SAVE COMMUNITY BENEFITS

HOMEOWNER & COMMUNITY BENEFITS ARE AT RISK

March 15, 2011

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

Subject: Proposed Rule on Private Transfer Fees: (RIN 2590-AA41)

Dear Mr. Pollard:

We appreciate the opportunity to comment on the proposed rule on Private Transfer Fees (the "Proposed Rule"), which was published in the Federal Register on February 8, 2011. This letter and the attached analysis, which is incorporated herein, are sent on behalf of the members of the Coalition to Save Community Benefits ("Community Benefits Coalition" or "Coalition"). The Coalition includes a wide range of national, regional and local stakeholders from both the private and nonprofit sectors, including land owners, homeowners associations, major environmental and conservation organizations, and affordable housing interests from across the country. Collectively, the Coalition represents millions of constituents nationwide.

The Community Benefits Coalition supports the Proposed Rule's restriction on transfer fees that only benefit private third parties (*e.g.,* developers); however, the regulation would have the unintended affect of chilling the already weakened housing finance market and, without articulating the presence of an existing problem, the Proposed Rule takes away the right of home buyers, as a practical matter, to pay for the resources and services they believe best serve them and their community. In addition, several of the Proposed Rule's definitions lack a requisite degree of precision, creating substantial uncertainty for home buyers, homeowners associations, banks, developers and others. Moreover, other terms are inconsistent with federal tax law concerning organizations established under Internal Revenue Codes ("IRC") 501(c)(3) and (c)(4), creating an internal conflict in the Proposed Rule's terms and policy intent. These concerns, and issues pertaining to the administration of the rule, require comprehensive revisions to the Proposed Rule. Please see ***Exhibit A*** detailing our analysis.

In the interest of expediency, we are sending you this analysis of the Proposed Rule in advance of our detailed proposed suggestions, clarifications and recommended modifications. A further comment letter from the Coalition setting forth these suggestions will follow. Fundamentally, the Coalition recommends that the Proposed

Rule be revised based, in large measure, on the lead of states across the country and at least one bill in the last Congress by protecting homeowners and taxpayers from unscrupulous uses of transfer fees through requirements including:

- Recording and notice requirements to ensure homebuyers and title companies are aware of the presence of a transfer fee encumbrance;
- Express statements in the transfer fee covenant that fees are not payable upon foreclosure to protect the financial market, Fannie Mae, Freddie Mac, and taxpayers; and
- Clearly exempting from the Proposed Rule community benefit transfer fees paid to certain categories of entities (*e.g.* all nonprofit organizations including IRC section 528 community associations).

These approaches, rather than the new "direct benefit" test with respect to nonprofit organizations including IRC section 528 community associations, would achieve the Proposed Rule's policy goals in an administratively workable manner and in a way that preserves the rights of individuals to enhance the value of their respective homes and communities through the use of community benefits fees.

Again, we appreciate the opportunity to provide comments on the Proposed Rule. The Coalition would welcome the opportunity to work with the Federal Housing and Finance Agency to address abusive use of private transfer fees, while preserving those community benefit fees that evidence shows enhance the value of mortgaged properties and the communities in which they are located.

Sincerely yours,

Tim Frank
Coalition to Save Community Benefits

Encl. (A): Coalition to Save Community Benefits Analysis of FHFA Proposed Rule

Cc: Honorable Melody Barnes, Director, White House Domestic Policy Council
Honorable Gene B. Sperling, Director, White House National Economic Council
Honorable Shaun Donovan, Secretary, Department of Housing and Urban Development
Honorable Ray LaHood, Secretary, Department of Transportation
Honorable Timothy Geithner, Secretary, Department of Treasury
Honorable Kenneth Salazar, Secretary, Department of the Interior
Honorable Harry Reid, Majority Leader, United States Senate
Honorable Mitch McConnell, Minority Leader, United States Senate
Chairman, Ranking Member and Members of the Senate Banking Committee
Honorable John Boehner, Speaker, United States House of Representatives
Honorable Nancy Pelosi, Minority Leader, United States House of Representatives
Chairman, Ranking Member and Members of the House Financial Services Committee
Edward DeMarco, Interim Director FHFA

EXHIBIT "A"

EXECUTIVE SUMMARY

The Federal Housing Finance Agency ("FHFA") announced, on February 8, 2011, the publication of a proposed rule concerning private transfer fees and noticed the opening of a 60-day comment period. While the proposed rule appropriately restricts transfer fees that only benefit private third parties (*e.g.,* developers), the regulation would create numerous problems through the use of vague and inconsistent definitions, inconsistency with federal tax law governing non-profit organizations and needless limitations on commonly used property enhancing funding mechanisms. The proposed rule would, among other things:

- take away the right of home buyers, as a practical matter, to pay for the resources and services they believe best serve them and their community;
- functionally disallow the use of transfer fees to maintain value in mortgaged property through support of activities that provide community-wide benefits (*e.g.*, parks) in addition to benefits conferred to those paying the fee;
- create substantial uncertainty for home buyers whose property is encumbered by private transfer fee covenants due to the proposed rule's lack of clarity;
- create uncertainty for developers and homeowner associations as to whether planned for community financing will be available;
- place new limitations on the way communities organize themselves;
- require banks and other mortgage making entities to engage in a fact intensive, case-by-case analysis to determine whether a specific transfer fee is excepted from the rule. This analysis will add new time, expense and uncertainty to the mortgage making process; and
- result in FHFA and other Federal regulators interpreting the ambiguously written rules through informal guidance documents and legal opinions.

By way of background, the FHFA was established as an independent regulatory entity under the Housing and Economic Recovery Act of 2008 (Pub.L. 110-289). The Act founded the agency to coordinate the Federal response to the housing crisis and provide oversight of the United States housing finance market. FHFA's regulatory mission is "to ensure, among other things, that each regulated entity it supervises "operates in a safe and sound manner" and that their "operations and activities * * * foster liquid, efficient, competitive, and resilient national housing finance markets." (12 U.S.C. 4513(a)(1)(B))." President Obama designated Edward J. DeMarco as the Acting Director in August 2009.

A. Background

On August 16, 2010, the FHFA issued a proposed guidance document that would have prohibited the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Federal Home Loan Banks (collectively, "Regulated Entities") from dealing in mortgages on properties encumbered by private transfer fees. The FHFA received over 4,210 (mostly negative) comments, including comments pointing

out to FHFA that proceeding by guidance rather than rulemaking violates the Administrative Procedure Act.

FHFA's new proposed rule attempts to narrow the scope of the draft guidance, but creates problems caused by the use of open-ended language, inconsistent terms, and a continued improper intrusion into the way communities organize themselves. The proposed rule principally departs from the guidance by (1) excepting transfer fees imposed prior to the date of the publication of the rule; and (2) attempting, albeit unsuccessfully, to except from the rule transfer fees that pay for, *e.g.*, homeowner association facilities and services. The proposed rule is available on the FHFA's website at http://www.fhfa.gov/Default.aspx?Page=27.

The ambiguities and inconsistencies of the proposed rule, in addition to FHFA's policy overreach, defeat the proposed rule's purpose by creating uncertainty and undue restrictions on properties encumbered by community benefits transfer fees.

B. Rule Summary

The proposed rule provides that the Regulated Entities are prohibited from "purchas[ing] or invest[ing] in any mortgages on properties encumbered by private transfer fees… unless such covenants are *excepted transfer fee covenants*." Proposed Rule section 1228.2 (emphasis added). A discussion of "excepted transfer fees" follows below. The proposed rule also excludes from its application, "fees, charges, or payment, or other obligations… [i]mposed by or are payable to the Federal government or a State or local government…" Proposed Rule section 1228.1. Taking the exceptions and exclusions into consideration, the proposed rule restricts the Regulated Entities from dealing in mortgages on properties encumbered by transfer fees that benefit:

- Private third parties (*e.g.*, developers/Freehold-type transfer fees);
- The general public (*e.g.*, community-wide affordable housing, parks or sustainable building practices), except in certain instances where the benefitting members of the public pay a fee; and
- Homeowner's Associations and like organizations, when the transfer fees also benefit members of the public.

The FHFA explains its rationale for the proposed rule's policy against transfer fees in the preamble to the regulations. With respect to private third parties the FHFA states, "there is no relationship between the transfer fee and the actual cost to the developer." 76 Fed. Reg. 6706. Therefore, under the FHFA's rationale, value is removed from the property without a commensurate benefit to the collateral property. With respect to transfer fees that benefit the general public the FHFA states, "[a]lthough the activities themselves may be meritorious, it appears that these private transfer fees provide a benefit to the general community rather than specifically to the community that is burdened by the private transfer fee covenant, and hence are not dedicated to enhancing the value of the residential housing collateral that is central to the underwriting of mortgage loans." *Id.* Consequently, FHFA proposes to restrict the Regulated Entities from dealing in mortgages encumbered with such transfer fees, regardless of whether the fees also benefit the encumbered community. No analytical support other than inference is provided for the proposed rule's policy rationale.

Again, noting the ambiguity of the proposed rule, the following is a best effort summary of the proposed rule's effect on different categories of transfer fees.[1]

	Excepted or Excluded **(Regulated Entities Not Barred from dealing in mortgages)**	**At Risk**	**Not Excepted** **(Regulated Entities Barred from dealing in mortgages)**
Grandfathered Transfer Fee Covenants	• Transfer fee covenant created prior to February 8, 2011		
Private Third Party (*e.g.*, a developer)			• Freehold-type Transfer Fees
Mandatory Membership Residential Organization or Organization (*e.g.*, Homeowner's, Condominium, or Coop Associations) or non-profit organizations incorporated under IRS section 501(c)(3) or 501(c)(4)	• Maintenance of cooperative/ homeowners associations' common areas and amenities (*e.g.*, pool) provided: (1) members of the public are either excluded or pay a fee for use; and (2) facility is within 1000 yards of the mortgaged property	• Maintenance of homeowner associations common areas/amenities (*e.g.*, pool) not within 1000 yards of the encumbered property • Shuttle bus service for HOA members to off-site locations • Open space/ conservation lands extending beyond 1000 yards from the encumbered property from which members of the public are excluded • Affordable housing solely within the encumbered community	• Funding for development or operation of open access educational or cultural centers, and parks
Federal/State/ Local Entities	Excluded from proposed rule		

[1] For example, the proposed rule limits the benefit conferred by the use of transfer fees to "encumbered properties" in the definition of "excepted transfer fee covenant." However, the definition of the term "direct benefit" appears to allow the benefit incurred to attach to "adjacent or contiguous property."

C. Analysis of What Constitutes an "Excepted Transfer Fee"

The proposed rule provides exceptions to its prohibition on the Regulated Entities' ability to deal in mortgages of properties encumbered by private transfer fee covenants created after February 8, 2011. FHFA proposes to except private transfer fee covenants from the general rule, if the transfer fee payment is: (1) made to a "covered association;" and (2) "used exclusively for the direct benefit of the real property encumbered by the transfer fee covenant." Proposed Rule section 1228.1. These terms are defined below. Because qualification under these terms requires a fact-based determination, banks and other mortgage making entities will be required to analyze individual transfer fee covenants on a case-by-case basis, including field-level investigation.

1. The entity receiving the transfer fee must be a "Covered Association"

The proposed rule requires that the entity receiving the transfer fee to be a "covered association." The term, "covered association," includes typical homeowners/condominium or cooperative associations established under a declaration or covenant, and nonprofit entities organized under IRS section 501(c)(3) or 501(c)(4). Proposed Rule section 1228.1. It is noted that in practice 501(c)(3) organizations would likely not be "covered associations," because under federal tax law, the benefits such organizations provide must be exclusively public; whereas, the proposed rule requires the benefit from transfer fees to flow exclusively to the encumbered property (i.e., private benefit). *See* 26 CFR §1.501(c)-(1)(d)(ii) (IRS rule requiring charitable entities to provide public benefits); *compare* Rev. Rul. 75-286, 1975-2 C.B. 210 (holding that a block association established to preserve and beautify the immediate vicinity of the residents did not qualify under 501(c)(3) as the entity was created to serve private interests) *to* Rev. Rul. 70-186, 1970-1 C.B. 128 (holding that an organization established for the improvement of a large lake, created benefits "principally to the general public through the maintenance and improvement of public recreational facilities[, and the benefit to lake-front residents was incidental only.]"). Similarly, entities organized under IRS section 501(c)(4) would also, in practice, rarely qualify as "covered association." The IRS requires that a 501(c)(4) organization primarily provide benefits to the "community," which "has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or unit or district thereof." IRS Rev. Rul. 74-99, 1974-1 C.B. 132. To the extent the transfer fee benefit is conferred to the encumbered property--the touchstone of excepted transfer fees--, the organization would not qualify for 501(c)(4) status. *See, e.g.,* Letter ruling 20080935 (exemption under 501(c)(4) denied where a homeowners association limited benefits, including social activities and security patrol, only to members rather than the community); *see also* Letter Ruling 200910067.

2. The "Encumbered Property" must receive the "Direct Benefit"

The proposed rule defines the term, "direct benefit," based on: (1) the type of activities to which funds are applied; (2) the specific properties that are benefited; and (3) how exclusive the benefits are to the subject properties. Each of these issues is further discussed below.

i. Range of activities that may be funded

The proposed rule provides that the private transfer fee funds must be used "exclusively to support maintenance and improvements to encumbered properties as well as cultural, educational, educational, charitable, recreational, environmental, conservation or other similar activities…" Proposed Rule section 1228.1. Although this range of activities is broad, it does not facially include transportation or affordable housing activities or resources, calling into question whether they are the type of activity envisioned by the FHFA. Depending on subsequent interpretation and case-by-case analysis of the nature of the benefit conferred, these activities may be included under the phrase "other similar activities," but this is not assured. In practice "charitable" activities would likely not qualify as permitted uses of transfer fees, as the benefit conferred would likely be found to be public, rather than inuring exclusively to the benefit of the subject encumbered property.

ii. Properties that may be benefited by the use of the transfer fees

The properties benefited by the use of the transfer fees must either be the encumbered properties or proximate to the encumbered properties. 76 Fed. Reg. at 6707. Specifically, the proposed rule provides that the "benefit [from the use of the transfer fee] must flow to the encumbered property or the community comprising the encumbered properties and their common areas or to adjacent or contiguous property [*i.e.*, property that is proximate to, and not more than 1000 yards from, the encumbered property]."[2] *Id.* It is noted that the phrase, "community comprising the encumbered property," is not defined. Moreover, the proposed rule leaves undefined how the "1000 yard" limit would be applied in practice (*e.g.*, whether the 1000 yards is measured from each encumbered parcel or the closest such property to the beneficial resource or service). Potentially, this provision could result in a transfer fee covenant falling outside the exception if the revenues generated are used to fund a clubhouse, for example, and the individual lot that would be subject to the transfer fee is not within 1000 yards of the clubhouse.

iii. No public benefit, unless a fee is paid

The proposed rule requires that the activities supported by the transfer fee "benefit exclusively the real property encumbered by the private transfer fee covenant." Proposed Rule section 1228.1. The proposed rule emphasizes that, "members of the general public may use the facilities funded by the transfer fees in the burdened community and adjacent or contiguous property only upon payment of a fee, except that *de minimis* usage may be provided free of charge for use by a charitable or other not-for-profit group." *Id.* Thus, in general, the facilities and programs funded by transfer fees may not benefit the general public in any way, although the general public may be allowed to use "facilities" upon payment of a fee.

[2] More specifically, the proposed rule states that "Adjacent or contiguous property means property that borders or lies in close proximity to the property that is encumbered by a private transfer fee covenant or to other similarly encumbered properties located in the same community and owned by members of the same covered association, provided that in no event shall a property greater than one thousand (1000) yard from the encumbered property be considered adjacent or contiguous." Proposed Rule section 1228.1.

As discussed above, this requirement potentially excludes all 501(c)(3) and all but a few 501(c)(4) organizations from administering private transfer fee funds and precludes charitable (*e.g.,* public benefit) uses. In addition, this requirements would exclude homeowner's association, and like organizations, that create amenities, e.g., parks or open space, that are not restricted from public use. The notion that tax exempt 501(c)(3) and 501(c)(4) organizations could provide services or facilities that exclusively benefit private property owners is anathema to the federal tax laws governing non-profits.

D. Administration

The proposed rule, should it become effective, would provide a significant challenge to mortgage lenders attempting to determine whether a particular transfer fee covenant is excepted. Making such a determination would require in depth analysis of how transfer fees are actually used, whether the use of fees exclusively benefits the encumbered property, distance between the encumbered lot and the use to which the transfer fee is applied, and whether fees for use of facilities are charged to the general public. The difficulty in making these determinations will undoubtedly disincent lenders from considering loans against properties encumbered by transfer fee covenants, even where such covenants should be excepted.

E. Conclusion

Under the proposed rule, the Regulated Entities would be proscribed from dealing in properties subject to a new transfer fee covenant that convey: (1) public benefits in addition to those to the encumbered property; (2) benefits to property located more than 1000 yards from the encumbered property; or (3) benefits to third party private entities (*e.g.,* Freehold). Additionally, as a practical matter, nonprofit entities organized under Internal Revenue Code 501(c)(3) or 501(c)(4) could not receive or use private transfer fees. Finally, the lack of precision in the proposed rule's language will create substantial compliance challenges for the Regulated Entities and those funding mortgages and uncertainty for homeowners, developers, homeowner associations and others. It may reasonably be assumed that properties encumbered by post-proposed rule transfer fees will face new hurdles to financing, regardless of whether they are excepted.