JOINT EDITORIAL BOARD
for
UNIFORM REAL PROPERTY ACTS

April 5, 2011

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

Re: Public Comments on RIN 2590-AA41 [Fannie Mae, Freddie Mac and the Federal Home Loan Banks: Restrictions on the Acquisition of, or Taking Security Interests in, Mortgages on Properties Encumbered by Certain Private Transfer Fee Covenants and Related Securities]

Dear Mr. Pollard:

On behalf of the Joint Editorial Board for Uniform Real Property Acts (JEBURPA), we are submitting these comments on the above-referenced proposed rule, which would be promulgated as 12 C.F.R. § 1228.1 *et seq*.

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

On October 12, 2010, the JEBURPA submitted an extensive comment letter regarding the FHFA's previous proposed guidance regarding private transfer fee covenants. In that comment letter, we noted our concern principally with (a) the overbreadth of the proposed guidance (which would have covered any covenants imposing transfer fees payable to community associations to finance the provision of community services or the maintenance of community facilities) and (b) the retroactive nature of the proposed guidance (which would have rendered unmarketable the titles of a substantial number of existing homeowners with properties already subject to an existing private transfer fee covenant). Upon reviewing the above-referenced proposed

rulemaking (hereafter, the "Proposed Rule"), we are pleased to see that the FHFA so thoroughly addressed the concerns raised in our prior comment letter.

While the JEBURPA is generally supportive of the overall purpose and objectives of the Proposed Rule, a through review of the Proposed Rule — particularly its definitions (or, in some cases, lack of defined terms) — reveals several concerns that we believe should be addressed by further clarification. This comment letter elaborates on these concerns.

I. The scope of the defined term "private transfer fee." In its current form, the proposed rule contains a narrow exclusion from the term "private transfer fee" for four particular types of fees: (1) fees imposed by a court decree; (2) fees imposed by or payable to the federal government or a state/local government; (3) fees arising out of a mechanic's lien; or (4) fees arising from an option to purchase land or from the waiver of the right to purchase land. In our view, some additional scope exclusions are needed so that the proposed rule will not be overbroad in its application. For example:

Loan assumption fees. A mortgage or deed of trust sometimes contains a provision permitting the lender to impose an assumption fee if the mortgagor makes a permitted transfer of the mortgaged premises to a transferee that assumes the underlying mortgage debt. Such an assumption fee would be a "fee ... imposed by a ... restriction or other similar document and required to be paid in connection with or as a result of a transfer of title to real estate" and thus a "private transfer fee" within the meaning of the Proposed Rule.

An assumption fee reimburses the lender's expenses incurred in investigating an assumption transfer and/or compensates the lender for the fee income the lender forgoes by permitting a loan assumption (rather than making a new mortgage loan). An assumption fee provision does not place a continuing charge on the land (i.e., it remains effective only until the mortgage authorizing the assumption fee is satisfied) and does not unreasonably restrain the alienability of mortgaged land. Nor would the presence of an assumption fee provision render the mortgage unsafe or unsound as an investment for Fannie Mae or Freddie Mac (the "Enterprises") or the Federal Home Loan Banks (the "Banks"). As such, we would suggest that FHFA modify the proposed definition of "private transfer fee" to exclude any provision of a mortgage that imposes a fee payable to the mortgage lender upon that lender's consent to a transfer of the mortgaged premises.

Loan prepayment fees. Commercial mortgages or deeds of trust frequently contain a provision permitting the lender to impose a prepayment fee if the obligor/mortgagor should choose to prepay all or part of the debt prior to its originally scheduled maturity. While the JEB believes it was not the FHFA's intent for the Proposed Rule to cover a prepayment fee, a prepayment fee could nevertheless be characterized as "a fee ... imposed by a ... restriction or other similar document and required to be paid in connection with or as a result of a transfer of title to real estate," at least to the extent that the prepayment fee is triggered by a payoff of the mortgage loan in connection with a transfer of the mortgaged real estate. Thus, it is

possible that such a prepayment fee falls within the definition of a "private transfer fee" within the meaning of the Proposed Rule.

A prepayment fee compensates the lender for income lost because the prepayment deprived the lender of the ability to collect future interest payments at a favorable interest rate negotiated at the time of the mortgage transaction. It does not place a continuing charge on the mortgaged premises and does not unreasonably restrain the alienability of the mortgaged land. Further, the presence of a prepayment fee would not render a mortgage unsafe or unsound as an investment for the Enterprises or the Banks. Consequently, we would suggest that the FHFA modify the proposed definition of "private transfer fee" to exclude any provision in a mortgage that imposes a fee payable to the mortgage lender upon prepayment of some or all of the mortgage debt prior to its originally scheduled maturity.

Deferred purchase price payments/appreciation sharing contracts. In some transactions, a seller of land may agree to defer the buyer's payment of some portion of the purchase price until the buyer's subsequent resale of the land. In such a transaction, the seller might prudently place a restriction in the deed to buyer stating that buyer's obligation to pay the deferred price would "run with the land" to bind buyer's successors in title until that obligation was satisfied. Such a provision would effectively require a subsequent transferee from the buyer to ensure that the deferred price had been paid to seller to ensure that the subsequent transferee receives a clear title.

Likewise, sometimes a buyer of land might agree that upon the buyer's subsequent resale, the buyer shall pay to the seller some portion of any appreciation recognized by the buyer upon the resale. Again, the seller in such a case would insist that the deed of conveyance make the buyer's obligation one that "ran with the land" until that obligation was satisfied.

If a purchase and sale agreement imposes such a fee upon retransfer on a one-time basis only, with no additional fee arising upon subsequent retransfers of the affected property, that agreement does not unduly hinder the alienability of land. Courts have generally enforced such fee provisions as valid. *See, e.g., United States v. 397.51 Acres of Land,* 692 F.2d 688 (10th Cir. 1982); *Kerley v. Nu-West, Inc.*, 762 P.3d 631 (Ariz. App. 1988); *Application of Mazzone,* 22 N.E.2d 315 (N.Y. 1939); *Whittemore v. Woodlawn Cemetery,* 75 N.Y.S. 847 (App. Div. 1902); *Bennet v. Washington Cemetery*, 11 N.Y.S. 203 (Sup. Ct. 1890). As a result, such a fee should not be viewed as a "private transfer fee" within the meaning of the Proposed Rule. We respectfully suggest that the Proposed Rule except such provisions by adding an additional exception to the definition of "private transfer fee" that would exclude a fee that "is payable on a one-time basis only upon the next transfer of an interest in the encumbered real property and, once paid, shall not bind successors in title to that property."

II. The scope of the definitions of "excepted transfer fee covenant," "adjacent or contiguous property," and "direct benefit." As drafted, the Proposed Rule creates an exclusion for covenants imposing transfer fees payable to a "covered association" if the fee is used "exclusively for the direct benefit of the real property encumbered by the private transfer

fee covenants." This exclusion recognizes the need to protect common interest communities that have chosen to finance the construction, operation, and maintenance of common amenities through the use of transfer fees payable to the owners' association. As drafted, the Proposed Rule also provides some additional flexibility by defining the term "direct benefit" such that an excepted transfer fee covenant could flow to the benefit of "adjacent or contiguous property." This would protect, for example, a covenant imposing transfer fees to be used to support the preservation/maintenance of land subject to a conservation servitude, even if the benefitted land did not lie within the affected common interest development, so long as the benefitted land was considered "adjacent or contiguous." Finally, the Proposed Rule creates a radius provision under which the benefitted property can be considered "adjacent or contiguous" only if it is within 1000 yards of the land burdened by the covenant.

While we understand the intended objective of the Proposed Rule, we are concerned that the definitions do not work together seamlessly to accomplish these objectives in a sufficient fashion. The following paragraphs articulate our primary concerns.

The "direct benefit" requirement and "user fees." The Proposed Rule provides that "[a] private transfer fee covenant will be deemed to provide a direct benefit when members of the general public may use the facilities funded by the transfer fees in the burdened community and adjacent or contiguous property only upon payment of a fee, except that de minimis usage may be provided free of charge for use by a charitable or other not-for-profit group." We note several problems with this provision.

First, there will be some situations in which a user fee for nonresidents of the affected development might be entirely inappropriate to the nature of the benefitted land. For example, a common interest community might impose a transfer fee covenant to subsidize the operation/maintenance of a recreational trail that is located outside the common development, but which links that common interest community to a broader public trail network that exists throughout the municipality. In such a situation, the very idea would be for the trail to be open to the general public; imposition of a user fee on nonresidents of the development would be unwarranted (and, in any event, impracticable). Furthermore, the operation/maintenance of that trail would provide the same benefit to all residents within the development, whether or not a user fee was imposed.

Second, it is not clear whether the "direct benefit" provision is meant to require the imposition of a user fee to satisfy the rule, or instead to create a type of "safe harbor" under which a community that did not impose such a fee could nevertheless argue that the fee provided a "direct benefit." If the intent is to require a user fee to satisfy the rule, then (as discussed above) it would prevent use of private transfer fees to fund certain types of parks, trails, or conservation areas where exclusion of the general public is impracticable. If the intent is to create only a safe harbor, such an approach would appear unworkable unless the FHFA is prepared to establish some type of administrative process by which a developer/community could obtain prior approval that a particular transfer fee covenant

satisfied the "direct benefit" standard. However, the current Proposed Rule does not appear to provide any such administrative process.

The "direct benefit" requirement and fees that fund programs rather than facilities. In some situations, developers have used private transfer fee covenants to fund the activities of nonprofit organizations that provide community services (e.g., educational programs). In some cases, these services — and the nonprofit organizations that provide them — are located outside the physical boundaries of the common interest development, which may be exclusively residential in nature. It is not clear whether, or to what extent, the Proposed Rule would permit the use of private transfer fees to fund such programs and services. While the JEB does not wish to express a normative position as to whether private transfer fee covenants should be used to fund such programs and services, the JEB is of the firm view that the Proposed Rule should provide greater clarity as to this issue.

The 1000-yard radius provision in the definition of "adjacent or contiguous property." To satisfy the "adjacent or contiguous property" definition, the property benefitted by the private transfer fee must border or lie "in close proximity to the property that is encumbered by a private transfer fee covenant or to other similarly encumbered properties located in the same community and owned by members of the same covered association, provided that in no event shall a property greater than one thousand (1000) yards from the encumbered property be considered adjacent or contiguous." The JEB understands the FHFA's desire to limit the use of private transfer fee covenants to fund activities or services that are sufficiently remote from the encumbered land that the encumbered land is likely to receive little or no practical benefit. Nevertheless, the 1000-yard radius restriction may not be a sufficient proxy for "adjacent or contiguous" in several important respects.

First, there may occur a number of situations in which a common interest community might choose to acquire, improve, and maintain land for the direct benefit of community residents even though the land in question is located more than 1000 yards outside the physical boundaries of the community. For example, consider a common interest community located near an ocean, but more than a mile from the beach. The community might choose to acquire land for beach access for its members, and to fund the acquisition of this land through a private transfer fee covenant. Such access would provide a direct benefit to the community residents — the covenant would certainly "touch and concern" lots within the community — but under the Proposed Rule, could not be funded by a private transfer fee covenant as the land on which beach access is provided would not be considered "adjacent or contiguous."

Second, the definition of "adjacent or contiguous" does not adequately contemplate master-planned communities with multiple layers of community associations. For example, consider a large master-planned community (30,000 acres in size) comprised of six different residential communities, each of which is subject to a transfer fee that funds cultural, charitable, or recreational activities outside the physical boundaries of the community. Each of the six residential sub-communities would have its own owners' association which, in

turn, would be a member of the master or umbrella association governing the entire development. Nevertheless, one or more of these sub-communities could be situated more than 1000 yards from the benefitted land (outside the radius limit for constituting that land as "adjacent or contiguous property"). While the master development itself (and some of the other sub-communities) might lie within the 1000-yard radius limit, those properties may not be "similarly encumbered properties located in the same community and owned by members of the same covered association." As a result, under the current definition, it is arguable that in a large master-planned community, private transfer fee covenants might satisfy the Proposed Rule in some sub-communities but not other sub-communities. This uncertainty may be magnified by the fact that nothing in the Proposed Rule defines the term "community," leaving that scope of that term subject to interpretation and/or doubt.

III. Effect on state laws. Legislatures in at least sixteen states have enacted statutory prohibitions on the enforceability of private transfer fee covenants, and comparable prohibitions have been introduced in approximately 20 additional states in the current legislative session. In issuing the Proposed Rule, the JEB encourages FHFA to make clear, beyond any doubt, that the Proposed Rule will have no pre-emptive effect with respect to existing state laws.

Presently, Section 1228.4 provides that the Proposed Rule "does not affect state restrictions or requirements with respect to private transfer fee covenants, such as with respect to disclosures or duration." By using only the terms "disclosure and duration," the Proposed Rule might be read to preserve only state laws of a regulatory nature (i.e., the California statute which permits private transfer fees subject to disclosure requirements) and not those that create a strict statutory prohibition on the creation and enforcement of private transfer fee covenants. The JEB respectfully suggests that the language of Section 1228.4 be modified to state that the Proposed Rule "does not affect state restrictions or requirements with respect to private transfer fee covenants, such as with respect to ***validity, enforceability***, disclosures, or duration." The suggested language would make clear the continued validity of state law prohibitions on the enforceability of private transfer fee covenants.

IV. Prospective application. Section 1228.3 of the Proposed Rule states that it "shall apply only to mortgages on properties encumbered by private transfer fee covenants created on or after [the effective date of the Proposed Rule]." Based upon the Supplementary Information preceding the Proposed Rule, it appears clear that the FHFA's intent is that the Proposed Rule should only affect mortgages on land affected by a private transfer fee covenant if that ***covenant*** was created after the effective date.

However, because the terms "mortgages" and "covenants" both appear as antecedents in that sentence, there is at least potential ambiguity as to which term "created on or after" is intended to refer. If the Proposed Rule rule were interpreted to apply to ***mortgages*** created on or after the effective date, then the Proposed Rule would still prohibit the Enterprises and the Banks from acquiring or investing in mortgages on land subject to existing private transfer fee covenants. As

discussed in the JEB's previous comment letter, this would have the unfortunate effect of rendering such titles unmarketable.

For the sake of maximum clarity, we would recommend that the FHFA modify the language of § 1228.3, to make clear that the Proposed Rule would "apply only to mortgages on properties encumbered by private transfer fee covenants ***if those covenants are*** created on or after" the effective date of the Proposed Rule.

Conclusion. The JEB appreciates the opportunity to provide its comments on the Proposed Rule, and we view these comments as part of a continued and constructive conversation with the FHFA on the subject of the proper legal limitations on the use and enforcement of private transfer fee covenants. If the FHFA requires further information or wishes to discuss the contents of the JEB's comment letter, please do not hesitate to contact our Executive Director, Wilson Freyermuth, at (573) 882-1105.

Respectfully submitted,

R. Wilson Freyermuth
Executive Director

Barry B. Nekritz
Co-Chair

William R. Breetz
Co-Chair