented in Table 1. The mean sale price for the sample is $233,420. The mean age of the properties is 10.2 years with a standard deviation of 14.2 years, and the mean square footage is 1,751 with a standard deviation of 360. Table 1 also provides descriptive statistics for other variables including fireplace, garage, type of structure, lot size, and whether or not the property has a view. The means and standard deviations of housing attributes for single-family dwelling units surrounding the Community Facility District are also provided in Table 2.

MODEL SPECIFICATION

A traditional hedonic pricing model is used to estimate the effect of Mello–Roos taxes on single family homes:

1

$$SP_i = f(X_{ij}, \text{MELLOROOS}_i)$$

where SP_i is the price of the ith house. X_{ij} is the standard set of explanatory variables including:

SF = total square footage of the house;
AGE = age of the structure in years;
LSZ = lot size in square feet;
FP = a dummy variable indicating whether the property has a fireplace (FP equal to one if the house has a fireplace and zero otherwise);
ST = number of stories;
GAR = garage size (one-car, two-car, *etc.*);
DMKT = number of days that property remained on the market prior to being sold;
VU_i = whether the property has a view; and

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TABLE 1
MEANS AND STANDARD DEVIATIONS OF HOUSING ATTRIBUTES FOR SINGLE-FAMILY DWELLING UNITS IN THE SAMPLE[a]

Variable Abbreviation	Variable Definition	Mean Value	Standard Deviation
SP	Selling price ($)	233420.09	32857.68
ST	Number of stories	1.58	0.49
AGE	Age (years)	10.48	14.20
DMKT	Market time (days)	75.98	81.51
SF	Total square footage (ft^2)	1750.96	359.87
GA	Number of garages	1.92	0.41
FP	Number of fireplaces	0.88	0.40
VU	View	0.38	0.48
LSZ	Lot size (ft^2)	6829.84	2978.54

[a]Total sample size is 645 homes.

TABLE 2
MEANS AND STANDARD DEVIATIONS OF HOUSING ATTRIBUTES FOR SINGLE-FAMILY DWELLING UNITS SURROUNDING THE CFD[a]

Variable Abbreviation	Variable Definition	Mean Value	Standard Deviation
SP	Selling price ($)	224381.85	34126.91
ST	Number of stories	1.24	0.43
AGE	Age (years)	23.39	12.15
DMKT	Market time (days)	83.49	69.99
SF	Total square footage (ft^2)	1590.99	362.78
GA	Garage size	1.82	0.59
FP	Number of fireplaces	0.81	0.53
VU	View	0.28	0.45
LSZ	Lot size (ft^2)	7965.03	3734.38

[a]Sample size of 289 homes.

$MELLOROOS_i$ = a dummy variable equal to one if property i is located in the special taxing district and zero otherwise.

These standard explanatory housing-price variables are consistent with previous studies on housing price determinants, such as that by Sirmans and Sirmans (1991). The expected influences of these explanatory variables on selling price are positive, with the exception of AGE and the DMKT that the house remained on the market. The Mello–Roos dummy variable ($MELLOROOS_i$) captures the effect of infrastructure financing. Because the taxes are expected to be totally capitalized into the purchase prices, this allows us to derive the implied discount rate.

EMPIRICAL RESULTS

Table 3 shows the results from estimating equation 1. All of the signs of the estimated coefficients are correct and significant with the exception of FP and ST. The variable capturing Mello–Roos taxes, namely, MELLOROOS, is of direct interest in this paper. The estimated coefficient of this variable is significantly negative. The empirical results are used to calculate the discount rate that buyers use to capitalize the Mello–Roos taxes into housing values.

In determining the appropriate func-

TABLE 3
REGRESSION RESULTS OF MELLO–ROOS TAX EFFECTS ON SELLING PRICE IN SINGLE-FAMILY HOMES[c]

Variables	Coefficient	t-Statistics
Constant	99659.223	18.83[a]
Age	−464.797	−5.46[a]
Market time	−26.167	−3.16[b]
Story	696.428	0.35
Square footage	69.402	25.14[a]
Garage	4614.255	2.66[b]
Fireplace	−804.211	−0.43
View	9179.812	6.71[a]
Lot size	2.029	7.87[a]
MELLOROOS	−13502.091	−5.61[a]
Adjusted R^2	0.75	
F-statistic	218.47	
Sample size	645	

[a]Significance at the .01 level.
[b]Significance at the .05 level.
[c]Dependent variable: selling price (SP_i).

tional form for equation 1, we conducted a Box–Cox test on both the linear model and the log-linear model. The results indicate that we cannot reject the reported linear functional form as a correct one. The resulting chi-squared test statistic (*i.e.*, likelihood ratios) for the linear functional form is 0.56. This indicates that the linear functional form is not rejected at the five percent significance level. The results are largely consistent with the functional form used in housing pricing literature. However, the Box–Cox test rejected the log-linear model. Hence, the results of the log-linear model are not included in this paper.[3]

Table 3 presents the results of the linear form estimation. Adjusted R-square values indicate that variations in the independent variables explain 75 percent of the differences in selling prices of the sample properties. Furthermore, the F-statistics also indicate that the estimated equations are well behaved and significant at 0.01 levels.

The coefficient −$13,502 is statistically significant at the one percent level ($t = -5.61$) indicating that homes in the special district sell for significantly less than surrounding houses. For the CFD examined in this paper, the mean Mello–Roos tax payment is $704.56 for the first year with a required two percent annual increase for 25 years. Using these facts, the actual payment stream of Mello–Roos taxes can then be calculated. Given the resulted capitalized amount of $13,502 and the actual payments, the before-tax discount rate is simply the internal rate of return which equals 4.03 percent[4]. Because the discount rate depends on the real interest rate and inflationary expectations, and the Mello–Roos tax is expected to be paid over a 25 year period, it is appropriate to point out that the average 30 year T-bond rate existing during the sample period was around eight percent.

Conclusions

The current tax capitalization literature finds that taxes are capitalized into property values to some degree. The degree of capitalization depends upon the rate used to discount the tax payment stream, which, in previous literature, has been assumed to be between three percent to six percent. This paper is the first to empirically determine the discount rate using a unique data set in which buyers are expected to totally capitalize taxes into housing values. The housing

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transaction data are collected from a Mello–Roos CFD in San Diego county, where new homeowners are levied special (additional) taxes. In turn, these taxes are used for the expansion of a middle school and a high school to accommodate the expected increase in the number of students residing in the newly created CFD. Because the expansion of these two schools benefits homeowners in the CFD as well as in the surrounding area, the special taxes are expected to be 100 percent capitalized into the purchase prices. This allows us to empirically derive the implied discount rate. The results show that payments used to finance the CFD have a negative impact on housing values. Buyers of homes within these Mello–Roos community districts appear to use an average discount rate of about four percent to capitalize these taxes into the prices of purchased properties. During the period of March 1991 and April 1992, when the discount rate was derived, the average 30-year T-bond rate was around eight percent. This study takes an important step toward determining the actual discount rate used by individuals to capitalize taxes into housing prices.

ENDNOTES

We thank Gregory Gutierez and Jolene Tsurue Yamanuha for data collection. We are particularly grateful to David Ely and to the three anonymous referees for valuable insights and suggestions. The research support of the California Real Estate and Land Use Institute at San Diego State University is also greatly appreciated.

1 Mello–Roos is the colloquial name for the Mello–Roos Community Facilities Act. The Act was co-authored by Senator Henry J. Mello of Monterey and then-Los Angeles Assemblyman Michael Roos and was enacted by the California legislature in its 1982 session. The Act enables local government agencies to assess special taxes in newly established CFDs, thus providing an alternative means to finance infrastructure in developing areas and areas undergoing rehabilitation. The law authorizes a form of municipal bond financing allowing developers and local governments to sell tax-exempt revenue bonds to build roads, fire stations, schools, sewage plants, and other such public facilities.

2 Establishment of these CFDs is voted and approved by two-thirds of the landowners living within the proposed special districts. A provision in the Act allows one vote for each acre owned if the number of landowners is less than 12 (Connell, 1992; Raineri, 1987; and Fulton, 1991).

3 Although we do not report the results, it is, noted that the log-linear form resulted in a similar discount rate and is statistically significant at the one percent level. Thus, the discount rate is robust with respect to the functional form of the model.

4 There are three alternative ways to test the Mello–Roos tax effect: include a dummy variable for homes in and out of the tax district, discount the stream of payments at some discount rate and include this "present value" variable, and include the first year's tax payment. We chose to use the dummy-variable approach, because the second method requires an assumption about the discount rate, which we want to calculate from the results. Including the first year's payment as a variable makes the interpretation of the estimated coefficient difficult. Also, the third method is complicated by the fact that the tax payments are growing at a rate of two percent per year.

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Exhibit B

The Economics of Private Transfer Fee Covenants

By Dr. Tom McPeak, Ph.D.

As a Land Economist, I have always been fascinated by the allocation of land resources. One emerging area in this field is the use of private transfer fees (also called reconveyance fees) to allocate increasing development costs and fund infrastructure.

A private transfer fee is created when a real estate developer files a legal instrument (typically called a private transfer fee covenant) in the real property records. Unlike a government transfer tax (which simply adds to the cost of home ownership), private transfer fees are paid by parties who willingly assume the obligation, and who negotiate their price and terms accordingly.

From a typical developer's perspective, a private transfer fee represents an alternative to putting 100% of development costs onto the shoulders of first-time buyers. In addition, if the future income stream could be sold off, much needed liquidity would be brought to the project. In return, the developer can lower the sales price, pay down bank loans, and even restart failed projects (creating jobs).

From the buyer's perspective, the willingness to pay a fee in the future in return for a lower initial price will result in lower acquisition costs, reduced carrying costs, and reallocation of the savings (i.e. does the buyer pay down high interest credit card debt with the savings). In addition to the quantifiable savings, a buyer may consider intangible issues such as the portion of the transfer fee that goes to non-profits, and whether the Buyer can qualify for the lower priced home (with a transfer fee) but would be unable to qualify for the higher priced home (without a transfer fee). All of these variables go into the decision-making process and both buyer and seller make an economic decision based upon their respective perceptions of the market value of the trade. If these perceptions match, a bargain is struck and the transaction is *Pareto-efficient.*

The assumption is that the seller will lower the sales price. This assumption is well-founded because economic theory suggests that buyers armed with the facts will not pay the same for a home with a transfer fee as they will pay for the same home without a transfer fee. It would be illogical to argue otherwise. (Having said that, the illogical nature of this argument does not appear to have prevented organizations from making the argument.) As is often the case, economics lies at the heart of the decision. Realtors apparently see transfer fees as a threat to commissions and the title industry see transfer fees as a potential liability for which they will be held responsible. Each entity is responding in an economically predictable way by protecting its own interest.

The community benefits because a portion of the income from a private transfer fee covenant is virtually always allocated to a non-profit operating within the community. This provides long-term sustainable revenue for clean air, clean water, youth programs and other benefits to the community while reducing reliance on government funding. This builds stronger property values, which in turn protects and enhances the fee stream. (See charitable endowment program of Freehold Capital Partners at http://www.freeholdcapitalpartners.com)

Since the amount of the future fee stream is dependent on long-term sustainable value, it is in the developer's economic interest to take a longer-term view of the project. Simply stated, in lieu of accepting a lump sum and having no further economic interest in the project, developers imposing a private transfer fee covenant have a vested interest in ensuring that the project value remains as high as possible for as long as possible, and in fact investors looking to buy the future income stream would be expected to scrutinize the long-term merits of the project. This mutuality of interest benefits home buyers, taxing authorities, and the community in general.

When the parties to a transaction come away satisfied with the bargain they have made, it is referred to as a *Pareto-efficient* transaction. An economic system that is *Pareto-efficient* is an important metric for evaluating economic efficiencies and public policies. Private transfer fee covenants balance the needs of the buyer, the developer, and the community in a *Pareto-efficient* way by more efficiently restructuring the economics of the real estate transaction.

About Dr. Tom McPeak, Ph.D.: In 2000 I began teaching at one of the nation's top business schools, the Terry College of Business at the University of Georgia. I received my Ph.D. in Resource Development (Land Economics) from Michigan State University. I have studied private transfer fee covenants for several years.

A Balance Sheet Solution to the Economic Crisis

By Dr. Tom McPeak, Ph.D.

Real estate projects across the country have stalled, resulting in widespread unemployment.[1] It is not uncommon for a developer to owe $40 million on a project that was formerly appraised for $70 million, but which now appraises for $40 million. At these valuations the project is no longer economically viable, and both the lender and the borrower are in distress. As a result of the stalled project, both *direct* and *related* employment evaporate, property prices decline, government receipts drop, and taxpayer losses mount as banks fail.

Giving the borrower a $40 million loan, or an extension of an existing loan (a process cynically referred to within the industry as "extend, amend and pretend")[2], will not solve the problem because the project is simply not economically viable in the current environment. In addition, while a decline in value from $70m to $40m (continuing the example above) represents a 43% decline, *property values would have to increase 175% in order to restore the valuation to the prior level*, an unlikely event under even the most aggressive scenario, particularly given the current lack of price discovery.

The solution is to restore the balance sheet and restore economic viability. **Simply stated, project debt must be reduced to an economically viable level.** In the current market, this can be accomplished one of two ways: Increase the value of the project, or reduce the debt. As discussed, in the current environment the former is unrealistic. However, private transfer fee covenants successfully accomplish the latter, and it does so using the developer's own asset.

A private transfer fee covenant (also called a reconveyance fee covenant) assesses a "transfer fee" each time title to the real property transfers. Private transfer fees have been around for decades, and have been used to fund environmental initiatives, green space, and HOA dues. Recently developers have been utilizing transfer fees as a way to apportion development costs over time, instead of allocating development costs onto the first time buyers.

A developer imposing a transfer fee covenant has created a future income stream, in return for which the future payors enjoy the amenities and infrastructure installed by the developer as

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1 *Signs of Recovery Don't Extend to Jobs.* Wall Street Journal Online, Oct. 22, 2009. http://online.wsj.com/article/SB125613391710198857.html
2 See generally, Salmon, Felix. *Should Banks Extend and Pretend?* Reuters, Aug. 21st, 2009.

well as a lower sales price today.[3]

This future income stream has real value. If a developer carves out this future income stream and sells it for its present value, the proceeds can be applied to the real estate project, reducing the loan indebtedness[4] and restoring economic viability. **This is a balance sheet solution to a balance sheet problem.**

When economic viability is restored, the inverse of the destructive cycle of declining property values and diminishing jobs occurs. When a stalled project recovers economic viability, the impact on employment is immediate and sustainable. Likewise, when development loans are brought within conforming ratios, the project owner's balance sheet is restored, the lender's balance sheet is restored, lender confidence is increased, and lending activity resumes, all of which has a positive ripple effect within the economy.

A Manhattan-based company, Freehold Capital Partners (www.FreeholdCapitalPartners.com), has assembled a portfolio of private transfer fee covenants covering hundreds of billions of dollars worth of real estate projects across the United States. The sale of this portfolio of long-term asset-backed income streams would inject liquidity into the most troubled areas of the economy, create jobs, reduce lender exposure to commercial real estate debt, and restore the balance sheet of distressed real estate projects. More importantly, it would accomplish this using the developer's own asset, without creating additional debt, and it would benefit homebuyers in the form of a lower purchase price and associated transactional savings.

Private transfer fee covenants represent a fair and equitable way to apportion infrastructure costs. In addition, these instruments offer the opportunity for injecting liquidity into communities and lenders across the United States.

About Dr. Tom McPeak, Ph.D.: In 2000 I began teaching at one of the nation's top business schools, the Terry College of Business at the University of Georgia. I received my Ph.D. in "Resource Development" (Land Economics) from Michigan State University. I have studied private transfer fee covenants for several years.

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3 Criticism of private transfer fees as "just another fee that does not benefit the homeowner" ignores the economic reality that the market adjusts to all encumbrances, and it further ignores the savings that accrue to the homebuyer when that adjustment occurs.

4 Since an existing lender's lien position is superior to the private transfer fee covenant, the lender must be at the closing table.

Exhibit C

NOTICE OF CONFIDENTIALITY RIGHTS. IF YOU ARE A NATURAL PERSON, YOU MAY REMOVE OR STRIKE ANY OF THE FOLLOWING INFORMATION FROM THIS INSTRUMENT BEFORE IT IS FILED IN THE PUBLIC RECORDS: YOUR SOCIAL SECURITY NUMBER OR YOUR DRIVER'S LICENSE NUMBER.

NOTICE: THIS DOCUMENT MAY REQUIRE PAYMENT OF A FEE IN CONNECTION WITH A TRANSFER OF TITLE

Closing Information: Seller shall pay one percent (1%) of the Gross Sales Price (see ¶5 & ¶6). To obtain an Estoppel Letter (see ¶8) or contact Trustee for assistance with closing (see ¶10 & ¶14).

DECLARATION OF COVENANT

This Declaration of Covenant was designed to comply with Tex. Prop. Code §5.017.

STATE OF TEXAS

KNOW ALL MEN BY THESE PRESENTS

COUNTY OF COLLIN

This Declaration of Covenant (this "Declaration") is made by **SAMPLE, LTD., A TEXAS LIMITED PARTNERSHIP**, whose mailing address is 100 Anywhere Street, Anywhere Texas 10001 (hereinafter "Declarant") for the purposes herein set forth as follows:

WITNESSETH:

WHEREAS, Declarant is the owner of that certain real property ("Property") located in Collin County, State of Texas, described as follows:

The real property described in Exhibit "A" attached hereto and incorporated herein for all purposes.

NOW THEREFORE, Declarant hereby declares that the Property shall be transferred, held, sold and conveyed subject to this Declaration and all matters set forth in this Declaration, which shall be deemed covenants running with the land and the title to the Property and shall be binding upon all parties having or acquiring any right, title or interest in the Property or any part thereof:

1. DEFINITIONS. In addition to words and phrases defined elsewhere in this Declaration, the following words when used in this Declaration shall have the following meanings:
   a. "Beneficial Interest" shall refer to an undivided ownership interest in the rights, interest, ownership and privileges in and to this Declaration, apportioned pursuant to section 17 and thereafter in accordance with section 18 or as otherwise provided herein.
   b. "Beneficiary" shall refer to the owner of a Beneficial Interest.
   c. "Closing Agent" or "Settlement Agent" shall have its customary meaning within the real estate industry, and generally shall refer to the party responsible for conducting and/or facilitating a closing of a conveyance of all or any portion of the Property; usually either a title company, attorney or escrow agent who prepares paperwork and

Exhibit D

Property Address: ________________________________ Date: ____________

TITLE, OWNERSHIP AND LEGAL CLAIMS: **ARE YOU (SELLER) AWARE OF...**

22. Any other person or entity on title other than Seller(s) signing this form . . . . ☐ Yes ☐ No
23. Leases, options or claims affecting or relating to title or use of the Property . . . . ☐ Yes ☐ No
24. Past, present, pending or threatened lawsuits, mediations, arbitrations, tax liens, mechanics' liens, notice of default, bankruptcy or other court filings, or government hearings affecting or relating to the Property, Homeowner Association or neighborhood . . . . ☐ Yes ☐ No
25. Any private transfer fees, triggered by a sale of the Property, in favor of private parties, charitable organizations, interest based groups or any other person or entity . . . . ☐ Yes ☐ No

Explanation: ________________________________

NEIGHBORHOOD: **ARE YOU (SELLER) AWARE OF...**

26. Neighborhood noise, nuisance or other problems from sources such as, but not limited to, the following: neighbors, traffic, parking congestion, airplanes, trains, light rail, subway, trucks, freeways, buses, schools, parks, refuse storage or landfill processing, agricultural operations, business, odor, recreational facilities, restaurants, entertainment complexes or facilities, parades, sporting events, fairs, neighborhood parties, litter, construction, air conditioning equipment, air compressors, generators, pool equipment or appliances, or wildlife . . . . ☐ Yes ☐ No

Explanation: ________________________________

GOVERNMENTAL: **ARE YOU (SELLER) AWARE OF...**

27. Ongoing or contemplated eminent domain, condemnation, annexation or change in zoning or general plan that apply to or could affect the Property . . . . ☐ Yes ☐ No
28. Existence or pendency of any rent control, occupancy restrictions or retrofit requirements that apply to or could affect the Property . . . . ☐ Yes ☐ No
29. Existing or contemplated building or use moratoria that apply to or could affect the Property . . . . ☐ Yes ☐ No
30. Current or proposed bonds, assessments, or fees that do not appear on the Property tax bill that apply to or could affect the Property . . . . ☐ Yes ☐ No
31. Proposed construction, reconfiguration, or closure of nearby government facilities or amenities such as schools, parks, roadways and traffic signals . . . . ☐ Yes ☐ No
32. Existing or proposed Government requirements affecting the Property **(i)** that tall grass, brush or other vegetation be cleared; **(ii)** that restrict tree (or other landscaping) planting, removal or cutting or **(iii)** that flammable materials be removed . . . . ☐ Yes ☐ No
33. Any protected habitat for plants, trees, animals or insects that apply to or could affect the Property . . . . ☐ Yes ☐ No
34. Whether the Property is historically designated or falls within an existing or proposed Historic District . . . . ☐ Yes ☐ No

Explanation: ________________________________

STATUTORILY REQUIRED OR RELATED: **ARE YOU (SELLER) AWARE OF...**

35. Within the last 3 years, the death of an occupant of the Property upon the Property . . . . ☐ Yes ☐ No
36. An Order from a government health official identifying the Property as being contaminated by methamphetamine. (If yes, attach a copy of the Order.) . . . . ☐ Yes ☐ No
37. Whether the Property is located in or adjacent to an "industrial use" zone. (In general, a zone or district allowing manufacturing, commercial or airport uses.) . . . . ☐ Yes ☐ No
38. Whether the Property is affected by a nuisance created by an "industrial use" zone . . . . ☐ Yes ☐ No
39. Whether the Property is located within 1 mile of a former federal or state ordnance location. (In general, an area once used for military training purposes that may contain potentially explosive munitions.) . . . . ☐ Yes ☐ No

Explanation: ________________________________

Buyer's Initials (________) (________)
Seller's Initials (________) (________)
Reviewed by ____________ Date ____________

Exhibit E

Property Address: ______________________________ Date: ______________

G. **VERIFICATION OF DOWN PAYMENT AND CLOSING COSTS:** Buyer (or Buyer's lender or loan broker pursuant to 3H(1)) shall, within 7 (or ☐ __________) Days After Acceptance, Deliver to Seller written verification of Buyer's down payment and closing costs. (If checked, ☐ verification attached.)

H. **LOAN TERMS:**

(1) **LOAN APPLICATIONS:** Within 7 (or ☐ __________) Days After Acceptance, Buyer shall Deliver to Seller a letter from lender or loan broker stating that, based on a review of Buyer's written application and credit report, Buyer is prequalified or preapproved for any NEW loan specified in 3C above. (If checked, ☐ letter attached.)

(2) **LOAN CONTINGENCY:** Buyer shall act diligently and in good faith to obtain the designated loan(s). Obtaining the loan(s) specified above **is a contingency** of this Agreement unless otherwise agreed in writing. Buyer's contractual obligations to obtain and provide deposit, balance of down payment and closing costs are **not contingencies** of this Agreement.

(3) **LOAN CONTINGENCY REMOVAL:**

(i) Within 17 (or ☐ __________) Days After Acceptance, Buyer shall, as specified in paragraph 14, in writing remove the loan contingency or cancel this Agreement;

OR (ii) (if checked) ☐ the loan contingency shall remain in effect until the designated loans are funded.

(4) ☐ **NO LOAN CONTINGENCY** (If checked): Obtaining any loan specified above is NOT a contingency of this Agreement. If Buyer does not obtain the loan and as a result Buyer does not purchase the Property, Seller may be entitled to Buyer's deposit or other legal remedies.

I. **APPRAISAL CONTINGENCY AND REMOVAL:** This Agreement is (or, if checked, ☐ is NOT) contingent upon a written appraisal of the Property by a licensed or certified appraiser at no less than the specified purchase price. If there is a loan contingency, Buyer's removal of the loan contingency shall be deemed removal of this appraisal contingency (or, ☐ if checked, Buyer shall, as specified in paragraph 14B(3), in writing remove the appraisal contingency or cancel this Agreement within 17 (or __________) Days After Acceptance). If there is no loan contingency, Buyer shall, as specified in paragraph 14B(3), in writing remove the appraisal contingency or cancel this Agreement within 17 (or __________) Days After Acceptance.

J. ☐ **ALL CASH OFFER** (If checked): Buyer shall, within 7 (or ☐ __________) Days After Acceptance, Deliver to Seller written verification of sufficient funds to close this transaction. (If checked, ☐ verification attached.)

K. **BUYER STATED FINANCING:** Seller has relied on Buyer's representation of the type of financing specified (including but not limited to, as applicable, amount of down payment, contingent or non contingent loan, or all cash). If Buyer seeks alternate financing, (i) Seller has no obligation to cooperate with Buyer's efforts to obtain such financing, and (ii) Buyer shall also pursue the financing method specified in this Agreement. Buyer's failure to secure alternate financing does not excuse Buyer from the obligation to purchase the Property and close escrow as specified in this Agreement.

4. **ALLOCATION OF COSTS** (If checked): Unless otherwise specified in writing, this paragraph only determines who is to pay for the inspection, test or service ("Report") mentioned; it **does not determine who is to pay for any work recommended or identified in the Report.**

A. **INSPECTIONS AND REPORTS:**

(1) ☐ Buyer ☐ Seller shall pay for an inspection and report for wood destroying pests and organisms ("Wood Pest Report") prepared by ______________________________ a registered structural pest control company.

(2) ☐ Buyer ☐ Seller shall pay to have septic or private sewage disposal systems pumped and inspected __________.

(3) ☐ Buyer ☐ Seller shall pay to have domestic wells tested for water potability and productivity __________.

(4) ☐ Buyer ☐ Seller shall pay for a natural hazard zone disclosure report prepared by __________.

(5) ☐ Buyer ☐ Seller shall pay for the following inspection or report __________.

(6) ☐ Buyer ☐ Seller shall pay for the following inspection or report __________.

B. **GOVERNMENT REQUIREMENTS AND RETROFIT:**

(1) ☐ Buyer ☐ Seller shall pay for smoke detector installation and/or water heater bracing, if required by Law. Prior to Close Of Escrow, Seller shall provide Buyer written statement(s) of compliance in accordance with state and local Law, unless exempt.

(2) ☐ Buyer ☐ Seller shall pay the cost of compliance with any other minimum mandatory government retrofit standards, inspections and reports if required as a condition of closing escrow under any Law. __________.

C. **ESCROW AND TITLE:**

(1) ☐ Buyer ☐ Seller shall pay escrow fee __________.
Escrow Holder shall be __________.

(2) ☐ Buyer ☐ Seller shall pay for owner's title insurance policy specified in paragraph 12E __________.
Owner's title policy to be issued by __________.
(Buyer shall pay for any title insurance policy insuring Buyer's **lender**, unless otherwise agreed in writing.)

D. **OTHER COSTS:**

(1) ☐ Buyer ☐ Seller shall pay County transfer tax or fee __________.

(2) ☐ Buyer ☐ Seller shall pay City transfer tax or fee __________.

(3) ☐ Buyer ☒ Seller shall pay Homeowner's Association ("HOA") transfer fee __________.

(4) ☐ Buyer ☒ Seller shall pay HOA document preparation fees __________.

(5) ☒ Buyer ☐ Seller shall pay for any private transfer fee __________.

(6) ☐ Buyer ☐ Seller shall pay the cost, not to exceed $ __________, of a one-year home warranty plan, issued by __________, with the following optional coverages:
☒ Air Conditioner ☐ Pool/Spa ☐ Code and Permit upgrade ☐ Other: __________.
Buyer is informed that home warranty plans have many optional coverages in addition to those listed above. Buyer is advised to investigate these coverages to determine those that may be suitable for Buyer.

(7) ☐ Buyer ☒ Seller shall pay for __________.

(8) ☐ Buyer ☐ Seller shall pay for __________.

Buyer's Initials (________) (________) Seller's Initials (________) (________)

Reviewed by ________ Date ________

EQUAL HOUSING OPPORTUNITY

Exhibit F

Common Myths About Private Transfer Fees

Synopsis: Private transfer fees (also called home resale fees, capital recovery fees and private transfer fee covenants) have been in the news a lot lately. In fact, a significant disinformation campaign has been waged by special interest groups seeking to preserve their outdated, anti-consumer fee structures at the expense of this important funding tool. Recently, Rep. Maxine Waters introduced HR 6260, which seeks to ban transfer fees. In contrast, Rep. Phil Gingrey introduced HR 6332, which provides for a national disclosure standard patterned after the successful California Statute (§1098.5), giving consumers a choice about how to finance infrastructure costs and, in the process, resolving negative equity, restarting failed projects, and creating jobs.

Myth: Transfer fees increase the cost of homeownership.
Truth: It lowers the cost of homeownership. The homeowner pays less up front, in return for agreeing to pay the fee at the time of a future sale. A homeowner that pays $245,000 instead of $250,000, and agrees to pay 1% at the time of a future sale, will likely save more in interest payments than the total transfer fee. Other savings include lower closing costs, including a reduced real estate commission, a reduced title insurance commission, etc., and the opportunity costs (does the homeowner use the savings to pay down credit card debt?)

The use of [transfer fee] financing serves to reduce the up-front costs of such projects and goals, which results in a more affordable home price to an initial buyer. Cal. Staff Analysis to AB 1574

Myth: Transfer fees are new.
Truth: Transfer fees have been around for decades. Homes across the country have transfer fees dedicated to a variety of uses, from HOA maintenance to charity to infrastructure reimbursement. Data suggests that between ten and twelve million homes nationwide currently have a transfer fee of some kind on them, with virtually no reported problems.

Myth: Transfer fees are hidden.
Truth: Homeowner associations put transfer fees in the exact same document as HOA dues. Developers go one step further, and use a stand-alone instrument (referred to as a private transfer fee covenant), with a bold header, easily identifiable by the title company. After all, if the fee is hidden, who will pay it?

Myth. Homeowners are stuck with the fee.
Truth: Every homeowner that pays the fee voluntarily agreed to do so (by buying the house), and negotiated their price accordingly. For those who prefer not to pay the fee, and who instead prefer to pay 100% of infrastructure costs up front, and to finance those costs, and to then pass these expenses along to the next buyer, numerous choices abound.

Myth: Only the initial buyer saves money. Future buyers will pay more.
Truth: Each buyer pays less up front, enjoys the transaction savings and interest savings, and can sell for less. When the fee expires, the home value will rise, because the encumbrance is removed.

Myth: Transfer fees run in perpetuity.
Truth: While it is true that certain transfer fees payable to non-profits have been imposed in perpetuity, capital recovery fees (imposed by developers to spread development costs), run for 99 years.

While 99 years is a long time, it is important to remember that the fee is only paid upon each sale (not annually). The typical home will sell 8-11 times in 99 years, generating 8-11% in fees. Compare this to other fees used to reimburse the developer (such as Mello-Roos fees) which charge an annual assessment for periods of 20-30 years, leading to a significant debt burden on the homeowner. Transfer fees are clearly a better choice.

Myth: Transfer fees steal equity.
Truth: This myth is particularly flawed. If John paid $245,000 for home with a transfer fee and sold it for $370,000 John has made the same as Bill, who paid $250,000 for a home without a transfer fee and sold it for $375,000.00.

While it is true John will pay a transfer fee at closing, John has saved money every month he has owned the home through a reduction in his monthly carrying costs. More importantly, John made a consumer choice to buy a home with the fee and pay less up front. Bill elected not to pay the fee, and made his purchase decision accordingly.

Myth: There is no guarantee the seller will lower the price.
Truth: This argument is particularly disingenuous (and flawed) because it pre-supposes that a seller can sell for whatever price they desire. Studies confirm that homes with a fee will sell for less than the same home without the fee. This makes sense. A buyer decides what the home is worth, based on all factors related to the home, and simply will not pay the same for a home with a transfer fee as they will pay for the same home without the fee. Would you?

Myth: Transfer fees can reduce sales activity because buyers won't have the cash to close.
Truth: The fee is almost always paid by the seller, which means the fee is a reduction at closing. This avoids a buyer showing up with insufficient cash to close. Transfer fees payable by the buyer are typically very small.

Myth: If there is a transfer fee, the Buyer gets less than full ownership.
Truth: First, a transfer fee is an encumbrance – it is not an ownership interest in the home. Second, few if any homes are sold free of encumbrances. There is an obligation to comply with subdivision restrictions, pay dues and assessments, grant easements to utility companies, etc., all of which are encumbrances against the land. In addition, most residential homes do not convey the mineral rights, oil rights, and, when it comes to commercial property, the air rights.

Myth: Opponents of transfer fees are looking out for homeowners.
Truth: Opposition comes almost exclusively from Realtors and the Title Industry. Although good people undoubtedly work as real estate agents and title insurance agents and the function they play in the marketplace is important, since the fees collected by members of the National Association of Realtors and the American Land Title Association are all based on the sale price of the home, those two organizations are more than a little conflicted and their criticism of these transfer fees lacks credibility. NAR members fear that a seller faced with a transfer fee will ask the real estate agent to take the fee out of their generally 5-6% commission (the NAR calls this a "commission-ectomy"). The title industry fears they will miss the fee, and have to pay a claim. These two special interest groups spend tens of millions each year to influence policy-makers.

Myth: When paid to the developer, the fee has no connection to the land.
Truth: Try owning a home with no streets, no water or sewer lines, no master planning, etc., all of which clearly benefit the land. A fee imposed to reimburse these costs is clearly connected to the land. Also, a portion of every fee is allocated back into the community, which further benefits the community and everyone who lives there.

Myth: A transfer fee does not benefit the community.
Truth: Transfer fees provide important funding not only for infrastructure, but also for community associations and non-profit uses. Developers who create the funding and sell it off to investors (which is why capital recovery fees have been referred to as "development bonds") can bring out-of-state dollars into the community, which restores project viability and avoids bank failures. This creates (or saves) jobs, and has a positive ripple effect.

Myth: A transfer fee interferes with marketability (restrains alienation).
Truth: Transfer fees have been around for decades, and there is no evidence that even hints at an impairment to marketability. The market adjusts the sales price to reflect the fee, just as it does for HOA dues, taxes, easements, etc.

Myth: A transfer fee can cloud title.
Truth: A transfer fee is an encumbrance of record, handled just like any other encumbrance. Tens of millions of home sales with transfer fees have occurred over the past few decades, problem-free.

Myth: FHA has said that transfer fees violate FHA's prohibition on covenants that restrict sales proceeds.
Truth: A letter to that effect was issued, but we believe it is in error. If a transfer fee renders a home FHA-ineligible then over ten million homes with transfer fees would be FHA ineligible.

Myth: Only homeowners pay transfer fees.
Truth: Transfer fees are routinely imposed on commercial projects as a way to pay for capital improvements.

Myth: It's a way for greedy developers to make money.
Truth: A capital recovery fee reimburses the developer for millions of dollars in capital expenditures for improvements such as streets, roads, etc. In return, the developer lowers the sales price, and can even sell off the fee to help finance the project. *Reimbursement of an expense is not a windfall.* In addition, every capital recovery fee covenant allocates a portion of the income stream back into the community, providing long-term sustainable funding for clean air, clean water, the environment, etc.

Myth: This is some sort of exotic Wall Street deal like the ones that caused all the trouble.
Truth: The use of capital recovery fees, and the ability of developers to sell their rights to those fees, is a plain vanilla transaction that is fully documented and transparent. Furthermore, by pulling some of the cost of infrastructure out of the initial and future purchase price for the home, it helps to ensure that homeowners do not over-extend themselves. It is such over-extension, and real estate agents and mortgage brokers constantly pushing the homebuyer to get into loans that sounded too good to be true, in order to allow them to buy more house than they can afford, that helped push the economy to the brink. The future of home buying will be about value and about staying within one's means. Utilizing capital recovery fees helps to achieve such goals.

As to the investment potential of the future income stream, it is a low-risk collateralized obligation that does not depend upon anything other than for the property to sell. Over eight billion in bonds have been sold backed by fees assessed to reimburse developers for infrastructure costs, with zero defaults.

When you cut through the myths, the reality is that transfer fees are used for a variety of purposes that benefit the public, including:

- To lower the cost of homeownership by spreading infrastructure costs, thereby reducing the initial purchase price. Consumers then save on transaction costs and monthly interest costs.
- To reduce or eliminate negative equity by selling off a "development bond" as a way to finance development projects. **This reduces bank stress, restarts failed projects and creates jobs.**
- By homeowner associations as a way to reduce quarterly or annual dues.
- To non-profit uses such as libraries, medical clinics, affordable housing, the arts environmental initiatives and development concessions, such as open space, parks, etc. Over $60 billion in transfer fee income to non-profits is estimated to occur within the next 99 years.

Summary: In the end, it is about giving consumers a choice about the things we want (such as streets, utilities, clean air, clean water, open space, parks, etc.) and how we elect to pay for them.

October 15, 2010

<u>VIA E-MAIL</u>: <u>regcomments@fhfa.gov</u>

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
Fourth Floor, 1700 G Street NW
Washington, DC 20552

Re: Guidance on Private Transfer Fee Covenants (No. 2010-N-11)

Dear Mr. Pollard:

We are the leadership of the Hospitality, Timesharing and Common Interests Development Group and the Commercial Real Estate Transactions Group of the Real Property, Trust and Estate Law Section of the American Bar Association ("ABA"), and we each practice primarily in the area of real estate law. We are dedicated to serving all lawyers and the public in this field of practice and produce educational materials and seminars in our respective leadership capacities within the ABA. We are submitting comments regarding the Federal Housing Finance Agency's "Guidance on Private Transfer Fee Covenants" (No. 2010-N-11) (the "<u>Guidance</u>") published in the Federal Register on August 16, 2010, since the Guidance impacts several practice areas of interest to our respective Groups. However, the views expressed in this letter are solely the personal opinions of the undersigned, and do not necessarily represent the official position of either Group, any client or employer of the undersigned, any entity with which the undersigned are otherwise associated, or the American Bar Association or any of its subdivisions.

The Guidance states that "Fannie Mae and Freddie Mac should not purchase or invest in any mortgages encumbered by private transfer fee covenants or securities backed by such mortgages" and that the Federal Home Loan Banks "should not purchase or invest in such mortgages or securities or hold them as collateral for advances." 75 Fed. Reg. 49932-34. While the Guidance recognizes the difference between "private transfer fee covenants which purport to render a benefit to the affected property and those which accrue value only to unrelated third parties," it nonetheless applies its prohibition to any and all private transfer fees. 75 Fed. Reg. 49932-33. While we agree that the prohibition included in the Guidance should apply to private transfer fees used to fund purely private continuous streams of income for select (unrelated) market participants, either directly or through securitized investment vehicles which do not benefit the affected property or the common interest community where the affected property is located (hereafter, "<u>Non-Beneficial Transfer Fees</u>"), we, however, believe that private transfer fees that directly benefit and enhance the community by, without limitation, funding maintenance and improvements of common areas and infrastructure, preserving environmentally sensitive or historically significant sites, funding affordable housing initiatives, or promoting the arts and other cultural programs or supporting nonprofit organizations or initiatives that benefit the community (hereafter "<u>Beneficial Transfer Fees</u>"), should be permitted for purposes of Fannie Mae or Freddie Mac financing approval.

The application of the Guidance to Beneficial Transfer Fees will have consequences which we do not believe the Federal Housing Finance Agency ("<u>FHFA</u>") has properly considered. The Guidance will effectively render the title to thousands of homes throughout the country subject to these Beneficial Transfer Fees unmarketable and uninsurable, since purchasers will not be able to obtain financing necessary to close on these homes. Further, if this Guidance is approved by FHFA in its current form, homeowners whose title is subject to these Beneficial Transfer Fees will not be able to refinance existing mortgages or seek other financing secured by their homes.

We acknowledge the argument that these communities could simply amend their declarations or covenants to remove these Beneficial Transfer Fees, but in many communities this is impossible, practically speaking, because their declaration (or applicable state law) requires a unanimous or supermajority vote of the common interest community members to effect the amendment to eliminate the Beneficial Transfer Fee. Additionally, many declarations require that a third-party beneficiary of these fees must consent to the proposed amendment and such consent cannot be obtained unless significant consideration is paid to such third party. There may also be requirements for obtaining existing lender consent to such an amendment, which is exceedingly difficult to do in this day of special servicers and lenders not being receptive or responsive to changes. Finally, it is often exceedingly difficult for communities to amend their covenants, regardless of the requisite percentage for approval, because of the time frames involved for meetings as well as general apathy towards amendments regardless of their nature (much in the way of voter apathy for municipal elections, where routinely a minority percentage of registered voters actually participate in the election process), thereby practically rendering the documents as unamendable.

The resulting inability of (a) lot owners subject to these Beneficial Transfer Fees to refinance their homes and (b) prospective buyers to obtain financing for the purchase of a home will destabilize otherwise viable and marketable communities and will further deflate real estate property values. This result seems contrary to the public mission of Fannie Mae and Freddie Mac which is, in part, to "provide stability in the secondary market for residential mortgages." The Guidance states that the "expanded use of private transfer fee covenants poses serious risks to the stability and liquidity of the housing finance markets" (75 Fed. Reg. 49932-33), but the most serious risk to the stability and liquidity of these markets will be the lack of financing that will inevitably result upon the implementation of the Guidance as written.

While we recognize that not all Beneficial Transfer Fee covenants "touch and concern" the land (i.e., the funds generated by such covenant provide a benefit to the affected land or other related lands), there are many local and state level considerations that must be taken into account before determining whether to ban any or all Beneficial Transfer Fees within a given state. This question has been traditionally left to the states to decide and should remain within each state's purview. If a particular state legislature elects to prohibit community associations from imposing any form of Beneficial Transfer Fees, such decision should be within the state's prerogative and purview. It is our understanding that as of the date of this letter, fifteen (15) states have banned the enforcement of private transfer fees, but a significant number of these states have created exceptions for transfer fee covenants imposing a fee payable to an owners' association to fund the provision of services or the maintenance of facilities that benefit the common interest community (basically, the exceptions permit Beneficial Transfer Fees).

For the reasons outlined above, we recommend that FHFA revise the current Guidance to apply only to Non-Beneficial Transfer Fees. Implementation of the Guidance as written will be contrary to the mission of FHFA, Fannie Mae and Freddie Mac and will have a devastating effect on the stability and liquidity of the housing finance markets. Thousands of homes in communities throughout the country will be effectively rendered unmarketable and uninsurable due to lack of financing. Further, the implementation of this Guidance could forestall the already slow recovery of the housing market in this country since the impact of this Guidance will be felt by multiple residential real estate market participants (e.g., homeowner associations, individual owners, sellers, purchasers, builders, developers, real estate brokers and lenders).

We thank you for the opportunity to present our views. Please do not hesitate to contact any of us if you have any questions about any of the matters discussed in this letter or would like any further information.

Sincerely,

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(Original Signature of Member)

111TH CONGRESS
2D SESSION

H. R. ______

To amend the Real Estate Settlement Procedures Act of 1974 to prohibit certain transfer fees and covenants in connection with the sale of real property.

IN THE HOUSE OF REPRESENTATIVES

Ms. WATERS (for herself and Mr. SHERMAN) introduced the following bill; which was referred to the Committee on ______________________________

A BILL

To amend the Real Estate Settlement Procedures Act of 1974 to prohibit certain transfer fees and covenants in connection with the sale of real property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Homeowner Equity Protection Act of 2010".

SEC. 2. PROHIBITION ON TRANSFER FEES AND COVENANTS.

(a) PROHIBITION.—The Real Estate Settlement Procedures Act of 1974 is amended by inserting after section 12 (12 U.S.C. 2610) the following new section:

"SEC. 13. PROHIBITION ON TRANSFER FEES AND COVENANTS.

"(a) TRANSFER FEE COVENANTS AFTER EFFECTIVE DATE.—No person shall demand or accept a transfer fee pursuant to a transfer fee covenant that is recorded in any State if the transfer for which the transfer fee is imposed involves a federally related mortgage loan and such transfer occurs after the effective date under section 3 of the Homeowner Equity Protection Act of 2010. No person shall enforce or seek to enforce any lien purporting to secure the payment of a transfer fee pursuant to a transfer fee covenant recorded in any State in connection with any transfer involving a federally related mortgage loan if such transfer occurs after such effective date.

"(b) COORDINATION WITH STATE LAW.—No provision of State law or regulation that imposes more stringent limitations on transfer fees or transfer fee covenants shall be construed as being inconsistent with this section.

"(c) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) COVERED ASSOCIATION.—The term 'covered association' means a nonprofit, mandatory membership organization comprised of owners of homes, condominiums, cooperatives, manufactured homes, or any interest in real property, created pursuant to a declaration, covenant, or other applicable law.

"(2) STATE.—The term 'State' means the States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any other territory or possession of the United States.

"(3) TRANSFER.—The term 'transfer' means, with respect to real property, the sale, gift, grant, conveyance, assignment, inheritance, or other transfer of an interest in the real property.

"(4) TRANSFER FEE.—The term 'transfer fee' means a fee or charge imposed by a transfer fee covenant, except that such term shall not include any tax, assessment, fee, or charge imposed by a governmental authority pursuant to applicable laws, regulations, or ordinances.

"(5) TRANSFER FEE COVENANT.—

"(A) IN GENERAL.—The term 'transfer fee covenant' means a provision in a document relating to the transfer of specified residential real property located in any State and designed principally for the occupancy of from one to four families, whether recorded or not and however denominated, that—

"(i) purports to run with the land or bind current owners of, or successors in title to such real property; and

"(ii) obligates a transferee or transferor of all or part of the property to pay a fee or charge to a third person upon transfer of an interest in all or part of the property, or in consideration for permitting any such transfer.

"(B) EXCLUSIONS.—Such term shall not include—

"(i) any provision of a purchase contract, option, mortgage, security agreement, real property listing agreement, or other agreement that obligates one party to the agreement to pay the other, as full or partial consideration for the agreement or for a waiver of rights under the agreement, an amount determined by the agreement, if such amount—

"(I) is payable on a one-time basis only upon the next transfer of an interest in the specified real property and, once paid, shall not bind successors in title to the property;

"(II) constitutes a loan assumption or similar fee charged by a lender holding a lien on the property; or

"(III) constitutes a fee or commission paid to a licensed real estate broker for brokerage services rendered in connection with the transfer of the property for which the fee or commission is paid;

"(ii) any provision in a deed, memorandum, or other document recorded for the purpose of providing record notice of an agreement described in clause (i);

"(iii) any provision of a document requiring payment of a fee, charge, assessment, dues, fine, contribution, or other amount payable to a covered association pursuant to a declaration or covenant or law applicable to such covered association, including fees or charges payable for estoppel letters or certificates issued by the covered association or its authorized agent; or

"(iv) any provision of a document requiring payment of a fee or charge to an organization described in paragraph (3) or (4) of section 501(c) of the Internal Revenue Code of 1986, to be used exclusively to support cultural, educational, charitable, recreational, environmental, conservation, or other similar activities benefitting the real property affected by the provision or the community of which the property is a part.

"(d) REMEDIES.—

"(1) PENALTIES.—Any person or persons who violate this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.

"(2) JOINT AND SEVERAL LIABILITY; TREBLE DAMAGES.—Any person or persons who violate the prohibitions or limitations of this section shall be jointly and severally liable to the person or persons charged for the transfer fee involved in the violation in an amount equal to three times the amount of any such transfer fee involved.

"(3) ACTIONS BY SECRETARY AND STATE OFFICIALS.—The Secretary, the Attorney General of any State, or the insurance commissioner of any State may bring an action to enjoin violations of this section.

"(4) COURT COSTS AND ATTORNEYS FEES.—In any private action brought pursuant to this subsection, the court may award to the prevailing party the court costs of the action together with reasonable attorneys fees.".

(b) JURISDICTION OF COURTS.—Section 16 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2614) is amended by striking "or 9" each place such term appears and inserting ", 9, or 13".

SEC. 3. EFFECTIVE DATE.

The amendment made by section 2 shall take effect upon the expiration of the 90-day period beginning on the date of the enactment of this Act.

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111TH CONGRESS
2D SESSION

H. R. 6332

To enhance disclosure of private transfer fees in real estate transactions.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 29, 2010

Mr. GINGREY of Georgia introduced the following bill; which was referred to the Committee on Financial Services

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A BILL

To enhance disclosure of private transfer fees in real estate transactions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Homebuyer Enhanced Fee Disclosure Act of 2010".

SEC. 2. CONGRESSIONAL FINDINGS.

The Congress finds that transfer fee covenants represent an important economic tool with the potential to make homeownership more affordable and benefit local communities by positively restructuring the economics of real estate transactions by apportioning certain infrastructure and overhead costs over time.

SEC. 3. RECORDATION OF TRANSFER FEES.

(a) RECORDATION REQUIREMENT.—A transfer fee covenant recorded on or after the date of the enactment of this Act shall be void and unenforceable unless, at the time the document containing the transfer fee covenant is submitted for recording, a notice described in subsection (b) is contemporaneously submitted for recording in the office of the applicable county recorder.

(b) NOTICE REQUIREMENTS.—Notice required under subsection (a) shall—

(1) be titled, in boldface type, "Payment of Transfer Fee Required";

(2) include statements of—

(A) the name or names of the owner or owners of the affected property;

(B) the legal description of the affected property;

(C) the dollar amount or, if applicable, the percentage of sales price constituting the transfer fee required to be paid under the transfer fee covenant;

(D) the method and manner of payment of the transfer fee;

(E) in the case of affected property that is residential property, actual dollar-cost examples of the amount of the transfer fee for property priced at $250,000, $500,000, and $750,000; and

(F) if applicable, the date on which or circumstances under which the transfer fee covenant expires.

(c) PRESUMPTION OF VALIDITY.—A transfer fee covenant that imposes a transfer fee of not more than 1 percent of the gross sales price for the affected property, effective for a term of not more than 99 years, and which complies with the requirements under subsections (a) and (b) shall be presumed to be valid.

(d) LIMITATION.—No property shall be subject to more than one transfer fee covenant.

SEC. 4. DEFINITIONS.

For purposes of this section, the following definitions shall apply:

(1) AFFECTED PROPERTY.—The term "affected property" means, with respect to a transfer fee covenant, the real property that is encumbered by the transfer fee covenant.

(2) APPLICABLE COUNTY RECORDER.—The term "applicable county recorder" means, with re-

spect to affected property, the recorder of the county in which the affected property is located.

(3) TRANSFER FEE.—The term "transfer fee" means a fee, charge or payment imposed by a covenant, restriction, or similar document filed in the applicable county recorder's office and required to be paid in connection with or as a result of a transfer of title to affected property, but does not include fees, charges, payments, or other obligations that—

(A) are imposed by a court judgment, order, or decree;

(B) are imposed by or payable to the Federal Government or a State or local government;

(C) arise out of a mechanic's lien;

(D) arise from an option to purchase, or for waiver of the right to purchase, the affected property;

(E) are payable to a homeowners association, condominium association, or similar entity for the benefit of the owners; and

(F) are imposed by or payable to lenders or purchasers of loans.

(4) TRANSFER FEE COVENANT.—The term "transfer fee covenant" means a covenant, restric-

tion, or agreement filed with the office of the applicable county recorder that—

(A) affects real property; and

(B) obligates a future buyer or seller of the affected real property, other than a person who is a party to the covenant, restriction, or agreement, to pay a transfer fee.

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