



2012

Private Transfer Fees: Developer Exploitation or Legitimate Financing Vehicle

Burke T. Ward

Jamie P. Hopkins

Follow this and additional works at: <https://digitalcommons.law.villanova.edu/vlr>



Part of the [Civil Procedure Commons](#), and the [Contracts Commons](#)

Recommended Citation

Burke T. Ward & Jamie P. Hopkins, *Private Transfer Fees: Developer Exploitation or Legitimate Financing Vehicle*, 56 Vill. L. Rev. 901 (2012).

Available at: <https://digitalcommons.law.villanova.edu/vlr/vol56/iss5/5>

This Symposia is brought to you for free and open access by Villanova University Charles Widger School of Law Digital Repository. It has been accepted for inclusion in Villanova Law Review by an authorized editor of Villanova University Charles Widger School of Law Digital Repository.

2012]

PRIVATE TRANSFER FEES: DEVELOPER EXPLOITATION OR
LEGITIMATE FINANCING VEHICLE?

BURKE T. WARD & JAMIE P. HOPKINS*

I. INTRODUCTION

IMAGINE that Mr. Smith, his wife, and two children purchase a new home for \$250,000; however, a year later, Mr. Smith is forced to relocate his family across the country because his company is moving its operations. Mr. Smith is forced to sell his new home quickly and when he attempts to sell his property he is informed at the settlement proceedings that he must pay a private transfer fee of one percent before any transfer of the property is finalized. Now, within one year of buying his home, Mr. Smith owes a third party \$2,500 (one percent of his home's value) upon the transfer. Mr. Smith pays the \$2,500 because he must relocate immediately and has no other options. He wonders why he never knew about the fee and why his realtor never explained to him its existence when he originally purchased the property. Mr. Smith is not alone in this predicament as more than 11 million homes are encumbered by private transfer fee covenants.

A private transfer fee (PTF) is typically created when a developer or homeowner decides to attach a covenant to the title of the home.¹ This covenant, the PTF covenant, attaches the PTF to the real property. These covenants require payment of a fee—typically stated as one percent of the property's sale price—upon each resale or transfer of the property and often survive for a period of ninety-nine years.² The recipients or owners of the PTF (PTF beneficiaries) can be almost anyone, including property developers, PTF developers, home owner associations (HOA), private investors, state governments, and non-profit charities. Usually, the PTF payment is designated to a trust in which a trustee retains a portion of the fee for expenses and pays the remainder of the fee to the PTF beneficiaries.

* Burke T. Ward is a Professor of Business Law and Taxation at the Villanova University School of Business and a member of the faculty at the Graduate Tax Program. Jamie P. Hopkins, Esq. is a Pennsylvania-licensed attorney. He graduated *cum laude* from the Villanova University School of Law with a J.D. in 2010, from Villanova University School of Business with an M.B.A. in 2011, and from Davidson College with a B.A. in 2007.

1. See FREEHOLD CAPITAL PARTNERS, FILE NO. 5434, DECLARATION OF COVENANT (on file with authors) (discussing how PTFs are created by property developers via restrictive covenants to titles of new homes in property developments).

2. See Margaret Jackson, *Transfer Fees of Home Sales Under Fire*, DENVER POST, July, 30, 2010, available at http://www.denverpost.com/business/ci_15636063 (stating PTF covenants can last anywhere from one to ninety-nine years, but are typically designed to bind subsequent owners of the property for ninety-nine years).

Are PTFs a form of financial exploitation by developers or a reasonable financing vehicle?²

Proponents of PTF covenants argue that PTFs are financial instruments designed to spread out housing development costs and lower the costs of homeownership.³ Their opponents argue that PTFs lower housing values, surprise homebuyers with extra fees, create unreasonable restraints on alienation, and impair the marketability of title.⁴ PTFs can surprise potential homebuyers even when the PTF covenant is recorded and clearly identified; buyers often do not know that the property they are buying has a PTF covenant until the closing.

The use of PTF covenants has been regulated in thirty-six states and federal legislation has been proposed that would all but eliminate the creation of new PTF covenants.⁵ While PTFs have been banned in some states, in a majority they remain legal and enforceable in some form. Under existing laws, PTFs are unlikely to be an illegal restraint on alienation and should be protected by freedom of contract because the fees are agreed upon by both parties before the sale of the property. However, legislation is needed to ensure that potential homebuyers are aware of PTF covenants well before the closing. Requiring timely disclosure of PTFs would protect potential buyers and could protect PTFs from an outright ban through federal legislation. An outright ban on PTFs would have negative financial consequences for HOAs, charities, and others that commonly use and rely on transfer fees to fund their operations. Ultimately, legislation is needed in order to ensure that potential homebuyers are notified before the closing that PTFs are attached to the real property.

The recent increase of state and federal legislation aimed at regulating the widespread use of PTF covenants has put the continued use and legality of PTFs in doubt.⁶ This Article examines the potential benefits and pitfalls of regulating PTF covenants by reviewing both enacted and proposed PTF legislation. Part II of this Article discusses the history and

3. See Aldo Svaldi, *Home Fee Ban Awaits Signing*, DENVER POST, May 10, 2011, at B5 (summarizing that proponents of PTFs have set forth argument that PTFs assist property developers to recover their upfront infrastructure costs by spreading these costs across multiple owners and therefore lowering the initial sales price of the property).

4. See N.C. GEN. STAT. § 39A-1 (2011) (stating purpose of act).

5. See Samantha Elliot Krepps, *Private Transfer Fees Now Prohibited in PA*, PA. ASS'N OF REALTORS (June 24, 2011), <http://www.parealtor.org/news/2011/06/24/2011/private-transfer-fees-now-prohibited-in-pa/> (noting Pennsylvania is thirty-sixth state to regulate use of PTFs).

6. See *id.* (declaring thirty-six states have passed legislation restricting use of PTF covenants and that multiple other states are considering similar regulations); Press Release, Fed. Hous. Fin. Agency, *FHFA Proposes Rule on Private Transfer Fee Covenants* (Feb. 1, 2011), available at http://www.fhfa.gov/webfiles/19671/Private_transfer_fee_020111.pdf (declaring FHFA proposed rule “would limit Fannie Mae, Freddie Mac, and the Federal Home Loan Banks from dealing in mortgages on properties encumbered by certain types of private transfer fee covenants and in certain related securities”).

development of PTFs and their close relation to government-mandated real estate transfer taxes. Further, Part III describes the legality of PTF covenants under the current legal constructs of “touch and concern,” restraint on alienability, and freedom of contract. Part IV delves into the potential drawbacks and benefits accompanying the use of PTF covenants in order to spread out development costs. Additionally, Part V explores the wide array of enacted and proposed legislation designed to regulate the use and transparency of PTF covenants. Finally, Part VI sets forth a proposed model statute combining new elements with those of currently enacted statutes in an attempt to develop a less restrictive ban on PTF covenants while at the same time providing the consumer protections sought after in currently enacted statutes.

II. BACKGROUND

A. *History and Development of Private Transfer Fees*

Governments and HOAs have been using transfer taxes and fees for decades in order to lower costs to homeowners and help maintain healthy communities.⁷ HOAs collect transfer fees in order to pay for community maintenance and community services.⁸ Municipalities have utilized transfer taxes and fees, often referred to as impact fees, in order to raise revenues and recoup expenses for private development projects.⁹ Municipalities have imposed impact fees through the police power in order to generate revenue to provide adequate public facilities such as water and sewer lines.¹⁰ Government transfer fees and HOA dues spread out development and maintenance costs to multiple homeowners just as PTFs are able to spread out community development costs to multiple property owners. Transfer fees lower the cost of property ownership by requiring multiple subsequent owners of real property to pay a fee each time the property is transferred, thereby spreading out development, public ser-

7. See *State Real Estate Transfer Taxes*, FTA BULLETIN (Fed’n of Tax Adm’rs, Washington, D.C.), Feb. 16, 2006, at 3-5, available at <http://www.taxadmin.org/fta/rate/B-0306.pdf> (listing thirty-five states and D.C., all of which impose real estate transfer fees that range from .001 to 2.2% of transferred property’s value).

8. See Jason Story, Recent Development, *Transfer Fee Covenants and Homeowner’s Associations*, ILL. BUS. L.J. (Dec. 8, 2010), <http://www.law.uiuc.edu/bljournal/post/2010/12/08/Transfer-Fee-Covenants-and-Homeowners-Associations.aspx> (describing how HOAs use PTFs to fund community operations and that these fees are not used to create profit for HOAs but are used in order to keep HOA dues lower as dues are only paid when property is transferred and selling homeowner receives lump sum of cash for property).

9. See Robbie Whelan, *Home-Resale Fees Under Attack*, WALL ST. J., July 31, 2010, at A3 (stating that municipalities have imposed transfer taxes on private property for decades in order to raise revenues and recoup public development costs).

10. See *FAQ, IMPACT FEES.COM*, <http://www.impactfees.com/faq/general.php#> (last visited Aug. 10, 2011) (asserting that impact fees are enforced through police power and not taxing powers because they are required to provide and develop adequate public facilities).

vice, and community maintenance costs. The alternative is to have the original buyer pay one hundred percent of the costs upfront.

While PTFs have existed for many years in the form of government transfer taxes and HOA fees, the use of PTF covenants to create a payment stream back to property developers or private investors is a relatively new financial tool.¹¹ PTFs frequently have been attached to new development properties built in the past decade, especially in Texas and California.¹² The American Land Title Association has estimated that nearly 11 million homes in the United States are encumbered by PTFs.¹³ From 2001 to 2006, Lennar Corporation, a California-based homebuilder, structured PTFs into over 13,000 homes.¹⁴ Freehold Capital Partners (Freehold), a New York-based PTF development firm, stated that since 2007 it has \$600 billion in real estate subject to PTFs.¹⁵ Freehold operates by leasing PTF agreements to developers in exchange for a percentage of the PTF.¹⁶ The \$600 billion in real estate subject to Freehold's PTFs could potentially generate the company and its partners over \$60 billion over the next ninety-nine years.¹⁷

With the use of PTF covenants becoming more commonplace in new developments over the last decade, a strong anti-PTF movement has also developed. Opponents have referred to PTFs as "Wall Street home resale fees," and many consider them to be a predatory financial scheme.¹⁸ However, one of the first PTFs recorded was created for the Sierra Club and the Audubon Society, for what those groups considered environmen-

11. See Whelan, *supra* note 9 (stating that transfer taxes have existed for long time but that PTFs are relatively new development in real estate transaction fees).

12. See AM. LAND TITLE ASS'N, PRIVATE TRANSFER FEE COVENANTS AND THEIR CONSEQUENCES FOR REAL PROPERTY 3-4 (2010), available at http://www.clta.org/formembers/LegalCenter/alta_TransferFeeBackground-feb2010.pdf (noting that widespread use of PTFs originated in California and Texas but use of PTF covenants has spread rapidly across country in just few years).

13. See CMTY. ASS'N INST., FOR THE COMMON GOOD: USE OF COMMUNITY TRANSFER FEES BY COMMUNITY ASSOCIATIONS 8 (2010), available at <http://www.caionline.org/govt/news/Political%20HeadsUp%20Public%20Document%20Library/CAI%20Survey%20Report%20Community%20Transfer%20Fees.pdf> (reporting results of PTF survey completed by close to 1,300 communities across country in effort to determine effects of PTF covenants on residential properties).

14. See Whelan, *supra* note 9 (describing practices of Lennar Corp.).

15. See *id.* (detailing amount of real estate that is subject to PTFs created by Freehold).

16. See FREEHOLD CAPITAL PARTNERS, LEARN HOW CAPITAL RECOVERY FEE INSTRUMENTS CAN HELP YOU 11 (n.d.), available at http://www.freeholdcapitalpartners.com/forms/freehold_brochure.pdf (explaining Freehold's PTF licensing agreements).

17. See *id.* at 4 (describing financial holdings). Freehold states that it holds the rights to PTFs on over \$600 billion of real estate. See *id.* If these PTF covenants run for ninety-nine years at the typical one percent payment and the properties are transferred once every seven to ten years, this would create over \$60 billion in PTF payments over the next ninety-nine years.

18. See Whelan, *supra* note 9 ("[Opponents] charge[] that the fees amount to 'Wall Street lining their pockets while stealing equity from homeowners.'").

tal protections during the development of Fiddymment Farm in Roseville, California.¹⁹ This PTF covenant was set up to run for twenty years and any transfer fees paid were earmarked for the preservation of open spaces.²⁰ The original agreement was made between two well-established organizations with the intention of setting up a long-term financing stream to benefit their environmental projects. In addition to the Sierra Club-Audubon Society agreement, PTFs have been used to provide financing for land conservation, sustainable building programs, wildlife habitats, and affordable housing programs in California.²¹ PTF covenants have been successfully used to provide flexible funding options for a wide range of socially beneficial causes.²²

B. *Defining Private Transfer Fees*

PTFs, also known as re-conveyance fees, capital recovery fees, Wall Street home resale fees, private transfer taxes, and residential home transfer fees, are attached to real property through PTF covenants.²³ PTF covenants require payment of a fee to a third party upon each resale or transfer of the real property.²⁴ PTFs are typically stated as a percentage of the property's sales price (usually one percent) and often survive for a

19. See Lita Epstein, *Real Estate Ripoffs: Private Transfer Fees Gouge New-Home Buyers*, AOL REAL ESTATE (Aug. 16, 2010), <http://www.housingwatch.com/2010/08/16/real-estate-ripoffs-private-transfer-fees-gouge-new-home-buyer/> (“[O]ne of the first ones noticed was a PTF covenant created for the Sierra Club and the Audubon Society, for environmental protections during the development of Fiddymment Farm in Roseville, Calif.”); see also CMTY. ASS’N INST., CAI TRANSFER FEE SURVEY RESPONSE 1 (Sept. 22, 2010), available at <http://www.caionline.org/govt/news/Political%20HeadsUp%20Public%20Document%20Library/CAI%20Transfer%20Fee%20Survey%20Response.pdf> (stating that many homeowners insist that PTFs have been attached to their properties for well over decade).

20. See Epstein, *supra* note 19 (detailing duration and purpose of Audubon Society PTF covenant which was to support charitable cause of protecting environment through funding of open spaces).

21. See Letter from David L. Ledford, Senior Vice President, Nat’l Ass’n of Home Builders, to Alfred M. Pollard, Gen. Counsel, Fed. Hous. Fin. Agency (Oct. 15, 2010), available at http://www.nahb.org/fileUpload_details.aspx?contentID=147200&fromGSA=1 (urging FHFA to reconsider and amend proposed PTF regulations because of known, beneficial, multipurpose uses of PTFs).

22. See *id.* (declaring that National Association of Home Builders has received no consumer complaints regarding such beneficial PTF covenants).

23. See Whelan, *supra* note 9 (listing alternative names for PTFs).

24. See Private Transfer Fee Covenants, 75 Fed. Reg. 49,932, 49,933-34 (Aug. 16, 2010), available at http://www.fhfa.gov/webfiles/16484/75_FR_49932_8-16-2010.pdf (summarizing proposed FHFA ban on PTFs and defining PTFs).

period of ninety-nine years.²⁵ However, fees can be in excess of one percent or stated as a specific dollar amount.²⁶

PTF payments can go to a wide variety of third parties, including, but not limited to, property developers or their trustees, HOAs, non-profits, or community housing organizations.²⁷ For example, in a commonly used design by Freehold, the one percent fee is split between Freehold (thirty percent), the developer/PTF-holder (sixty percent), and the trustee (ten percent).²⁸ This means the PTF could be divided between the developer, trustee, collection agent, Freehold, and any other third party designated as a recipient by the PTF covenant.²⁹ In addition, the buyer or seller may be required to pay the fee depending on the wording of the PTF covenant. The seller is usually in a better position to pay since they receive cash upon closing; hence, the seller is typically required to pay the fee.³⁰ PTF covenants are contracts agreed upon by the initial seller and buyer and are therefore extremely flexible and can be customized to serve a variety of purposes.³¹

The South Carolina General Assembly proposed a bill that defined a transfer fee covenant:

a provision in a document, whether recorded or not and however denominated, which purports to run with the land or bind current owners or successors in title to specified real property located in this State, and which obligates a transferee or transferor of all or part of the property to pay a fee or charge to a third

25. See *id.* at 49,933 (describing typical PTF covenant arrangement); see also FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 4 (explaining benefits, structure, and development of PTF covenants under Freehold's patent pending system).

26. See Private Transfer Fee Covenants, 75 Fed. Reg. at 49,932-33 (stating that PTFs are sometimes stated as set price and not as percentage of sales price).

27. See *id.* (describing potential PTF beneficiaries); see also FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 2 (asserting that PTF covenants are win-win situation for developers, investors, and homeowners).

28. See Justin Ailes, Am. Land Title Ass'n, Public Hearing on Private Transfer Fee Covenants (Oct. 17, 2010) (on file with authors) (detailing Freehold's PTF covenant leasing scheme).

29. See FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 7 (noting that real property interest created by PTF can be split between multiple parties and sold to investors as freely assignable property rights).

30. See FREEHOLD CAPITAL PARTNERS, *Common Myths About Private Transfer Fees*, PR NEWSWIRE, Aug. 28, 2010, available at <http://www.prnewswire.com/news-releases/common-myths-about-private-transfer-fees-101722078.html> ("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.").

31. See Tom McPeak, *The Economics of Private Transfer Fee Covenants*, PR NEWS WIRE, Apr. 22, 2010, available at <http://www.prnewswire.com/news-releases/the-economics-of-private-transfer-fee-covenants-91860909.html> (noting that PTF covenants can be extremely flexible because buyers, developers, and investors can negotiate terms, price, and duration of PTF).

person upon transfer of an interest in all or part of the property, or in consideration for permitting this transfer.³²

Furthermore, the South Carolina bill states that any fee payable on a one-time basis that does not attempt to bind successors in title is not a PTF under the proposed legislation.³³ Instead, PTFs must be bound to the property through a covenant and effect the transfer of the property until the covenant runs its originally agreed upon duration.³⁴

C. Construction of Private Transfer Fees

As stated earlier, PTFs are attached to real property through a PTF covenant.³⁵ The PTF covenant can be a standalone document created by a licensing company or it can be part of the original property's title document. A PTF covenant is created when a "Declaration of Covenant" is filed in the public records.³⁶ Once the PTF covenant is recorded in the chain of title, it runs with the real property³⁷ and provides constructive notice to all potential future buyers, title companies, and closing agents that the property is encumbered by the PTF.³⁸ Constructive notice is implied by law when a document is properly recorded and open to the public.³⁹ However, actual notice exists only when the potential buyer has knowledge of the existence of the PTF covenant.⁴⁰ While the recordation provides constructive notice to potential buyers, actual notice and knowledge of the PTF might not occur until closing.

The PTF covenant purports to be a servitude that attaches to the real property's title and burdens future owners from twenty to ninety-nine

32. H.R. 4808, 118th Gen. Assem., Reg. Sess. (S.C. 2010), available at http://www.scstatehouse.gov/sess118_2009-2010/bills/4808.htm.

33. See *id.* (noting that one-time transfer fees do not qualify as PTFs under statute because they fail to burden future owners).

34. See *id.* (discussing duration of PTFs).

35. See McPeak, *supra* note 31 (describing PTFs).

36. See Letter from Micah S. Green, Patton Boggs LLP, on behalf of Freehold Capital Partners, to Alfred M. Pollard, Gen. Counsel, Fed. Hous. Fin. Agency (Oct. 15, 2010), available at http://www.fhfa.gov/webfiles/19294/2521_Patton_Boggs_LLC_on_behalf_of_Freehold_Capital_Partners.pdf (stating PTF covenants are created by filing Declaration of Covenant in public records).

37. See Marjorie Ramseyer Bardwell & James Geoffrey Durham, *Transfer Fee Rights: Is the Lure of Sharing in Future Appreciation a Flawed Concept?*, PROB. & PROP., May/June 2007, at 24, 25-28 (describing how PTF covenants run with property after being attached to chain of title).

38. See Letter from Micah S. Green to Alfred M. Pollard, *supra* note 36, at 9 (stating that public recordation of PTF covenants provides constructive notice to all potential buyers).

39. See *Westland Oil Dev. Corp. v. Gulf Oil Corp.*, 637 S.W.2d 903, 911 (Tex. 1982) (Wallace, J., dissenting) ("Constructive notice is implied by law, from duly recorded instruments or from the possession of land.").

40. See *Sickles v. White*, 17 S.W. 543 (Tex. 1886) (discussing how actual notice is satisfied).

years, or even into perpetuity.⁴¹ PTF covenants are considered restrictive servitudes because their burdens purport to run with the land.⁴² Depending on the jurisdiction, rules will vary when determining if a servitude is valid and if it can run with the land.⁴³

As with any type of encumbrance, PTFs are filed in the public record as a Declaration of Covenant.⁴⁴ The PTF is usually listed in a document entitled “Payment of Transfer Fee Required.”⁴⁵ Opponents have claimed that PTFs are often buried within paperwork and surprise potential homebuyers with extra fees. In response to this criticism, Freehold—currently the largest PTF developer—entered into a written contract with Fidelity National Title Group—who handles sixty percent of the U.S. title insurance market—to voluntarily provide a standalone document disclosing the existence of any Freehold-owned PTF covenants at closing.⁴⁶ This voluntary disclosure mirrors the required PTF disclosure form in California Civil Code sections 1098 to 1099.⁴⁷

Generally, potential buyers will be informed about PTF covenants upon closing.⁴⁸ For example, all Fannie Mae and Freddie Mac loans require title insurance, and therefore a title search.⁴⁹ During a title search, all title search companies acting with due diligence should find PTF covenants the same way in which they would find any other encumbrance or covenant.⁵⁰ PTFs typically appear in the same manner as other common

41. See Bardwell & Durham, *supra* note 37 (asserting that PTFs may burden property for up to ninety-nine years).

42. See Rjon Robbins, *Private Transfer Fee Covenants: An Overview of the Three Applicable Servitude Regimes*, STREET, Mar. 5, 2010, <http://www.thestreet.com/story/10696766/1/private-transfer-fee-covenants-an-overview-of-the-three-applicable-servitude-regimes.html> (detailing why PTF covenant is considered servitude).

43. See *id.* (indicating that different jurisdictions apply different rules to legality of servitudes).

44. See Letter from Micah S. Green to Alfred M. Pollard, *supra* note 36 (stating that PTFs are recorded as Declaration of Covenant).

45. See *id.* (noting that PTF covenants are often entitled “Payment of Transfer Fee Required” in order to give notice to potential buyers, creditors, investors, and other interested third parties).

46. See FREEHOLD CAPITAL PARTNERS, *Freehold Capital Partners Enters Agreement with Fidelity Title to Ensure Private Transfer Fee Disclosure*, PR NEWSWIRE, Oct. 8, 2010, available at <http://www.prnewswire.com/news-releases/freehold-capital-partners-enters-agreement-with-fidelity-title-to-ensure-private-transfer-fee-disclosure-104588454.html> (announcing that Freehold will voluntarily disclose its PTF covenants to all interested parties upon closing in order to increase PTF covenant transparency).

47. See CAL. CIV. CODE §§ 1098-99 (West 2011) (outlining California law regarding PTFs).

48. See Letter from Micah S. Green to Alfred M. Pollard, *supra* note 36 (describing disclosure of PTFs).

49. See *id.* (explaining that Fannie Mae and Freddie Mac require title searches for all of their mortgages that should uncover any recorded PTF covenants attached to property).

50. See *id.* at 9 (stating that title insurance companies will find recorded PTF covenants during reasonable search).

encumbrances—such as deed restrictions—in the Schedule B of the title commitment.⁵¹ Schedule B of the title commitment lists the specific exceptions from coverage that the title company discovered during its title search.⁵² It also generally includes certain standard exceptions such as mineral and water rights.⁵³ The title insurance policy will not insure against any financial loss resulting from title problems listed in the Schedule B exceptions.⁵⁴

While all buyers should know about the PTF upon closing, because it must be recorded with the title in order to be enforceable, there have been instances where buyers did not know about the PTF until they attempted to resell their property.⁵⁵ However, even if a buyer first finds out about the PTF upon closing, this can still be an unwanted surprise late in the real estate transaction. The buyer may have already put significant time, effort, and money into the closing process only to find out that the land or home is encumbered by a PTF covenant. Since the PTF was not disclosed earlier, the buyer might have difficulty negotiating down the price to accurately reflect the PTF. In addition, if the buyer used an appraiser to determine the value of the property, it is unlikely that the appraiser knew of the PTF and therefore did not accurately appraise the property's value.⁵⁶ Ultimately, the buyer may suffer significant financial losses if the PTF is only first disclosed to the buyer at closing.

Potential homebuyers should receive actual notice and knowledge of PTFs well before closing. In *Easton v. Strassburger*,⁵⁷ a non-PTF case, a Cali-

51. See K. Michelle Lind, *The Importance of Reviewing the Title Commitment*, ARIZ. ASS'N OF REALTORS (Dec. 2004), <http://www.aaronline.com/documents/TitleIns.aspx> (noting PTFs are found in Schedule B of title commitment, which discloses potential important legal restrictions on property such as easements, liens, foreclosures, judgments, court orders, and other legal concerns).

52. See *id.* (detailing contents of Schedule B title commitment list).

53. See *id.* (stating that Schedule B title commitment list typically includes certain standard exceptions such as mineral and water rights).

54. See *id.* (“The title insurance policy will not insure against loss, nor will the title insurer pay costs, attorney fees, or expenses, resulting from title problems listed in Schedule B.”).

55. See Kenneth R. Harney, *A New Real Estate Cost to Watch For: Developer's Private Transfer Fee*, WASH. POST, Mar. 6, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/03/04/AR2010030405416.html> (stating that many PTFs were attached to homes before states had any restrictions on fees and that buyers have purchased homes without being aware that fee even exists).

56. See Mike Unger, *Private Transfer Fees Catch Home Sellers by Surprise*, WASH. EXAM'R, Sept. 21, 2010, <http://washingtonexaminer.com/news/business/private-transfer-fees-catch-home-sellers-surprise> (asserting that appraisers might have difficulty appraising properties with PTF covenants). “An appraiser isn't going to know that a private transfer fee is attached to a property, so they might not be able to accurately give the value of a house because the price initially is artificially brought down to pay for this fee.” *Id.* (quoting director of communications for the American Land Title Association); see also FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 3 (indicating that one percent PTFs reduce the purchase price of property by two percent).

57. 199 Cal. Rptr. 383 (Cal. Ct. App. 1984).

fornia court held a real estate broker liable for negligence when the real estate broker failed to disclose all material facts that may have affected the value or desirability of the property to potential buyers.⁵⁸ PTFs are likely to be material to the real estate transaction because they impact the real property's value and should be disclosed to potential buyers early in the transaction.

While the typical PTF is one percent of the purchase price, it can be negotiated by the original developer and the original buyer.⁵⁹ The one percent fee is paid by each subsequent property owner upon each transfer of the property.⁶⁰ Typically, the fee is divided among the original developer, a trustee, the company that developed the PTF documentation, and sometimes agents, brokers, or other professionals associated with the sale.⁶¹ If the PTF is not paid upon the sale, a lien may be established on the property for the unpaid amount.⁶² A lien is a claim against the property for payment of the PTF, and a lien against the property gives the owner of the PTF (the creditor) security that the fee will be paid.⁶³ The property cannot be sold or declared marketable until this lien is paid.⁶⁴

Liens can cause problems for homeowners and lenders because the property will be unmarketable until the lien is paid, and the property cannot be sold or refinanced until the lien is satisfied.⁶⁵ Potential PTF liens present problems for lenders because lenders typically want to be certain that they have first-lien priority in the case of a default.⁶⁶ However, the PTF lien holder may have first priority as a creditor, which would remove

58. *See id.* at 390 (“[T]he duty of a real estate broker, representing the seller, to disclose facts . . . includes the affirmative duty to conduct a reasonably competent and diligent inspection of the residential property listed for sale and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal.”).

59. *See* R. Wilson Freyermuth, *Putting the Brakes on Private Transfer Fee Covenants*, PROB. & PROP., July/Aug. 2010, at 20, 22 (discussing arguments made by PTF proponents that these fees are valid under freedom of contract principles, partly because parties can negotiate their own economic arrangements and trade-offs).

60. *See id.* at 21 (“[T]he declaration also imposes a 1% fee on the seller at the time of *each subsequent resale* of the parcel during the 99-year term.”).

61. *See id.* (explaining how PTF payment may be divided and owned by multiple third parties).

62. *See* AM. LAND TITLE ASS’N, *supra* note 12, at 3 (stating that unpaid PTFs create liens on real property that make it difficult for homeowners to transfer property).

63. *See* Ailes, *supra* note 28 (discussing how liens provide financial security to PTF beneficiary).

64. *See* AM. LAND TITLE ASS’N, *supra* note 12, at 3 (stating that real property encumbered by unpaid lien can remain unmarketable until lien is satisfied).

65. *See* Ailes, *supra* note 28 (stating that unmarketable property often cannot be sold or refinanced); *see also* CMTY. ASS’N INST., *supra* note 13, at 3 (reporting that only one percent of survey respondents reported PTF covenants holding up real estate transfer); Pollard, *supra* note 21, at 3 (stating that NHBA had no reports of PTF covenants causing any marketability or mortgage problems).

66. *See* Ailes, *supra* note 28 (discussing how lenders prefer to have first-lien priority in case of payment default).

the first priority assurance that most lenders seek.⁶⁷ By making lenders less secure, PTFs increase the risk lenders take on when approving mortgages. This heightened risk can increase costs for both the lender and the homeowner.

PTFs can limit the ability of a homeowner to obtain financing on a property encumbered by a PTF covenant because lenders fear losing first-lien priority.⁶⁸ In addition, some lenders have refused to extend financing to transactions involving PTFs because PTFs are not recognized as a standard title exception by most lenders.⁶⁹ Lenders have also refused to loan money for transactions involving PTFs when the PTFs were only used as a financial tool to generate money for disinterested third parties.⁷⁰

Because PTFs are usually set up to run for twenty to ninety-nine years, the fee is typically paid to a trustee or collection agent, who enforces the PTF, receives payment, collects the fee, and then distributes the remaining amount to the PTF beneficiary.⁷¹ While some PTFs have been imposed for the benefit of non-profits into perpetuity, PTFs cannot be imposed on homeowners into perpetuity.⁷² Further, a PTF is a property interest, and as such is assignable. Thus, any party that owns some of the property interest should be able to enforce and freely assign the PTF.

III. LEGALITY OF PTFs

A. *Private Transfer Fees Are Not an Unreasonable Restraint on Alienation*

The widespread use of PTFs is a relatively new development and it is uncertain if courts will uphold their legality. PTFs have been attacked as an attempt to create a new property right not recognized by traditional common law, as an impermissible restraint on alienation, and as an unenforceable servitude.⁷³ Traditionally, courts have invalidated attempts to

67. *See id.* (indicating that properly and timely recorded PTF may provide first-lien priority over other lenders).

68. *See id.* (stating financing for homeowners can be limited when financial institutions would not have first-lien priority); *see also* Tom Larson, *Private Transfer Fees: Coming Soon to a Real Estate Market Near You?*, WIS. REAL ESTATE MAG., OCT. 2010, at 27, available at <http://news.wra.org/story.asp?a=1373> (arguing that PTFs can limit ability of homeowners to obtain financing because PTFs are not considered acceptable title exceptions by all lenders).

69. *See* Larson, *supra* note 68, at 27 (describing why some lenders have refused to finance transactions involving PTFs).

70. *See id.* (asserting that some lenders have declined financing properties encumbered by PTF covenants because PTFs may benefit third party not involved in transaction).

71. *See* FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 5 (declaring that PTFs are often paid to trustees, who then collect fees and distribute remaining amounts to beneficiaries).

72. *See id.* (asserting that PTFs can only be created to last for ninety-nine years and cannot be imposed onto homeowners into perpetuity).

73. *See* Bardwell & Durham, *supra* note 37, at 28-29 (articulating multiple potential legal avenues to attack PTFs); Larson, *supra* note 68 (stating that PTF covenants may result in increased litigation based on fraud and nondisclosure).

create new forms of property ownership.⁷⁴ However, requiring PTFs is not an entirely new concept as they have existed for decades as HOA fees.⁷⁵

Multiple states have passed legislation prohibiting the use of PTFs based on the public policy concern that PTFs create an unreasonable restraint on alienation.⁷⁶ Courts attempt to protect the free alienability of fee simple property by invalidating impermissible restraints on the free alienation of the property.⁷⁷ The Restatement (Third) of Property states that any “servitude that imposes a direct restraint on alienation of the burdened estate is invalid if the restraint is unreasonable.”⁷⁸ The reasonableness of a servitude is measured by weighing the benefit of the servitude against the burden of the restraint.⁷⁹

Opponents argue that PTFs are unreasonable because the burden of enforcing a PTF outweighs its benefit. Under the right conditions, a PTF covenant could create an impermissible restraint on alienation.⁸⁰ For example, in 1852, the New York Court of Appeals, in *De Peyster v. Michael*,⁸¹ held that a transfer fee of twenty-five percent was overly burdensome and an illegal restraint on alienation. The typical PTF is as little as one percent of the sale price⁸² and not anywhere near the twenty-five percent reserved in *De Peyster*. However, because PTFs can bind a property for ninety-nine years, the homeowner would not be able to sell the property without paying the one percent fee during his or her life.⁸³

74. See *Johnson v. Whiton*, 34 N.E. 542, 542 (Mass. 1893) (indicating that courts will not allow people to create new types of property rights). “A man cannot create a new kind of inheritance.” *Id.*

75. See FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 4 (noting that other asset-backed investments have existed for institutional investors in past, including mortgage-backed securities).

76. See *New Developments in Real Estate Transfer Fees*, ISSUE UPDATE (Nat’l Ass’n of Home Builders, Washington, D.C.), Sept. 9, 2010 (on file with authors) (noting that several states have banned use of PTFs due to public policy); see also FLA. STAT. § 689.28 (2008) (stating that PTFs are counter to public policy because they create title defects and unreasonable restraints on alienation of real property); KAN. STAT. ANN. § 58-3822 (2009) (declaring any PTF, as defined by statute, void and unenforceable as against public policy).

77. See *Bardwell & Durham*, *supra* note 37, at 28 (stating that U.S. court system works to protect fee simple estates from title defects and unreasonable restraints on alienation).

78. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 (2000).

79. See *id.* (noting that to measure reasonableness of servitude, restraint’s utility should be compared to side effects).

80. See *Bardwell & Durham*, *supra* note 37, at 28 (noting that some extreme transfer fee requirements could constitute restraints on alienation).

81. See *De Peyster v. Michael*, 6 N.Y. 467, 495 (1852) (“There is, however, abundant authority to show that conditions that the grantee shall not alien without paying a sum of money therefor, are unlawful restraints on alienation, and therefore void.”).

82. See *Bardwell & Durham*, *supra* note 37, at 28 (stating that PTF covenants typically require payment equal to at least one percent of sales price).

83. See *id.* at 25 (“This agreement purports to be a servitude that attaches to the title to the land and burdens future owners for 99 years.”).

Covenants that require one percent PTFs are not likely to create an unreasonable restraint on alienation.⁸⁴ As long as the PTF is rationally justified and recorded, the PTF does not create an undue burden on alienation.⁸⁵ This is so because the covenants are recorded and the buyer can therefore adjust the offer price to take into account the PTF payment that the buyer will be obligated to make upon a future transfer of the property.⁸⁶ PTFs have a rational justification because they benefit both the initial buyer and developer.⁸⁷ The initial buyer is able to buy the real estate at a lower price because the PTF should reduce the selling price of the property if the buyer is aware of the back-end cost of paying the PTF upon any future transfer.⁸⁸ In addition, developers benefit from PTFs because the real property interest created provides the developer with a long-term income stream and increased liquidity.⁸⁹ Because the PTF is a real property interest, it is freely assignable by the owner and can be sold for present value to acquire cash. PTF covenants are not an illegal restraint on alienation because they do not create an undue burden on alienation and are rationally justified.⁹⁰

Courts applying the common law of servitudes to PTFs could find that the covenant is an unenforceable agreement.⁹¹ PTFs do not dissolve after the sale of the property but rather they continue to bind the new owner for the duration agreed upon in the original PTF covenant.⁹² For PTFs to successfully run with the land, the covenant must satisfy the legal requirements of a servitude.⁹³ A legally enforceable servitude contract requires: (1) intent for the servitude to run; (2) the establishment of privity of es-

84. See McPeak, *supra* note 31 (discussing multiple benefits that PTFs provide both developers and home purchasers).

85. See *id.* (noting multiple virtues of PTFs).

86. See Freyermuth, *supra* note 59, at 22 (noting as counterpoint to article's thesis that if buyers have notice of PTF covenant, they will adjust their offer to reflect future payment).

87. See *id.* (arguing as counterpoint to article's thesis that PTFs benefit buyer by lowering property's price and developer by providing long-term income stream).

88. See *id.* (stating as counterpoint to article's thesis that backend payment of PTF will cause buyers to pay less for property).

89. See *id.* (detailing as counterpoint to article's thesis how PTFs benefit developers by making housing more affordable, creating long-term income stream, and increasing liquidity of housing developments); see also FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 3 (asserting that developers and property owners benefit from spreading out development costs through PTF covenants).

90. See FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 3 (explaining that PTF covenants are rationally justified because they benefit developer, property owner, and potential future owners).

91. See Bardwell & Durham, *supra* note 37, at 29 (articulating common law of servitudes).

92. See Freyermuth, *supra* note 59, at 25 (recounting that PTFs purport to run with land and bind subsequent owners of property).

93. See Bardwell & Durham, *supra* note 37, at 29 (asserting that in some courts, PTF covenants must satisfy common law of servitudes in order to run with real property).

tate or notice; and (3) that the servitude “touch and concern” the land.⁹⁴ The first two requirements are satisfied when a PTF covenant specifically states that it is intended to bind each transferor of the real property for a specific duration of time and is properly recorded.

Under traditional common law rules, the burden of a covenant would only run with the land if the benefit and burden of the covenant touched and concerned the land.⁹⁵ Several courts have noted that the touch-and-concern requirement cannot be summed up in one simple sentence or test.⁹⁶ In addition, a covenant need not have a physical effect on the land to meet the requirement.⁹⁷ However, courts have typically found that a restrictive covenant touches and concerns the burdened estate when it “restricts the owner’s use and enjoyment of the property and thus affects the value of the property.”⁹⁸ While PTFs are unlikely to have a physical effect on the land, they should affect the property’s value and restrict the owner’s use of the property if the owner is unable to sell the property for its full value or refinance because of the PTF.

Many courts no longer rigidly enforce the touch-and-concern requirement and often find that servitudes touch and concern the land. For example, the court in *Candlewood Lake Ass’n v. Scott*⁹⁹ found that an HOA fee touched and concerned the land and, therefore, was a valid servitude that bound subsequent owners.¹⁰⁰ Furthermore, the Restatement (Third) of Property abandoned the touch-and-concern requirement and instead stated that the burden of a servitude would not run if it was “‘arbitrary, spiteful, capricious,’” or imposed an “‘unreasonable restraint on aliena-

94. See *id.* (listing common law of servitudes requirements).

95. See Freyermuth, *supra* note 59, at 21-22 (describing touch-and-concern requirement of servitudes).

96. See *Runyon v. Paley*, 416 S.E.2d 177, 183 (N.C. 1992) (asserting that touch-and-concern requirement cannot be reduced to absolute test or definition); see also *Neponsit Prop. Owners Ass’n v. Emigrant Indus. Sav. Bank*, 15 N.E.2d 793, 795-96 (N.Y. 1938) (holding valid and enforceable liens based on covenants because all three requirements to run with land and bind subsequent owners of property were satisfied).

97. See *Runyon*, 416 S.E.2d at 183 (stating that touch-and-concern requirement need not have physical effect on property); *Flying Diamond Oil Corp. v. Newton Sheep Co.*, 776 P.2d 618, 624 (Utah 1989) (explaining that touch-and-concern requirement may be satisfied without physical effect and touching on real property). “That does not mean, however, that the covenant must have a physical effect on the land.” *Flying Diamond Oil*, 776 P.2d at 624.

98. See *Runyon*, 416 S.E.2d at 183 (“As recognized by some courts, a restriction limiting the use of land clearly touches and concerns the estate burdened with the covenant because it restricts the owner’s use and enjoyment of the property and thus affects the value of the property.”); see also *Net Realty Holding Trust v. Franconia Props.*, 544 F. Supp. 759, 762 (E.D. Va. 1982) (asserting that limiting use of real property clearly touches and concerns property).

99. No. 01AP-631, 2001 WL 1654288 (Ohio Ct. App. Dec. 27, 2001).

100. See *id.* at *8 (holding that deed restrictions placed on real property such as maintenance, water, and sewage fees were found valid and could run with land by binding subsequent property owners).

tion.’”¹⁰¹ While the touch-and-concern requirement is still good law, it is unlikely that a PTF covenant failing to satisfy it would be invalidated.

B. *Freedom of Contract Still Applies*

A strong argument in favor of protecting PTF covenants is freedom of contract. All PTF covenants are recorded and therefore put potential buyers on constructive notice of the agreement. Each buyer willingly agrees to buy the property knowing, at least constructively, about the existence of the PTF, and should negotiate the price accordingly.¹⁰² Potential buyers are able to shop around for houses and are not forced into buying only houses with PTF covenants, but rather have the option to purchase houses with or without the covenants.

The Restatement of Property offers strong freedom of contract rhetoric in favor of protecting PTF agreements.¹⁰³ A comment to section 3.5 of the Restatement (Third) of Property states:

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.¹⁰⁴

As long as PTFs are not an illegal restraint on alienation, it is unlikely that they violate any public policies, and should be allowed under freedom of contract. Courts should not interfere and second-guess every business and contract decision. PTF covenants are agreements between two parties on how to pay for property development costs and these parties should be

101. See Freyermuth, *supra* note 59, at 22 (quoting RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 3.1(1), (3)-(5) (2000)) (describing requirements set forth in Restatement (Third) of Property surrounding abandonment of touch-and-concern requirement for servitudes).

102. See FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 11 (stating that buyers will adjust their offers for properties accordingly because PTF covenants are recorded and put buyers on notice and therefore costs associated with purchasing property will not increase).

103. See Freyermuth, *supra* note 59, at 22 (stating strong freedom of contract rhetoric in Restatement (Third) of Property supports creation and legality of PTF covenants).

104. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.5 cmt. a (2000) (arguing that individual parties are better able to determine economic trade-offs than judges and that these contracts should be left to individual parties to create).

entitled to freedom of contract in order to determine how they will pay for the property.¹⁰⁵ All potential buyers are able to accept or reject the PTF agreement by purchasing or refusing to purchase the property.¹⁰⁶ However, a potential buyer needs actual notice and knowledge of the PTF in order to make an informed purchase.¹⁰⁷ If the buyer is informed of the PTF late in the process—for example, at the closing—the buyer is at a disadvantage because he or she has already invested time and money, and has become contractually obligated, without actual knowledge of a potentially burdensome PTF.

IV. BENEFITS AND BURDENS OF PTF COVENANTS

A. *Who is Concerned with PTF Covenants?*

Freehold claims that PTF covenants are a “win-win” for all parties.¹⁰⁸ However, the benefits and disadvantages of PTF covenants do not identically impact all interested parties. Property developers, trustees, homeowners, and PTF covenant developers (e.g., Freehold) argue that PTF covenants produce such benefits as lower home costs, lower mortgage payments, increased liquidity for developers, financial flexibility, investment opportunities, and cost-spreading options.¹⁰⁹ Opponents of PTF covenants, including the Coalition to Stop Wall Street Home Resale Fees,¹¹⁰ realtors, state governments, and federal housing agencies, argue PTF covenants create uncertainty in the housing market, lower property values, increase costs, and violate public policy.¹¹¹

Certain benefits argued by PTF proponents are also argued as disadvantages by opponents.¹¹² One example is whether decreased property

105. See McPeak, *supra* note 31 (indicating PTFs are used to spread out development costs and are entered into between two willing parties).

106. See *id.* (stating PTFs are willingly assumed by parties who negotiate price and contract for their own benefit).

107. See *id.* (indicating potential buyer needs notice of PTF in order to include all possible variables into their decision-making process when negotiating price for PTF-encumbered property).

108. See FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 5 (stating that PTF covenants provide win-win scenario for all interested parties).

109. See *id.* (describing potential financial benefits provided by PTF covenants to developers, trustees, investors, and homeowners).

110. See *About*, COAL. TO STOP WALL ST. HOME RESALE FEES, <http://www.stophomesalefees.org/about> (last visited Sept. 18, 2011). The coalition’s members consist of a variety of real estate groups and associations such as the National Association of Realtors and American Land Title Association. See *id.*

111. See *The Issue*, COAL. TO STOP WALL ST. HOME RESALE FEES, <http://www.stophomesalefees.org/issue> (last visited Aug. 11, 2011) (stating PTFs hurt homeowners by lowering property values); see also Private Transfer Fee Covenants, 75 Fed. Reg. 49,932, 49,932 (Aug. 16, 2010) (indicating that PTFs damage housing market by increasing total costs of homeownership); Krepps, *supra* note 5 (arguing PTFs hurt housing market and potential homeowners by making property transfers increasingly difficult).

112. See Krepps, *supra* note 5 (arguing PTFs harm potential homeowners). But see FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 5 (arguing lowered housing

values are a benefit or burden caused by PTF covenants. Lower initial property values would be a benefit for potential homeowners because they would pay less upfront, have lower mortgage payments, need to borrow less money, and could pay less in taxes on the property.¹¹³ However, realtors and state governments would collect less revenue because realtor fees and taxes are typically based off of a percentage of the selling price of the property.¹¹⁴ This provides a financial incentive for state governments and realtors to oppose PTF covenants that would lower real property values. Not unsurprisingly, it has been realtors and not individual home owners who have been the major drivers behind the increased state regulation of PTF covenants.¹¹⁵

B. *Do PTF Covenants Lower Ownership Costs?*

PTFs were originally called capital recovery fees because they were designed to spread out community development costs. By requiring payment of a fee to the original land developer each time a piece of real property is transferred, the development costs of the property are spread out to the multiple buyers of the real property.¹¹⁶ In a real property transaction without a PTF covenant, the developer must put one hundred percent of its costs onto the first buyer because the developer will have no additional income after the first sale. However, with a PTF, the developer is able to sell the property for a lower price to the initial buyer because the developer will be entitled to a future income stream from subsequent transfers of the property. PTFs create a long-term income stream for the developer, segregate the income stream from the property, and lower the sales price of the property.¹¹⁷ The sales price of the property should be

prices are beneficial for homeowners because they make housing more affordable by lowering costs associated with buying home).

113. See *FREEHOLD CAPITAL PARTNERS*, *supra* note 16, at 4 (stating benefits provided to homeowners by PTF covenants).

114. See Freyermuth, *supra* note 59, at 22-23 (explaining that lower property values correlate to lower tax revenue generated by government).

115. See *NAR Hails Proposal to Restrict GSE Mortgages with Private Transfer Fees*, NAT'L ASS'N OF REALTORS (Aug. 13, 2010), http://www.realtor.org/press_room/news_releases/2010/08/gse_mortgages ("NAR is the leading advocate for private property rights and housing issues and we firmly believe that private transfer fees add an unnecessary burden to the real estate transaction and can delay a closing or even kill the transaction. There is no service performed for such fees and they add nothing to the value of a property" (quoting NAR president Vicki Cox Golder)); see also *CMTY. ASS'N INST.*, *supra* note 13, at 3 (noting that less than one percent of real estate transactions with PTF covenants are lost because of PTF covenants); Svaldi, *supra* note 3 (noting that some legislatures have had trouble pushing through restrictive PTF legislation because there have been very few constituent complaints regarding PTF covenants).

116. See *FREEHOLD CAPITAL PARTNERS*, *supra* note 16, at 3 ("[A] buyer will always pay less for property encumbered by a 1% fee than for the same property without the fee.").

117. See *id.* (stating that PTF covenants lower property prices by spreading out costs to multiple subsequent owners).

lower for the initial buyer and any buyer subsequently affected by the PTF because they will be obliged to pay one percent of the sale price when they transfer the property in the future. Freehold states that a PTF should create a one to two percent price deduction in offer prices.¹¹⁸

As long as PTFs are timely and fully disclosed to potential buyers, the market will adjust to the fee and the property's price will be lower.¹¹⁹ However, the price may not be lower if potential buyers do not find out about the PTF until after signing the sales contract, or even as late as the closing. Conversely, if the PTF is fully disclosed to potential buyers, the PTF will then spread out the development costs of the property to all subsequent owners of the property for the life of the PTF covenant. By forcing the initial selling price down, PTF covenants result in more affordable housing for buyers by making the down payment, mortgage, and monthly payments smaller. In addition, the developer is now tied to the success of the property; the longer the property holds its value and increases in value, the more money the developer stands to make. This gives the developer incentive to build properties that will hold their value for the life of the PTF covenant.

While PTFs were designed to spread out development costs over multiple buyers, PTFs may have had the unintended consequence of increasing litigation and closing costs.¹²⁰ Because many buyers and sellers do not know about the existence of PTFs until closing, a property's price might not be properly negotiated. The surprise of a PTF at closing can result in lawsuits, failed transactions, and liens being placed on the property. These lawsuits could be based on fraud, misrepresentation, non-disclosure, or negligence. The uncertainty surrounding the legality of PTFs could also cause litigants to balk at settlement offers, whether reasonable or not.¹²¹

While PTFs are recorded and should be disclosed at closing or before, it may still be difficult for potential buyers to negotiate an appropriate price. The buyer will need to know about the PTF's existence and terms, fully understand the PTF covenant, and adjust the price to account for the

118. See JOINT EDITORIAL BD. FOR UNIF. REAL PROP. ACTS, POSITION PAPER ON TRANSFER FEE COVENANTS 6 (2010) [hereinafter POSITION PAPER] (on file with authors) ("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.")

119. See *Information for Legislators*, FREEHOLD CAPITAL PARTNERS, <http://www.freeholdcapitalpartners.com/information.php?info=legislators> (last visited Aug. 11, 2011) ("To the extent the existence of a [transfer] fee impacts the value of property, as long as the fee is fully disclosed the market will adjust to the fee." (citation omitted) (internal quotation marks omitted)).

120. See Harney, *supra* note 55 (stating that PTFs could lead to increase in litigation because many buyers and sellers are unaware of existence of PTF covenants).

121. See *id.* (stating that uncertainty around PTF covenants may cause buyers to balk at reasonable settlement offers and may jeopardize property sales).

covenant's future financial impact.¹²² However, this can be extremely difficult for even the most prepared and informed buyer.¹²³ The potential buyer will need to account for a variety of unknown variables, including how long he or she will hold onto the property, the future value of the property at the time of the next transfer, and the effect that the PTF will have on the next potential purchaser.¹²⁴ With so many variables for a buyer to take into consideration, it may be difficult to accurately appraise the value of the property.

C. *An Investment Opportunity*

In addition to lowering costs for first-time buyers, the revenue stream created by the PTF can be sold by the developer to create more cash to reinvest into housing projects.¹²⁵ Because the PTF creates a real property interest for developers, it is freely assignable and creates increased liquidity for them. This increased liquidity can be used to pay off debts, restart failed projects, and start new development projects.¹²⁶

Communities may benefit from PTFs when they are designed to be reinvested into local housing, non-profits, roads, or other valuable community services.¹²⁷ Instead of a one-time payment, the community receives a long-term stream of cash that can build stronger property values by increasing income to the community.¹²⁸ In addition, many communities have used PTFs or similar HOA fees in order to fund community development and maintenance projects.¹²⁹

122. See POSITION PAPER, *supra* note 118, at 5-6 (listing potential issues of valuing real property encumbered by PTF covenant).

123. See *id.* (stating that potential buyers cannot accurately gauge monetary effect of PTF covenants); Freyermuth, *supra* note 59, at 23 (stating that potential homebuyers cannot accurately determine monetary effect PTF covenant will have on real property's future value).

124. See Freyermuth, *supra* note 59, at 23 (explaining unknown variables that must be accounted for when determining value of property encumbered by PTF).

125. See McPeak, *supra* note 31 (asserting that PTFs are real property interests and are freely assignable); see also FREEHOLD CAPITAL PARTNERS, *supra* note 16 (claiming that PTF covenants can be bundled, divided, or sold as property right to investors).

126. See Letter from Micah S. Green to Alfred M. Pollard, *supra* note 36, at 12 (stating that increased liquidity benefits PTFs provide developers can help these developers restart stalled projects and start new property development projects).

127. See McPeak, *supra* note 31 (stating that PTFs are used to encourage affordable housing and benefit non-profits, HOAs, and community services).

128. See *id.* (explaining that PTFs can build stronger property values by requiring portion of PTF payment to be reinvested in surrounding community).

129. See Kenneth R. Harney, *FHFA's Proposed Ban on Private Transfer Fees Could Cost Homeowners*, WASH. POST, Aug. 21, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/08/20/AR2010082000053.html> ("Many new housing development projects come with not-for-profit homeowners associations that collect assessments from owners to fund community improvements and property management.")

The property interest that is created by the PTF can be bought and sold. For example, Freehold uses PTFs as development bonds that can be packaged into large pools and sold to investors as a future income stream. However, opponents argue that using PTFs purely for third-party investments is unethical¹³⁰ because PTFs bundled and sold as financial investments take money away from the homeowner and give a financial benefit to someone completely disassociated with the real estate transaction.¹³¹ In response to Freehold's PTF scheme, the Coalition to Stop Wall Street Home Resale Fees stated that "[t]hese fees add no benefit or value to a property, and are little more than a predatory scheme meant to take advantage of unsuspecting homeowners."¹³²

However, gathering property rights into a large financial pool that is later sold to investors is not a new or unique idea. The federal government and private organizations are already engaged in mortgage-backed securities (MBSs), in which unrelated third parties buy residential property interests for purely monetary purposes.¹³³ PTFs and MBSs are collected and sold to investors in an almost identical manner. The federal government has consistently supported Fannie Mae, Freddie Mac, and Ginnie Mae in order to facilitate the development of MBSs.¹³⁴ However, in 2011, the Obama Administration announced a proposal that would phase out Fannie Mae and Freddie Mac.¹³⁵

130. See Janet Morrissey, *Resale Fees That Only Developers Could Love*, N.Y. TIMES, Sept. 11, 2010, http://www.nytimes.com/2010/09/12/business/12fees.html?_r=1&sq=home%20resale%20fee&st=cse&scp=1&pagewanted=all (quoting realtor Michael Cameron saying that use of PTFs is unethical because it is bad for potential real property buyers).

131. See Brooke Hunt, *Standing Up to Private Transfer Fees*, NAT'L ASS'N OF REALTORS: VOICES OF REAL ESTATE BLOG (Mar. 3, 2010), <http://voicesofrealestate.blogs.realtor.org/2010/03/03/standing-up-to-private-transfer-fees-posted-by-brooke/> (stating PTFs deprive homeowners of affordable housing in order to provide financial benefit to disinterested third party).

132. Carla Hill, *Resale Fees*, REALTY TIMES, Oct. 6, 2010, available at http://realtimes.com/rtpages/20101006_resalefee.htm (quoting Coalition to Stop Wall Street Home Resale Fees).

133. See *Mortgage-Backed Securities*, U.S. SEC. AND EXCH. COMM'N, <http://www.sec.gov/answers/mortgagesecurities.htm> (last modified July 23, 2010) (explaining that residential mortgages, purchased by banks and other entities, are gathered into pools creating securities that are claims on principle and interest payments made on mortgages).

134. See *id.* (indicating that most MBSs are issued by Ginnie Mae and all MBSs issued by Ginnie Mae are backed by full faith and credit of U.S. government to ensure timely payments).

135. See Nick Timiraos, *Views of Life After Fannie, Freddie*, WALL ST. J., Feb 12, 2011, at A5 (stating plans to phase out Fannie Mae and Freddie Mac). Timiraos writes that "the Obama administration outlined on Friday its plans to begin shrinking the government's broad support of the nation's crippled mortgage market, a process that officials said could take several years and would include phasing out Fannie Mae and Freddie Mac." *Id.*

D. PTFs Provide Financial Flexibility for Commercial Transactions

PTFs can be used in both residential and commercial real estate transactions. In commercial real estate transactions, PTFs would work in the same manner by lowering the initial selling price of the property. While this would make investments and purchases more affordable for businesses, it would also give businesses a higher return on both initial investment (ROI) and operating income because their initial costs would be lower.¹³⁶ In addition, the lower real property costs would lower carrying costs for companies, which would also help increase their ROI.¹³⁷ The parties involved in commercial real estate transactions are typically considered to be more sophisticated and business savvy than the typical residential purchaser, and they should be granted the freedom of contract to create and use PTFs in their business transactions. Commercial real estate transactions occur at arm's length and the parties should be able to determine the best economic manner in order to finance a real estate transaction without courts second-guessing their business decisions.

V. LEGISLATION PICKS UP SURROUNDING PTF COVENANTS

A. States Legislatures Take PTFs to the Public

As of March 2012, thirty-six states have passed legislation that regulates the use and disclosure of PTFs,¹³⁸ and at least another six states are currently considering legislation.¹³⁹ States are moving quickly to enact legislation intended to regulate and ban the use of PTF covenants. For example, bills were introduced and voted on in eight states during 2011.¹⁴⁰ However, three very different approaches have been utilized: (1)

136. See FREEHOLD CAPITAL PARTNERS, *supra* note 16, at 3 ("Capital Recovery Fees work equally well for commercial property, allowing buyers to defer a portion of the sales price, thus increasing operating income and ROI.")

137. See *id.* (stating that combination of lower acquisition costs and lower carrying costs equals higher cash flow and higher ROI).

138. See Krepps, *supra* note 5 (asserting that Pennsylvania was thirty-sixth state to regulate use of PTF covenants); see also SUSAN STUTZKY & MARK WOLF, A SUMMARY OF HOUSE BILLS 4227 AND 4228 AS INTRODUCED 2-10-11, H.B. 4227 & 4228, 2011 Gen. Assem., Reg. Sess., at 2 (Mich. 2011), available at <https://www.legislature.mi.gov/documents/2011-2012/billanalysis/House/pdf/2011-HLA-4227-1.pdf> (stating that as of March 11, 2011, nineteen states had passed legislation regulating use of PTFs).

139. See Slade Smith, *Private Transfer Fee Bans Introduced in at Least Six States*, SOURCE OF TITLE (Jan. 25, 2011), <http://www.sourceoftitle.com/article.aspx?uniq=6587> (stating that Montana, Nebraska, South Dakota, Virginia, Washington, and Wyoming are considering bans); see also S.B. 146, 62d Leg., 1st Reg. Sess. (Mont. 2011); L.B. 26, 102d Leg., 1st Reg. Sess. (Neb. 2011); S.B. 70, 86th Legis. Assemb., Reg. Sess. (S.D. 2011); S.B. 931, 2011 Gen. Assemb., Reg. Sess. (Va. 2011); S.B. 5115, 62d Leg., Reg. Sess. (Wash. 2011); H.B. 137, 61st Leg., Gen. Sess. (Wyo. 2011).

140. See Slade Smith, *Private Transfer Fee Bans Move Swiftly Through State Legislatures*, SOURCE OF TITLE (Feb. 25, 2011), <http://www.sourceoftitle.com/article.aspx?uniq=6630> (setting forth states that have voted on PTF legislations before 2011); see

a complete ban on all new PTF covenants; (2) a requirement of full disclosure of any PTF; and (3) a ban on all new PTF covenants on residential properties. A complete ban on any newly created PTF covenant has been the most widely enacted and proposed form of legislation, with fifteen states enacting such statutes.¹⁴¹ However, California only requires full disclosure to potential buyers and sellers of the existence of a PTF covenant, and Hawaii, Mississippi, Colorado, Oregon, and Texas have banned PTFs in some instances, but not all.

1. *Required Public Disclosure of PTFs*

California was the first state to see widespread use of PTFs *and* to put significant restrictions on their use. In 2008, California adopted California Civil Code sections 1098 and 1098.5, which require pre-sale disclosure of PTFs.¹⁴² Section 1098 describes a transfer fee as a payment of a fee that is required by a restriction or covenant upon the sale or transfer of real property.¹⁴³ The statute lists nine types of fees that are not considered transfer fees and are not regulated by the statute:

- (a) Fees or taxes imposed by a governmental entity.
- (b) Fees pursuant to mechanics' liens.
- (c) Fees pursuant to court-ordered transfers, payments, or judgments.
- (d) Fees pursuant to property agreements in connection with a legal separation or dissolution of marriage.
- (e) Fees, charges, or payments in connection with the administration of estates or trusts
- (f) Fees, charges, or payments imposed by lenders or purchasers of loans
- (g) Assessments, charges, penalties, or fees authorized by the Davis-Stirling Common Interest Development Act

also Slade Smith, *Private Transfer Fees Newly Outlawed by Eight States So Far in 2011*, SOURCE OF TITLE (May 10, 2011), <http://www.sourceoftitle.com/article.aspx?uniq=6722>.

141. Arizona, Delaware, Florida, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, and Utah have all passed bans on PTFs. *See* ARIZ. REV. STAT. ANN. § 33-442 (2010); DEL. CODE ANN. tit. 25, § 319 (2010); FLA. STAT. § 689.28 (2008); 765 ILL. COMP. STAT. 155/15 (2011); IOWA CODE § 558.48 (2010); KAN. STAT. ANN. § 58-3821 (2009); LA. REV. STAT. ANN. § 9:3133 (2010); MD. CODE ANN., REAL PROP. § 10-708 (West 2010); MINN. STAT. § 513.74 (2010); MO. REV. STAT. § 442.558 (2008); N.J. STAT. ANN. § 46:3-30 (West 2010); N.C. GEN. STAT. § 39A-3 (2010); OHIO REV. CODE ANN. § 5301.057 (West 2010); 68 PA. CONS. STAT. § 8104 (2011), UTAH CODE ANN. § 57-1-46 (West 2010).

142. CAL. CIV. CODE §§ 1098-1098.5 (West 2011).

143. *See* § 1098 (defining transfer fee for purposes of statute).

(h) Fees, charges, or payments for failing to comply with, or for transferring the real property prior to satisfying, an obligation to construct residential improvements on the real property.

(i) Any fee reflected in a document recorded against the property on or before December 31, 2007, that is separate from any covenants, conditions, and restrictions, and that substantially complies with subdivision (a) of Section 1098.5 by providing a prospective transferee notice of the following:

- (1) Payment of a transfer fee is required.
- (2) The amount or method of calculation of the fee.
- (3) The date or circumstances under which the transfer fee payment requirement expires, if any.
- (4) The entity to which the fee will be paid.
- (5) The general purposes for which the fee will be used.¹⁴⁴

Section 1098.5 requires that transfer fees created before and after the passage of the statute must be recorded in a separate document.¹⁴⁵ In order to receive payment of a PTF recorded before the passage of section 1098.5, the fee receiver must record the transfer fee document “against the real property in the office of the county recorder for the county in which the real property is located.”¹⁴⁶ In addition, the document must be entitled “Payment of Transfer Fee Required.”¹⁴⁷ The document must include a description of the real property and the names of all current owners of the real property subject to the transfer fee.¹⁴⁸ The document must set forth the fee amount or percentage and if it is a residential home there must be examples of the fee payment for real properties valued at \$250,000, \$500,000, and \$750,000.¹⁴⁹ In addition, the document must set forth the entity that will be paid, the entity’s contact information, and signature.¹⁵⁰ The document must also explain the purpose for which the funds will be used after they are paid to the entity.¹⁵¹ Lastly, the document must include an explanation of when and how the transfer fee requirements will expire.¹⁵²

144. *Id.*

145. *See* §§ 1098.5(a)-(b) (requiring recorded document indicating existence of PTF covenant in order to provide notice to potential buyers and other interested parties).

146. § 1098.5(a).

147. *See* § 1098.5(a)(1).

148. *See* § 1098.5(a)(2)(A).

149. *See* §§ 1098.5(a)(2)(B)-(C).

150. *See* §§ 1098.5(a)(2)(F)-(G).

151. *See* § 1098.5(a)(2)(E).

152. *See* § 1098.5(a)(2)(D).

The statutory requirements of a transfer fee covenant recorded after the enactment of the statute are identical except that the person imposing the transfer fee is required to file the Payment of Transfer Fee Required document.¹⁵³ California's statute addresses many of the concerns that were raised by opponents of PTFs. The statute requires disclosure to potential buyers so that there can be no PTF surprises. In addition, the length and amount of the fee must be detailed and described with real examples for residential homes. Lastly, the document creates transparency about the entity collecting the PTF and requires the entity to disclose how it will use the payment. California's legislation does not ban the use of PTFs, but instead requires that PTFs are properly recorded so as to not surprise potential real estate buyers with extra fees upon the purchase or transfer of real property. While required recordation will put potential buyers on constructive notice, buyers may still not receive actual notice of the PTF until closing.

2. States Seek Complete Ban on PTFs

In 2008, Governor Crist of Florida signed into law the first PTF ban in the United States.¹⁵⁴ The Prohibition Against Private Transfer Fee Covenants (PAPTF) states that PTF covenants violate the public policy of Florida "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."¹⁵⁵ PAPTF states that PTF covenants recorded after the act do not bind subsequent owners of the real property encumbered and that PTF covenants do not run with the title.¹⁵⁶ However, any PTF covenant that was recorded before July 1, 2008, in Florida is deemed valid and enforceable.¹⁵⁷

While Florida appeared to ban all future PTF covenants, the definition and exceptions section of the PAPTF sets forth ten exceptions to the ban.¹⁵⁸ Fees paid "to a homeowners', condominium, cooperative, mobile home, or property owners' association," if properly executed through a binding covenant, are not considered PTFs under the statute.¹⁵⁹ Additionally, transfer fees do not include fees that encumber four or more properties in one community and are paid to a charity or nonprofit, or any fee that entitles the landowner membership to a club.¹⁶⁰ Lastly, the

153. See § 1098.5(b) (indicating there are not any legal distinctions between PTF covenants in existence before passage of statute and after passage of statute).

154. See FLA. STAT. § 689.28 (2008).

155. § 689.28(1).

156. § 689.28(3).

157. See *id.* (stating any PTF properly created and recorded before 2008 is still valid and enforceable).

158. See § 689.28(2)(c) (listing ten scenarios not defined as transfer fee for purposes of statute).

159. See § 689.28(2)(c)(7).

160. See §§ 689.28(2)(c)(8)-(9).

PAPTF stated that any transfer fees, taxes, or fines paid to the government are exempt from the ban.¹⁶¹

In September 2008, Missouri passed legislation banning the use of PTFs.¹⁶² Missouri's legislation is very similar to Florida's, except that Missouri does not include all of the exceptions contained in Florida's ban.¹⁶³ Missouri's ban does not include the club membership, charity, and HOA exceptions that Florida's statute exempts from the PTF ban.¹⁶⁴

In 2010, Louisiana, Minnesota, and New Jersey all passed legislation banning the use of PTFs, requiring disclosure of current PTF covenants and creating penalties for attempting to create or enforce illegal PTFs.¹⁶⁵ These states have the most comprehensive statutory bans on PTFs. However, none of these bans are applied retroactively.¹⁶⁶ This means that PTFs in these states will continue to be enforceable until their covenants expire, which in some cases could be up to ninety-nine years.

In 2011, Pennsylvania became the thirty-sixth state to pass legislation limiting the use of PTF covenants.¹⁶⁷ The Private Transfer Fee Obligation Act declares that all non-statutorily excluded PTF covenants violate public policy by impairing the marketability and transferability of real properties.¹⁶⁸ While Pennsylvania excludes PTF covenants where fees are paid to charities and HOAs, it also excludes some fees paid specifically to licensed real estate brokers.¹⁶⁹ Commissions paid to real estate brokers upon the future transfer of a property that appreciates in value are excluded from the PTF ban.¹⁷⁰ A violation of the Pennsylvania statute may result in liability for any damages resulting from the PTF (not limited to the amount of the fee paid) and any fees or costs associated with an action to quiet title.¹⁷¹

161. See § 689.28(2)(c)(6).

162. See MO. REV. STAT. § 442.558 (2011).

163. Compare § 442.558(1)(2), with FLA. STAT. § 689.28(2)(c).

164. Compare MO. REV. STAT. § 442.558(1)(2) (asserting certain limited exceptions to PTF ban), with FLA. STAT. § 689.28(2)(c) (declaring fees paid to charities, club memberships, and HOAs exempt from PTF ban).

165. See LA. REV. STAT. ANN. §§ 9:3131-36 (2011); MINN. STAT. §§ 513.73-76 (2011); Assemb. B. 2681, 214th Leg. (N.J. 2010) (enacted) (codified at N.J. STAT. ANN. §§ 46:3-28 to -33 (West 2011)).

166. See, e.g., LA. REV. STAT. ANN. § 9:3136 (stating any PTF created before passage of bill is still valid and enforceable).

167. See 68 PA. CONS. STAT. §§ 8101-07 (2011).

168. See § 8102 (declaring PTFs created after statute void as against public policy in Pennsylvania).

169. See § 8103 (stating exceptions to Pennsylvania's PTF ban).

170. See *id.* (excluding from definition of PTF "[a]ny commission payable to a licensed real estate broker for the transfer of real property pursuant to an agreement between the broker and the grantor or the grantee, including, but not limited to, any subsequent additional commission for that transfer payable by the grantor or the grantee based upon any subsequent appreciation, development or sale of the property").

171. See § 8105.

While the Pennsylvania statute bans the creation of any new PTF covenants, the statute does not retroactively make PTF covenants illegal.¹⁷² Any real property sale subject to a PTF covenant must include a provision disclosing the existence of the PTF covenant in the sales contract.¹⁷³ Consequently, any sales contract that does not include this disclosure and description is unenforceable by the seller.¹⁷⁴ In addition, the statute requires that any existing PTF covenant be recorded “in the office of the recorder of deeds for each county in which the real property is located.”¹⁷⁵ Pennsylvania’s PTF regulation bans the use of PTF covenants except in a few select instances and requires upfront disclosure to potential buyers of any existing PTF covenants in order to protect real property buyers from unwanted and unknown fees.¹⁷⁶

There has been no uniform approach to PTF regulation adopted by all states; however, PTFs have become a priority issue for both federal and state governments. Maryland’s legislation illustrates the urgency with which both federal and state governments are giving PTFs. Maryland’s bill banning all new PTFs was passed as an emergency bill.¹⁷⁷ This means the bill was necessary for the “immediate preservation of the public health or safety.”¹⁷⁸ Maryland’s legislature argued that “transfer fee covenants violate the public policy by impairing the marketability and transferability of real property by constituting an unreasonable restraint on alienation.”¹⁷⁹ The bill stated that PTFs were a new attempt to destroy fee simple estates without “any right of possession presently or in the future.”¹⁸⁰ In addition, courts have consistently turned back attempts by landowners to create new estates in land not traditionally recognized by common law.¹⁸¹

3. *States Distinguish Between Residential and Commercial Uses*

California’s PTF disclosure act was the first state legislation to draw distinctions between regulations for residential and commercial PTFs.¹⁸² However, in 2010, Mississippi enacted H.B. 886, which prohibits the pay-

172. *See* § 8104 (stating PTFs in existence prior to statute are “presumed valid and enforceable”).

173. *See* § 8106 (detailing disclosure requirements and punishment for not disclosing PTFs when real property is sold).

174. *See id.*

175. *See* § 8107(a) (setting forth recording requirements of PTF covenants with office of recorder of deeds).

176. *See* §§ 8103, 8104, 8107.

177. *See* S.B. 666, 2010 Gen. Assemb., Reg. Sess. § 3 (Md. 2010) (enacted) (codified at MD. CODE ANN., REAL PROP. § 10-708 (West Supp. 2010)) (stating Maryland bill was enacted as “emergency measure” to protect public).

178. *Id.* (asserting that passage of PTF covenant regulations was high priority and was needed in order to protect public).

179. *Id.* pmb1.

180. *Id.*

181. *See id.* (illustrating desire of courts to protect fee simple estates).

182. *See* CAL. CIV. CODE § 1098.5 (West 2011) (identifying specific requirements singling out residential properties).

ment of certain fees for the future conveyance of real residential properties.¹⁸³ H.B. 886 prohibits a deed restriction or covenant that requires the “transferee of residential real property” to pay a fee to a third party in connection with a future transfer of the real property.¹⁸⁴ In addition, H.B. 886 specifically states that it does not apply to fees payable to HOAs, governmental organizations, or 501(c)(3) organizations.¹⁸⁵ Texas also passed a legislative ban on PTFs that initially applied only to residential properties.¹⁸⁶ Texas Property Code section 5.017 banned the future use of PTFs in connection with the transfer of residential properties unless the PTF payment went to a 501(c)(3) organization, the government, or an HOA that manages a subdivision with more than one residential plot.¹⁸⁷ Section 5.017 was later replaced by sections 5.201 to 5.207, which prohibit all PTFs, not just those encumbering residential property.¹⁸⁸

In 2009, Oregon passed legislation banning the use of PTF declarations and covenants.¹⁸⁹ Nevertheless, Oregon’s H.B. 2481 only applies to individual property owners and not to partnerships, LLCs, LLPs, corporations, or joint ventures.¹⁹⁰ The Oregon statute keeps individual owners from placing PTFs on their own houses, but still allows almost all developers to place PTF covenants on large community projects and commercial real estate projects.¹⁹¹

183. See H.B. 886, 2010 Leg., Reg. Sess. (Miss. 2010) (enacted) (codified at Miss. CODE ANN. § 89-1-69 (2011)) (enacting statute to prevent “certain covenants on future conveyances of real property”).

184. See *id.* (prohibiting use of PTF covenants).

185. See *id.* (indicating certain exceptions were provided by Mississippi legislature to PTF ban).

186. See TEX. PROP. CODE ANN. § 5.017(b) (West 2010) (repealed 2011).

187. See § 5.017(c).

188. See H.B. 8, 82d Leg. Sess. (Tex. 2011) (enacted) (codified as amended at TEX. PROP. CODE ANN. §§ 5.201-07) (repealing § 5.017); see also Josh Botts, *Transfer Fee Covenant Comes at a Cost*, RPTE eREPORT (Am. Bar Ass’n Section of Real Prop., Trust & Estate Law), Oct. 2011, available at http://www.americanbar.org/content/dam/aba/publications/rpte_ereport/2011/2011_aba_rpte_ereport_05_rp_botts.authcheckdam.pdf (discussing changes to Texas PTF prohibition). Botts writes that the prohibitions in section 5.017 were often circumvented

by stating that (1) it only applied to residential situations, and (2) the term “transferee” meant “one who is acquiring title,” referring to a particular place and time, not to an individual, which meant at the time of a future sale, the person who originally was the transferee is now the transferor (the person responsible for paying the fee).

Botts, *supra*, at 1. According to Botts, the changes made in sections 5.201-07 were intended to resolve the ambiguities of 5.017. See *id.*

189. See H.B. 2481, 75th Leg. Assemb., Reg. Sess. (Or. 2009) (enacted) (codified at OR. REV. STAT. § 93.269 (2009)) (banning PTFs on future transfers of real property unless otherwise exempted by statute).

190. See OR. REV. STAT. § 93.269(3).

191. See *id.* (indicating exemptions to PTF ban, including agreements involving “a series of related transfers of the fee simple interest in a real property” and certain instruments executed by government, housing cooperatives, and public benefit corporations).

In 2011, Colorado passed legislation banning any new PTF covenants recorded on residential properties.¹⁹² Notably, the statute sets forth certain exemptions from the PTF ban for fees paid to HOAs, charities, and local governments.¹⁹³ In addition, the statute attempts to increase notice of existing PTF covenants by requiring any party receiving a PTF to record a notice of the PTF covenant on the property's title.¹⁹⁴ Ultimately, Colorado's statute requires more notice for potential buyers and limits some PTF covenants on residential properties where the fee is not paid to a party related to the development, maintenance, or improvement of the real property.¹⁹⁵

B. *Federal Regulation and Legislation Seek PTF Ban*

1. *Federal Housing Finance Agency Considers Comprehensive Ban*

In addition to state laws, the Federal Housing Finance Agency (FHFA) proposed federal regulations that would restrict government-owned companies like Freddie Mac, Fannie Mae, and any federal home loan bank—which currently hold up to ninety percent of all residential mortgages—from investing in properties encumbered by PTFs.¹⁹⁶ The FHFA stated that many PTF covenants are not intended to benefit the community, but rather create purely private streams of income to select market participants that have nothing to do with the original real estate transaction.¹⁹⁷ The FHFA stated that it did not find the typical one percent transfer fee to be minimal or reasonable and that PTFs pose a serious risk to the financial stability of the housing market.¹⁹⁸ Moreover, the FHFA believes that all the benefits provided by PTFs can be obtained in more transparent ways.¹⁹⁹ However, the FHFA did not offer any suggestions on how the benefits of PTFs could be accomplished in a more transparent manner.

192. See COLO. REV. STAT. § 38-35-127 (2011) (stating public policy of Colorado requires that residents not be burdened with covenants “that do not touch and concern residential real property”).

193. See §§ 38-35-127(2)(b), 38-35-127(8) (indicating certain exemptions to PTF ban put in place by Colorado legislature).

194. See § 38-35-127(4)(a) (requiring PTFs existing prior to enactment to register with office of county clerk before October 1, 2011).

195. See § 38-35-127 (limiting use of PTF covenants and requiring filed notice of existence of PTF covenants).

196. See Broderick Perkins, *Homeowner Groups: Don't Ban Private Transfer Fees*, CALIFORNIAN, Nov. 5, 2010 (stating that federal government currently holds up to ninety percent of all residential mortgages).

197. See *Private Transfer Fee Covenants*, 75 Fed. Reg. 49,932, 49,932 (Aug. 16, 2010) (arguing PTFs are detrimental to homeowners because they often surprise homeowners with unwanted fees).

198. See *id.* at 49,933. (stating PTFs are unreasonable and pose significant risk to stability of housing market).

199. See *id.* (stating opponents argue benefits of PTFs can be obtained in more transparent ways).

The FHFA voiced multiple reasons why PTFs should be regulated.²⁰⁰ For example, the FHFA argued that PTFs increase the costs of home ownership, limit property transfers, detract from the stability of the secondary mortgage market, expose market participants to unknown risks or liens, contribute to reduced transparency, increase last-minute real estate costs, and complicate residential home transactions.²⁰¹ Because of the potential risks associated with PTFs, the FHFA proposed 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.”²⁰²

The FHFA’s proposed rule would “ban Fannie Mae and Freddie Mac from purchasing any loan on a house, townhouse or condominium with a deed-based transfer fee, which is recorded along with the title and binding on subsequent purchasers, often for as long as 99 years.”²⁰³ However, the FHFA’s proposed ban of PTFs would not only limit the use of PTFs, but would also limit other types of fees commonly associated with real properties,²⁰⁴ such as payments to HOAs, affordable housing groups, and community organizations.²⁰⁵ The Community Association Institute argues that the FHFA’s proposed ban would ensnare community associations that have effectively used PTFs for decades and would cause an increase in annual assessments to individual property owners.²⁰⁶ The period for public comments on the FHFA closed on October 15, 2010, after being open for sixty days.²⁰⁷

On February 1, 2011, the FHFA announced that it was moving forward with its formal rulemaking process with regards to banning federally backed mortgages on properties encumbered by PTFs.²⁰⁸ The previously proposed guidance was amended to take into consideration comments

200. *See id.* (listing multiple reasons to ban use of PTFs).

201. *See id.*

202. *Id.* at 49,934.

203. Lew Sichelman, *FHFA’s Proposed Private Transfer Fee Ban ‘Goes Too Far’*, NAT’L MORTG. NEWS, Oct. 11, 2010, at 6, 6 (detailing FHFA’s proposed ban on PTFs).

204. *See id.* (explaining that FHFA’s proposed ban on PTFs would ban variety of other legitimate transfer fees).

205. *See Harney, supra* note 129 (“The wording of the ban, however, appears to reach well beyond Freehold-type fees to include mortgages where covenants require payments to homeowners associations, affordable housing groups, or other community or nonprofit organizations upon each resale of the property.”).

206. *See Sichelman, supra* note 204 (arguing that complete ban on PTFs would harm HOAs).

207. *See* Press Release, Fed. Hous. Fin. Agency, FHFA Proposes Guidance to Restrict GSEs from Investing in Mortgages with Private Transfer Fee Covenants (Aug. 12, 2010), available at <http://www.fhfa.gov/webfiles/16480/PrivTransferFeeGuidance081210.pdf> (setting forth timeline for FHFA’s proposed PTF guidance and regulations).

208. *See* Press Release, *supra* note 6 (stating FHFA would move forward with its regulation limiting government-backed banks from dealing with properties encumbered by PTF covenants).

and concerns received by the FHFA.²⁰⁹ The FHFA's proposed rules "would limit Fannie Mae, Freddie Mac, and the Federal Home Loan Banks from dealing in mortgages on properties encumbered by certain types of private transfer fee covenants."²¹⁰ The newly amended rule would exempt PTFs paid to HOAs, condominiums, cooperatives, and tax-exempt organizations that use the fee to directly benefit the property.²¹¹

2. Federal Legislation at a Cross Road

In addition to state laws and the proposed FHFA guidelines, Congress is currently considering legislation that would outlaw PTFs at the federal level. While multiple PTF bills were considered in 2010, none were enacted, and it is still unclear if any federal legislation will be passed in 2011. On September 29, 2010, H.R. 6260—sponsored by Representative Maxine Waters—was introduced in the House of Representatives.²¹² H.R. 6260, the Home Equity Protection Act of 2010, was referred to the House Financial Services Committee for further investigation and review.²¹³ As proposed, H.R. 6260 would prohibit the use of PTFs and PTF covenants on all federally collected mortgages.²¹⁴ In support of the proposed PTF legislation, Congressman Albio Sires stated that PTFs are dangerous to the housing market and that the federal government "need[s] to protect consumers from these corporate practices on a federal level."²¹⁵

In addition to an overall ban on the use of PTFs, Congress is also considering another bill that would require increased transparency for PTF covenants. Representative Phil Gingrey introduced H.R. 6332, the Homebuyer Enhanced Fee Disclosure Act of 2010, which would require increased disclosures to buyers and require PTFs to be properly labeled and recorded with the real property's title.²¹⁶ The House Committee on Financial Services is currently reviewing the bill. With both of the major bills on PTFs in the House Committee on Financial Services, a decision by

209. *See id.* (indicating FHFA updated guidance based on comments received on previous guidance by excluding fees paid to HOAs and other similar organizations).

210. *Id.*

211. *See id.* (indicating PTFs have beneficial uses in certain situations).

212. *See* Homeowner Equity Protection Act of 2010, H.R. 6260, 111th Cong. (2d Sess. 2010) (proposing ban on PTFs for federally backed mortgages).

213. *See id.*

214. *See id.* (stating transfer fees are illegal after effective date of legislation on federally related mortgage loans).

215. *See* Press Release, Office of Congressman Albio Sires, Sires Cosponsors Bill to Ban Private Transfer Fees (Sept. 29, 2010), available at http://sires.house.gov/index.php?option=com_content&view=article&id=569:9292010-sires-cosponsors-bill-to-ban-private-transfer-fees&catid=33:2010-press-releases&Itemid=107 (asserting federal legislation is needed in order to regulate PTF covenants).

216. *See* Homebuyer Enhanced Fee Disclosure Act of 2010, H.R. 6332, 111th Cong. (2d Sess. 2010) (proposing federal legislation to require increased disclosure and recording of PTFs).

that committee could decide the future of PTFs covenants. Currently, it appears unlikely that either of these bills will be passed into law.

C. *Model Legislation*

PTF covenants are contractual agreements that two or more parties agree on and enter into for the future payment of a fee upon the transfer of real property. PTFs, when properly recorded and disclosed, can provide benefits to all parties of the contract. However, a potential homebuyer might overpay for the property if the PTF is not timely disclosed to the buyer. As previously discussed, if the buyer does not find out about the PTF until after signing a purchase agreement or until closing, the buyer could be at a disadvantage in the real estate transaction because the buyer would have already invested significant time and money into the transaction and become contractually obligated, without actual knowledge of a potentially burdensome PTF. Further, the buyer would not be able to effectively negotiate the sales price to take into consideration the PTF.

While a complete ban on PTFs would eventually ease many of these problems, there are still currently an estimated 11 to 12 million homes encumbered by PTFs.²¹⁷ A complete ban on PTFs could have unintended consequences on these still-encumbered homes. Many of these homes will continue to be bound by PTF covenants for up to ninety-nine years. In addition, a complete ban would deprive developers, potential buyers, HOAs, non-profits, and businesses of their freedom of contract and a useful financial tool.

Instead of a complete ban on PTFs, adopting and amending California Civil Code sections 1098 and 1098.5 as model legislation would ensure that all PTF covenants are recorded, clearly identified, and timely disclosed to potential buyers. While sections 1098 and 1098.5 do a decent job of creating constructive notice for potential buyers by requiring that all PTF covenants are clearly identified and recorded with the county recorder, the provisions do a poor job of solving the issue of actual notice. The statute should be amended to include a section that requires all real property listings to include a disclosure of the PTF covenant, its stated amount, and its duration. Sellers and sellers' agents should be required to provide prospective buyers with a separate "Payment of Transfer Free Required" document, signed by the buyer as an acknowledgement of receipt. This requirement would provide important consumer protections to potential buyers before the signing of a purchase agreement, increase PTF transparency, and preserve a valuable financial mechanism for developers, HOAs, non-profits, and businesses without impeding on their freedom of

217. See Broderick Perkins, *CAI, CPCF: Don't Ban Private Transfer Fees*, EXAMINER.COM (Oct. 28, 2010), <http://www.examiner.com/real-estate-news-in-national/cai-cpcf-don-t-ban-private-transfer-fees> ("Banning private transfer fees on home sales could dam up the sale of some 11 to 12 million properties, according to a major homeowner association group and a new coalition supporting the fees.")

contract. Failure to comply with the proposed statute would permit the buyer to rescind the purchase agreement, recover all funds advanced to the seller or seller's agent, and be reimbursed for any and all of the buyer's costs, such as a home inspection fee.

VI. CONCLUSION AND RECOMMENDATIONS

PTFs already encumber billions of dollars of real estate; they will not be going away anytime soon, even if they are uniformly banned by federal regulations or legislation. However, the current trend is for states to ban the use of PTF covenants in new contracts while requiring full disclosure of existing PTF obligations. Changes to federal laws regarding PTFs are likely coming, with multiple bills under consideration in Congress and proposed regulations by the FHFA pending. However, it is unclear whether or not the federal government will go the path of banning PTFs or requiring full disclosure of PTF covenants.

PTFs are not an inherently bad financing tool. However, PTFs do lower the price of real property and this can have negative consequences for a potential buyer if the buyer is not made aware of the PTF in a timely manner. If the PTF covenant is not disclosed to the buyer before closing, the buyer will have already put significant time, money, and effort into the real estate transaction. The buyer will likely have signed a contract for the sale of the property and will not have been able to properly negotiate the real property's price in order to take into account the PTF.

Buyers need to know about the PTF covenant in a timely manner in order to effectively negotiate the sales price and complete the real estate transaction. While a full ban on PTFs would eliminate this problem, it can also be eliminated in a less burdensome manner. A full ban on PTFs may harm HOAs, non-profits, and a variety of other community associations currently relying on PTF payments. Failure to disclose in a timely, clear, and concise manner should give the buyer a right of rescission, create a cause of action for the buyer for all costs and funds advanced to the seller or seller's agents, and discharge the buyer to any parties under the purchase agreement including the realtor. PTFs should be disclosed in the listing of the real estate along with other material information such as property taxes and fees. In addition, the seller and seller's agents should be required to provide prospective buyers with a separate document—Payment of Transfer Fee Required—signed by the buyer as an acknowledgment of receipt. This would inform the buyer about the PTF with adequate time to negotiate the price.

PTF covenants are contracts between the initial buyer and property developer that run with the land for a determined length of time. These covenants can provide flexible financing to both the developer and buyer. The buyer is able to pay less money up front and the developer is able to attain a future income stream and interest in the property. In conclusion, PTFs are a reasonable financing vehicle that can bring about long-term

2012] PTFs: EXPLOITATION OR FINANCING VEHICLE? 933

economic stability to communities, lower housing costs, increase finances available for community improvements, increase housing values in the long-run, and provide potential packages for investors. However, the benefits of PTFs are only acceptable if a buyer has actual notice of a PTF prior to executing a purchase agreement.

