

Legislative Analysis



PROHIBIT RESIDENTIAL & COMMERCIAL PROPERTY TRANSFER FEES

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House Bill 4227 (Substitute H-3)
Sponsor: Rep. Paul Opsommer

House Bill 4228 (Substitute H-3)
Sponsor: Rep. Bruce Rendon
Committee: Regulatory Reform

First Analysis (3-22-11)

BRIEF SUMMARY: The bills would create two new acts to effectively nullify any transfer fee covenant involving commercial or residential property executed on or after the bills' effective date, define terms, allow exemptions, and provide remedies.

FISCAL IMPACT: The bill would have no direct fiscal impact on the state or local units of government.

THE APPARENT PROBLEM:

Recently, a real estate investor created a patented method or system by which his firm, Freehold Capital Partners, can append to the title of a home a special rider, or covenant. Generally speaking, this covenant does not affect the initial home or commercial property buyer. But each time that the property is subsequently sold, transferred, or in any way conveyed, for a period of 99 years, one percent or more of the sales price must be conveyed to the beneficiary or trustee. The beneficiary, besides including Freehold Capital Partners, is typically a builder or real estate developer of commercial and/or residential properties. It works like this: a home sale of \$200,000 would generate a private transfer fee of \$2,000. If the home appreciates to \$500,000 and is sold again, the fee would be \$5,000, and so on. Known as "reconveyance fees," "capital recovery fees," or "private transfer fees," these fees by any name are controversial.

Opponents of the transfer fees include title agents, real estate agents, lawyers, consumer advocates, property rights groups, military families, and many others. They say that the transfer fee clauses are hidden in real estate documents and either not disclosed until closing (when home buyers are unlikely to walk away) or not disclosed at all. Often it is not until a subsequent owner decides to sell and a clear title cannot be obtained because of the attachment of the transfer fee covenant that the realization hits that the seller must either take a one percent loss on the sale of the property or that the buyer will have to pay one percent more. In times like these, when the economy makes it difficult for both buyers and sellers, the existence of a transfer fee can break a deal. Moreover, some attorneys question the legality and enforceability of private transfer fees as they may not stand the test under common law of a covenant running with the land. Even the Federal Housing Administration (HFA) is taking a look at the issue by considering adopting a

rule prohibiting private transfer fees on any mortgage backed by Fannie Mae or Freddie Mac. According to the American Land Title Association, "private transfer fee covenants harm economic growth by hindering the legal, secure and efficient transfer of property."

However, there is another side, that of the beneficiaries of such transfer fees. "Developers are desperate," says a lawyer and former developer in a New York Times article entitled, "Resale Fees That Only Developers Could Love." Many development projects have been canceled or abandoned midstream, with half-finished buildings and equipment left behind, due to investors' money drying up in the latest recession. Infrastructure required for new neighborhoods, such as sewers, gas lines, and sidewalks, are expensive. Private transfer fees are one way that developers of both commercial and residential projects can create a new revenue stream to fund current and future projects. They say that knowing a project will continue to generate revenue into the future enables them to find investors now and also works to keep costs down for the initial buyers. Securitizing the fees also provides upfront money to begin or finish a development project. According to some media reports, developers have already moved some multi-million dollar projects from states adopting a ban on private transfer fees to states that do not prohibit them.

Currently, at least 19 states have adopted legislation restricting the use of private transfer fees. Most of these laws are out-and-out bans on the transfer fees. Some states, such as California, have opted instead to adopt mandatory disclosure requirements and require a portion of the fees be paid to environmental groups. Legislation has been introduced that would ban private transfer fees for both commercial and residential property sales or conveyances in Michigan.

THE CONTENT OF THE BILLS:

Together, the bills would prohibit a transfer fee covenant executed on or after the bills' effective date from running with the title to real property. Specifically, the transfer fee covenant would not be binding on or enforceable against any subsequent owner, purchaser, or mortgagee of any interest in the real property as an equitable servitude or otherwise. This would be the case whether or not the transfer fee covenant had been recorded. Any lien purporting to secure the payment of transfer fee covenant executed on or after the effective date of the legislation would be void.

"Transfer fee covenant" would mean a declaration or covenant that required or purported to require the payment of a transfer fee to the declarant or other person specified in the declaration or covenant or to that person's successors or assigns.

"Transfer fee" would be defined to mean a fee or charge payable upon the subsequent sale, gift, conveyance, assignment, inheritance, or other transfer of an ownership interest in nonresidential (commercial) or residential real property located in the state, or payable for the right to make or accept such a transfer, regardless of whether the fee or charge was a fixed amount or was determined as a percentage of the value of the property, the purchase price, or other consideration given for the transfer.

Numerous categories of private transfer fees would be excluded from the definition of the term. For example, homeowners' association fees, which are used to make improvements in the community for the benefit all the owners in a subdivision, would be exempt from the ban imposed by the bills.

A person who was aggrieved by the imposition of a transfer fee, whether being the original or subsequent transferee or purchaser, could bring an action to clear the title and void the transfer fee and for other equitable relief. The court could award actual reasonable attorney fees and other costs of bringing the action.

House Bill 4227 would apply to nonresidential or commercial properties. House Bill 4228 would apply to residential properties.

BACKGROUND INFORMATION:

The issue of capital recovery fees, also known as private transfer fees, is one of longstanding practice, and of increasing interest nationally. The Federal Housing Finance Authority (FHFA) notes that "private transfer fee covenants may be attached to real property by the owner or another private party – frequently, the property developer – and provide for a transfer fee paid to an identified third party – such as the developer or its trustee – upon each resale of the property. The fee typically is stated as a fixed amount or as a percentage, such as one percent of the property's sales price, and often exists for a period of ninety-nine (99) years."¹ Others have noted that, "[c]apital recovery fee covenants are a type of private transfer fee that helps to reduce negative equity, thereby assisting in restarting failed development projects and creating jobs. These fees have been utilized like homeowner association fees, but rather than providing for the cost of maintenance and upkeep of common infrastructure, capital recovery fees are used to spread the cost of the development and construction of common infrastructure over the life of the property."² Under this second view, the future revenue from private transfer fee covenants can be securitized (or monetized) and used as a type of investment that provides the developer with an upfront payment.

In response to growing concern about the use of these covenants, the FHFA issued proposed rules on February 8, 2011, that restricts Fannie Mae, Freddie Mac, and the Federal Home Loan Banks from investing in mortgages with private transfer fee covenants, except for transfer fees paid to certain associations (homeowners, condominium, etc.) for the direct benefit of the property encumbered by the private transfer fee covenant. The proposed rules would not affect state restrictions or requirements imposed on private transfer fee covenants, such as disclosure requirements

¹ Federal Housing Finance Authority, *Notice of Proposed Rule Making, Private Transfer Fees, RIN 2590-AA41*, http://www.fhfa.gov/webfiles/19672/76_FR_6702_2-8-11.pdf. In August, the FHFA issued proposed guidance on the use of private transfer fee covenants, http://www.fhfa.gov/webfiles/16484/75_FR_49932_8-16-2010.pdf. Together the proposed guidance and the proposed rules have generated thousands of written comments, which may be read at, <http://www.fhfa.gov/Default.aspx?Page=89>.

² See the testimony of Patton Boggs LLP on behalf of Freehold Capital Partners responding to the FHFA guidance, http://www.fhfa.gov/webfiles/19294/2521_Patton_Boggs_LLC_on_behalf_of_Freehold_Capital_Partners.pdf.

or limitations on durations. Reportedly, 19 states have enacted legislation restricting the use of these fee covenants.

ARGUMENTS:

For:

The bills represent an important consumer protection needed to stop the problem of homeowners' equity being stripped at the time of a sale for the benefit of someone who – because the life of the transfer fee covenant generally is 99 years – has no relationship any longer with either the property or the property owner. Reportedly, military families are hit hardest by transfer fees as they must move frequently and often with little time to prepare or wait for the best offer. And to whom do these fees go? Beneficiaries may include the developer, a real estate agent working with Freehold Capital, other investors, whoever buys a securitized transfer fee covenant, and all of their heirs or assignees until the 99 years is up.

According to information derived from a letter by the National Association of Independent Land Title Agents (NAILTA) to the National Association of Insurance Commissioners (NAIC) informing NAIC of its opposition to private transfer fee covenants, if a covenant is missed at closing, a lien is attached to the title that must be paid the next time the home or property is sold. "In such a situation, the buyer who was unaware of the covenant, who did not successfully negotiate a reduction in the sales price to account for the encumbrance, will be forced to pay the previous transfer fee that was missed, his transfer fee due on the sale, and most likely be forced to reduce the price of the home once the covenant is discovered." The homeowner likely would have little recourse against the previous owner who did not disclose the transfer fee. There may even be an increase in title insurance claims, though title insurance does not guarantee that such a homeowner would be protected from these covenants. Moreover, transfer fee covenants "add a significant burden to title searchers to not only locate these covenants in recorded documents and report them," but due to their very nature will, over time, "increase the period of time a searcher will have to review land records looking for these covenants."

Whether attached to residential or commercial properties, there is no compelling justification for future generations on one side of the deal to profit from the sale of property when those living on the property – who had no choice whether to accept such a covenant or not – must lose precious equity and face difficulties finding a buyer willing to take a similar loss when selling in the future. Michigan should join the swell of states choosing to ban, rather than restrict, the use of transfer fee covenants.

Against:

Not everyone is opposed to private transfer fee covenants. Legislation banning or restricting their use has been defeated by some states, such as Texas. Some home buyers looking to be the first generation to move into a new residential development welcome the fee system as a way to buy at a lower price. This is possible because the transfer fees allow a developer to spread the cost of infrastructure to subsequent buyers. After all, it is

argued, these individuals will be benefiting from the trees and sidewalks one day, too, so why shouldn't they share in the costs?

Perhaps most importantly, at a time when financing is hard to come to by, when jobs need to be created, when local economies need an infusion of new property tax payers, and so on, commercial and residential development projects funded in part by transfer fees on other properties can be the answer.

Plus, many do not realize that Freehold Capital requires each of their instruments to require that a portion of the gross transfer fee go to non-profits in the community for as long as the covenant lasts, thus creating a long-lasting revenue stream for local non-profits.

The point is, some believe that the option to use transfer fee covenants as a revenue stream for future development projects and to lower the costs to buy into new developments is one tool that should not be taken away from developers, investors, and consumers.

POSITIONS:

The Michigan Credit Union League indicated support for the bills. (3-9-11)

The Michigan Bankers Association indicated support for the bills. (3-9-11)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

